Basics

A New Kind of Loan: In Reverse

A "reverse" mortgage is a loan against your home that you do not have to pay back for as long as you live there. With a reverse mortgage, you can turn the value of your home into cash without having to move or to repay the loan each month. The cash you get from a reverse mortgage can be paid to you in several ways:

- all at once, in a single lump sum of cash;
- as a regular monthly cash advance;
- as a "creditline" account that lets you decide when and how much of your available cash is paid to you; or
- as a combination of these payment methods.

No matter how this loan is paid out to you, you typically don't have to pay anything back until you die, sell your home, or permanently move out of your home. To be eligible for most reverse mortgages, you must own your home and be 62 years of age or older.

Other Home Loans

To qualify for most loans, the lender checks your income to see how much you can afford to pay back each month. But with a reverse mortgage, you don't have to make monthly repayments. So you don't need a minimum amount of income to qualify for a reverse mortgage. You could have no income and still be able to get a reverse mortgage.

With most home loans, you could lose your home if you don't make your monthly payments. But with a reverse mortgage, there aren't any monthly repayments to make. So you can't lose your home by not making them. Most reverse mortgages require no repayment for as long as you — or any co-owner(s) — live in the home. So they differ from other home loans in these important ways:

- you don't need an income to qualify for a reverse mortgage; and
- you don't have to make monthly repayments on a reverse mortgage.

"Forward" Mortgages

You can see how a reverse mortgage works by comparing it to a "forward" mortgage — the kind you use to buy a home. Both types of mortgages create debt against your home. And both affect how much equity or ownership value you have in your home. But they do so in opposite ways.

"Debt" is the amount of money you owe a lender. It includes cash advances made to you or for your benefit, plus interest. "Home equity" means the value of your home (what it would sell for) minus any debt against it. For example, if your home is worth $150,000 and you still owe $30,000 on your mortgage, your home equity is $120,000.

Falling Debt, Rising Equity

When you purchased your home, you probably made a small down payment and borrowed the rest of the money you needed to buy it. Then you paid back your traditional "forward" mortgage loan every month over many years. During that time:

- your debt decreased; and
- your home equity increased.

As you made each repayment, the amount you owed (your debt or "loan balance") grew smaller. But your ownership value (your "equity") grew larger. If you eventually made a final mortgage payment, you then owed nothing, and your home equity equaled the value of your home. In short, your forward mortgage was a "falling debt, rising equity" type of deal.

Rising Debt, Falling Equity

Reverse mortgages have a different purpose than forward mortgages do. With a forward mortgage, you use your income to repay debt, and this builds up equity in your home. But with a reverse mortgage, you are taking the equity out in cash. So with a reverse mortgage:

- your debt increases; and

- your home equity decreases.

It's just the opposite, or reverse, of a forward mortgage. With a reverse mortgage, the lender sends you cash, and you make no repayments. So the amount you owe (your debt) gets larger as you get more and more cash and more interest is added to your loan balance. As your debt grows, your equity shrinks, unless your home's value is growing at a high rate.

When a reverse mortgage becomes due and payable, you may owe a lot of money and your equity may be very small. If you have the loan for a long time, or if your home's value decreases, there may not be any equity left at the end of the loan.

In short, a reverse mortgage is a "rising debt, falling equity" type of deal. But that is exactly what informed reverse mortgage borrowers want: to "spend down" their home equity while they live in their homes, without having to make monthly loan repayments. There's more about this important concept in an article called "A 'Rising Debt' Loan" in the Basics section of this site.

Exception

Reverse mortgages don't always have rising debt and falling equity. If a home's value grows rapidly, your equity could increase over time. Or, if you only get one loan advance and no interest is charged on it, your debt would never change. So your equity would grow as your home's value increases. But most home values don't grow at consistently high rates, and interest is charged on most mortgages. So the majority of reverse mortgages end up being "rising debt, falling equity" loans.

AARP does not endorse any reverse mortgage lender or product.

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