

Helping Your Parents: Does a Reverse Mortgage Make Sense?

by Cindy Richey, CFP® and Ken Borum

Parents typically don't like to burden their kids with their financial problems. That hesitancy can sometimes lead seniors to choose financial solutions that charge high fees and often don't deliver what they promise.

Reverse mortgages – advertised so frequently on TV and other media, have become a major attraction for people over the age of 62 who need to pay medical bills or otherwise have a need for cash. They are perfectly legal transactions under the law – they are called “reverse” mortgages because of the way they work. Instead of the borrower making payments to the lender, the lender releases equity to the borrower in a lump sum or monthly cash payment, or as a line of credit.

But reverse mortgages can be costly. Closing fees can go as high as 7 percent of a home's value. If not part of HUD's HECM program, interest rates can also be higher than conventional market rates on a reverse mortgage. The lender may also require mortgage insurance and monthly servicing fees. If the homeowner doesn't live in the house for long, a reverse mortgage can end up being an extremely expensive short-term loan.

So what are some alternatives? If children or other close relatives have the means, they can buy the house outright or essentially create a private reverse mortgage. With proper planning, the parent gets the benefit of more cash in their pocket and the adult child may receive some attractive tax benefits.

A promissory note will need to be written to reflect a revolving credit agreement, and depending on state or county requirements, deeds and other paperwork will need to be filed. The loan must charge a fair market rate of interest so as not to trigger gift tax. It's also a good idea to do a title search, in case there are any surprise liens on the home. It's important to structure and record the loan legally so it's less likely to be challenged by other family members after a parent dies. That's why it makes sense for all family members to be brought in at the idea stage.

Another possibility is for the adult children to buy their parents' home outright and allow them to live in that property. It's a way to avoid transaction costs and keep one or both parents in the home for as long as they are able, avoiding the whole loan question altogether.

Advice is the first step in this process. A CERTIFIED FINANCIAL PLANNER™ can team with an attorney and tax professional to advise children and parents on these options.

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