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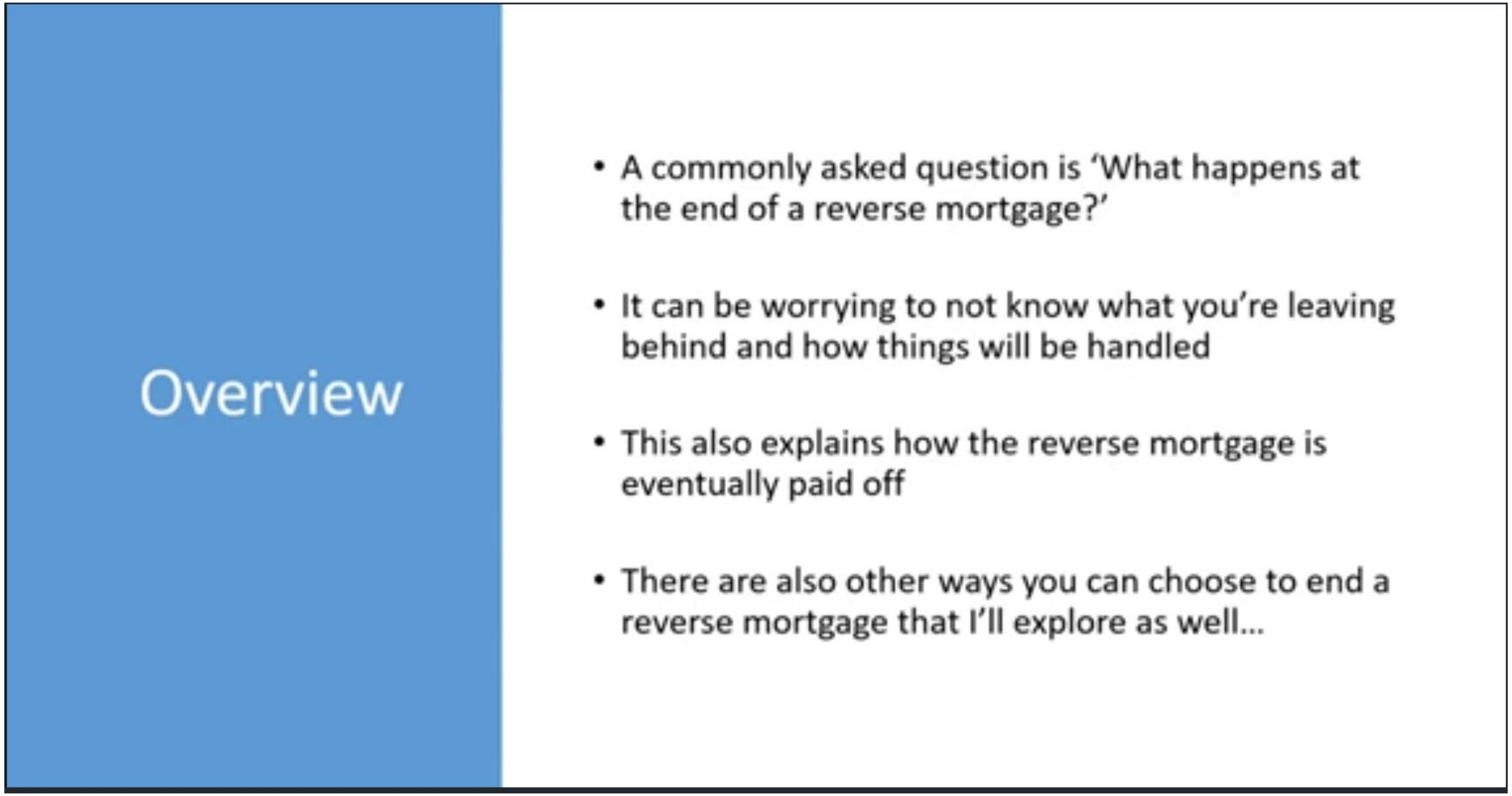
Home Equity Take Out /Reverse /CHIP Explain



What Is A Reverse Mortgage (In 20 Seconds)

- A mortgage available to homeowners 55 and over that doesn’t require you to repay any money – no monthly payments
- You can get up to 55% - usually 10% to 55% of your home value - depending on your age, property type and location
- You can get as much money as you qualify for, but any existing mortgage on your home must be paid off first using the funds
- Designed to help you tap into your home equity for retirement and to continue to live in your home

Reverse Mortgages – What's The Catch??

Common Concerns & Questions About Reverse Mortgages

- It's seems too good to be true
- Won't I run out of equity in my home?
- What can go wrong?
- What's in it for the lender?

Why Do They Seem Too Good To Be True?

- It *feels* like you're being given money for free without having to pay it back (which isn't the case)
- The amount of money involved can be quite high
- It seems too easy – filling out some forms and going through a relatively painless experience to get a lot of money
- The lender is paying you instead of you paying them (hence the 'reverse' name)

In Reality…

- Reverse mortgages are a popular product worldwide and just another kind of mortgage
- The lender is going to make money and will be paid back – it just won't happen for many years & it might not be you paying them back
- A reverse mortgage tends to be a 'win win' solution for everyone – the lender will (eventually) make some money at a good rate and you get cash out of your home

What's In It For The Lender?

- Reverse mortgages offer a solid return on the lender with interest rates around 2% higher than a regular mortgage
- The lender does have their money tied up for years – potentially many years – but they will eventually get it back
- It's similar (from a lender perspective) to a long-term Bond paying interest but with a higher rate

But Won't You Lose Your Home Or All Your Equity?

- The lender can't take your home (ever) and doesn't want your home. They are doing this for investment purposes, not to acquire homes
- Losing all your home equity would be bad for the lender (something I'll come back to)
- You can run calculations and see your home equity vs reverse mortgage balance over time
- 99% of Canadians have equity remaining when a reverse mortgage is eventually paid off

The Real Catch With A Reverse Mortgage – It's Actually A 'Win Win' Solution

- It's in the lenders best interest and your best interest that you don't lose your home equity
- You can't owe more than your house is worth, so if the balance of the reverse mortgage is higher than the home is worth **the lender takes a loss on this amount**
- The **last thing** in the world that banks and lenders want to do is take a loss on a mortgage (or any investment)!

Protecting Home Equity

- This is why lenders only lend 10% to 55% of your home equity – based on your age, location and property factors

- They are running calculations themselves to make sure they don't lend you too much money so that you run out of home equity (which is bad for them too)

- If they didn't care about your home equity, they'd lend 60%, 70%, 80% even 90%

- This is why they are often a 'win win' solution

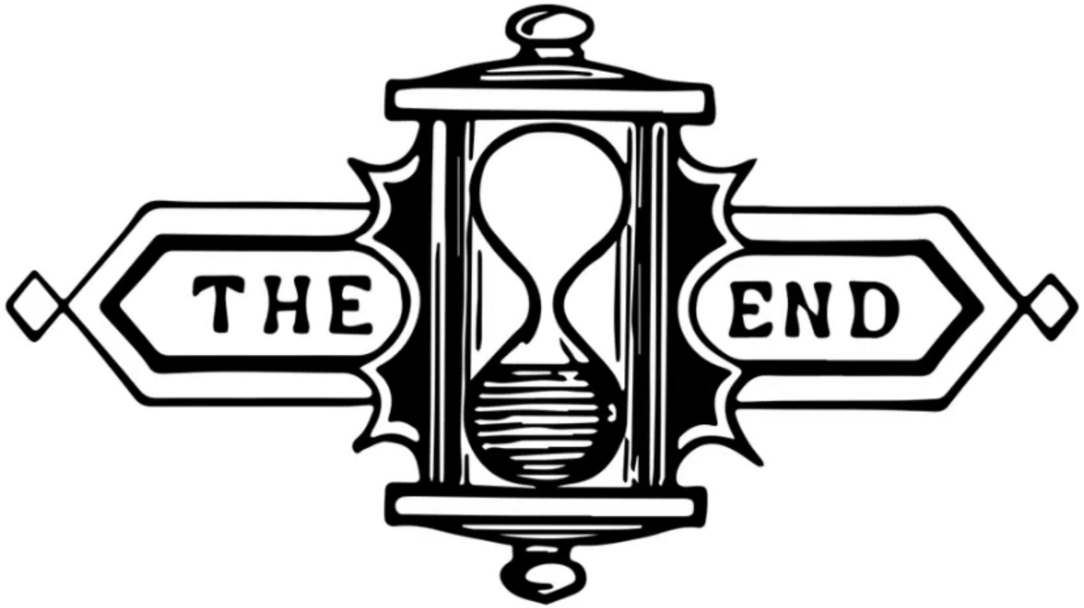
Summary

- Reverse mortgages can seem too good to be true because it feels like you're getting money for free (which is not the case)

- In reality, reverse mortgages are a 'win win' solution where you get cash that is tied up in your home and the lender gets a good return from the interest when it's eventually paid off

- It is neither in your best interest nor the best interest of the lender for you to run out of home equity – another reason that I consider reverse mortgages a 'win win' solution in many instances

What Happens At The End Of A Reverse Mortgage?



Balance Payable At The End

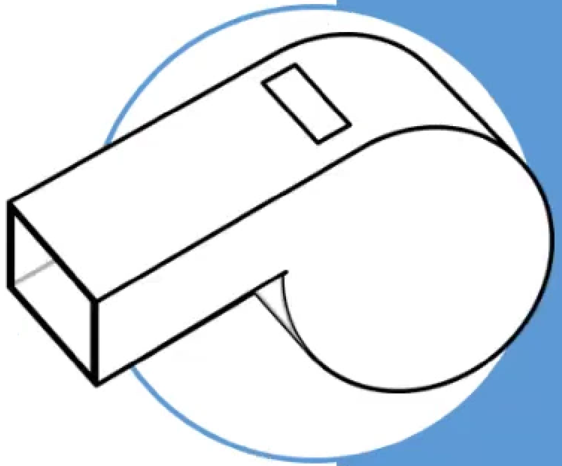
- The entire reverse mortgage balance (capital plus interest) is paid when the reverse mortgage ends

- This the point where lenders make their money on the loan (another common question)

- Remember – you can't ever owe more than your home is worth

Penalties For Ending A Reverse Mortgage

- No penalties where all homeowners pass away
- 50% reduction where homeowners move to a care home
- Otherwise, penalties are payable – higher in first 3 years and lower after this

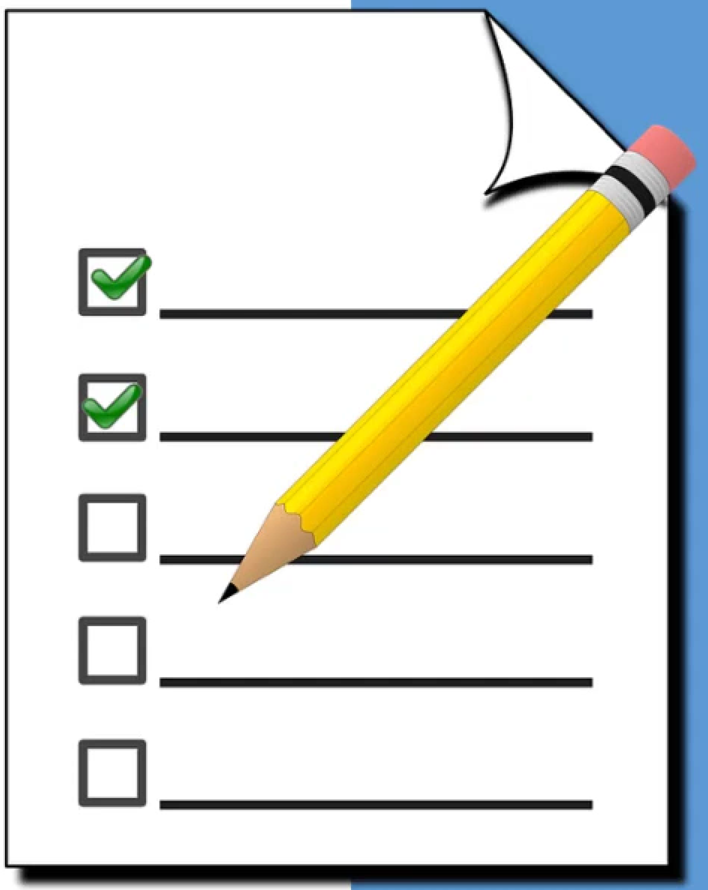


The 3 Ways A Reverse Mortgage Can End

1. All homeowners/spouses move out and it’s no longer their principal residence

2. You choose to end the reverse mortgage by either selling your home or paying it off

3. All homeowners/spouses pass away



1. Moving Out

- Most common scenario is moving to a retirement home
- You likely won't want to keep up property taxes and insurance on a home you're not using
- Technically required to inform the lender

2. Selling Your Home Or Paying Off The Mortgage

- If you decide to sell your home, this is another point at which the reverse mortgage ends
- You could also remortgage (take out a new mortgage) or use any money you have to pay off the reverse mortgage too
- The reverse mortgage would be paid off just like any other mortgage in both these scenarios

3. All Homeowners/Spouses Pass Away

- Your Estate takes over the reverse mortgage
- Not really inherited – no mortgage can be – so the Estate must pay off the mortgage (same as any other mortgage in Canada)
- Your Estate will have around 180 days to inform the lender what they intend to do

What Options Does Your Estate Have?

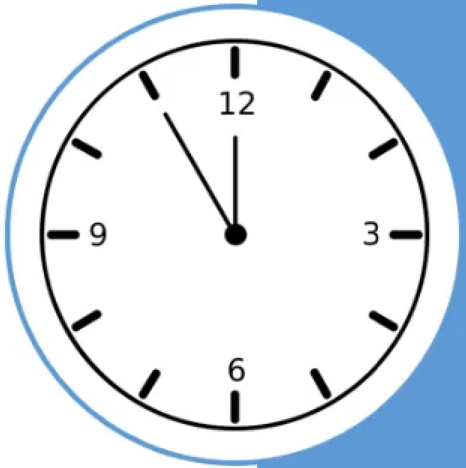
1. Sell the home – use the funds to pay off the reverse mortgage

2. Pay off the reverse mortgage with other funds (e.g. life insurance, other Estate proceeds) and keep the home

3. The Heirs can refinance or remortgage the home to pay off the reverse mortgage and keep it

Timelines For Your Estate

- There is a '180 day' rule written in the reverse mortgage agreement
- In reality, this is not enforceable in court – the Estate simply has to take reasonable actions (not do nothing)
- Only reason this exists is that there has to be *some* timeline – otherwise Estates could just sit on homes forever and lenders never paid back



3 Ways To Break A Reverse Mortgage

1. Paying it off

2. Move it to another lender – commonly called 'switching' in the mortgage industry

3. Refinance it – this is where you look to take out more money and it can be with your current lender or a new lender

Why Break A Reverse Mortgage?

Several reasons include:

- You're looking to get more money
- There are better rates available with other lenders
- You no longer need the money
- You're selling the home or no longer need it

Paying The Reverse Mortgage Off

- This can be done at anytime you like – you'll need to pay off the amount borrowed plus any interest that will be added to the amount

- Early repayment is subject to penalties – I have a whole other video on penalties and I'm going to discuss them in this video too

- Generally speaking, it is not a good idea to repay a reverse mortgage in the first 3 years, as penalties are at their highest – I'll come back to this later

Refinancing Or Switching A Reverse Mortgage

- When it comes to a reverse mortgage, **switching to another lender and refinancing are essentially the same thing**

- With a regular mortgage you could switch to another lender and not have to go through a full application process – but this isn't possible with a reverse mortgage

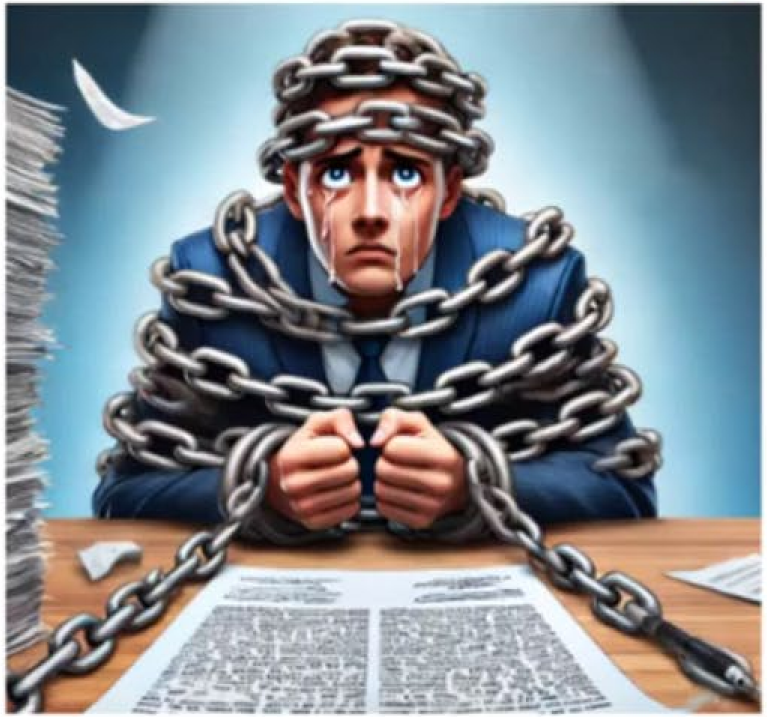
- **This means that when you switch you can decide to take more money (refinance) and it doesn't change anything (rates, fees etc.)**

“But I Signed Up For A 5 Year Term – Am I Not Stuck?”

- Terms do not work the same way for reverse mortgage as they do with regular mortgages

- With a regular mortgage the term sets the rate **and** penalty amount. For example, if you have a 5 year term you get the opportunity to switch (or pay it off) at the end of 5 years with no penalty

- **With a reverse mortgage terms <u>only</u> set the rate & length of time you are paying a set interest rate - they have absolutely no impact on the penalties at all**



A Simple Example

- If you took out a 1-year term, the penalty to break the reverse mortgage at the end of 1 year is exactly the same as if you were on a 5-year term

- If you took out a 3-year term, the penalty to break the reverse mortgage at the end of 3 years is exactly the same as if you were on a 5-year term

- Essentially: **the term has absolutely no influence on the penalty at all with a reverse mortgage**

When To Switch Or Refinance?

- While the term you took out has no influence on the penalties, there are still penalties payable

- **The best time to switch or refinance a reverse mortgage is after 3 years but before 4 years (since you took it out)**

- Penalties are highest in the first 3 years you hold a reverse mortgage.

- **After the 3rd year the penalties drop but then gradually go up every year**

Exceptions

- There are no penalties payable after 10 years – so you're free to switch to a different lender or refinance at that time without penalty

- With some of the lenders they offer a short, 30-day window at the end of 5 years at which you can pay off a reverse mortgage with no penalty

- Covered in another video: Home-owners passing away – there is no penalty; moving to a retirement home – 50% reduction

Penalty Example

Let's go through a simple example:

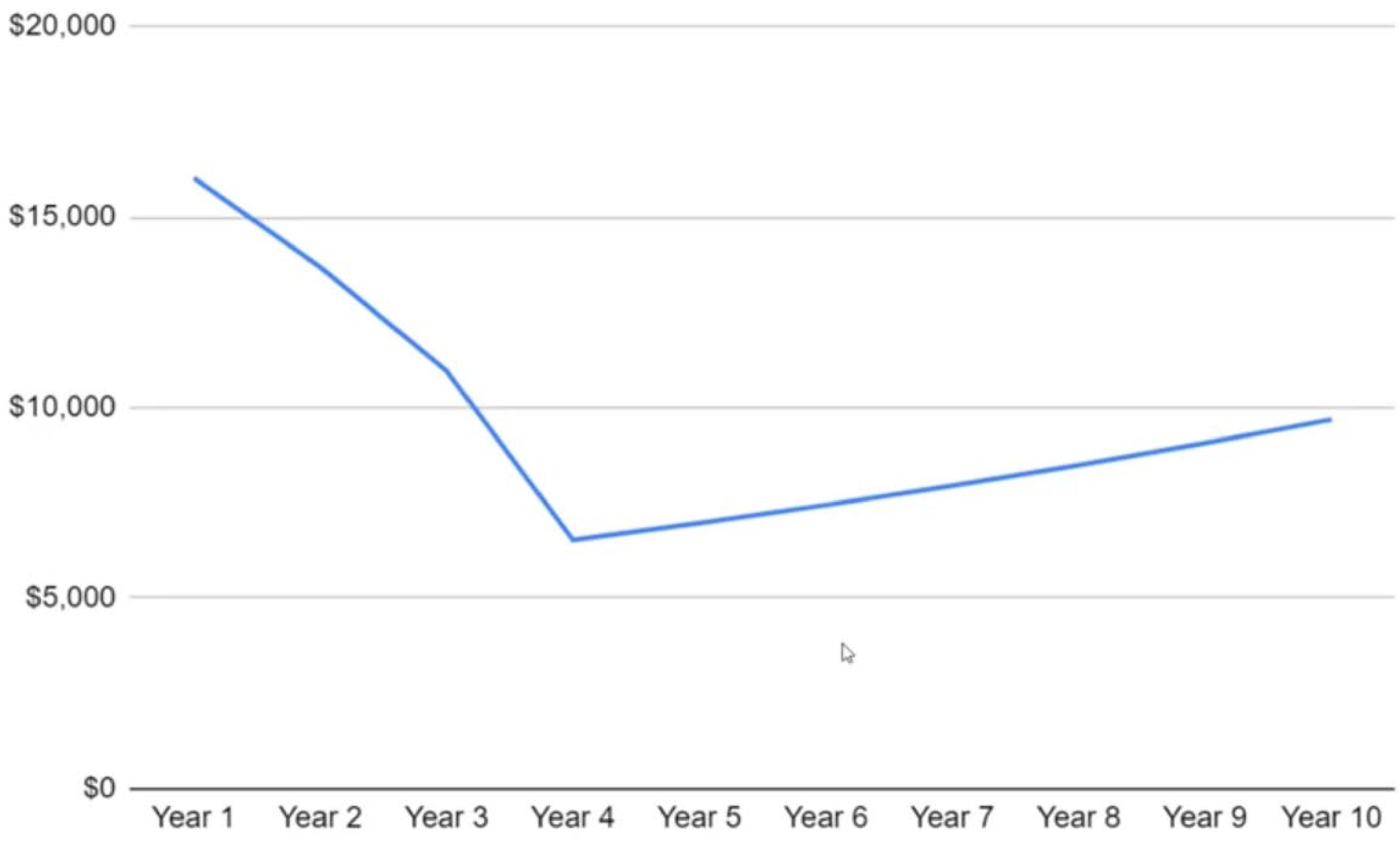
- **You've taken out a reverse mortgage for $300,000**
- **When can you refinance or switch it and what penalties would be payable?**
- **Note that different lenders have different penalties, for this example we're going to use the biggest lender in Canada – but the principles apply to all current lenders**

Penalty Example Calculation

- **In the 1st year** – the penalty is ~**$16,020**
- **After 1 year** – the penalty is ~**$13,688**
- **After 2 years** – the penalty is ~**$10,964**
- **After 3 years** – the penalty is ~**$6,528**
- **After 4 years** – the penalty is ~**$6,972**
- **After 5 year** – the penalty is ~**$7,447**
- **After 6 years** – the penalty is ~**$7,953**
- **After 7 year** – the penalty is ~**$8,494**
- **After 8 years** – the penalty is ~**$9,072**
- **After 9 years** – the penalty is ~**$9,689**

Note: using current rates for the calculations – also your term doesn't matter at all in calculating these penalties

Penalties On A $300,000 Reverse Mortgage



Other Costs & Considerations

- In weighing up the decision to switch or refinance there are other costs & considerations you need to factor in – in addition to the penalties:

  - **What will the new interest rate be – are there any savings?**

  - **How much additional money can I get (if this is something you're looking for)?**

  - **What costs and fees apply to the new lender?**

When To Switch Or Refinance - Rules Of Thumb

- Here's how much you need to save on the interest rate – for different reverse mortgage balances – to pay for the costs of switching or refinancing – **not including penalties**:

  - **$100,000 – you need a rate roughly 0.6% lower**
  - **$200,000 – you need a rate roughly 0.3% lower**
  - **$300,000 – you need a rate roughly 0.2% lower**
  - **$400,000 – you need a rate roughly 0.15% lower**
  - **$500,000 to $1M – you need a rate roughly 0.1% lower**
  - **Over $1M – you need a rate roughly 0.05% lower**

So, Should You Switch Or Refinance?

- With penalties included, you'd need slightly higher savings than I just showed
- However, one of the lenders is running a promotion just now that effectively makes switching or refinancing free (they are essentially paying for all the costs & possibly even some of your penalty) – **so even a 0.1% better rate may make it worth switching**
- **Lender promotions & offers** are another factor that you need to consider as well as the fact these promotions might not exist forever

Summary

- Breaking a reverse mortgage – by either moving it to a new lender or paying it off – is an option available to anyone regardless of what term you're on

- Penalties are payable – they are not linked to your term but rather how long you've had the reverse mortgage

- Penalties are highest in years 1-3, lowest in year 3-4 and gradually increase after this up until year 10 – after which they are zero

- In making the decision you'll need to weigh costs, savings & any lender promotions (which may not last forever)

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