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Reverse Mortgage Or Home-Equity Loan?

By Jean Folger | October 17, 2014

If you are a homeowner and at least 62 years old, you may be able to convert your home equity into cash to pay for living expenses, healthcare costs, a home remodel or whatever else you need. Two options for doing so are reverse mortgages and home-equity loans. Both allow you to tap into your home equity without the need to sell or move out of your home. These are different loan products, however, and it pays to understand your options so you can decide which is better for you: a reverse mortgage or a home equity loan?

Reverse Mortgages

Most home purchases are made with a regular, or forward, mortgage. With a regular mortgage, you borrow money from a lender and make monthly payments to pay down principal and interest. Over time, your debt decreases as your equity increases. When the mortgage is paid in full, you have full equity and own the home outright.

A reverse mortgage works differently: Instead of making payments to a lender, a lender makes payments to *you*, based on a percentage of your home's value. Over time, your debt increases (as payments are made to you and interest accrues) and your equity decreases as the lender purchases more and more of the equity. You continue to hold title to your home, but as soon as you become delinquent on your property taxes and/or insurance, the home falls into disrepair – or you move, sell the home or pass away – the loan becomes due. The lender sells the home to recover the money that was paid out to you (as well as fees). Any equity left in the home goes to you or your heirs.

Note that if both spouses have their name on the mortgage, the bank cannot sell the house until the surviving spouse dies – or the tax, repair, insurance, moving or selling-the-house situations listed above occur. Couples should investigate the surviving-spouse issue carefully before agreeing to a reverse mortgage. For more, see *Is A Reverse Mortgage Right For You?* and *The Reverse Mortgage: A Retirement Tool.*

Home-Equity Loans

Like a reverse mortgage, a home equity loan lets you convert your home equity into cash. It works the same way as your primary mortgage – in fact, a home equity loan is also called a second mortgage – in that you receive the loan as a single lump-sum payment, and you make regular payments to pay off the principal and interest, which is usually fixed-rate.

Another type of home-equity loan is the home equity line of credit, or HELOC. With a HELOC, you have the option to borrow up to an approved credit limit, on a as-needed basis. With a standard home-equity loan, you pay interest on the entire loan amount; with a HELOC, you pay interest only on the money you actually withdraw. HELOCs are adjustable loans, so your monthly payment changes as interest rates fluctuate.

Unlike reverse mortgages, the interest that is paid on home-equity loans and HELOCs is generally tax-deductible for loan amounts up to $100,000. In addition – and this is a key reason to make this choice – your home remains an asset for you and your heirs. It's important to note, however, that your home acts as collateral, so you risk losing your home to foreclosure if you default on the loan. For more, see *Home Equity Loans: What You Need To Know.*

Key Differences

How You Are Paid

- Reverse mortgage – Monthly payments or lump-sum payment.
- Home-equity loan – Lump-sum payment.

- HELOC – As-needed basis, up to a preapproved credit limit. You get a credit/debit card and/or a checkbook and withdraw money when needed.

Repayment

- Reverse mortgage – Deferred repayment. The loan becomes due as soon as you become delinquent on your property taxes and/or insurance, the home falls into disrepair, you move, sell the home or pass away. The loan is typically repaid through proceeds from the sale of the house.
- Home-equity loan – Monthly payments made over a set amount of time with a fixed interest rate.
- HELOC – Monthly payments based on the amount borrowed and the current interest rate.

Age and Equity Requirements

- Reverse mortgage – Must be at least 62 and own the home outright, or have a small mortgage balance.
- Home-equity loan – No age requirement and must have at least 20% equity in the home.
- HELOC – No age requirement and must have at least 20% equity in the home.

Credit and Income Requirements

- Reverse mortgage – No income requirements, but some lenders may check to see if you are capable of making timely and full payments for ongoing property charges (e.g. property taxes, insurance, HOA fees, etc.).
- Home-equity loan – A good credit score and proof of steady income sufficient to meet all financial obligations.
- HELOC - A good credit score and proof of steady income sufficient to meet all financial obligations.

Tax Advantages

- Reverse mortgage – None.
- Home-equity loan – Interest is generally tax deductible for loan amounts up to $100,000.
- HELOC – Interest is generally tax deductible for loan amounts up to $100,000.

The Bottom Line

Reverse mortgages, home equity loans and HELOCs all allow you to convert your home equity into cash. They differ in terms of disbursement, repayment, age and equity requirements, credit and income requirements, and their tax advantages.

In general, a reverse mortgage is considered a better choice if you are looking for a long-term income source and don't mind that your home will not be part of your estate. Be sure that the rights of the surviving spouse are clear, if you are married. A home-equity loan or HELOC is considered a better option if you need short-term cash, will be able to make monthly repayments and prefer to keep your home. Both bring considerable risk along with their benefits, so review the options thoroughly before taking either action. And take a look at *Is Relying On Home Equity For Retirement A Good Idea?* and *Reverse Mortgage Pitfalls.*

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