Home Sweet Home

Reverse Mortgages Can Keep You from Becoming Institutionalized

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If you're like most retired people, the single largest asset you have is your home. Since it may be paid for or possibly subject to a small home equity loan, there is significant equity there that could be used for living expenses, including luxuries (such as vacations or a new car) or necessities (such as a new roof or medical expenses).

Another reason people find reverse mortgages helpful is to pay for in-home care instead of becoming institutionalized. Most individuals prefer to remain at home if they have the choice and the funds to do so. A reverse mortgage can make this happen for people who are "land-rich and cash-poor" because most of their money is tied up in their home. Rather than selling their home and looking for a new place to live, it is more convenient and appealing to withdraw equity out of their house.

When most people purchase a home, they take out a mortgage rather than using their own funds. Their bank loans them money, and the monthly payments of principal and interest are paid back monthly until the loan is paid in full and discharged. Most home equity loan and standard mortgages require that the loan be repaid over a number of years. With a reverse mortgage, the loan does not have to be repaid under most circumstances.

The bank providing the funds for a reverse mortgage bases the amount on the acceptable maximum designated for each particular town or city. It then either provides the borrower with a lump sum of cash, makes monthly payments to the borrower, or merely permits the borrower to withdraw funds on an as-needed basis.

Since interest accrues only on the amount advanced by the bank, these payments will be repaid when the borrower dies or moves to a long-term care facility for an extended period of time. If the house is sold before the borrower moves, then the bank has to be repaid. Therefore, the interest and principal will be repaid from the proceeds of the sale of the property, but in most cases, this does not occur until after the borrower is deceased.

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Reasons for Reluctance

In any event, there are some people who are dead-set against encumbering their home because they've worked hard to pay off their mortgage. They may even have made double payments or paid additional principal on the home mortgage while they were working in order to pay it off sooner. There is something to be said for this, as some people have more security in having their mortgage paid off in retirement. However, a reverse mortgage may be a good option under certain circumstances.

If you're having a difficult time making your home equity loan payments and need additional funds, a reverse mortgage is an excellent way to obtain additional cash without having to pay it back. In this situation, you shouldn't worry so much about whether your children will inherit your house, but rather concentrate on your own needs, drawing on your home's equity if necessary.

For instance, if your home is valued at $225,000 and there is a mortgage outstanding of $50,000 when you die, your children will still receive $175,000. This is probably significantly more than you paid for your home, so your children will receive a windfall based on your investment.

If you want the total amount of the value of your home to be passed onto your children, then consider taking out an insurance policy on your life that will pay off the mortgage, thus allowing the entire value of the home to pass to your children.

If this is your situation, you should consider having your children own the life insurance policy, since, if you become institutionalized, the cash value of this policy will be includable in your assets and may have to be withdrawn, or the policy surrendered in order to pay for long-term care expenses.

If your children own the policy, there is a substantial likelihood that it will not be includable in your countable-asset picture for Medicaid-type considerations. Even if you or your spouse is not healthy and may not be insurable at standard rates, many policies are sold as second-to-die, whereby a husband and wife are insured by one policy that will not pay off until both are deceased.

This second-to-die or joint and survivorship policy is an excellent way to provide additional funds for your family to pay off your mortgage and thus receive the full amount of value in your house upon your death.

The Bottom Line

While each situation is different, you should explore all your options and consider the tax and non-tax implications of a possible reverse mortgage with your financial advisors. Such advisors will ensure that you have been duly informed of all the pros and cons before making a decision.❖

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