

Chapter 20

Reverse Mortgages

Doni Dolfinger
Paulette Wisch, CML
Universal Lending Corporation

SYNOPSIS

- 20-1. What Is a Reverse Mortgage?
 - 20-2. Reverse Mortgage Financial Assessment
 - 20-3. Eligibility, Responsibility, and Repayment
 - 20-4. HECM (Reverse Mortgage) for Purchase
 - 20-5. Pros and Cons
 - 20-6. Awareness and Education
 - 20-7. Frequently Asked Questions
 - 20-8. Real-Life Examples
 - 20-9. Proprietary (Private) Reverse Mortgage Products
 - 20-10. Resources
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Many senior homeowners realize that their greatest financial asset is the equity or money they have accumulated in their homes. If they want to use this money, for whatever reason, they consider either selling the home or borrowing against it. The problem with selling is, they still need a place to live and may not want to rent. The problem with borrowing may be the difficulty in making the mortgage payments. Another option might be a reverse mortgage, which allows the homeowner to live in the home without a monthly repayment to the lender. This often misunderstood option is not as complicated as it is made out to be.

20-1. What Is a Reverse Mortgage?

A reverse mortgage is a special type of mortgage loan designed for homeowners who are 62 years of age and older. It is a loan against the home that does not have to be paid back as long as the homeowner lives in the home.

Proceeds received from a reverse mortgage are considered proceeds of a loan instead of income; therefore, you do not pay income taxes on the money you receive. There are also no restrictions on how you choose to spend your money. A few ideas might be to:

- ▶ Increase monthly income;
- ▶ Hire in-home help;
- ▶ Eliminate a house payment;
- ▶ Update the home;
- ▶ Pay off credit cards;
- ▶ Pay for long-term care insurance; or
- ▶ Purchase a second home.

20-2. Reverse Mortgage Financial Assessment

Effective April 27, 2015, the Federal Housing Authority (FHA) requires lenders to conduct a financial analysis of the borrower's income and credit to prove "capacity and willingness" to pay taxes and insurance. Proof of all income is required, and monthly obligations are subtracted to determine residual income. The amount of residual income needed is determined by family size and geographic area of the country. The analysis also includes a review of the borrower's credit history, including history of payment of property taxes, homeowners insurance, and homeowners dues. If the borrower has *not* demonstrated willingness to meet his or her financial obligations, the lender will require a set-aside of some of the mortgage proceeds to cover future property charges. Lenders will not automatically decline borrowers based on derogatory credit; there may be extenuating circumstances, such as an illness, job loss, or death that contribute to credit issues. The borrower will be required to fully explain all circumstances surrounding derogatory credit.

20-3. Eligibility, Responsibility, and Repayment

When considering a reverse mortgage, it is important to know if you are eligible, how much money you qualify for, and if the programs you are looking at help you accomplish your goal. If your goal is to pay off your \$45,000 mortgage and the reverse mortgage provides you with \$100,000, you can leave the balance in the line of credit or you can receive payments. If you are short of funds, you may want to wait until the variables are more favorable or you may bring in the difference from other assets or savings.

How Much Money Can I Get with a Reverse Mortgage?

The money that you qualify for is based on the following factors:

- ▶ The age of the borrower(s);
- ▶ The current interest rate;
- ▶ The appraised value of the home; and
- ▶ The lending limits (on the HECM program).

Eligibility Requirements

- ▶ ALL homeowners *must* be 62 years or older. At least one of the homeowners must live in the home as his or her principal residence. If your spouse is not yet 62, you may still qualify; however, you would be subject to the “non-borrowing spouse” rules.
- ▶ All homeowners must agree to attend a one-on-one educational meeting on reverse mortgages with an approved counselor. After speaking with the counselor, you will receive a certificate. Your lender will need the original signed certificate in order to process your loan.
- ▶ The home must be owned free and clear or have a mortgage balance that can be paid off by the proceeds of the reverse mortgage or by the homeowner. As explained earlier, the homeowner may choose to bring cash in to make up a shortage.
- ▶ The property can be a single-family home or a one- to four-unit dwelling on most programs.
- ▶ Townhomes, approved condominium units, planned unit developments (PUDs), and some manufactured homes qualify on most programs.

Responsibilities of the Homeowner

- ▶ Keep property taxes current.
- ▶ Maintain adequate homeowners’ insurance.
- ▶ Maintain the property in good condition.
- ▶ Use the home as your primary residence.

Choices on Your Payment Plans

Although there may be other reverse mortgage products available, the FHA-Insured program (also called a Home Equity Conversion Mortgage, or HECM) has been the most popular nationwide for the past 25+ years. An experienced reverse mortgage lender will offer you several options. You choose the one that best fits your needs. With the FHA-Insured program, you are able to adjust your payment plan as your life situation changes. You may change your plan as many times as needed for a small fee of \$20 per change. The exception to this is the fixed-rate plan, which is a closed-end loan and cannot be changed.

FHA-Insured Options

- ▶ **Tenure Payments.** The lender pays you equal monthly payments for as long as at least one homeowner is living in the home. This monthly payment continues even if the loan balance grows higher than the value of the home. (Tenure payments are not available on all programs.)
- ▶ **Term Payments.** The lender pays you equal monthly payments for a pre-determined period of time. Even after the last payment ends, you still remain the homeowner. No repayment is required for as long as you are living in the home. (Term payments are not available on all programs.)
- ▶ **Line of Credit.** With a line of credit, you may access your money as needed. The remaining balance in your line of credit grows in value over time. There is no fee to withdraw money from your account. Once your withdrawal request has been made, the lender has five business days to deposit it to your account. (Not all programs have line of credit growth.)
- ▶ **Initial Draw or Lump-Sum Cash Advance.** Lump-sum withdrawal allows for immediate cash at loan disbursement (three business days after closing). You may choose to draw all or a portion of the money available to you. If you have an existing mortgage or property lien, these would be paid at loan disbursement.
- ▶ **Combination.** You may choose a combination of the above plans. (Not available on all programs.)

When Is the Reverse Mortgage Repaid?

A reverse mortgage becomes due and payable when the last living homeowner sells, dies, or moves away. If needed, a homeowner can be away from the home for 12 months due to health reasons.

The total loan amount owed is the amount of money the lender has disbursed to you, plus interest and fees accrued during the life of the loan. You, or your estate, are legally required to pay back *only* the balance due on the loan. All money (equity) left after the loan is repaid belongs to you or your estate.

The reverse mortgage is repaid in one payment, either from the sale of the house or by other assets. If the amount owed is more than the sale of the house, *the remaining debt is paid by the insurance fund*. You, or your heirs, have no personal liability.

Interest Rate Information

Reverse mortgages, like traditional mortgages, are tied to a specific index that may be tracked by the public. They are usually based on the LIBOR (London Inter Bank Offering Rate) plus the investor margin. Once your loan closes, changes in interest rates do not affect the amount of money that you originally qualified for. Even if you choose the variable rate option, your payment will only change if you change it. If, for example, you receive \$850 a month, you will get that for your chosen term unless you change the plan.

Interest rates are determined by the program. Remember, one size does not fit all. Each program has pros and cons. A knowledgeable lender will be able to explain them so you can make an educated decision about which reverse mortgage would be best for you.

20-4. HECM (Reverse Mortgage) for Purchase

Effective January 1, 2009, the FHA added an HECM (Reverse Mortgage) for Purchase enhancement. HECM stands for Home Equity Conversion Mortgage. HECM mortgagors can now purchase a home with reverse mortgage proceeds. This saves the customer money, as it is a “one close” transaction.

- ▶ Transactions may be completed on a single-family home, an FHA-approved condo, a duplex, a triplex, or a fourplex, so long as the owner lives in the dwelling.
- ▶ Additional monetary investment must come from current assets or from the sale or liquidation of the mortgagor’s home.
- ▶ The lender must verify the source of all funds.
- ▶ No bridge loans are allowed.
- ▶ If the property is new construction, a Certificate of Occupancy must be issued.
- ▶ Customers must occupy the property within 60 days of closing.

20-5. Pros and Cons

Pros

- ▶ You remain in title to the home.
- ▶ You decide how you would like to spend your money.
- ▶ There are no monthly payments required. Your lender cannot foreclose on you for non-payment because there is no monthly repayment required.
- ▶ There is no pre-payment penalty on most reverse mortgages.
- ▶ A reverse mortgage is an insured loan. You (or your heirs) are guaranteed never to owe more than the value of the home.
- ▶ There are several choices in how you can receive your money.
- ▶ The money you receive is considered proceeds of a loan, not income; therefore, it does not affect Medicare, Social Security, SSI, or Medicaid. (Note: It is important to know and follow your benefit program rules to maintain your eligibility for certain programs.)

Cons

- ▶ Your loan balance gets larger, not smaller, because you are not making payments; however, interest and fees accrue and add to the balance owing. If you want to leave the home free and clear to the heirs, you should not choose a reverse mortgage.
- ▶ Reverse mortgages may be desirable for someone planning to stay in their home because of the initial costs. The longer you stay, the more cost effective the loan, just like a traditional loan.
- ▶ There are adjustable and fixed rate reverse mortgages. Obviously, the adjustable rate loans will change according to the program chosen. The fixed rate loan would guarantee the rate for the life of the loan.
- ▶ The adjustable rate offers many different options to remove proceeds from the loan and interest is charged only on what is taken. If the fixed rate is chosen, all the money must be taken at the time the loan is completed.

20-6. Awareness and Education

Many homeowners have not had a mortgage or loan against their home for many years. It is important to know what to expect from the lender and how to get your questions answered. Gathering information is fairly easy. Classes are often provided on reverse mortgages, free booklets from AARP are available, and, of course, approved counselors are a great resource.

- ▶ **Counseling.** Counseling is mandatory for all reverse mortgage programs. This is a one-on-one session with an approved counselor to review the legal and financial implications of the reverse mortgage, as well as any other alternatives that may be available. As part of your session, you will be given a Certificate of Borrower Counseling. If you choose to go forward with an application, you must provide the original copy of the certificate to your reverse mortgage lender. This certificate may expire in 180 days.
- ▶ **Application.** This is when you sign all the paperwork to get the loan started. Typically, your reverse mortgage specialist will meet you at your home or his or her office to explain each page in great detail. You will receive a copy of all the paperwork you sign. If you have completed your counseling, the lender will need the *original* counseling certificate and photocopies of other documents such as homeowners' insurance. Your lender will let you know what they require for application.
- ▶ **Appraisal.** An appraisal will be ordered to determine your home's value. You should receive a copy of the appraisal at or prior to closing. The appraised value of your home will be used for the final loan calculations. The FHA reverse mortgage requires that your home meets FHA guidelines. The appraiser will determine if any repairs are required on your home. In many cases, if repairs are needed, they can be completed within six months after your loan closing.

- ▶ **Processing and Underwriting.** There are many things happening behind the scenes while your loan is in process. Your lender will order the appraisal, title work, credit report, flood certification, lien payoffs (if applicable), homeowners' insurance verification, etc. After receiving all the pertinent data, the lender sends your loan package to underwriting for final loan approval. When your loan is ready for closing, your loan specialist will contact you to determine which payment plan you have selected. Processing typically takes three to six weeks, depending on your lender.
- ▶ **Loan Closing and Disbursement.** Now it is time to sign the final closing documents. This typically takes place in your home, the lender's office, or the title company office. If you want your lawyer to review your documents, notify your lender so it may provide them in advance of your closing. You will receive copies of all the paperwork you sign to retain for your personal records. After closing, you have three business days in which to cancel the loan, if you so choose. After this three-day period passes, the loan is in place and the funds are disbursed. (The three-day cancellation period only pertains to refinances, not purchases.)

20-7. Frequently Asked Questions

Q: What is so unique about this program?

A: There are no required monthly payments – *none*.

Q: Can I make payments if I want to?

A: Yes, and any payments you make will increase the amount of equity that will be left when the home is sold.

Q: Who is eligible for a reverse mortgage?

A: You and any co-borrowers must:

- ▶ Be at least 62 years of age;
- ▶ Live in the home as a primary residence;
- ▶ Speak with the approved counselor;
- ▶ Have equity in the home; and
- ▶ Meet certain credit and residual income guidelines.

Q: Do I have to own my home free and clear?

A: No. Even if you have an existing loan, in many cases, reverse mortgage proceeds can be used to pay the debt.

Q: May I use a reverse mortgage to buy a new home?

A: Yes, but working with an experienced reverse mortgage lender is key. There may be additional steps required. Your lender can walk you through this process.

Q: Will I have to pay fees?

A: No out-of-pocket fees are usually required. Closing costs, origination fees, and mortgage insurance (if required) can be financed by the loan. Ask your lender if it charges any up-front fees; some lenders may ask you to pay for the appraisal up front, while others ask you to pay it only if your loan does not close.

Q: Is there a charge for the required FHA Counseling?

A: Some counseling agencies do charge and some *do not*. The fees vary, but are usually between \$90 and \$175. When you set your appointment, ask your counselor if the agency charges any fees.

Q: Are there any ongoing fees after closing?

A: Yes, there are typically mortgage insurance fees (on the HUD program), as well as interest accrual and sometimes servicing fees, but you are not required to pay them; they are added to your loan balance.

Q: I know I will be charged interest, but on what?

A: Interest is charged only on the amount disbursed to you or on your behalf and is added to your loan balance each month.

Q: Is this a fixed rate loan?

A: There is a fixed rate option available. The fixed rate program requires that the homeowner take a full disbursement of funds (no line of credit or monthly payments).

Q: What is helpful when “shopping” for a reverse mortgage lender?

A: You should shop for a knowledgeable, experienced lender who can accurately complete your loan in a reasonable time frame and offer you more than one program. Ask your lender how long they have offered reverse mortgages and how many they personally have done. You may want to ask for references and speak with a previous customer they worked with and who has had their reverse mortgage for a while. Are they a member of the Better Business Bureau?

Q: Can I sell my home whenever I want?

A: Yes – and you keep whatever money is left over after you pay off your loan balance. Most programs have *no* prepayment penalty. Have your lender confirm this in writing or show you where it is in your paperwork.

Q: If I take a reverse mortgage, who owns my home?

A: *You* remain the owner of the property.

Q: What are my/our responsibilities?

A: Borrowers must live in the home, keep the property in good repair, make sure the property taxes and homeowners insurance are current, and pay any homeowners association dues and utilities.

Q: Are reverse mortgage benefits taxable by the IRS?

A: No, benefits are considered loan proceeds and the reverse mortgage is not considered a taxable event.

Q: What if my property is in a revocable trust?

A: Property in a revocable trust usually qualifies. The lender will need a copy of the trust to see that it meets the program guidelines. If it does not, oftentimes your lawyer can modify it so that it meets the program guidelines and you may leave the property in the trust.

Q: Are there restrictions on how I use the money?

A: No. It is your money and your decision on how to spend it.

Q: What if my house needs repairs?

A: You find the contractor or handyman, get the estimate, and the repairs can be completed after your loan is finalized. Money will be reserved from your loan for these repairs, and you will have up to six months to complete them. (Repairs cannot be more than 15 percent of the value of the home.) This does not apply to the purchase program.

Q: When is my loan due?

A: When the borrowers no longer live in the home as a primary residence.

Q: Are reverse mortgages safe?

A: Yes. You or your heirs are guaranteed never to owe more than the value of the home at the time of sale.

Q: Can I sell whenever I want to?

A: Absolutely. It is no more difficult to sell a home with a reverse mortgage than to sell a home with a traditional mortgage.

Q: Will my heirs owe anything if I die?

A: No, reverse mortgages have insurance to guarantee that you would never leave a debt to your heirs. When you die, the house goes to your estate. The reverse mortgage is repaid from either the sale of the house or other assets, and the remaining equity goes to your estate. If the house does not repay the loan, it is paid by the insurance fund, *not* your heirs.

Q: If my home appreciates in value, who gets that money?

A: You or your estate are legally required to pay back only the balance due on the loan. Again, all money left after the loan is repaid belongs to you or your estate.

Q: What if I have to go to a nursing facility?

A: You can be gone from the property for up to one year because of illness and the loan is not affected.

Q: Will this affect Social Security, Medicare, or Medicaid?

A: Money from a reverse mortgage will not affect Social Security or Medicare. Even if you are getting Medicaid, Supplemental Security Income, or Old Age Pension, you may qualify. You must abide by program guidelines to avoid termination of benefits.

20-8. Real-Life Examples

Lois had her home paid free and clear, and then her daughter needed some money because of a divorce. Lois secured a traditional loan on her home to help her daughter, who promised to help with the payments. When her daughter did not help her, Lois could not keep up with the payments and was in danger of losing her home. She applied for and completed the reverse mortgage, and, with the proceeds, paid off her previous mortgage in time to rescue the home from foreclosure.

When Betty's husband died suddenly, she was in shock. She and Bill had been getting by on their fixed incomes, and when Bill died, her Social Security benefits were reduced and the loan on the house still had to be paid. Betty researched reverse mortgage programs and decided the FHA-Insured program was the right one for her. She obtained the reverse mortgage and used part of the proceeds to pay off the home loan. With the balance of the proceeds, she is receiving \$400 a month to offset the loss of income, and she left \$35,000 in her line of credit that she can use as needs arise.

Davis and Jane sold their large home with a large yard to downsize and have a more maintenance-free retirement home. They netted \$350,000 from the sale of the old property and found their "dream retirement home" for \$438,000. They opted for an HECM for Purchase instead of a traditional mortgage because they wanted to also free up their monthly income and preserve some of their proceeds for future living expenses. Based on their ages, the value of the new home, and the interest rate at the time they closed, the HECM for Purchase provided them with about \$241,000 (plus closing costs and FHA mortgage insurance were included in the loan). The \$241,000, along with \$197,000 in proceeds from their previous home, enabled them to purchase the new \$438,000 property and still preserve \$153,000 to live on while also eliminating the need for a mortgage payment.

Grace, who is 98, said, "I saved for my retirement, I just didn't think I would live this long." As Grace aged, she used all of her savings to hire home care, as she was adamant she would not go to a nursing home. When she was 98, her savings was gone, so she secured a reverse mortgage and was able to remain in her home, with care paid for by utilizing the equity she had in her home.

20-9. Proprietary (Private) Reverse Mortgage Products

Many lenders are developing their own private reverse mortgage products. Unlike FHA reverse mortgages, where all lenders must follow the same rules, these products are designed and administered by the lenders who created them, so there are different rules and regulations for each product.

In general, private reverse mortgages offer a fixed rate loan that is higher than the FHA rate. Some mandate a disbursement of at least \$100,000 when the loan is completed, and some require a full disbursement of funds. Some offer a line of credit, like FHA, and most do not offer a monthly income. Some require the home value to be at least a certain amount. Some have different requirements for credit and income qualification.

20-10. Resources

Colorado is fortunate to have many good reverse mortgage counselors. Here are some of the local counselors for your convenience. You may look at the entire list on the FHA website, www.hud.gov.

The HUD-approved housing agencies listed below provide assistance to renters, homebuyers, and homeowners requiring housing information. They are not HUD offices. Any of these agencies will conduct the required informational session for the FHA-insured reverse mortgage.

City of Aurora Community Development Division

9898 E. Colfax Ave.

Aurora, CO 80010

(303) 739-7900

www.auroragov.org (Click on "Residents," then "Community Development.")

Boulder County Housing Authority

P.O. Box 471

Boulder, CO 80306

(720) 564-2279

www.bouldercountyhc.org

Northeast Denver Housing Center

1735 Gaylord St.

Denver, CO 80206

(303) 377-3334

www.nedenverhousing.org

GreenPath Debt Solutions

650 S. Cherry St., Ste. 1230

Denver, CO 80246

(800) 550-1961

www.greenpath.com

Money Management International

Telephone Counseling Only:

(866) 889-9347

www.moneymanagement.org

Grand Junction Housing Authority

8 Foresight Cir.
Grand Junction, CO 81505
(970) 245-0388
www.gjha.org

Douglas County Housing Partnership

9350 Heritage Hills Cir.
Lone Tree, CO 80124
(303) 784-7857
www.douglascountyhousingpartnership.org

Consumer Credit Counseling Service

(800) 769-3571
www.consumercredit.com

Helpful Reverse Mortgage Websites

National Reverse Mortgage Lenders Association

www.nrmlaonline.org

Federal Housing Administration

U.S. Department of Housing and Urban Development
www.hud.gov

AARP

www.aarp.org

Colorado Housing Counseling Coalition

www.coloradohcc.org

Loan Calculations

www.reversemortgage.org