

Is a Reverse Mortgage Right for Me?



A 7-Step Self-Assessment Tutorial to Help You Decide

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You probably first heard about reverse mortgages through one of the radio or TV ads that make them sound like the greatest thing since fresh air:

- ✓ Tax-free income!
- ✓ No Risk of Default!
- ✓ No Asset or Credit Score Requirements!
- ✓ Flexible Payment Options!
- ✓ No Restrictions on How You Use the Money!
- ✓ Easy Pre-qualifications!
- ✓ Federally Insured!
- ✓ Guaranteed Home Ownership for the Rest of Your Life!
- ✓ On and on....

The truth is that reverse mortgages are bewilderingly complex financial products that few borrowers ever fully understand. Seniors who clearly understood (and dutifully paid off) fixed-rate, 30-year home mortgages their entire adult lives are faced with a confusing mortgage product that:

- can have as many as five different interest rates associated with it (i.e. expected rate, current rate, compounding rate, credit line growth rate and the “total annual loan cost” or TALC rate);
- has no fixed term but rather is based on actuarial assumptions about life expectancy;
- has a dizzying array of optional payment forms; and,
- is opposite to everything you previously learned about loans and mortgages.

The purpose of this tutorial isn't to delve into the complex details of reverse mortgages or even the process for getting one. There are several guides that do a good job at that. Rather, the focus here is to provide a 7-point self-assessment to help you determine whether a reverse mortgage makes *any sense at all* for your particular circumstances.

- Am I the right age for a reverse mortgage?
- How long do I expect to stay in my home?
- How long do I expect to live?
- How much additional income do I need?
- How much equity do I have and how much can I borrow?
- Have I considered other options?
- How important is it to me to leave an estate?

If, you go through this self-assessment and determine that a reverse mortgage may be right for you, you'll still have work to do:

- Decide which type of reverse mortgage is best for you
- Decide which payment option to choose

- Go through required counseling and make application

Why I Wrote This Guide

When my 80-something mother asked me to check into the advisability of her taking on a reverse mortgage, I figured it would be a matter of spending a few weekend hours to research the topic, prepare a spreadsheet analysis and explain my findings to her. I had heard bits and pieces about these mortgages, but never had dealt with one directly.

But having spent more than 25 years as a finance executive and having been involved with numerous multi-million dollar bond issues, complex loans and retirement issues, I was confident this would be no big deal. I was mistaken.

Quickly I found that reverse mortgages are extremely complicated, confusing, and totally counter-intuitive – even for someone with a finance background. Yet these mortgages are being marketed daily to elderly people, many of whom have little financial background and little chance of fully comprehending the transaction or its implications.

I came across materials in my research (including many free ones) that did a good job explaining reverse mortgage details like the different types of programs, various payment options, and the procedures for getting a loan. But there was little practical information to help someone perform a basic assessment whether a reverse mortgage made sense for their circumstances.

The self-assessment questions outlined in this report are a summary of the process and issues our family went through. In the end, my mother decided a reverse mortgage wasn't the best option. Instead, she sold her home in Chicago (at a nice profit) and moved into an assisted living community in a smaller community, nearer to her children and with a substantially lower cost of living.

Reverse mortgages will play an expanded role in the years ahead as the senior population grows. They are excellent tools in the right set of circumstances. It is hoped that the information presented here provides some guidance to help you assess whether your circumstances (or your parent's) are the right fit for a reverse mortgage.

About the Author

Tim Paul has his master's degree in public finance administration and has more than twenty-five years experience as a governmental finance officer. His hobbies are personal finance topics and website development which he has brought together with the following sites: [HELOC Loan Tips](#), [Reverse Mortgage Help](#), and [529 College Savings Rewards](#).

If you have questions or comments about this publication, please direct them to heloc@sagetips.com.

1. Am I the Right Age for a Reverse Mortgage?

A simple question, right? All reverse mortgage products require that the youngest homeowner (you or your spouse) be 62 years old at the time of closing. The age of the youngest homeowner is the key – either they're 62 or they're not.

But the age question has another side to it too.

See, age is used not only to assess whether basic program qualifications are met; age also has an even more significant role in determining *how much can be borrowed*. In simplest terms, the older you are, the more you can borrow.

Key Point:

You (or the youngest homeowner) must be at least 62 to obtain a reverse mortgage but the older you are, the more you can borrow.

In other word, all other factors (such as location, value of home, etc.) being equal, an 80-year old homeowner will be able to obtain a much larger reverse mortgage – perhaps 30% larger - than a 62-year old homeowner.

Why?

Because reverse mortgages are not fixed-rate, fixed-term loans. Rather they are based on *life expectancy*. At any point in time, odds are that the 62-year old will live more years than the 80-year old. From the lenders standpoint, this mean they likely will be making payments to the 62-year old for a much longer period than the 80-year old.

On average the older borrower will have a shorter remaining life expectancy than the younger one. To equalize expected payments over the life of the loan, the amount available for the younger borrower is set at a lower level than an older borrower. In other words, compared with younger borrowers with exactly the same levels of interest rate and home value, an older borrower will get a higher amount of monthly payments or line of credit disbursements.

This runs counter to many of life's financial transactions where the younger person always seems to get the advantage. A \$100,000 term life insurance policy will cost far less for a 25-year old than for a 50-year old. But in the unconventional world of reverse mortgages, the opposite is true.

Does this mean that a 95-year old homeowner is the ideal candidate for a reverse mortgage?

Not necessarily. Even though the 95-year old can get a much larger loan than, say, a 62-year old, his expected lifespan is too short to efficiently amortize the high costs associated with taking out a reverse mortgage. Costs associated with reverse mortgages are much higher than for conventional mortgages. It is not

uncommon for fees and costs associated with obtaining a reverse mortgage to be 10-20% of the amount of the reverse mortgage. Fees can easily amount to more than \$10,000.

Key Point:

Fees and costs associated with obtaining a reverse mortgage are very high – amounting to as much as 20% of the loan.

This is not to say these fees are excessive; reverse mortgages are not only complex but also very costly loans to administer. In large part this is because the main attraction – *never having to pay back more than the value of your home no matter how long you live* – is a feature paid for by insurance fees charged to borrowers.

Also, the number of reverse mortgages issued annually across the country (about 50,000) and the number of lenders who deal in reverse mortgages (about 1,200) are relatively small compared to the conventional mortgage and home equity loan markets. As the reverse mortgage market grows it's likely that administrative efficiencies, innovations and increased competition for business will help drive these costs down.

But for now, from the borrower's point of view, the only way to justify paying the high upfront costs is to carry the loan for several years – at least seven. It's easy to see that a 95-year old has a limited odds of doing this.

Key Point:

Paying steep reverse mortgage fees makes economic sense only if you remain in the home for at least seven years.

The “Goldilocks” age – not too young and not too old – best suited for reverse mortgage borrowers seems to be the mid-seventies. And, in fact, the actual average age of Home Equity Conversion Mortgage (HECM) borrowers in 2004 was 74 according to the US Department of Housing and Urban Development (HUD).

A 74-year old male can expect to live 10.38 more years, according to the Social Security Administration. At this age a borrower can obtain a reverse mortgage equal to a healthy share of their home equity and still expect to hold the loan long enough to amortize upfront costs. This assumes, of course, the borrower is in good health. Health problems are an important consideration and are addressed later in this report.

Key Point:

The best age range to consider obtaining a reverse mortgage is between 73 and 77.

2. How long do I expect to stay in my home?

Many surveys and academic studies have reached the same conclusion: most older Americans would prefer to age in place in their own homes. “Aging in Place” has become the slogan of the reverse mortgage industry – there’s even a National Aging In Place Week in November.

Certainly no one would argue with the righteousness of helping seniors to age in the comfort and security of their own homes. There’s also a good public policy argument that providing long-term care to seniors in their homes and funding the costs via the reverse mortgage mechanism may be the only realistic way to deal with the looming long-term care burden of baby boom retirees.

But regardless of the high-level arguments for aging in place, individual borrowers must personally and honestly assess the likelihood of their being able to remain in their homes for several years. As previously noted, seven years should be considered the minimum time period for a reverse mortgage to be a cost-effective option. If this doesn’t seem likely, you may want to look at other options.

Consider the following points in your self-assessment:

- Is your health and the health of your spouse relatively good?
- If your health deteriorates, is there enough nearby support (children or relatives) to provide assistance so that you can continue living at home?
- What is your life expectancy? Your spouse’s? (See next section.)
- If one spouse dies, will the remaining spouse still wish to live in the house?
- Is your home too big for one or two people? Is downsizing a better option?
- Do you want to continue with the responsibilities and hassles of being a homeowner, particularly if the house is older and facing maintenance issues?
- Are you prepared to have your future financial flexibility limited?

Even if you don’t *think* you’ll be moving within seven years, you need to consider the impact that a reverse mortgage will have on limiting future options and financial flexibility.

The decision to take out a reverse mortgage is a decision to limit your future options in couple of ways. First, as noted, you will need to stay in the home long enough to spread the high closing costs out over time for the loan to be sensible. Second, depending on interest rates, home values and other factors, the rising debt of a HECM will eat into your home equity meaning that you won’t have this safety-net available in the future.

3. How long do I expect to live?

You may not want to think about how many years you have left or fix a projected date of your demise, but be assured that insurance companies, pension funds, the government, and, for reverse mortgages, lenders all have a pretty specific idea of when they think you'll be gone. Actuarial science is big business and the statistical analyses and computer models that underly these financial transactions are impressive.

From the individual's standpoint, the issue is fairly simple: live longer than "they" assume you will and you come out a winner. Further, despite their impressive actuarial tools, you have far better information about your life expectancy than any insurance company or reverse mortgage lender. Only you know the full story about your family medical history or about how well you take of yourself.

Life expectancy is the most important consideration for any type of retirement planning – including reverse mortgage planning. But many – perhaps most – reverse mortgage borrowers enter into transactions without giving adequate thought to the subject.

Key Point:

You have better information about your own life expectancy than insurance companies or reverse mortgage lenders – but you need to use it!

Combine your personal knowledge with the helpful tools and information available via the internet and you have the ability to assess your life expectancy with a high degree of sophistication. One excellent tool is the [Longevity Game](#) available from the Northwestern Mutual Finance Network. Work through the twelve steps of this interactive calculator with honest answers and you will have a reasoned basis to judge whether the high costs associated with a reverse mortgage can be effectively amortized over your expected remaining life.

Finally, one unfortunate fact about reverse mortgage industry practices that deserves mention is that the actuarial life expectancy tables currently used are based on *general* population life expectancies. Yet many people most in need of reverse mortgages are impaired seniors with a shortened life expectancy due to chronic illness. Unfortunately, these borrowers enter reverse mortgage transactions at a distinct disadvantage.

Key Point:

If you have a chronic illness or impairment that likely will shorten your life expectancy, be very cautious in your consideration of a reverse mortgage.

4. How much additional income do I need?

Presumably you are considering a reverse mortgage because you've determined that you have an immediate or future need to supplement your retirement income. Perhaps medical bills are mounting or perhaps you are feeling pinched by the need to pay for essential home repairs. Or, perhaps you've concluded that since you have home equity available and it can help you achieve a better standard of living, why not *just do it*?

Conventional wisdom holds that seniors live on fixed incomes that are continually being eroded by inflation. This is true, but there are other forces at work that counteract the negative effects of inflation. In fact, government data shows that there is an *inverse* relationship between aging and spending - in other words, people tend to spend **less** as they age.

As example, during the initial years of retirement, many households experience higher spending as long put-off trips, new cars, or other retirement "rewards" are bought. After several years, though, spending tends to taper off in areas such as entertainment. The following household spending data from the U.S. Department of Labor Bureau of Labor Statistics illustrates this trend:

Expense Category	Age 55-64	Age 65-74	75 and Older
Food			
Food at Home	3,315	2,888	2,241
Food Away from Home	2,215	1,656	968
Alcoholic Beverages	372	237	128
Housing	13,714	10,761	8,678
Apparel	1,562	1,190	611
Transportation	8,680	6,015	3,622
Healthcare	3,059	3,626	3,856
Entertainment	2,414	2,016	909
Personal Care Products & Services	549	491	387
Reading	168	149	134
Education	743	176	81
Tobacco	337	219	105
Miscellaneous	675	547	519
Cash Contributions	1,568	1,811	2,127
Personal Insurance & Pensions	4,819	1,847	651
	\$44,190	\$33,629	\$25,017

Source: Consumer Expenditures in 2003 U.S. Bureau of Labor Statistics, June 2005 (Report 986)

Notice that spending in most categories – healthcare being an important exception – trends lower with age. Of course, this data represents averages across the country and your specific circumstances may be far different. If you are looking into a reverse mortgage because of perceived future needs, you may want to

consider whether this trend may apply to you. Take a look at friends and relatives and judge whether they seem to be spend less as they age.

In any event, prior to obtaining a reverse mortgage, you should go through the exercise of preparing a budget worksheet like the one below. Always look for areas where you can *reduce expenses* or *increase income*. Going through this exercise will accomplish two important goals: 1) help you critically assess your need for a reverse mortgage and, if needed, 2) provide a measure of the monthly income you'd like to achieve from a reverse mortgage.

Category	Current Monthly Amounts	One Year From Now	Five Years From Now
Income:			
Social Security			
Pension			
Savings (IRA, 401k, etc.)			
P/T Employment			
Other			
Total Monthly Income			
Expenses:			
Food			
Food at Home			
Food Away from Home			
Alcoholic Beverages			
Housing (Mortgage)			
Apparel			
Transportation			
Healthcare			
Entertainment			
Personal Care			
Reading			
Education			
Tobacco			
Miscellaneous			
Cash Contributions			
Personal Insurance/Pensions			
Total Monthly Expenses			
Shortfall*			
* This provides an estimate of the amount needed from a reverse mortgage.			

5. How much equity do I have and how much can I borrow?

Home equity is the market value of a home minus mortgage debt and other encumbrances. If your home is valued at \$175,000 and you have outstanding mortgage(s) totalling \$75,000, then your home equity is \$100,000. The longer a borrower has been making payments on a home, the greater the home equity accumulated. Also, the more the home has increased in market value, the greater the home equity accumulated.

Key Point:

Home Value – Mortgage Debt = Your Home Equity

The home value used in the reverse mortgage process will be determined by a professional appraisal (that you will pay the fee for). But in advance of this, you should be able to get a good idea of your home's value by doing a little research using one or more of the following free resources:

- Use the remarkable database of information available at www.zillow.com. This tool will give you tax assessment values and/or recent sales information for your home as well as for other homes in your area – all displayed on an aerial photograph or map. This tool is still being refined so information for some areas is spotty. Still it is a great place to start.
- Your City or County Assessing Office – With a quick phone call to your local assessing office, you can get the specific property value used for property tax purposes. Be aware, though, that the quality and timeliness of assessment information varies widely across the country. Still, this is a good place to begin. You may also be able to obtain actual sales prices for homes similar to yours that sold recently. This is the same information that the appraiser will use and can give you a very good idea of your home's market value.
- Sunday Newspaper – Look at asking prices on homes similar to yours in the same neighborhood – and then reduce these prices by 10%.
- Get a “Free” Appraisal from a Real Estate Agent – This can be a useful information source, but be prepared for the obligatory sales pitch.

Once you've determined your home's value, it's a simple matter of subtracting the outstanding mortgage balance to arrive at your home equity.

But while home equity is an key factor (along with life expectancy and interest rates) in determining how much you can get from a reverse mortgage, don't expect to be able to borrow a high proportion of your equity. The likelihood is that your reverse mortgage loan amount will be somewhere between 35% and 70% of your home equity, depending on the other variables and on the specific reverse mortgage product.

The good news is that now armed with your home equity information, you can visit any one of several online reverse mortgage calculators to get a more precise handle on what a reverse mortgage can mean to you.

Most of the reverse mortgage calculators you'll find on the internet are licensed from the same company and are identical in terms of the output generated. For example, the calculators at popular reverse mortgage sites such as [AARP](#), [Wells Fargo](#) and the [National Reverse Mortgage Lenders Association \(NRMLA\)](#) are basically all the same. The calculator at [Freedom Financial](#) is different in that it outputs a helpful side-by-side comparison of all three major reverse mortgage

Key Point:

The majority of reverse mortgage calculators you'll find at different websites are the same. One exception is the Freedom Financial reverse mortgage calculator which is the only one that outputs a comparison of the three different reverse mortgage program options.

programs: HUD Home Equity Conversion Mortgage (HECM), Fannie Mae Home Keeper, and Financial Freedom's own Cash Account program.

Finally, it is important to know that, unlike regular home equity loans which typically are a second lien (priority) position to the primary mortgage, reverse mortgages *always* are the first (and only) lien on the property. This means that if you have a mortgage balance – even a small one- it will have to be paid off either in advance of getting the reverse mortgage or at closing with proceeds from the reverse mortgage.

Key Point:

Reverse mortgages *always* are the first (and only) lien on the property. This means that if you have a mortgage balance – even a small one- it will have to be paid off.

6. Have I considered other options?

Some personal finance experts regard reverse mortgages as loans of last resort – to be used only by seniors facing dire circumstances and who have run out of other options. This may be extreme, but it does beg the question “Have reverse mortgage borrowers considered all their options?”

It’s probably accurate to say that in many cases, they do not. Reverse mortgages (by law) are available only to senior citizen homeowners – age 62 and above.

Marketers can make it appear that reverse mortgages are the single best option designed specifically to meet seniors’ needs. Since most closing costs can be financed as part of the loan, borrowers typically face few out-of-pocket costs for a reverse mortgage (typically the appraisal fee and a credit check to make sure that the borrower is not delinquent on any other federally insured loans). Some marketers make it appear that a reverse is a low-cost loan when it clearly is not.

Key Point:

Reverse mortgages are designed for and targeted at senior citizens. But do not think that this makes them the “best” or “only” option available. In fact, many personal finance experts say reverse mortgages should only be considered as the “last” option.

But smart consumers need to look past the hype and consider other financial products and strategies that could meet their needs more effectively or efficiently.

This section provides an overview of other strategies you should at least consider before deciding on the reverse mortgage route. All of the ideas presented here have numerous pros and cons that are not addressed here but that you’ll need to carefully consider. The intent is to get you at least thinking about these alternate ideas.

- Sell & Downsize – This is the traditional, straightforward way to access your home equity in retirement. Simply sell the 4BR homestead that you raised the family in for \$250,000 and purchase a smaller home or condo for \$125,000. This frees up \$125,000 of tax-free, cash equity for you to invest or use as you please.
- Sell & Rent – Sell the house, but instead of buying another, smaller home – rent. The benefit here is that you can then invest the entire \$250,000 to supplement income.
- Move to a Lower Cost Community – Done in conjunction with either of the first two strategies, this move can really stretch your retirement

savings - particularly if the home you are selling is in a high-cost metropolitan area.

- Stay & Rent - Stay in your home and rent out one or two rooms to provide additional cashflow.
- Stay & Cost Share - Stay in your home and invite a trusted friend or relative to live with you and share living costs.
- Stay & Utilize Traditional Home Equity Financing - Consider accessing your home equity through a standard home equity loan or home equity line of credit (HELOC). The main benefit compared to a reverse: minimal closing costs and fees. The main drawback compared to a reverse: required monthly payments. This strategy can make good sense:
 - If you do not think you'll stay in your home for at least seven years.
 - If you are too young to effectively benefit from a reverse mortgage (see above). A standard home equity loan can be a cost-effective way to bridge the years until you reach your mid-seventies when a reverse mortgage may make more sense.
 - If, after reviewing your finances (see section 4), you anticipate the need for additional income to be relatively short-term (3-5 years).
- Consider Senior Assistance Programs – State and local governments commonly offer assistance to senior citizens for purposes such as paying for home improvements or assistance with paying property taxes. These programs may be in the form of low-interest loans or a specialized type of reverse mortgage. For example, in some areas seniors can defer property tax payments until they die or sell their home. For information on these programs, you should contact your local Area Agency on Aging. A nationwide listing of these agencies is available at www.mfaaa.org/AreaAging.aspx.
- Family-Financed Reverse Mortgage – Financial dealings between family members are always risky. But if done with everyone's full understanding and proper binding documents, this can be a good means to get the benefits of a reverse mortgage and avoid the high closing costs and other drawbacks. In the most straightforward form, children loan funds to their parents with the loan secured by the parent's home. In addition to avoiding high costs, this strategy has the benefit of allowing loan terms to be tailored specifically to meet the needs of the senior homeowner. This strategy can be particularly useful when a goal is to keep the home in the family.
- Family Payment Assurance – Many children, of course, do not have the means to serve as a “bank” for their elderly parents. However, it may

be possible for them to take on a less onerous financial role and serve as payment backup for their parents in a traditional home equity financing. As noted above, home equity loans and HELOCs are likely the more cost-effective means to tap home equity for shorter periods (e.g. less than seven years). The drawback is that monthly loan payments (interest-only in many cases) are required. Children can provide assurance to their parents that, if needed, they stand ready to assist in making monthly payments.

- Consider Tapping Other Financial Assets – Home equity is the main asset of most seniors. But many also own stocks, bonds or other financial assets that could be liquidated or restructured to provide additional income. The advantage is that these assets can be turned into cash much more efficiently than home equity.

7. How important is the goal of leaving a bequest?

Studies show that a large proportion (as high as 80%) of senior homeowners wish to leave a bequest to their children. For most seniors, home equity represents more than half of their net worth. A reverse mortgage – which uses up equity – is viewed as running counter to the bequest motive.

The adult children of seniors (the heirs) in many cases see the issue differently. Often these children would prefer their parents use their equity stake to adequately take care of themselves rather than scrimp through retirement for the sake of preserving an estate.

Clearly this is a matter of personal and family values and probably best handled through open discussion between the parents and children. There is no right or wrong answer, but open consideration of the issue will help in the assessment of whether a reverse mortgage is right for you.

Taking on a reverse mortgage does not preclude the possibility of leaving an inheritance. It does, however, set in motion the process of spending down accumulated home equity. Whether or not there is equity remaining for a bequest is a function of how large the accumulated reverse mortgage grows (including interest accumulation) and how much growth occurs in the market value of the home.

Key Point:

Falling interest rates and rising home values work to your advantage. On the other hand, rising interest rates (which will cause your loan balance to grow faster) and falling home values can quickly deplete your home equity.

When a reverse mortgage holder dies, the heirs will be responsible for paying off any remaining debts – including the reverse mortgage. Typically this is done by selling the home and applying the sales proceeds to the reverse mortgage debt:

- If the home sells for less than the accumulated reverse mortgage balance, all proceeds go to pay the debt and there is nothing more to pay. A reverse mortgage will never cost more than the value of the home.
- If the home sells for more than the accumulated reverse mortgage balance, the additional equity not used to retire the debt belongs to the estate.

Key Point:

A reverse mortgage will never cost more than the value of the home.

Conclusion

If, after going through this self-assessment guide, you believe that a reverse mortgage may be a good option for you, you will want to read further about specific program details and features and about the process for getting the loan.

Here's a list of free documents that will give anyone seriously considering a reverse mortgage a thorough look at the good, the bad and the ugly. These documents can be viewed online or downloaded in PDF format to be read with the free Adobe Acrobat Reader:

1. [Home Made Money](#) - This is AARP's 52-page "consumers guide to reverse mortgages". The guide is thorough and well-written. It focuses on the HUD HECM program, but covers other major reverse mortgage options only in passing. It does an especially good job of explaining the reverse vs forward mortgage concept in understandable terms.
2. [Money from Home](#) - This is Fannie Mae's 96-page version of a "consumers guide to reverse mortgage options". Like the AARP guide it covers the HUD HECM program in-depth but also covers its own Fannie Mae *Homekeeper* reverse mortgage option in detail.
3. [Reverse Mortgages for Seniors](#) - A three-page critique of reverse mortgages prepared by the American Institute for Economic Research. One of the better hard-nosed critiques of the reverse mortgage concept we've seen. Serious food for thought for anyone considering a reverse.
4. [Evaluation Report of FHA's Home Equity Conversion Mortgage Insurance Demonstration](#) - This 178-page report is a comprehensive review of the HUD HECM program. Though somewhat dated (March 2000) it provides very interesting insights into the HECM program and into reverse mortgages in general. Much of the report is technical and probably of little interest to the average reader. However, chapters two ("Profile of HECM Borrowers, Properties and Loans") and five ("Borrower Feedback") provide very helpful and interesting information.
5. [Use Your Home to Stay at Home Expanding the Use of Reverse Mortgages for Long-Term Care: A Blueprint for Action](#) – A detailed report and action plan outlining the relationship between long-term care needs and reverse mortgages.

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