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Use your home's equity, but don't forget the debt; The Mortgage Issue; Reverse Mortgages: Best Friend Or Worst Enemy

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As they turn 60, Canadian Baby Boomers can qualify for reverse mortgages.

A reverse mortgage is one way house-rich but cash-strapped seniors can remain in their homes. But until last week, there was only one place to get them: Vancouver-based Canadian Home Income Plan Corp., launched in 1986.

In 2005, **CHIP** cut the minimum age to qualify from 62 to 60, says president and CEO Steve Ranson. Of 11,000 who borrowed this way, 4,500 have repaid their **CHIP** loans.

The number of 60-year-olds will double in the next 25 years. The average **CHIP** client is 73 and stays in his or her home 10 to 12 years. **CHIP** lends up to 40% of the value of a home, though 30% is average. So a \$500,000 home qualifies for at most a \$200,000 loan.

Several banks distribute **CHIP**, but Canada lacks the multiple providers that exist in the United States, United Kingdom and Australia. However, late in August, New Zealand-based **Seniors Money** International entered the southern Ontario market. **Seniors Money** Canada is based in Mississauga, Ont. (www.seniorsmoney.ca.) How do reverse mortgages differ from conventional ones? For the latter, you borrow money, making them suitable for young families who can't otherwise buy their home. Over many years of paying principal and interest, these families slowly build equity. One happy day they pay off the principal and own their home outright. Previous generations celebrated this with mortgage-burning parties.

By contrast, reverse mortgages allow ageing homeowners to tap their home equity by going back into debt. They receive an upfront payment from the lender or arrange a regular series of payments over time. These payments are considered tax-free, which promoters depict as another benefit.

However, with a reverse mortgage, home equity gradually decreases as debt rises. Unless you pay back the loan early, indebtedness can double every eight or nine years (depending on rates).

The mortgage terminates when the house is sold, the homeowner moves out, a pre-set term ends or when the homeowner dies.

Pros and cons are described in the second edition of P.J. Wade's book *Have Your Home and Money Too*. A third edition is

about to be published. But even Wade regards them as a double-edged sword.

Sometimes, they can be your best friend, she says. "No other solution lets you stay in the home you love," she said in an interview. "The reverse mortgage turns your home into a pension."

But she cautions they can be "your worst enemy" for those happy to live somewhere else. As a source of funds for renovation projects, for example, "you've chosen a very expensive solution."

When home prices are rising, a reverse mortgage "really makes a home a bank," Wade says.

Of course, home prices are no longer rising in the United States and it remains to be seen how long they will keep rising in Canada.

CHIP users currently borrow money at an annual interest rate of 8.25% to 9.3%. This is one to two percent more than regular mortgages.

Reverse mortgages are not a substitute for proper retirement planning. I'd argue most retirees are better off with fully paid-up homes, deriving their income from pensions, savings and -- if necessary --part-time work.

Many financial advisors share this skepticism. "When any of my clients approach me with this option, none have pursued it once they hear the whole story," says Wayne Taylor, president of Edmonton-based Taylor Financial Group Ltd.

Warren Baldwin, regional vice-president of T.E. Wealth, is concerned that if lump sums are borrowed in order to spend or create an annuity, "the whole process becomes very distant for the senior."

The psychology is that with no visible loan payments, it's easy to forget how much is owing. If the loan was taken out to help make ends meet, seniors may be in for a shock when they need more money and can't get it, Baldwin says.

At that point they may wish to sell the house and move to smaller, cheaper premises. That's when they find out how much of their home's value is still owed to the reverse mortgage.

Better alternatives include a home line of credit or converting spousal RRSPs to RRIFs, Baldwin says. - Check out Jonathan Chevreau's blog at www.wealthyboomer.ca.