



REVERSE MORTGAGES AND ESTATE PLANNING

As the cost of living increases, financial institutions have taken the opportunity to release many new products to finance our lifestyles. One product in particular that is gaining in popularity is reverse mortgages (also known as equity release loans). It is estimated that there are about \$3.6 billion in reverse mortgages compared with just \$1 billion 10 years ago. However, before you even consider a reverse mortgage, you should consider both the benefits and risks involved – especially to your estate planning.

What is a reverse mortgage?

A lot of older people may find that they do not have enough money to retire on, especially if their investments (often term deposits) are not earning a decent rate of interest. The effect of the global financial crisis, coupled with the increasing cost of living, has left many people without sufficient funds to finance their lifestyle into retirement. For these people, a reverse mortgage may seem like an easy solution.

A reverse mortgage is available to individuals over 65 years of age and allows homeowners to borrow money using the equity in their home as security for the loan. These loans can only be used for personal use and not for further investments such as the purchase of shares.

What are the potential benefits?

The appeal of reverse mortgages for retirees is that, generally:

1. no income or credit check is required to qualify for the loan, making it ideal for retirees;
2. the loans can be drawn down as a lump sum or taken as a pension over a period of time;
3. no repayments need to be made;
4. if the value of the home winds up being less than the loan amount, the lender must accept the value of the home and cannot sue anyone for the balance. This is due to the negative equity protection introduced by the Government pursuant to the *National Consumer Credit Protection Act 2009*; and
5. as there are no repayments until the property is sold, refinanced or the borrower dies, the lender cannot foreclose on the property.

What are the potential disadvantages?

The disadvantages of obtaining a reverse mortgage may include the following:

1. having high interest rates for the term of the loan. As no repayments are being made, the interest component will most likely be capitalised meaning the debt keeps increasing;
2. obtaining a reverse mortgage can affect your pension eligibility as it may turn an “exempt” asset into an assessable asset;
3. as your home is security for the mortgage, if you wish to sell, lease, vacate or renovate your home, you need your lender’s consent;



4. upon your death, the loan will be repayable from your estate. This means that your property will be sold and the initial funds gained will be used to pay off the loan leaving potentially no inheritance for your children;
5. in order to be eligible for the reverse mortgage, the borrower has to reside in the home. The disadvantage of this is that, if the borrower moves into aged care, there may be a risk of breaching the contract with the lender. Further, if there is someone else living in the home too, they will not be able to live in it if the borrower is no longer residing in the home.

How does this affect your estate planning?

As you may have already discovered from reading about the benefits and disadvantages, reverse mortgages could have a heavy impact on your estate planning. While you are “living it up”, your children’s inheritance could be dwindling and they might not even be aware of it. As the main asset of someone’s estate is usually their home, once the mortgage is paid off, there may be nothing left to give to your children.

As the interest on the reverse mortgage is being capitalised and it is unlikely that you will be making any repayments, the overall amount payable on your death is likely to have ballooned out to a much greater amount than you originally borrowed. This essentially means that after the mortgage is paid out, there may be very little if no assets at all left for your children to inherit.

Before taking out a reverse mortgage, it is important to seek legal advice.

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