

REVERSE MORTGAGES: What you need to know.

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A reverse mortgage is a relatively new concept in financial lending available to homeowners. It is designed to provide additional cash flow to those who have retired and thus have a very limited income. For now, it is only available to seniors aged 62 years and older.

Currently the only national provider of reverse mortgages is a Vancouver-based company called Canadian Home Income Plan, or CHIP. The company offers the program through several major banks, including Royal Bank and T-D Bank.

Unlike conventional loans, mortgages and secured lines of credit, the borrowers are not required to make any interest payments or principal on the reverse mortgage for as long as they live in the mortgaged home. In order to qualify for a reverse mortgage the applicants must meet the following criteria:

1. Be over 62 years of age;
2. The home must be paid off;
3. The home must be located in a city (farm property does not qualify);
4. The loan must be at least 10% and at most 40% of the appraised value of the home; and
5. The home must be appraised.

Once approved, the borrowers have one of three repayment options:

1. Make no payments until the home is sold;
2. Make interest payments only; or
3. Repay the entire reverse mortgage within three years without penalty.

The fact that the borrowers are not required to make any payments on the principal and interest on the reverse mortgage until the home is sold is an attractive feature. However, the fact that the interest is being compounded for as long as the loan is outstanding can be a concern, if interest rates are high.

The crucial question then becomes, what if the principal amount and accrued interest add up to more than the price of the home at the time of its sale, are the borrowers obligated to pay the outstanding amount? For now, CHIP will absorb it. However, it is not clear whether loan must be paid from the proceeds of the sale of the home based on the value of the home only or the net assets of the estate. This is important since most homes that are owned by seniors are sold by their executors or administrators, and thus all real and personal property (e.g., cars, boats, jewelry, etc.) become part of the estate.