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Globe and Mail Online

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Rising home values turn on the equity taps

Globe and Mail

4 Oct 2007

B20

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With house prices on a steady rise across Canada and more seniors looking to tap the equity in their homes, reverse mortgages are gaining greater acceptance and attracting new providers into a relatively small niche.

Reverse mortgages are based on a simple concept: Rather than you, the homeowner, paying a lender for mortgage money, the lender pays you, either as a lump sum or in monthly payments. To qualify for what is essentially a cash loan against the equity in your home, you must be at least 60. But no income, medical or credit qualifications apply.

You retain title to your home and don't have to repay any of the loan amount so long as you live there; the full amount is due only when you move or sell the house. (If the homeowner dies, title is transferred to the estate.) Of course, annual interest accrues for the loan and can build up over time. That's why homeowners should be fully aware of the costs and consequences of a reverse mortgage.

DEMOGRAPHICS DRIVE GROWTH

Reverse mortgages have been available for about 20 years, and there's no doubt they are becoming more widespread, judging by the growth of the leading provider, Toronto-based Canadian Home Income Plan Corp. (CHIP). At the end of June, it had \$632-million in such loans under administration, compared with \$551-million at the end of June, 2006.

Greg Bandler, senior vice-president of sales and marketing, attributes the growth to Canada's aging population, now tallied at 4.3 million people over age 65 and expected to hit 9.8 million by 2026.

"Canadians are faced with an opportunity, where their homes have appreciated quite substantially," Mr. Bandler says, adding that consumers are more willing to take on debt to achieve a specific goal. "They have very strong desire to stay in their homes, and in their neighbourhoods. This is an opportunity to access the equity and use it to do the things they want to do."

In CHIP's experience, clients fit in two broad categories: early-stage retirees who want to fulfill a dream, such as frequent travel; and older retirees who want to renovate their homes to make it easier for in-home care and maintenance.

TYPICAL TERM IS 12 YEARS

A homeowner can usually access up to 40 per cent (maximum \$500,000) of the home's appraised value. A typical client borrows about \$83,000 and repays the mortgage after 12 years.

Seniors Money Ltd., the new kid on the block, is seeking to capture a piece of Canada's growing market. A specialist in reverse mortgages, the New Zealand-based company opened its Canadian operations at its head office in Mississauga, Ont., last month. "Most of the people on our management team come from the insurance industry. That helps us understand the long-term nature of the business," says Nick DiRenzo, president and chief executive officer of the Canadian branch. "A reverse mortgage can be on the books for 10, 12 or 15 years, and in some cases even longer."

Seniors Money says that about half its customers use the money for home improvements. The second most common reason is to free up cash or service a debt.

A reverse mortgage involves some upfront costs. At CHIP, these include appraisal fees of \$175 to \$400, and legal and closing costs of \$1,285, which are deducted from the initial payment. Clients must also obtain independent legal advice, costing about \$300 to \$600.

RISING HOME PRICES HELP

CHIP's variable mortgage rate is about 8.75 per cent. Mortgages with one-, three- and five-year terms are about 8.95 per cent per annum. Customers can also receive escalating interest-rate discounts depending on the mortgage terms.

One of the key tenets of CHIP's program is that it's based on the fact that house prices have risen steadily. Based on historic trends, someone with a \$300,000 home could see it rise in value to \$686,000 over a 15-year period. After paying off a \$100,000 CHIP mortgage, the homeowner would still have \$386,000 in equity.

But what happens if the market stalls or house prices tank? "That's our risk, not the client's," says Mr. Bandler. "In managing our portfolio, we lend very conservatively."

At Seniors Money, the issue of falling prices is addressed through its "no negative equity" guarantee, meaning that the customer will never owe more than the value of the home. "The way the product is designed, if you keep your home for 12 to 15 years, you will have about 50 per cent of the equity when you sell the home," explains Mr. DiRenzo.

While reverse mortgages may be appealing at first sight, some experts caution seniors to proceed carefully.

FOUR CRITERIA TO MEET

"These things are great for certain people. But you have to meet four criteria for them to be useful," says Olev Edur, a Toronto-based personal finance columnist for Good Times, a seniors magazine.

"First, you want some extra cash right away. Second, you do not contemplate moving for the long term," he says. Third, some seniors may not have access to other, less-costly sources of money. Lastly, the homeowner shouldn't count on bequeathing the house as

a major asset, because the compounding effect of the loan can eat away at its overall value. "You will be surprised at how little is left at the end of 15 or 20 years," he says.

Mr. Edur also recommends that if homeowners want to use a reverse mortgage as bridge financing, they should look at alternatives such as a line of credit or a regular mortgage with a lower interest rate. "Weigh up your interest costs and look at what you will owe in the end."