The Truth About Reverse Mortgages

If you watch TV, you have very likely seen one of those commercials, and maybe even one of the infomercials, on turning your home into cash for your retirement. The best part, according to these TV spots, is that you don't have to sell your home to access its value. Now they have your attention! How is that possible? It's called a reverse mortgage. A reverse mortgage is a way for a homeowner with significant equity to tap into that equity and get money to pay bills, travel and really enjoy those "golden years."

The advertising claims are grand, but how close to the truth are they? Let's see.

A reverse mortgage is often a Home Equity Conversion Mortgage, or HECM. A true HECM is a government-backed loan for homeowners 62 and older, and there really are no monthly mortgage payments. But, as is commented on below, not all reverse mortgages are HECMs that are governed by federal regulation. The risks are higher for reverse mortgages that are not HECMs and that is addressed below at #5 at page 5. Many of the benefits and protections required for HECMs do not exist for other reverse mortgages. For the sake of simplicity, all reverse mortgages, whether HECMs or not, will just be referred to as reverse mortgages in this article. But know *that not all reverse mortgages are HECMs*.

Equity-rich and cash poor creates temptation

Since many baby boomers own their homes and are equity-rich but savings-poor, there exists a great temptation to tap into available home equity. A homeowner does not have to have a high qualifying income for mortgage payments, because the reverse mortgage does not have to be repaid except out of home equity when the homeowner moves or dies. That sounds great! In fact, these are loans for which the lender cannot complain if the value of the property drops. And if there is equity left after the loan is settled it goes to the homeowner or the homeowner's estate. And reverse mortgage funds can be used for almost any reason – living expenses, surprise medical bills, paying a grandchild's tuition, credit card debt or even travel. It sounds like free money! However, there is more to the story than the advertisements disclose.

Reverse mortgages have never been as popular as many thought they would be at their inception in 1988. Only a small percentage of senior homeowners have gotten them, in the typical year only 2 to 3 percent of eligible homeowners get a reverse mortgage. They represent only a small fraction of mortgage debt in the US, about 1 percent in all. Still, they remain a significant temptation and at the same time, they have potentially significant risks about which consumers needs to be aware.

With the many tempting benefits it is easy to see why people have taken out reverse mortgages. Unfortunately, the most common reason for taking out a reverse mortgage is financial need arising from unfortunate circumstances or poor financial planning (or both). In a 2010 survey of elderly Americans with reverse mortgages, the National Reverse Mortgage Lenders Association reported that 72% of respondents wanted to be able to pay their expenses while they lived so their children would not have to worry about them and 48% of respondents believed they would have to leave their homes without additional income. In the right circumstances, a reverse mortgage can help some seniors pay their bills and stay in their homes. A reverse mortgage may also allow seniors to continue to build equity that would be lost if they had to sell too soon.

Reverse mortgages do work for some, but they can be a bad choice for others who may not have considered all of the risks and consequences. Some of the fears are misplaced however, because they are based upon outdated horror-stories. Reverse mortgages gained a bad reputation, some would say that reputation was well-deserved, because of predatory practices in their early years. Since those early days, Congress has worked to add protection against many of the excesses. Before starting the loan process for an FHA/HUD-approved reverse mortgage, all applicants must take an approved counseling course. The courses are designed to explain to the applicants how reverse mortgages work, the financial implications of taking out a reverse mortgage, the tax consequences of a reverse mortgage, the payment options, and the costs associated with the reverse mortgage.

In 2015, additional new guidelines were added to require reverse mortgage applicants to undergo a financial assessment in addition to the counseling. Although borrowers are not required to make payments, the FHA wanted to make sure borrowers had the financial ability and willingness to keep up with elements of home ownership such as maintenance, property taxes, association dues (if any) and homeowner's insurance as well as other applicable expenses. Some doubt if these protections are adequate so skepticism surrounding reverse mortgages continues.

Without a crystal ball showing you the future, it can be very difficult to know whether a reverse mortgage is a good choice when you sign up. But knowledge is a powerful weapon and your chances or making a wise decision are greatly improved if you know what the risks are and if you ask the right questions. Here are some of the issues to look for and questions to ask:

1. These are complex contracts that can have negative consequences. The Consumer Financial Protection Bureau states that reverse mortgages are "complex products and difficult for consumers to understand", especially since there is so much "misleading advertising", low-quality counseling, and a significant "risk of fraud and other scams". If you combine desperation over bad finances and the offer of “free” money and the freedom from repayment, it is easy to imagine that temptation can overwhelm common sense.

   

   How can you protect yourself? Ask questions during the counselling and assessment processes. These legally mandated processes are consumer protection tools to protect you against the negative effects of a reverse mortgage. Budget your next several years and imagine your financial future assuming inflation, increasing medical expenses and all the inevitable costs of aging. Look ahead and ask the counselor for assistance and advice. Get detailed and specific. If you are comfortable doing this, take a close family member or trusted friend with you to any appointment. There is strength in numbers and it is easier to say “no” if you have someone to help push back against a sales person.

2. You don't get 100 percent of your home's value through a reverse mortgage. If you understand the way lenders profit on reverse mortgages and keep their financial position secure, it is obvious why you not only don’t get 100% of your equity. You may not get much, if any, more than 50%. Lenders require that there be something for the interest of the reverse mortgage to accrue against. Lenders will not rely only on future appreciation in value to protect their investment. They know the real estate market is too unreliable.

   The earliest age for a reverse mortgage is age 62. A 62-year-old with a mortgage-free $300,000 home and an expectation of staying in the home 20 years, assuming an adjustable-rate mortgage starting at 3.3 – 4.5 percent, might get about $570 a month for as long as 20 years but with no initial cash draw. With an initial cash draw of $33,700, the monthly payment to the 62 year old drops to $400. A 70-year-old with the same equity and expectations could get $700 per month for life with no cash draw but could still get $570

   

per month for 20 years with a cash draw of over $24,000, according to the Reverse Mortgage Calculator on The Mortgage Professor website. Try it for yourself using your birthdate, home equity and financial interests. Be aware that a loan origination fee, mortgage insurance premium and other closing costs would be $2,500 to $6,000, while an applicant for an ordinary mortgage would likely pay thousands less.

Ask how much more you will get if you wait until you are a year or two older, ask different lenders for their available interest rate and if you chose an adjustable rate mortgage, chose one where the interest rate cannot increase greatly in any one year. Never shop with just one lender.

3. To make matters worse, interest rates and closing costs are usually higher than for a normal mortgage. Closing costs and interest

rates are affected by the loan amount. The maximum loan amount is affected by the age of the borrower. The younger the borrower, the lower the percentage of equity that is likely to be loaned. The lower the interest rate, the higher the closing costs. Closing costs tend to run higher for reverse mortgages than for ordinary home loans, in part because of the protections now required including the counseling and financial assessment. There is also a cost called the Initial Mortgage Insurance Premium (IMIP). This is a one-time cost paid at closing to the FHA primarily to protect the lender by insuring payment of the mortgage even if the debt exceeds the value of the home when the note comes due. The IMIP is charged as either 0.50% or 2.50% of the appraised value of the home but not more than $625,500.

   There are also ongoing annual fees that are or may be added to the loan amount, including an annual mortgage insurance charge of 1.25% of the loan balance charged by the FHA to insure the loan. Some lenders also charge a monthly servicing fee.

   Many reverse mortgages have variable or adjustable interest rates, although fixed rate reverse mortgages are usually available. At a time when interest rates have been at record lows for an extended period of time, people forget the days of the late 1970s and early 1980s when inflation soared and interest rates were far, far higher. Adjustable interest rates can cause the debt to swallow the equity and expand so as to make redemption difficult if not impossible. That may not matter, but family members may want to keep the home in the family. A change in interest rates might make that economically impossible.

Shop for a better interest rate. Use a website like The Mortgage Professor that compares available reverse mortgages. Perhaps most importantly, do not rely on the word of one sales person of one product. Know all the fees and charges that are added to the costs and the loan balance.

4. You have to carefully read the contract to determine when the lender may be able to claim the loan is due. The common thought is that the loan becomes due when the borrower passes away. That may be what happens. But the loan may come due far sooner if the mortgage note provides for the loan to become due after the borrower has moved out either for a period of time (typically 12 months) or permanently, such as to a nursing home, or if the homeowners doesn't pay taxes, or insurance, or keep the home in suitable condition. In other words, other family members may lose their home if you move out even though you may live on for years. A family member, disabled child, or roommate may lose their residence if they don't have the cash to pay off the mortgage balance.

   Reverse mortgages can be paid off, so the home is not necessarily lost. Many homeowners seek out a reverse mortgage so they can afford to stay in their homes or in a neighborhood or community they love, near life-long friends. In a 2010 survey of elderly Americans, 81% of those responding indicated they chose a reverse mortgage because they desired to remain in their current homes until death. Many of them doubtless did not understand that the home could be lost even while they still lived.

   There may be better options than a reverse mortgage. **A few alternatives to consider include**:

   > **Downsizing.** Selling the family home and moving into a nearby less expensive home, including one that is smaller, newer and may have less upkeep, may help add to a senior's retirement savings. Consider moving from a single family residence to a condominium where grounds and exterior upkeep are typically the responsibility of the Association. Make sure the condominium is responsibly managed and maintains a reserve for future capital expenses.

Relocate. Retirement communities provide excellent options as well as opportunities. Instead of living near where you used to live and work, you may now benefit by living near to where your children now live or where you prefer to spend your recreation and retirement years.

Rent. Selling your home and becoming a renter allows you to use all or your home equity as retirement savings, and not just the part allowed by a reverse mortgage. Maintenance and upkeep are no longer your problem. No more shoveling snow! You also can select the apartment in a safe neighborhood near stores and recreation. Still, rent increases and troublesome neighbors remain risks.

Reverse mortgages have become a better product than in their earlier years due to regulatory changes that were made to eliminate many of the most serious problem areas. They now incorporate many consumer protections. However, they remain a complex product with risks that can, for some, outweigh the benefits.

> Ecclesiastes 6:12a
> 12 For who knows what is good for a person in life, during the few and meaningless days they pass through like a shadow?

Can you know whether you will have to move out to a nursing home or a lengthy stay at a rehabilitation facility? Of course not. Ask about the risk you have of losing your home if you have an extended stay in the hospital or a rehabilitation facility. Insist upon answers that are in the contract and are based upon objective, not subjective factors. Never rely on the verbal assurances of a sales person.

5. Not all reverse mortgages have the protections of a true HECM. While HECMs make up the bulk of the reverse mortgage market, there are different products called reverse mortgages and a few offer less protection. Some reverse mortgages are backed by non-profit organizations to allow seniors to tap home equity for limited purposes, such as to make necessary repairs or to pay taxes. There are also some proprietary reverse mortgages, with one type called jumbo reverse mortgages, that are available and which exceed HECM regulatory limits. These reverse mortgages come with more risk

because they are not federally insured and don’t have all of the same consumer protections as a HECM.

Ask and make sure that the product you are looking at is a Home Equity Conversion Mortgage, a HECM. If you have doubt, check with a skilled attorney.

6. The mortgage balance might become due if you fail to pay property taxes, insurance, homeowners association fees (if any) or keep the home properly maintained. Often the need for a reverse mortgage is a sign that the borrower was not living within his or her financial means. If living beyond the borrower’s means doesn’t change, it is easy to expect that the loan balance will be spent on paying old bills and perhaps an expensive trip or two, and then the money is gone and cash is short again. Next, the borrower fails to pay taxes, maintain insurance, maintain the home, or keep current with homeowner’s association dues. Then the lender may step in.

   

   

   Ask about the conditions that can cause the lender to declare the note due. Make sure you know how the lender evaluates home upkeep. Know how long you have to pay the taxes and insurance. Be certain that you will always be able to pay the property taxes, insurance, association fees and upkeep.

7. Some government benefits may be affected by reverse mortgage monthly payments to the borrower and some of those payments may be taxable income.

   A borrower should still qualify for Medicare and Social Security. They are programs that are based on age and other qualifications, and are not needs based.

   However, needs-based programs such as Medicaid and Supplemental Security Income (SSI) (and potentially other state or local needs-based programs), may be affected by reverse mortgage proceeds. For further details, see the site linked here which is helpful even though it is the site of a seller of reverse mortgages. Medicaid and SSI take into consideration your assets when determining if you qualify to receive benefits. These considerations vary from state to state, so you should check your state’s requirements to find out if a reverse mortgage would affect your eligibility if you are presently receiving those benefits or hope to receive them in the future.

8. Consider in advance how you will receive the money coming from the lender. Make that consideration based upon a solidly crafted budget and cash flow plan for the upcoming years. The money from a reverse mortgage can be received in different ways, based on your financial circumstances, needs and goals. The potential options are:
   - A lump sum in cash at settlement (limited in 2013 due to the risk of spending too quickly);
   - Monthly payments for a set number of years;
   - A line of credit to draw upon when you want or need it; or
   - Some combination of the above.

   How you receive the money will depend upon the amount of equity available, your age when you take the loan, and your uses for the money.

9. You lose flexibility. Should you ever want to move, go to a continuous care community, an assisted living facility, you now have to pay off the loan balance. If you still have significant equity, selling the house remains the best option because the loan will be paid as a part of the transaction, but if you wanted to keep the home in the family, your family will have to come up with the money to pay off the loan equity. **Never forget that a reverse mortgage is a loan, you are borrowing money!**

So are reverse mortgages just too risky and too complex for everyone? No, but they should only to be used with a full understanding of the risks and a careful weighing of those risks against the benefits. To make sure that a reverse mortgage is the right financial product for you, study and understand the risks, and know if and how you can overcome each.

Among many questions and factors to consider, understand that:

1. Without a significant equity, a reverse mortgage may make no sense.
2. Non-HECM products have complex risks. Make sure it is a HECM and pay attention during the counseling and financial assessment. They are required by law for good reasons.
3. Your financial need should be meaningful. No debt should ever be incurred unless necessary.
4. You need to have a financial reserve for payment of property taxes, homeowner’s association dues, if any, insurance and upkeep.
5. A reverse mortgage may impact the financial plans and hopes of your heirs. Seek the advice and counsel of family about this step, especially if the home is your family home where children were raised.

6. A reverse mortgage may reduce or eliminate entirely your inheritance plans for your children.
7. You should consider your likely future to the extent possible, taking into consideration your present and likely future health, your desired uses for the funds and the current economic outlook for the country.
8. You should always factor God into your financial decisions. In addition to what is required by federal law, consider taking a Financial Peace University course, such as the course offered by Idlewild Baptist Church in Lutz, FL. A reverse mortgage may do little good if you get money and do not handle it wisely. Luke 12:16-21. You may just push a major financial problem off by a few years or make a minor problem a major one.
9. Come see us at The Idlewild Foundation and we can discuss this further or get you to a financial advisor or mortgage professional who can give you honest and personal advice.

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