



## COMBINED PENSIONERS AND SUPERANNUANTS ASSOCIATION OF NEW SOUTH WALES INC.

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Serving pensioners of all ages, superannuants and low-income retirees.

*Consumer Protection Awards – 2002, 2003, 2004, 2005*

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# FACT SHEET

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## Reverse Mortgages (& other Home Equity Release Products)

The following information has been compiled to inform asset rich but cash poor older people of financial products that allow you to access the equity in your home. For further information please phone CPSA on (02) 9281 3588 or 1800 451 488 (country callers) or refer to the organisations listed.

### What is a reverse mortgage or home equity release?

- Reverse mortgages (also known as Lifetime Loans, Home Equity Conversion Loans or Equity Release Mortgages) allow older people who own their home to borrow money against the future sale of their house.
- All fees, charges and interest are added to the original loan amount and can exceed the value of the property.
- No repayments are required until the house is sold (which may be when you move or die) but some products allow voluntary repayments. A fee may apply if you make voluntary repayments.
- Some home equity release products will allow you to access a percentage of the future sale of your home. The advantage with this method is that you retain a known percentage of equity in your home, even if the value of your home decreases.

### Who is eligible to apply?

- Generally it is people who are 60 years or over, or of pension age, and who own their own home but each company has different age criteria.
- If you have a mortgage you may still be eligible as long as you use at least some of the money to repay the loan.
- Specific eligibility criteria differ between products.

## **Where can I get a reverse mortgage or home equity release product?**

- Many banks, building or friendly societies and other financial companies offer these products.
- Centrelink and the Department of Veterans' Affairs offer a similar product to part pensioners and non-pensioners with a lower interest rate than typical reverse mortgages.
- It is advisable to shop around as fees, interest rates, terms and conditions vary. Some, but not all, ensure the debt will not be larger than the value of your home at the time of repayment. This is a "no negative equity guarantee".
- Legal & financial advice should be sought before signing any contract.

## **How much can I borrow?**

- This varies between products and is also dependent upon the value of the property you offer as security, the amount of equity you want to retain in the property and even your and your partner's age.
- Loans vary between 15% and 50% of the property value.

## **Will I have to pay interest?**

- Yes! Compound interest is charged which means interest is calculated after interest earned and fees have been added to the loan. When there are no repayments, the debt becomes larger more quickly than with other loans.
- The Bendigo Bank product charges no interest but establishment fees are higher than other products and the 'Early Sale Rebate' and 'Excess Proceeds Rebate' clauses can potentially rob you or your family of any financial gain when the property is sold.

## **What is the interest rate charged?**

- The interest charged varies between products but is currently between 8% and 9% variable.
- The interest charged is higher than for regular home loans even though administration costs are lower owing to there being no regular repayments.
- Interest is generally variable but if fixed for a specified term it tends to be even higher than the variable rate.

## **A working example of an equity release mortgage**

Colleen and Albert McGuire retired three years ago at the ages of 65 and 66 respectively. They are living on the Age Pension so have very little money saved but as they own their two bedroom house in Sydney they are considered to be asset rich and cash poor.

There are a lot of new things they would love to purchase, including a new car since the mechanic phoned yesterday with the bad news that their trusty 20 year old Holden will cost just over \$5000 to be made roadworthy.

They have talked all their working lives about taking a cruise together in their retirement years but the only way they believe they will be able to afford this is if they sell their home and move to a smaller home in a cheaper area. Neither of them wants to do this because they have lived in their house since they got married in 1961, so when Albert chatted with a lifelong friend who has applied for a reverse mortgage to pay for his wife's medical treatment and community care they thought they had found the answer.

The only cost appeared to be that their kids would receive a little less inheritance after they died so after discussing this with their kids they went ahead and applied for the loan.

Let's now take a closer look at the situation Colleen and Albert are legally bound to:

Value of home: \$546 500

Compound interest rate: 8.5% fixed

Amount of original loan: \$150 000

Amount to be repaid after 5 years\*: \$225 549

Amount to be repaid after 10 years: \$339 148

Amount to be repaid after 15 years: \$509 961

Amount to be repaid after 20 years: \$766 807

Conventional wisdom has it that, over time, house prices in metropolitan areas increase on average by about 8 per cent annually. However, house prices go through boom bust cycles of between ten to fifteen years. This means that a house may not go up in value for years before appreciating, first slowly and then at a frenetic pace. As a result, the equity in Albert and Colleen's house, assuming they took out a reverse mortgage at the start of the housing cycle would not increase very much in five years, whereas the amount to be repaid has gone up a lot. After ten or fifteen years, however, it's likely that the value of their house is lagging only slightly compared with the amount to be repaid.

It's all in the timing, but the problem is that death or the need to move to retirement accommodation is not subject to timing and therefore outside the control of people taking out a reverse mortgage. As a result, there is a real possibility that the repayment amount is greater than the value of the house when it is sold.

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\* Rounded to nearest whole dollar

## What other fees and charges are there?

- Establishment fees are between \$750 and \$1400.
- Service fees, where applicable, can be up to \$12 per month.
- Centrelink requires the loan to be secured by registering a charge with the Land Titles Office on the title deed of the property at your own expense.
- Other institutions charge a non-refundable valuation fee (up to \$300) before offering you a loan and some charge for revaluation every year or so.
- Most institutions charge withdrawal fees for accessing your money.
- Government taxes and fees may also apply.

## What are the main risks with a reverse mortgage?

- The biggest risk is that compound interest added to the original loan will leave little or no equity for the home owner when the property is sold. If selling to move to a nursing home, you may find there are insufficient funds and in the event of death there may be nothing left for your funeral or to pass to family.
- The period of greatest risk is when house prices are not going up, because during such periods the repayment amount continues to increase, eating into the owners' equity.
- Make sure that under no circumstances will the Contract allow for negative equity, which is where the debt is greater than the value of your house. To avoid leaving a debt to your estate you need to ensure the product has a "no negative equity guarantee".
- In many instances Centrelink and Veterans Affairs pensions will be affected so check this out before making your decision.
- The most important documents are the Contract, Agreement and Product Disclosure Statement (PDS). It is in the PDS that people commonly learn their rights and obligations (such as cancellation rights, fees charged if repayments are made, what happens if you don't meet the terms and conditions of the Contract etc). It is vitally important to read the PDS before you sign anything.

## Are there any benefits of a reverse mortgage?

- Only that you have additional money right now.

## FOR FURTHER INFORMATION

- **The National Information Centre on Retirement Investments Inc (NICRI)** – Phone (02) 6281 5744, 1800 020 110 or [www.nicri.org.au](http://www.nicri.org.au).
- **Australian Securities & Investment Commission (ASIC)** – Phone 1300 300 630 or visit the website [www.asic.gov.au](http://www.asic.gov.au).

**This information was correct at the time of printing. CPSA does not endorse any product. CPSA recommends seeking independent financial or legal advice.**

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