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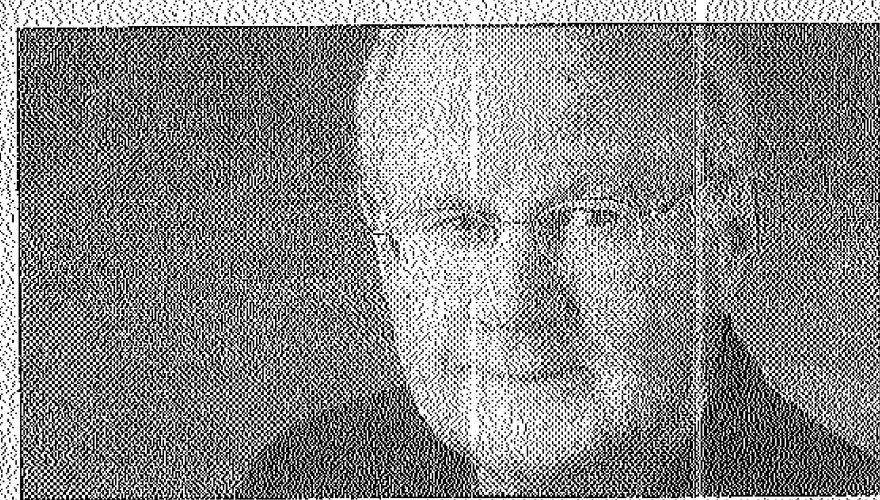
PERSONAL FINANCE

Reverse mortgages are not for everybody



SCOTT BURNS

We are 75 and 69. Our financial situation is good. We live in a controlled senior citizen environment.

We have a $100,000 mortgage on a $200,000 home. Our payment is less than $600 a month. We know people are jumping on the reverse mortgage concept. I am sure that some do this for the right reasons and some for the simple cash flow advantages the concept provides.

But down the road, homeowners walk away, and no value is left in their home for the survivors or those who expect some inheritance.

With the economy as it is, home values may never be what they have been in the past. Does it make sense to have a reverse mortgage now, or is there something in that process we are not seeing?

— P.H., Sun City

In recent years, reverse mortgages have become better deals than they once were. Expenses have come down. That's the good news.

A reverse mortgage is an improved option for those who would really benefit from having one. The real question, however, is: Who would really benefit from having a reverse mortgage?

Most of the people interested in getting a reverse mortgage have little or nothing in financial assets. They need the money to continue living in their house. This means they are massively "house poor." It means they are probably spending a very large portion of their income on the cost of operating their home. It means they are short-changing almost everything else in their lives to stay in their home.

That's why I think most of the people who are thinking about getting a reverse mortgage would do better to think about selling their home and buying or renting a more affordable place.

Although people often have great sentimental attachments to their homes (and equally great fear of change), the most common end result is a poorly maintained home. Worse, the homeowner is trapped because he doesn't have money to do anything but stay at home.

Although it may be nice to stay in a home you've lived in for many years, a better exercise would be to make a list of all the opportunities that are being forgone because of being house poor.

For you, a reverse mortgage would not be enough to pay off your existing mortgage, but it would provide a monthly payment almost large enough to cover your mortgage payment.

I recently moved the funds from my former employer's 401(k) account to my own IRA investment account. I elected to stay with the same company that has managed the funds for the former employer. After several telephone conferences, I am about to sign an investment management contract. But I would like to know if an annual fee of 0.98 percent is reasonable. I have slightly more than $200,000 in the account.

— C.F., by e-mail

It is common for mutual fund management accounts, often called "wrap" accounts, to cost 1 percent a year in addition to the cost of the underlying mutual funds. The companies that offer this service generally think the cost is reasonable because it is common.

Unfortunately, reasonable for them isn't the same as reasonable for you. They fail to consider the burden the additional cost puts on your investments. Worse, many of the same firms will often choose relatively expensive managed funds for your portfolio.

In the end that means you're gambling about 1.5 percent a year, or more, on the skills of the mutual fund managers and your portfolio manager.

As I've pointed out many times, this is a very poor bet. Over a 10- or 15-year period, it is likely to take your portfolio return down to levels well below what you'd achieve with an index investing approach such as my basic Couch Potato investing idea or my Couch Potato Building Block portfolios, Bill Schultheis' Coffee House Investor portfolios or William Bernstein's Coward's Portfolio.

This conclusion does not come from a deep psychological injury in my childhood. It's a statistical reality that usually brings hate mail from financial managers.

They think I have a low opinion of them. But that's not what it's about.

There is little evidence that anyone can beat the market and add to investment returns. There is much evidence that humility and low costs will do much better.

Questions about personal finance and investment may be sent by e-mail to scott@scottburns.com.