Could reverse mortgage solve financial trouble?

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Q: In a recent column, you provided advice to the relative of an underemployed person who owned a home free of mortgage but was in financial distress with inconsistent cash flow and was falling in arrears with their property taxes.

Wouldn't a reverse mortgage work here, providing a consistent cash flow? What would be any possible downsides? Is there a minimum age requirement for reverse mortgages (since we don't know the person's age but who is probably a senior citizen because the mortgage is paid off)?

A: Thank you for your comment. We aren't huge fans of reverse mortgages, though they can be useful in some circumstances. Let's walk through the issue and see if a reverse mortgage might work here.

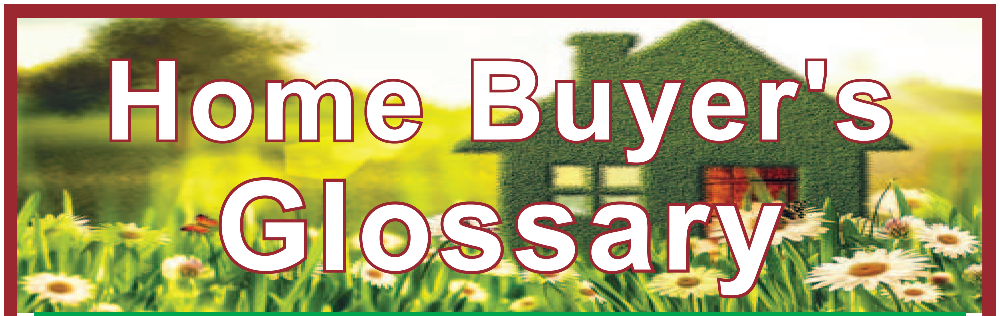
If we assume the person seeking a reverse mortgage was 62 years old (the minimum age to get a reverse mortgage), and owned the home outright, that person might qualify for a reverse mortgage. But we're not sure that taking money from the equity in the home to pay for her housing expenses would solve our reader's problems, and that is often the best use for a reverse mortgage. For that reason, we suggested that our reader consider selling the home.

While you are correct that our reader didn't have a mortgage on the home, our reader appears to have accumulated some debt over time due to her inability to pay her living expenses. So, the question is: Would it be worthwhile to get a reverse mortgage and use the proceeds to pay off her debt issues?

We thought it might be better for her to evaluate her living situation and make a decision to sell based on her current income and expenses. What happens if she lives to be 95? If she eats up half her equity but only gets 10 years out of it, what will happen after that? And, she'll still have home maintenance expenses, property taxes and insurance premiums to pay.

Instead, imagine she sells the home and downsizes to something that's more affordable based on her project retirement income. She could invest the $100,000 she gets from the home and use it for some extras or for an emergency fund.

Given that the home seemed to be her largest expense, we thought it would be better for her to look at alternative living situations with the hope that she might find something to her liking but at a much lower monthly cost. At the same time, she'd have any money she had from the sale of the home in the bank.



Adjustable-rate Mortgage (ARM) - A mortgage for which the interest rate and the payments change during the life of the loan.

Agreement of Sale - The contract in which the seller agrees to sell and buyer agrees to buy, with conditions and terms spelled out and signed by both parities.

Amortization - A plan for gradually repaying, in periodic payments, money borrowed.

Balloon Mortgage - A mortgage that has a large amount of the principle due at the time of maturity.

Bridge Loan - A loan that finances a mortgage at the end of one loan and the start of a new one.

Closing Costs - Expenses and fees that are added to the price of the property, paid by the buyer and the seller at the closing. The Agreement of Sale states who pays which costs.

Commercial Bank - A financial institution authorized to provide a variety of financial services, including consumer and business loans (generally short-term), checking services, credit cards and savings accounts.

Condominium - The buyer owns title to a residential unit, shares common areas with other unit owners and pays maintenance fees to the condominium association for property upkeep.

Conventional Loan - A loan not guaranteed by the VA or insured by the FHA.

Co-op - In exchange for the right to occupy a co-op unity, the buyer owns shares in the co-op corporation (made up of co-op residents), rather than owning real property.

Debt-to-income Ratio - A percentage arrived at by dividing the borrower's fixed monthly obligations by the borrower's monthly income.

Due-on-sale Clause - A mortgage stipulation demanding payment of the entire loan balance upon sale or other transfer of the real estate securing the loan.

Equity - The ownership interest remaining in property after payment of all liens or other charges on the property.

Escrow - Funds left in trust with a third party, to be paid to a designated recipient at a designated time.

Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac) - A quasi-governmental secondary market agency that purchases whole mortgage loans. Freddie Mac sells interest in pools of mortgage loans to obtain funds for mortgage loan purchases.

Federal Housing Administration (FHA) - A government agency within the Department of Housing and Urban Development that administers many programs involving housing loans made from private funds, including mortgage insurance for lenders and rent or interest assistance for low-income tenants and mortgagors.

Federal National Mortgage Association (FNMA or Fannie Mae) - A privately owned and managed corporation that purchases mortgage loans originated by other lenders. Fannie Mae issues stocks and securities to obtain funds for its purchases.

Fixed-Rate Mortgage - A loan that has one set interest rate. Installment Debts - A buyer's long-term debts; they usually extend for periods longer than nine months.

Intermediate-term Loan - A home loan of less than 30 years.

Life-of-loan Cap - A consumer protection on some adjustable loans. It limits the total upward adjustment that may occur during the life of the loan. Also known as an overall cap.

Loan-to-value Ratio - The relationship between the amount of a home loan and the total value of the property. Lenders may limit their maximum loan to 80-95 percent of value.

Lock-in Rate - A rate commitment made by lenders when making a mortgage loan to commit to or "lock in" that rate pending loan approval. Lock-in commitment periods vary.

Market Value - The highest price the buyer is willing to pay for a property and the lowest price the seller will accept.

Mortgage - A lien or claim on property given by a buyer to a lender as security for money borrowed.

Mortgage Broker - An individual or company that obtains mortgages for others by finding lending institutions, insurance companies, or private lenders to lend money.

Payment Cap - Limits the amount that a monthly payment on an ARM loan can increase at the time of adjustment.

Points - One percent of the amount of the mortgage loan.

Prepayment - Payment of a mortgage loan, or portion of the loan, before the due date.

Prime Rate - The interest rate that banks charge to their preferred customers. Changes in prime rate are used as indexes in some adjustable rate mortgages, especially home equity lines of credit.

Principal - The basic loan amount, separate from interest, insurance, and taxes.

Private Mortgage Insurance (PMI) - The insurance coverage offered by a private company that protects a lender against loss on a default mortgage loan. Its use is usually limited to loans with high loan-to-value ratios. The borrower pays the premiums.

Title - Proof of ownership.

Title Search - A check of title records to assure that the buyer is purchasing property with no liens, encumbrances, or other claims which might adversely affect the title's value or marketability.

Veterans Administration (VA) - A government agency that helps veterans of the armed forces obtain housing.

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