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Reverse Mortgages Information Statement

Borrowing against your home

A reverse mortgage can help older Australians unlock the wealth in their homes after retirement. However, there can be long-term financial risks.

Here are some important things to consider before you take out a reverse mortgage. You should also seek independent financial and legal advice, and speak to your partner and family before you sign up for this type of loan.

What is a reverse mortgage?

A reverse mortgage is a type of loan that allows you to borrow money using the equity in your home as security. The loan can be taken as a lump sum, a regular income stream, a line of credit or a combination of these options.

Interest is charged like any other loan, except you don't have to make repayments while you live in your home - the interest compounds over time and is added to your loan balance. You remain the owner of your house and can stay in it for as long as you want.

You must repay the loan in full (including interest and fees) when you sell or move out of your home or, in most cases, if you move into aged care, or die.

While no income is required to qualify, credit providers are required by law to lend you money responsibly, so not everyone will be able to obtain this type of loan.

The risks of a reverse mortgage

An ASIC review of reverse mortgage lending in Australia found that borrowers can struggle to recognise the long-term risks of their loan.

By taking out a reverse mortgage, you could face financial difficulty later in life, because:

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- interest rates and ongoing fees are generally higher than the average home loan
- your debt will increase as interest rates rise on your loan
- the effect of compound interest means your debt can increase quickly as the interest compounds over the term of the loan
- if the value of your home does not rise, or it falls in value, you will have less money for your future needs, like aged care or medical treatment
- the loan may affect your pension eligibility
- if you have a fixed interest rate loan then the costs to break your agreement can be very high.

Also keep in mind that if you are the sole owner of the property and someone lives with you, that person may not be able to stay when you move out or die (in some circumstances).

Reverse mortgage income stream

You may come across companies that offer you an income stream in return for the capital growth on your home (a property option).

While the cashflow may look attractive now, the income you receive will probably be much lower than the capital appreciation of your home, that you are forgoing. These types of offers are unlikely to be covered by credit or financial services laws, meaning you will not have access to important consumer protections, such as free external dispute resolution.

So make sure you research all your options before committing.

How much can you borrow with a reverse mortgage?

The older you are, the more you can borrow. Different lenders may have different policies about how much they will let you borrow.

As a general guide, if you are 60, the maximum amount you can borrow is likely to be 15-20% of the value of your home. You can usually add 1% for each year older than 60. That means if you are 70, the maximum amount you could borrow would be about 25-30%.

The minimum amount you can borrow may depend on the provider; it could be as low as $10,000. Keep in mind that if you borrow the maximum amount now, you may not have access to any more money later.

How much will a reverse mortgage cost?

The cost of the loan depends on the interest rate and fees. The main issue is that as the interest compounds, the debt will grow rapidly.

Figure 1 shows how compound interest could make a debt grow by almost $158,000 in interest, if the interest rate rises by 2%.

Figure 1: Effect of compound interest on a reverse mortgage loan

YearsLoan balance770,521770,521549,871549,871392,189392,18910.3% interest rate8.3% interest rate6.3% interest rate01 year2 years3 years4 years5 years6 years7 years8 years9 years10 years11 years12 years13 years14 years15 years16 years17 years18 years19 years0200k400k600k800k1,000k

Assumptions: $118,627 loan at age 65, no regular withdrawals. Interest rates increase from 6.3% to 8.3%, calculated and charged monthly. House valued at $632,598.

Some reverse mortgage products also allow you to protect a portion of the value of the property. For example, you might want to ensure that you have an amount left in case you need to pay for residential aged care. Use our reverse mortgage calculator to explore your options.

Negative equity protection

On 18 September 2012, the Government introduced statutory 'negative equity protection' on all new reverse mortgage contracts. This means you cannot end up owing the lender more than your home is worth (the market value or equity).

When the loan contract ends and your home is sold, the lender will receive the proceeds of the sale and you cannot be held liable for any debt in excess of this (except in certain circumstances such as fraud or misrepresentation). Of course, where your home sells for more than the amount owed to the lender, you or your estate will receive the extra funds.

If you entered into a reverse mortgage before 18 September 2012, check your contract to see if you are protected in circumstances where your loan balance ends up being more than the value of your property.

Questions to ask the reverse mortgage provider

Before you sign on the dotted line, check the following.

Reverse mortgage information statement

Do you understand how a reverse mortgage works? Your credit provider or credit assistance provider (such as a broker) must give you a 'reverse mortgage information statement'.

The information statement includes:

- details about how a reverse mortgage works

- how costs are calculated
- what to consider before taking out a reverse mortgage
- useful contacts for more information.

Reverse mortgage projections

What is the long-term impact of a reverse mortgage? Before you sign up, your credit provider or credit assistance provider must go through reverse mortgage calculations with you, using MoneySmart's reverse mortgage calculator.

These projections will:

- illustrate the effect a reverse mortgage may have on the equity in your home over time
- show the impact of interest rates and house price movements.

You must receive a copy of these projections to take away with you (e.g. a printed copy, or by email). Make sure you understand how the projections work and how changes in interest rates and house prices could change how much equity you hold in your home. Be aware that the projections are only an estimate and not a guarantee of how much equity you will have if you take out the loan.

If there's anything you're not sure about, ask the loan provider to explain it to you.

See how a reverse mortgage can affect the equity you have in your home.

reverse mortgage calculator

Life changes

Find out what happens if you or your spouse were to die, or if you need to transfer the loan to another house if you move. Check if you need the lender's permission to sell, lease, vacate or renovate your home or have someone move in with you.

Non-title-holding residents

If you are the homeowner and someone else is living with you, find out if the other resident would have to move out when the loan becomes repayable. Some reverse mortgage contracts may protect the rights of the other (non-title-holding) resident by allowing them to stay in the home. If you want this option, make sure you discuss this with your lender before taking out a reverse mortgage.

Security

Check if the lender will accept a holiday home or investment property as security so the family home can remain debt-free. Find out if there are any special arrangements if your home is already mortgaged.

Special terms and conditions

Ask if there are any restrictions on what you can do with the money.

Cooling-off period

Check if there is a cooling-off period so you can pull out if you change your mind.

If things go wrong

Ask the lender what external dispute resolution scheme they belong to. Then you will know where to go if you have a problem. Find out how to complain if you need to resolve a dispute.

Do your own reverse mortgage research

Be proactive and do some homework before you sign up.

What is the impact on your social security?

Talk to the Department of Human Services' Financial Information Service to check how a reverse mortgage would affect your pension entitlements.

Think about your likely future expenses

Smart tip

Residential aged care upfront payments could cost at least $380,000 per person. The average age most Australians go into aged care is 84.

You may not want to think too far into the future or about how your health and living situation might change 10, 20 or even 30 years from now. But it is important to start planning now for the extra costs you could incur, like medical expenses and aged care, so that you will have enough money left to cover them.

How should you take the loan?

You can take the loan as a lump sum, regular income stream, line of credit or a combination of these options. Regular income stream payments or a line of credit are less costly than a lump sum. Use the reverse mortgage calculator to work out the most cost-effective options.

Use the budget planner to work out your budget before and after taking out a reverse mortgage.

Get independent legal and financial advice

Ask your legal adviser to explain the fine print of the contract so you understand the consequences of breaching any terms and conditions.

Consider getting financial advice before you commit to a reverse mortgage.

A reverse mortgage can be useful to relieve financial pressure or improve your lifestyle in retirement, but be aware of the conditions of the loan and the choices available.