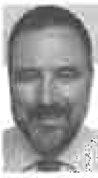
The reverse mortgage problem



LEGAL MATTERS

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J asks what reverse mortgages are and about the fishhooks.

Reverse mortgages, also called Home Equity Release mortgages, have been heavily promoted, particularly to the elderly who own their own homes.

They are loans secured against your home by a mortgage, where the loan amount, together with all the interest on that loan, does not become payable until you leave your home – eg, if you sell, go into a rest home, or on your death.

For people living on a modest retirement income these loans can enable unexpected one-off expenses to be met, such as having to replace a roof or other major repairs, or having major surgery.

Home equity loans are much more expensive then ordinary mortgages.

Some companies currently offering these loans charge up-front fees. In addition, you will incur a house valuation fee and legal fees, so you need to be prepared for this.

The interest rates of these loans are significantly higher than an ordinary mortgage.

The total interest payable over the term of the loan is also very much more because it compounds, and the loan amount does not reduce during the term of the loan, unlike most mortgages.

A $15,000 loan at 11 per cent compounding annually grows to $38,370 over 10 years, and $64,656 over 15.

The overall effect is that your equity in your home can be quickly eroded by the operation of one of these loans. This might make it difficult in the future to move from your home to a smaller property, or to buy a unit in a retirement village.

In some cases you would be able to take the loan with you if you want to move to another property.

Obviously the amount left for your family out of your estate can be seriously eroded, because of all the interest mounting.

What should you do?

Because these mortgages are so expensive, we suggest the first thing to do is to explore other options.

If your income is sufficient, try getting a small ordinary mortgage. That will cost much less overall.

Consider moving to a smaller home now, and releasing some of your cash equity that way.

Also, see if your family can lend you the money instead. It will be much cheaper and will preserve the family home as an asset.

If you do decide to take one of these mortgages, shop around first.

Borrow only the minimum amount you need. You can probably take more later, so do not be persuaded to borrow more than is absolutely necessary.

Talk to your financial adviser, lawyer or accountant before you make a decision.

D asks about obligations as a partner in a family business venture.

D and his two siblings set up a partnership and bought a rental property in the partnership.

The partnership took out a mortgage with a bank to purchase the property.

Their lawyer suggested they enter into a partnership agreement recording, such things as what happened if one party wanted to sell their share of the partnership, but they decided that they didn't need one as "they were family".

After a time, D wanted to move overseas and to withdraw his share of the partnership.

He asked the other two if they would buy out his share or let him sell it to someone else. Things turned sour because his siblings couldn't afford to buy him out and couldn't agree on any other arrangement.

There is specific law relating to partnerships (the Partnerships Act 1908), but it didn't provide D with much assistance in this situation.

If the partners had put in place a written partnership agreement, it could have provided a clear process to deal with the issue of buying D out.

Partnerships are not "legal" entities, so partners are generally personally liable for any matters relating to the partnership, and that includes mortgage borrowings.

This liability is joint and several (separate), so D would remain personally liable for the mortgage until he was removed from the partnership.

Partners hold property on behalf of the partnership.

It pays to be aware of your obligations as a partner and to make sure you have a written agreement with the partners in your partnership to avoid any disputes down the track.

■ Column courtesy of Rainey Collins Lawyers, phone 0800 733484. If you have a legal inquiry you would like discussed, email aknowsley@raineycollins.co.nz.