

Reverse Mortgages

Many retired individuals find themselves living on a fixed income. Many also own a home which is either paid for, or which has a very small mortgage, a situation often described as “house-rich-and-cash-poor.” In the past, there have been few acceptable ways to take advantage of this home equity, apart from selling the home. Recently, however, a new financial tool has been developed – the reverse mortgage – which provides qualified individuals access to the equity in their homes, and still permits them to retain ownership of the home.



What Is a Reverse Mortgage?

Most homeowners are familiar with the traditional home mortgage. An individual buys a home, and, over time, as the monthly payments are made, the balance due on the mortgage is gradually reduced. A homeowner’s equity – the difference between what is owed and the market value – is also increased if a home’s market value increases. In the traditional, forward mortgage, as debt decreases, equity increases.

A reverse mortgage, as the name implies, works in the other direction. With a reverse mortgage, cash flows from a lender to a borrower. Over time, the balance due increases. In a reverse mortgage, as debt increases, equity decreases.

- **Eligibility:** Reverse mortgage programs generally require that all borrowers be at least 62 years of age. The home must be owner-occupied, and be the borrower’s principal residence. Not all types of homes qualify; all programs accept single-family detached homes, and some allow 2-4 unit owner-occupied homes, condominiums and manufactured homes. Only first mortgages are permitted. Any other debt secured by the home must either be first paid off, or paid off with proceeds from the reverse mortgage.
- **Ownership:** During the term of the mortgage, the borrower remains the owner of the home, and is responsible for payment of property taxes, maintenance and repair, and keeping the home insured.
- **Repayment:** No payments are required as long as the borrower lives in the home. The outstanding loan balance, including accrued interest and any loan costs, is due when the last borrower sells the home, permanently leaves or dies. In a few instances, the loan is due at the end of a fixed term. Typically, the loan is repaid by either selling or refinancing the home. Any remaining equity is paid to the borrower, the borrower’s estate or heirs.
- **Maximum loan balance:** A borrower can never owe more than the value of the home at the time the loan is repaid. Reverse mortgages are generally nonrecourse loans, which means the lender can only look to the value of the home for repayment.

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The Pros and Cons of Reverse Mortgages

There are a number of reasons why a reverse mortgage may not be appropriate:

- **Not needed:** Some retired individuals will not want to consider a reverse mortgage simply because it is not needed; their financial needs during retirement are already adequately met.
- **Security:** Reflecting long-held attitudes toward savings and debt, some individuals may not be comfortable with the idea of placing any type of mortgage on the home, once it is paid for.
- **Legacy for heirs:** Rather than using the equity in the home for current needs, a homeowner may want the equity to pass to family members or other beneficiaries, such as a charity.



There are also a number of situations where a reverse mortgage can help:

- **Enjoy life:** For some, the extra dollars provided by a reverse mortgage may make it easier to pay routine monthly expenses. For others, it may allow an occasional splurge.
- **Pay off debt:** Funds from a reverse mortgage can be used to pay off other types of personal debt that require monthly payments, such as credit card balances.
- **Maintain independence:** Some may wish to make improvements to the home, or pay for in-home care, to allow them to remain independent as long as possible
- **Provide for the future:** Even though the present financial situation is stable, a reverse mortgage can provide a way to meet unforeseen future circumstances.

Choosing a Reverse Mortgage

Unlike just a few years ago, a wide range of reverse mortgage programs is available today. Further, the specific details of each program can vary greatly. A standard series of questions can be used to compare and contrast each program:

- **How much cash?** In general, the amount of cash which can be borrowed will depend on the lender's policies, the age of the borrowers, the value of the home, the home's condition and location, and the interest rate. The amount of available cash can vary greatly from one lender to the next.
- **How will the cash be paid?** Depending on the lender, the cash from a reverse mortgage is typically available to the borrower in one of three ways. In some cases a combination of payment methods may be available:
 - **Lump sum:** The loan proceeds can be paid with one check, usually at the time the loan is closed.

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- **Periodic advances:** Cash payments of a fixed amount are usually made monthly. Term advances are made for a specified period of time; tenure advances continue as long as the borrower lives in the home; lifetime advances are paid as long as the borrower lives.
- **Credit line:** This is a line of credit the borrower can use when needed, up to the loan limit. Some credit lines are flat, i.e., the total amount of available credit is fixed. Other credit lines grow and provide an amount of credit which increases over time.
- **Cost of the loan:** Federal law requires reverse mortgage lenders to provide prospective borrowers with a loan cost analysis. The total annual loan cost (TALC) analysis looks at the cost of a loan under a specified set of circumstances, over the entire length of the loan. The standardized nature of the TALC makes it easy to compare the cost of loans from different lenders.
- **Remaining equity:** If a borrower decides to sell the home after only a few years, how much equity would be left?



Major Reverse Mortgage Programs

While there are a number of lenders in the private sector who make reverse mortgage loans, the two most widely available programs are operated under the auspices of the federal government:

- **Federal Housing Administration (FHA):** The Federal Housing Administration, part of the U.S. Department of Housing and Urban development, insures reverse mortgage loans made by private lenders under its Home Equity Conversion Mortgage (HECM) program. If a lender fails to make the promised payments, the FHA takes over responsibility for fulfilling the lender's obligations. The HECM program has specific loan limits and is targeted at moderate-income families.
- **Federal National Mortgage Association (FNMA):** The Federal National Mortgage Association, also known as Fannie Mae is a government created private corporation. FNMA operates the Home Keeper reverse mortgage program, with many features similar to the FHA's HECM program.

Additional Resources

The federal government entities directly involved with reverse mortgages, the FHA and FNMA, have freely available information on the details of each reverse mortgage program. Further, these agencies require consumer education as a part of the lending process. There are also several independent, third-party sources of information on reverse mortgages:

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- **American Association of Retired Persons (AARP):** The AARP provides publications on reverse mortgages. On the Internet, the AARP maintains a website at: <http://www.aarp.org>
- **National Center for Home Equity Conversion (NCHEC):** The NCHEC is an independent, not-for-profit organization whose goal is to provide consumer education about home equity conversion options. On the Internet their website is: <http://www.reverse.org/>
- **U.S. Department of Housing and Urban Development (HUD):** Information on reverse mortgages is available from the U. S. Department of Housing and Urban Development at their website at: <http://www.hud.gov>

Seek Professional Advice

Because they are relatively new, reverse mortgages are unfamiliar to many. Also, those most likely to consider a reverse mortgage are usually at a point in life where long-term commitments must be very carefully considered. Individuals considering a reverse mortgage are strongly advised to seek professional advice before entering into a loan contract.