

MARKET

# How to avoid an unlucky break



## Super & funds

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Some retirees who want to sell their homes face big break fees on their reverse mortgages. These are the mortgages available to home owners 60 and over who need to access some of the cash in their homes. The mortgage allows them to borrow against their home without having to pay back the principal or interest until they die, or go into a nursing home or a retirement village, at which time the debt is repaid. The cash can be taken as an income stream or as a lump sum.

But consumers need to understand that reverse mortgages can carry hefty break fees. These can run to tens of thousands of dollars, especially for those who took out a fixed-rate reverse mortgage when interest rates were high.

Interest rates have fallen by more than 4.25 percentage points since September last year and so those who took out a fixed-rate reverse mortgage before then, are likely to be paying a much higher rate than the current variable rate.

But what a lot of those with reverse mortgages do not realise is that if they move before the end of the fixed-rate term, typically five or 10 years or life, they have to pay the economic cost to the lender for breaking the contract.

Wendy Schilg, the director of the

National Information Centre on Retirement Investments, which offers independent information on reverse mortgages, says the product can be helpful to those who are asset rich but cash poor but the break fee is an issue of concern.

"People on a fixed-interest reverse mortgage who have wanted to sell their house before the fixed-interest term ends have found themselves paying huge break fees," Schilg says. "In some cases, these have been over \$50,000. We have not had a break fee reported to us yet that has been under \$12,000. In most cases, the break fee has been around 50 per cent of the value of the original loan."

John Cox, a 76-year-old retiree from Perth, took out a reserve mortgage at the end of 2007. A fixed rate was attractive when interest rates were rising. He is on his own and wants to move to NSW to be with friends but faces a break cost of

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\$34,000. Had the lender spelled out the potential break costs, he would have taken a variable rate.

Kevin Conlon, the chief executive of the Senior Australians Equity Release Association of Lenders (SEQUAL), an industry body covering most reverse mortgage providers, says the fixed-rate

option is a "really poor interest rate management tool as it does not protect you from interest-rate risk". He says what a fixed-rate loan gives is certainty. "They provide certainty as to the dollar value of the outstanding loan." He says most people take out reverse mortgages with a variable interest rate.

It is not only those people voluntarily opting out of reverse mortgages who may be hit with the fee. If one of the trigger events, such as sale of the home to move into retirement village, occurs within the fixed-rate contract period, break costs may be incurred.

SEQUAL'S Conlon says its members are not charging borrowers arbitrary fees if they break their fixed-rate contract either voluntarily or because of a trigger event.

He says SEQUAL members only pass on the "wholesale cost" of the provider extracting itself from a fixed-rate option and there is no premium being added to the economic cost.

The National Information Centre on Retirement Investments has recommended to the Federal Government that break fee examples be included in reverse mortgage contracts.

Reverse mortgage contracts and documentation will say that break fees may apply but the centre wants reverse mortgage providers to include examples that show the break fees one, three and five years into the term. Assumptions should include that no repayments are made during the term and that the standard variable rate falls by a certain amount below the fixed-term rate.