Reverse Mortgages

The following article will primarily be discussing HECM Reverse Mortgages (Home Equity Conversion Mortgages) which are the most common reverse mortgage.

As with any loan "understand the agreement" is it good or bad for "you." Does it accomplish what you want.

Loans make things possible when you do not have enough savings to achieve an immediate goal in life. Numerous financial institutions have lined up lucrative credit deals to woo you – never look at these as the institution doing you a favor. As the borrower, you should know whether the loan you are about to take will prove useful or not. A lot of us do not pay attention to the details and later have the opinion that the product was a "Bad Loan." So, as a borrower, understand the terms of the loan, ask questions, and if the lender cannot explain it properly or you still feel unsure of the terms it is probably best to walk away or ask someone knowledgeable that you trust to explain the product. Remember you are the one that must pay for the loan, not the loan officer.

Throughout my career not many loans get more of a bad rap then reverse mortgages – one exception might be a leased automobile. But the truth of the matter is – both of these products in the right situation (and the right terms) can be a very useful way of financing something in your life. Again, the key is understanding the product. But I digress.

Before getting into what a reverse mortgage "IS" let us start with what it is not. The following are some widely held beliefs - that are actually "MYTHS."

A reverse mortgage sells the home to the bank.

- Lenders are not in the business of owning homes. The homeowner keeps the title to the home in their name. What the lender does is add a lien onto the title as with any mortgage loan to guarantee it will eventually get paid back.

Heirs will not inherit the home. If I die one day after signing, I lose everything.

- The estate inherits the home as usual, but there will be a lien on the title for the amount of the reverse mortgage loan plus any accrued interest and fees. For example, if someone passes away with a reverse mortgage and owes $50,000. And the estate sells the house for $250,000. The lender gets $50,000 and the estate inherits $200,000.

- A reverse mortgage is a "non-recourse" loan which means that the borrower (or his or her estate) will never owe more than the loan balance or value of the property, <u>whichever is less</u>. No assets other than the home must be used to repay the debt. Non-recourse means that if the borrower (or estate) does not pay the balance when due, the mortgagee's remedy is limited to foreclosure and the borrower will not be personally liable for any deficiency resulting from the foreclosure sale.

The homeowner could get forced out of the home.

- The HECM reverse mortgage was created specifically to allow seniors to live in their home for the rest of their lives. The homeowner will not be evicted or foreclosed on as long as the borrower meets the obligations of the loan.

Someone can outlive a reverse mortgage and be thrown out.

- The HECM reverse mortgage becomes due when "all homeowners" have moved out of the property for 12 consecutive months or passed away.

Social Security and Medicare will be affected.

- Government entitlement programs such as Social Security and Medicare are usually not affected by a reverse mortgage. However, need-based programs such as Medicaid can be affected. It is best to consult with a qualified financial advisor to learn how a reverse mortgage could impact eligibility.

The homeowner pays income taxes on the proceeds of a reverse mortgage.

- Generally, money received like on other loans is not considered income and is tax free, though you must continue to pay required property taxes. Consult your financial advisor for any effect on taxes.

There are large out-of-pocket expenses.

- Typically, the majority of lender closing costs and fees can be financed into the reverse mortgage loan.

So, What is a Reverse Mortgage?

If you're a property owner who is at least 62 years old, you can borrow against your equity to get cash or a line of credit from a lender. However, unlike a regular mortgage:

- You are not required to make monthly payments.
- You will repay the loan when you or your heirs sell the house.
- These loans are backed by the Federal Housing Administration (FHA).
- Borrowers pay an insurance premium to participate.
- Reverse Mortgages have been around since the early 1960's in the U.S. and exist in many other countries.
- The property must be your principal residence and you cannot be delinquent on any federal debt.
- As with any loan you must stay current on the property taxes, insurance, and any homeowners' fees (HOA etc.).

How Reverse Mortgages Work

You are probably wondering how it is possible to get a mortgage with no payments. Normally, when you take out a mortgage loan, the bank gives you a lump sum that you pay back with interest over time. At the end of the term, the loan is paid down to $0.

- A reverse mortgage works in, well, reverse. The lender makes payments to you: You can choose to receive a lump sum, monthly payments, a line of credit or some combination of those options.

- The interest and fees associated with the loan get rolled into the balance monthly. And the amount you owe grows over time, while your home equity may decrease.

- You get to keep the title to your home, and the balance is due when you move or die.

- When that time comes, proceeds from the home's sale normally are used to pay off the debt. If there is any equity left over, it goes to the estate or heirs.

- If the loan balance is higher than what the house is worth, the heirs are not required to pay the difference.

- Heirs also can choose to pay off the reverse mortgage or refinance it if they want to keep the property.

Reverse Mortgage Pros and Cons

PROS - If you are struggling to meet your financial obligations, a reverse mortgage may help. Here are a few benefits of a reverse mortgage.

Helps Secure Your Retirement

- Reverse mortgages can be ideal for retirees who do not have a lot of cash savings but do have wealth built up in their homes.

You Can Stay in Your Home

- Instead of having to sell your home to get needed cash, you can keep the property and still get cash out of it.

You Can Pay Off Your Existing Home Loan or other existing debt.

- Your home does not have to be paid off to take out a reverse mortgage. In fact, you can use the proceeds of a reverse mortgage to pay off an existing home loan. This can eliminate your current mortgage payment and free up additional money.

Remodel your home or take that dream vacation.

CONS - So what is the downside of a reverse mortgage? Though it might seem like there are many benefits, there are also some serious risks to consider.

You Could Lose Your Home to Foreclosure

- In order to qualify for a reverse mortgage, you have to be able to afford your property taxes, homeowners insurance, HOA fees and other costs associated with owning your home.

- You are also required to live inside the home as your principal residence for most of the year.
- If at any point during the loan period you become delinquent on these expenses, or spend the majority of the year living outside the property, you could default on the reverse mortgage and lose your home to <u>foreclosure</u>.

Your Heirs Could Inherit Less

- Homeownership is a key path to building generational wealth.
- However, a reverse mortgage often requires the home to be sold to repay the debt when you die or move.
- Your heirs will be required to pay the <u>full loan balance or 95% of the home's appraised value, whichever is less</u>. Usually, that means selling the home or turning the property over to the lender to satisfy the debt.
- A reverse mortgage eats away at your home's equity due to the accrued interest. By the time it needs to be paid off, there may not be equity left to your heirs.

It's Not Free

- Although you are not making payments with a reverse mortgage, there are still plenty of expenses associated with one.
- Not only do you have to keep up on your taxes, insurance, and HOA fees, but you also have to pay an upfront insurance premium. Usually, this is 2% of your home's appraised value. There may be origination fees at closing. You do have the option of rolling these costs into your loan balance.

It Could Impact Some Other Retirement Benefits

- Although not considered income for tax purposes, it could impact your ability to qualify for other need-based government programs such as Medicaid or Supplemental Security Income (SSI). Discuss this with a benefits specialist.

Reverse Mortgages Are Complicated

- There are a lot of rules and caveats to reverse mortgages. These loans come with many risks that may not be worth the extra cash. You should be wary of any reverse mortgage offer unless you understand the terms.

Is a Reverse Mortgage right for you?

A reverse mortgage may be helpful but is not for everyone. There are factors that can make a reverse mortgage worth it but knowing the facts as with any loan is pertinent. Some items to consider are:

- **If you are having <u>major</u> financial issues currently**, consider the extent of these issues. A reverse mortgage is not a cure-all to <u>major</u> financial problems. Possibly selling the home and downsizing is the answer for you.

- **Do you plan to stay in your home**? Just like a regular mortgage, there are significant costs associated with a reverse mortgage loan. You will want to be sure you plan to live in that home long enough to make those costs worth it.

- **Can you cover the costs of your home**? Since staying current on property taxes, insurance, maintenance, etc. is required as terms of the reverse mortgage, it is important that you have the cash flow for these expenses.

Other items:

- **Be Wary of Sales Pitches for a Reverse Mortgage**. A counselor from an independent government-approved housing counseling agency can help. But a salesperson is not likely to be the best guide for what works for you.

- **Home improvement items**. If the reverse mortgage is for home improvement – shop around before deciding on the first provider of these services even if you are not paying for these with a reverse mortgage.

- **Investing the proceeds of a reverse mortgage**. This is a popular item today (and fraud sometimes) -this should be a “Red Flag” under all situations. Resist that pressure. If you buy these financial products, you could lose the money from your reverse mortgage and your investment.

- **Bottom line**. If you do not understand the cost or features of a reverse mortgage, **walk away**. If you feel pressure or urgency to complete the transaction – **walk away**. Or do some research and find a counselor you feel comfortable with.

Ultimately, the decision to take out a reverse mortgage is one you should weigh very carefully. Though it is an easy way to get cash, it could put your finances more at risk in the long run. Be sure you fully understand your reverse mortgage before going forward.