Thinking of a reverse mortgage? Here's how that compares with a HELOC

THE GLOBE AND MAIL

September 13 2018

How does paying 6.59 per cent interest on a mortgage grab you? If that sounds high, it should, because Canada's average five-year fixed mortgage is only 3.47 per cent.

Yet thousands of seniors will pay that higher 6.59 per cent in a reverse mortgage, a loan secured against home equity where you make no payments until you move or sell your home.

At those rates, a reverse mortgage doubles in size every 11 years. That's why anyone who needs this kind of loan should first review the alternatives, particularly a home equity line of credit (HELOC), if they can qualify for one.

Rising rates aren't making a dent

Five-year fixed reverse mortgage rates are up 160 basis points from their low of 4.99 per cent in 2016, but these escalating rates aren't dissuading seniors. Reverse-mortgage sales are exploding.

This year alone, industry leader HomeEquity Bank projects to close more than $800-million worth, a record for the company and a 35-per-cent increase over last year. And it has just one direct competitor, Equitable Bank.

For cash-strapped seniors who want to stay in their home, can't qualify for traditional financing and/or don't want a monthly payment, 6 per cent-plus rates are the cost of doing business. That's especially true for those struggling with medical or mobility issues, where a reverse mortgage might be their last option to avoid a long-term care facility.

Now, one would think that rising rates might turn people off of comparatively pricey reverse mortgages. The reality is, higher rates could make people even more reliant on reverse mortgages given that payments aren't required and because they're easier to qualify for than other loans.

"The reasons people need money don't go away as rates rise," says Steven Ranson, president and chief executive of HomeEquity Bank.

A third of HomeEquity Bank's business comes from people having problems paying off mortgages and secured lines of credit. If mortgage – and reverse mortgage – rates shoot up two to three percentage points, "that problem is actually worse," so higher rates "may actually help our business," he says.

Strategies to lower interest expense

The thing most people don't realize is that you don't have to take all the money you're approved for, Mr. Ranson says. If you qualify for $200,000, for example, you can take as little as $25,000 up front.

You can then pull out money in increments whenever you want, as little as $5,000 at Equitable Bank and $10,000 at HomeEquity Bank. That way you're not incurring big interest on money you don't use. It's kind of like a line of credit in that sense.

Note that both HomeEquity and Equitable charge an annoying $50 fee each time you pull out more money after your initial draw. The former occasionally has promotions to waive this fee.

The HELOC alternative

HELOCs are another way seniors can get the cash they need at a much lower cost. HELOC rates are currently 3.7 per cent to 4.45 per cent. Compare that with a 5.99-per-cent variable reverse mortgage.

HELOCs are much harder to get, however, especially for seniors on a fixed income with high monthly expenses relative to their monthly cash flow.

If you're contemplating a reverse mortgage, try a mortgage broker first. They can assess your debt ratios and credit, confirm whether you'd be approved for a HELOC and compare the most flexible lenders.

And when it comes to lending to older Canadians, not all HELOC lenders are created equal. Some are more seniors-friendly than others, case in point being Manulife Bank.

As a broker, I've seen lenders kibosh HELOC applications from elderly clients for reasons I can only explain as age-related. But not all lenders in the HELOC space underwrite the same. At Manulife, for example, "The age of the client essentially has no bearing," says Jeff Spencer, vice-president of retail sales at Manulife Bank and a former reverse-mortgage executive at HomeEquity Bank. "A lot of clients who are at the retirement stage qualify with us." That's partly because Manulife makes it easier for people with 50-per-cent equity to qualify.

And if you don't want to make payments, you can essentially borrow the minimum interest-only payment from Manulife's HELOC itself. You just need to deposit some kind of income into the account each month, for example, your government benefits or pension.

And there's another benefit of "all in one" HELOC providers such as Manulife and National Bank. Since your chequing and borrowing are combined into one account, any deposits immediately reduce your debt, saving wads of interest over time. Compare that with a typical zero-interest chequing account – which is akin to loaning your bank money for free.

The key to seniors and HELOCs

HELOC lenders technically reserve the right to limit your line of credit borrowing at any time. That rarely happens, if you are making payments on time.

New regulations or financial crises are cases where HELOC lenders have restricted or increased the cost of borrowing in the past, but again, very rarely.

Another risk is if your spouse dies. If or when a lender finds out, and you can't prove you can afford the payments on your own, it has the right to call in – essentially to cancel – your HELOC.

If you're a senior with limited free cash flow, no assets besides your home and you want to leave yourself with options in the future, remember one thing. Never get a HELOC for more than 80 per cent of what a reverse mortgage company will lend you. That is, unless you're willing to sell the home when you deplete your HELOC credit.

Heeding this rule enables you to refinance your HELOC into a reverse mortgage if you run out of HELOC borrowing power – even if home values drop 20 per cent. That could be the difference between you staying in your home or not.

One last tip: If you think you might need a HELOC in retirement, do yourself a favour and apply for one before you retire. Other things equal, the higher your income, the easier it is to qualify.

Robert McLister is a mortgage planner at intelliMortgage and founder of RateSpy.com. You can follow him on Twitter at @RateSpy.