REVERSE MORTGAGE INSIGHTS

Enjoy a better lifestyle in retirement

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REVERSE MORTGAGES

Contents

The purpose of this guide is to provide an objective, information rich introduction to reverse mortgages—what they are, how they work and how Kiwis can use them to enjoy a better lifestyle.

Introduction

If you are retired or plan on retiring soon, you may be concerned about having sufficient income to fund a comfortable retirement.

You are not alone. Rising living costs are outstripping superannuation payments meaning many Kiwis face a possible shortfall in retirement savings.

There is a potential solution and it is based on home equity. Many Kiwis over the age of 60 have significant wealth tied up in their home. In the past, Kiwis could only access this equity through downsizing or selling. A reverse mortgage allows you to unlock some of the equity tied up in your home, without having to sell it.

Over the past decade, reverse mortgages have become a more popular financial product. A reverse mortgage could help you cover day to day expenses, consolidate debt, pay for health care, support family, renovate your home or enable travel.

Funding your retirement

Population trends and the mass retirement of the 'baby boomer' generation means that more people than ever are now either retired or approaching retirement.

If you are part of this group, having enough income to fund a comfortable retirement might be a challenge.

New Zealand Superannuation ('NZ Super') provides the first pillar of a retirement income. As at 1 April 2021 a retiree living alone receives $873.88 fortnightly (after tax), while a couple receives $672.22 each, fortnightly after tax. [1]

New Zealanders are encouraged to save for retirement, so they can 'top-up' their NZ Super to enjoy the level of comfort they are accustomed to during their working lives, and to pay for those little extras that are not affordable on NZ Super alone.

According to the New Zealand Retirement Expenditure Guidelines, a couple wanting to live a 'no frills' budget in a major city would need $898.73 per week. For a couple wanting to live more comfortably, with some luxuries or treats, they would need $1,436.00 a week. This is simply not possible on NZ Super only. [2]

While the scenarios are different for those living outside major cities, the report shows that retirees will need to have significant savings or additional income to live comfortably later in life. For some, saving such large amounts is not possible. Notably, the report states that both retirees and pre-retirees considered NZ Super insufficient on its own to fund their retirement.

Fortunately, there is a solution. Many Kiwis are 'asset-rich', despite not having a high level of savings. This is because they're likely to own their home, which is where the bulk of their wealth is tied up.

If you're a homeowner over 60, there is the option to turn some of that equity in your home into cash with a reverse mortgage.

1 www.workandincome.govt.nz/eligibility/seniors/superannuation/index.html

2 New Zealand Retirement Expenditure Guidelines 2019

What is a reverse mortgage?

A reverse mortgage allows people to convert part of the equity in their home into cash which can be used for a wide range of purposes.

Unlike a standard mortgage, you are not required to make regular repayments — although you are able to do so at any time. It's important to note that the loan balance will continue to grow over time due to the interest compounding. The loan is repaid when you sell the property, move out or pass away.

An important point to consider is that you continue to enjoy the full ownership of your home and remain the registered owner of the property until you sell. Just like a standard home loan, a reverse mortgage will be registered on the property as security for the loan.

To be eligible for a reverse mortgage, you need to own your home outright, or have a standard mortgage that can be paid off by the proceeds of the reverse mortgage. There will be additional lending criteria that you should inquire about with your provider.

The amount of money you can access with a reverse mortgage is usually determined by two factors — your age and the value of your home. As an example, the following table outlines Heartland Bank's lending limits, for illustration. You should inquire with your provider about their lending limits.

How much could you borrow?

Age of youngest borrower	Maximum % of home's value available
60	20%
65	25%
70	30%
75	35%
80	40%
85	45%
90+	50%

Please note this may vary for different lenders.

The following table outlines the differences between a standard mortgage and a reverse mortgage.

Standard mortgage	Reverse mortgage
– Criteria based on ability to repay loan. – Amount borrowed determined by property value and income. – Regular monthly principal and interest payments reduce debt over time.	– Person aged 60 and over – Amount borrowed based on age and property value. – Interest is compounded monthly so debt grows over time. – Loan repayments are not required until you sell, move out or pass away. – Additional protections and flexibility.

How am I protected?

Reverse mortgage providers should offer guarantees to protect you. You should always ask your provider about the guarantees they offer.

If you do decide to proceed with a reverse mortgage, look for the following safeguards.

- **Lifetime occupancy**
  You can own and live in your home for as long as you choose.

- **Loan repayments**
  You should not have to make any loan repayments until the end of the loan.

- **30-day cooling off period**
  It's important you feel comfortable with your decision. You should be given the opportunity to change your mind within 30 days of taking out your loan.

- **No negative equity**
  The amount required to repay the loan should not exceed the net sale proceeds of the property.

- **Equity protection option**
  You should be able to choose to protect a percentage of the eventual net sale proceeds of your home and the chosen percentage should be guaranteed.

- **Independent legal advice**
  It is important that you are completely happy with all aspects of your reverse mortgage. To ensure this, you should seek independent legal advice from a solicitor of your choice, who will represent your interests and work with you to explain and discuss your loan.

Here's an example

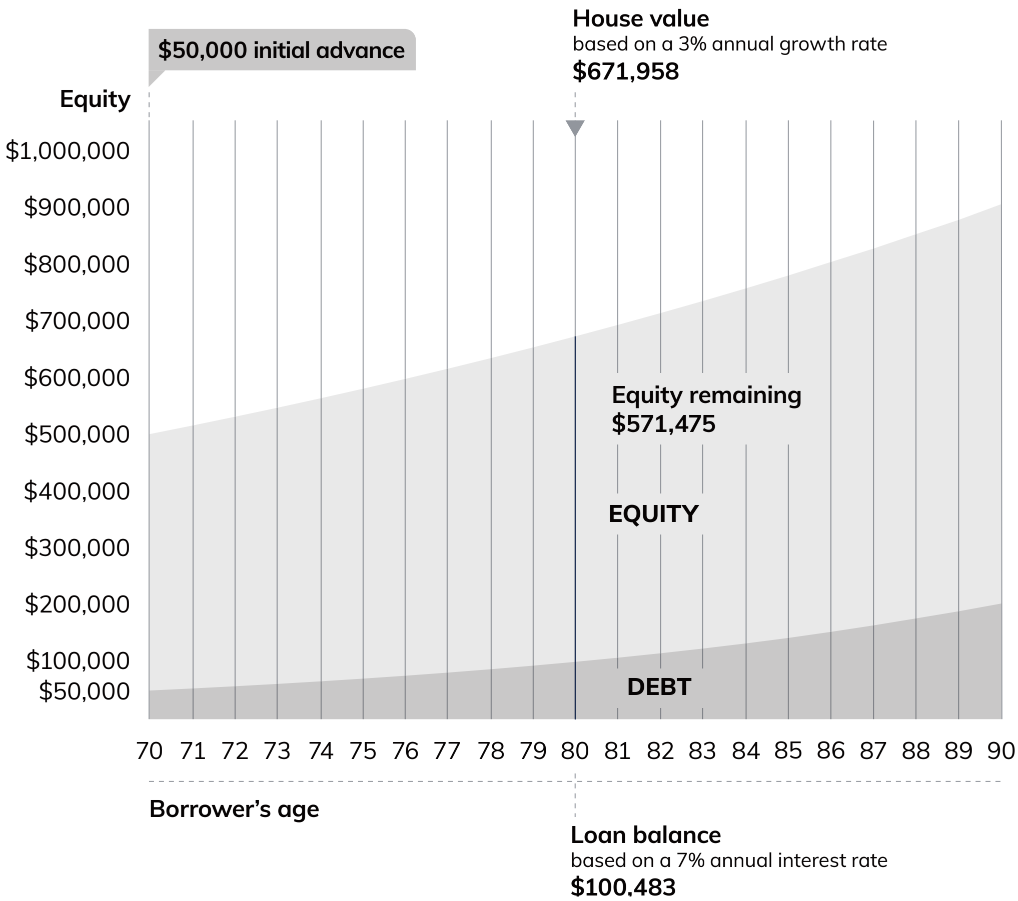
A common question is how a reverse mortgage adds up over time, and how much equity will remain in the property when the loan is due to be repaid. This depends on a number of factors including the interest rate, term of the loan and any increase in property value. Heartland has prepared the following example for a fictitious couple, for illustrative purposes.

Let's use the example of Jo and John. Both are 70 years old and they own a home valued at $500,000. The maximum amount to them available is $150,000. Initially, they choose to draw down $50,000 for home improvements, and set $100,000 aside in a cash reserve facility in case they need it in the future. The cash reserve is never drawn, meaning interest is never charged on that amount.

The graph below shows what happens to Jo and John's equity over time. While the loan debt increases so does the value of their property. The amount of equity increases as a result.

In dollar terms, Jo and John will have more 'net equity' after 10 years than what they did before the loan, about $571,000 of the home value. After 15 years, when they are both 85 years old, there would still be $636,000 remaining.

Remember, this graph is simply an example. A reverse mortgage is designed to last as long as required, or until you move permanently from your home. Your provider should be able to give you a personalised loan projection.



Important:

The example given is for illustrative purposes only and assumes a fixed interest rate of 7% p.a. compounded monthly, with no fees or charges applying and no repayments being made.

How are Kiwis using their reverse mortgages?

A reverse mortgage can be used to pay for almost anything to make life easier and more comfortable, including:

- **Debt consolidation**
  Consolidate debt and enjoy more of what life has to offer.
- **Support your family**
  Give your children or grandchildren a helping hand.
- **Medical and healthcare**
  Cover healthcare costs and look after your health.
- **Car purchase**
  Maintain or upgrade your car.
- **Day to day expenses**
  Supplement your income and cover daily expenses.
- **Home improvements**
  Future proof and enhance your home for years to come.
- **Travel and holidays**
  Tick off dream destinations from your bucket list or visit loved ones.

Top tip: There are many ways to use the money from your reverse mortgage. While it is up to you to decide how you want to use it, you should consider things such as longevity, like how much longer you could live for. Consult with your financial advisor and family to make an informed decision that are in your long-term best interests.

Pros and cons

There are advantages and disadvantages to a reverse mortgage. Here are some of the points you should consider.

Pros:

Stay in your home

A reverse mortgage can help you access funds for a better lifestyle in retirement, without selling or downsizing your home. It will allow you to stay in your home for as long as you choose.

Flexible

Some providers offer different options for draw downs, such as:

- **Initial advance**
  An initial, lump sum amount made on settlement.
- **Monthly advance**
  To supplement your retirement income with a regular monthly payment.
- **Cash reserve facility**
  A cash reserve facility lets you set aside funds for future needs or unexpected expenditure (e.g. home repairs, healthcare). It's possible to apply to draw on this reserve at any time.

No monthly repayments required

Unlike a standard mortgage you do not have to make regular monthly repayments. The interest is added to your loan balance.

No negative equity

The amount required to repay the loan will not exceed the net sale proceeds of the property.

Equity protection option

Reverse mortgages will often offer this option. If you want to keep an amount of capital in your home set aside, for your family or for a future home for example, you should ask about equity protection.

Cons:

Increases over time

Unlike a standard mortgage, where the principal decreases as you make repayments, the loan balance of a reverse mortgage increases due to the compounding interest effect on the loan when payments are not made.

Higher interest rates

Reverse mortgages tend to have a slightly higher interest rate than a regular mortgage, as loan repayments are optional. Reverse mortgage rates are usually lower than credit cards and personal loans.

Limit to how much you can access.

Your age will restrict how much equity you can release. For example, at the age of 65, the loan amount available may only be 25% of the value of the property. This could increase by 1% each year, so at 90 the maximum loan amount available could be 50% of the value of the property.

Frequently asked questions

Will I still own my own home?

Yes, you will always own your home and continue to live in it just as you do now. Only when you move permanently, or in the case of joint applicants, when both applicants have moved permanently, will the loan need to be repaid. Usually the payment is made from the proceeds of the sale of your home, leaving the balance to you or your beneficiaries.

You can stay in your home as long as you wish and continue to benefit from any capital growth.

Can I rent out my home?

If the loan is initially taken out over your investment property, you can rent out your property subject to meeting the provider's requirements.

If you wish to lease out your owner-occupied property, contact your provider. This isn't always possible.

How is my home valued?

To establish the value of your home and calculate how much you will be able to borrow, the reverse mortgage provider will arrange for an online valuation or for a registered valuer to visit your home and assess its value and condition.

How and when do I repay my loan?

Typically with a reverse mortgage, you do not need to make regular repayments. The value of your reverse mortgage, plus interest, applicable fees and costs is only due to be repaid when you move permanently from your home. Although a reverse mortgage is designed to last for as long as you remain in your home, you may repay your loan in full, (a discharge fee will apply) or repay part of your loan without penalty, providing you with flexibility to manage your finances.

Is there a risk I will end up having to repay more than the net sale proceeds of the property?

Not typically, although different providers might have different policies regarding this. As long as you observe the terms and conditions of the loan, the loan repayment amount should never exceed the net sales proceeds of the property.

Can I increase my loan amount?

Normally yes, but it will depend on circumstances. The lender will consider your application taking into account the age of the youngest person, the current property value and the total loan balance, at the time of application.

What if I move house?

If you move to another house you can repay your existing reverse mortgage and apply for another loan on your new home.

Will a reverse mortgage affect my other financial arrangements?

A reverse mortgage may affect your financial arrangements with the New Zealand Government, such as supplemental benefits. We recommend that prior to applying for a reverse mortgage you contact Work and Income to discuss any potential impact on your financial arrangements. Visit www.workandincome.govt.nz for more information. Your solicitor can also advise you accordingly.

Find out more

For more information on reverse mortgage products, please see:

Consumer Trusted
www.consumer.org.nz **|** 0800 266 786

Age Concern
www.ageconcern.org.nz **|** 04 801 9338

Ministry of Social Development
www.msd.govt.nz **|** 0800 552 002

Commission for Financial Capability
www.cffc.org.nz **|** 09 356 0052

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This guide has been prepared by Heartland Bank, New Zealand's leading reverse mortgage provider.