Reverse Mortgage Loans:
Learn how and why a reverse mortgage may be a useful option to help you stay in your home
In 2010, over 80 percent of individuals 65 and over owned a home according to the U.S. Census Bureau.¹ For most Americans, their house is their most important asset. Not only from a financial point of view in that it can be worth more than what you paid for it but also from an emotional point of view. It’s where you raised your family, its neighborhood and neighbors are familiar and comfortable for you. For those and other reasons, nearly 90 percent of Americans 65 and over view their home as the place they want to live in as long as possible and 80 percent believe their current residence is where they’ll always live.²

Most people will need to be able to draw from Social Security, savings and retirement plans to finance their retirement. But sometimes unexpected expenses come up. If your health makes living in your home unsafe or a health problem (even one that you fully recover from) leaves you with a large bill and not enough income to pay that bill how do you unlock the equity you’ve built up to handle those kinds of crises? That’s the sort of question that reverse mortgages otherwise known as Home Equity Conversion Mortgage (HECM) loans were created to answer.

Reverse mortgages have been around since 1961 when a then recently widowed Nellie Young in Portland, Maine turned to Nelson Haynes of Deering Savings and Loan to help her make ends meet.³ Since then reverse mortgages have gone through several iterations that finally involved the federal government first by offering insurance for the loans in 1989⁴ and later by partnering with AARP to produce consumer education programs to help educate and protect consumers.

In a traditional loan situation, a homeowner owes a debt to a bank and over time gradually pays that debt down resulting in the homeowner having equity in the home. Lenders offering traditional loans verify income and perform a credit check to ensure that the borrower can make monthly payments. Those monthly payments gradually pay down the debt and the homeowner’s value in the home increases. That increase is called equity.

Contrast that method to a reverse mortgage. Unlike a traditional home loan, the loans are available only to homeowners at least 62 years old or older and they turn the concept of a loan on its head by having the equity decrease over time by cashing out that

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equity rather than increasing it and also by not requiring repayment from mortgage borrowers until the homeowner sells the home, dies, fails to pay property tax or insurance premiums or moves. The amount the borrower owes continues to grow and the value of the equity shrinks. By not requiring payment, homeowners don’t have to pass credit checks nor do they have to have income at least that has been the case until changes being put into place by Congress via the Reverse Mortgage Stabilization Act.

That act, which passed in May 2013 and is expected to go into place in October of 2013, amended the National Housing Act with respect to reverse mortgages to authorize Housing and Urban Development (HUD) to establish additional requirements as necessary to improve the fiscal safety of the reverse mortgage program. The new loan program is expected to combine parts of both the Saver and the Standard (explained in more detail later), the current two programs with principle limit factors that range somewhere between them. Additional requirements include requiring homeowners to undergo a financial review before being approved for a loan and requiring a set-aside for taxes and insurance.6

For a number of reasons but primarily because home loan requirements have eased to the point that people now buy more expensive homes with a lot less down, retirees are often entering retirement still owing money on their homes. Over half of the American population age 55 to 64 carries a home mortgage according to a paper released at the 15th Annual Joint Conference of the Retirement Research Consortium and they are more likely to enter retirement with debt. Perhaps more surprisingly, almost half of individuals 65-74 had mortgages or other loans on their residences, a third had credit card debt and a quarter had installment loans amounting to two-thirds of Americans in that age bracket holding some form of debt. People in this age bracket also typically pay some of the highest interest rates for these services. The percentage of people with debt who were on the verge of retirement rose from 64 percent in 1992 to 71 percent by 2008 and the value of that debt rose from $6,200 in 1992 to $19,100 in the same time frame.

Originally reverse mortgages were designed to help cash-poor older people stay in their homes, as a loan of “last resort.” But boomers ages 62 to 64 now represent 20 percent of prospective borrowers (62 is the earliest age you can apply), according to a recent survey by MetLife Mature Market Institute. Two-thirds of people considering a reverse mortgage today are under 70. The current average age of reverse mortgage borrowers is 72.9 years, a drop of nearly four years since 1990. The loss of pensions, the downturn in the economy in 2008, and inadequate savings have all impacted the ability of many retirees to meet the financial demands of retirement. According to the National Council on Aging (NCOA), about 44 percent of reverse mortgage borrowers have incomes under 200 percent of the federal poverty level ($22,980 for a single individual). Increasingly, reverse mortgages are becoming part of retirement planning.

Before reverse mortgages, if a homeowner needed funds, he or she could access the equity in their home one of two ways: either by selling the home or borrowing against the home. Selling the home meant giving the home up and borrowing against the home meant needing to make payments. Neither option appealed to many older homeowners. A reverse mortgage provides a third option for people not planning on leaving their homes to their children. Money that is freed up by a reverse mortgage can be distributed in several ways:

- As a lump sum cash payment;
- As a regular monthly advance;
- As a credit line account; or
- In a combination of any of those payments.

**Getting a reverse mortgage is a decision that should be weighed carefully.** For one thing, just like a mortgage, reverse mortgages have fees associated with closing costs such as a loan origination fee, appraisal, title search and insurance, surveys, inspections, recording fees and other fees. Those fees are relatively high—as much as 5 percent of the loan amount. Another reason to be careful before choosing to get a reverse mortgage is that getting a reverse mortgage may impact your ability to access government programs such as Medicaid and VA benefits and community programs since these programs use income and or other means-tested criteria for determining eligibility. An elder law attorney or financial advisor with experience in these areas

should be consulted prior to taking out a reverse mortgage. That said, a reverse mortgage can be the vehicle that allows you to continue to age in your own home.

**How Does A Reverse Mortgage Work?**

The main reasons borrowers take out reverse mortgages are to pay off existing mortgages, make home repairs or improve quality of life. Generally speaking, a reverse mortgage cannot be outlived and does not have to be repaid until the last surviving homeowner sells the home, permanently moves out of the property or passes away, at which point, the heirs can choose to either repay the reverse mortgage loan or put the home up for sale.

By law, homeowners can never owe more than their home’s value at the time the loan is repaid. Under most circumstances, the borrower’s heirs will not owe more than the home is worth. An estate has approximately 6 months to repay the balance of the reverse mortgage or sell the home to pay off the balance. Any remaining equity is inherited by the estate. If the sale of the home is not enough to pay off the reverse mortgage, the lender takes a loss and requests reimbursement from the FHA. No other assets are affected by a reverse mortgage. For example, investments, second homes, cars, and other valuable possessions cannot be taken from the estate to pay off the reverse mortgage.

More than 90 percent of all reverse mortgages are insured by the Federal Housing Administration (FHA) HECM program. All homeowners must be at least 62 years old and at least one homeowner must live the majority (183 days per year or more) of the year in the house. The older the homeowner is, the larger the loan amount.

There are likely to be additional changes as the Reverse Mortgage Stabilization Act is enacted. One of the requirements likely to emerge from the act is to require both spouses to be on the loan. Currently a spouse may not be on the loan because he or she does not meet the age requirement or the loan amount may be greater without that spouse on the loan. However, having a single borrower puts the non-signing spouse in jeopardy of needing to repay the loan if the signing spouse passes away.

**To obtain a reverse mortgage, the home must be either:**

- A single family, one-unit dwelling,
- Owner-occupied two-to-four unit dwelling,
- Or some condominiums, planned unit developments or manufactured homes. (Cooperatives and most mobile homes are not eligible.)

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In addition, the following requirements must also be satisfied:

- The home must be owned free and clear or all existing liens must be satisfied with proceeds from the reverse mortgage;
- The homeowner must continue to pay all required property taxes and homeowners insurance (including hazard and flood insurance) and must maintain the home in accordance with FHA requirements;
- Borrowers are required to receive consumer information that is either provided free or at very low cost prior to obtaining the loan. In addition, educational material is available from HUD (hud.gov), AARP (AARP.org) and NRMLA (reversemortgage.org). Prior to being counseled, borrowers will receive an information packet from either the counseling agency, or the lender, depending on who the borrower contacted first.

The types of reverse mortgage products, all or some of which a lender may have available, include an HECM. An HECM is a reverse mortgage insured by and regulated by FHA, which is part of HUD. Ninety-nine percent of all loans are HECM loans. These loans are issued by a private lender but insured by the FHA through an annual insurance fee purchased by the borrower. Borrowers may apply for an HECM even if they did not purchase their home with an FHA mortgage. Online reverse mortgage calculators such as the one at http://rmc.ibisreverse.com/ can provide a loan estimate.

The amount available for borrowers depends on four factors:

- The age of the youngest borrower (older is better but the youngest borrower must be 62)
- Current interest rate
- Lesser of appraised value of the home or the HECM FHA mortgage limit or the sales price
- Initial Mortgage Insurance Premium, either HECM Standard or HECM Saver.

Once the loan has been approved, the borrower has three calendar days to cancel the loan. This is called a three day right of rescission. The process should be explained at loan closing. In most cases the right of rescission will not be applicable to HECM for purchase transactions.

The following options are available for HECM products until October 2013:

- HECM Standard loans have been around since 1989 and are desirable for people who need the largest loan they can get. The amount is based on a HUD table which takes into account the borrower’s age, the current appraised value of the borrower’s home and current interest rates. Fees include: origination fee, upfront mortgage insurance

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premium, appraisal fee, traditional closing costs and a monthly servicing fee.

- A lower cost version of the HECM Standard is the HECM Saver. Borrowers save money through a lower upfront mortgage insurance premium but they receive 10 to 18 percent less in loans. (The MIP collected by FHA on a HECM Saver is equal to 0.01 percent of the value of the home, rather than 2 percent on a HECM Standard. On a $250,000 home, for example, borrowers pay $25 in MIP under the Saver option, instead of $5,000 for a HECM Standard.)

- Proprietary Reverse Mortgages sometimes called “jumbo” reverse mortgages because they are for homes valued at $600,000 or more, are loans that are not FHA insured and don’t have as many regulations as HECMs.

A growing number of seniors are using HECMs to purchase homes that are safer, easier to navigate, more energy efficient or closer to family or friends. The advantage of using a reverse mortgage for purchase is that the home is purchased outright, leaving the borrower with no monthly payments.

Seniors may also choose to use HECMs to pay for services or home improvements. Today, many community services offered in the home along with new medical and technology advances make staying in the home easier and less costly than institutional care. However, less costly does not mean inexpensive, the average daily cost of in home care in 2012 was $21 an hour. Borrowers should determine whether or not the services necessary to continue living now and in the future in a private home are available in their community or if they must move to where those services are available. Even if the services are available, the borrower’s home may not be appropriate for aging.

An accessible home is a home that meets a person’s changing physical needs. Those needs may include proper lighting, wide hallways and doorways that provide access to those in a wheelchair or using a walker, bathrooms with grab bars and no threshold showers, access to sinks and cupboards, limited stairways and handrails for those stairways that do exist. Beyond the physical characteristics of a home, neighborhoods must feel and be safe and walkable.

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Costs associated with reverse mortgages

Reverse mortgage costs are capped and can be included in the financing. They include:\(^{20}\)

- The origination fee, which covers the lenders operating expenses. The maximum origination fee allowable is 2 percent of the initial $200,000 of the home’s value and 1 percent of the remainder with a cap of $6,000.

- HECM Standard borrowers pay a mortgage insurance premium (MIP) to the FHA to provide protections to both the lender and the borrower for the loan. This is an upfront cost equal to 2 percent of the Maximum Claim Amount, plus an annual premium equal to 1.25 percent of the balance of the loan. HECM Saver accounts pay only .01 percent of the Maximum Claim Amount and the same annual premium as the HECM Standard. The MIP provides borrowers with uninterrupted access to proceeds in the event that the lender is interrupted and provides lenders assurance in case the sale of the home is not enough to pay back the reverse mortgage.

- Appraisers assign a market value to the home. Fees vary but average $450 and must be paid in cash usually before the loan is made. Appraisers will also determine if the home has major structural problems, and complies with safety and local building codes. If repairs are needed to bring the home up to standard, a second fee of around $125 will be charged.

- Closing costs. These are the same costs associated with any other mortgage and include: credit report fee, flood certification fee, escrow, settlement or closing fee, document preparation fee, recording fee, courier fee, title insurance, pest inspection and a survey.

There are additional costs associated with the loan as well. For instance, lenders earn a monthly fee, known as servicing fees for administering the loan. Federal regulations hold service fees to no more than $35 per month. If the fee is a fixed monthly amount, that amount will be ‘set-aside’ to be used as the monthly fee. It is deducted from the available loan proceeds at closing. This amount is mainly determined by the borrower’s age and life expectancy and can amount to several thousand dollars. Borrowers will also pay interest. Borrowers are only charged interest (accrues at a compounded rate through the life of the loan) on the amount they receive. Reverse mortgages offer both fixed and variable interest rates.

Although reverse mortgages were created for lower income individuals, there has been some interest in the past few years to using reverse mortgages for individuals with healthier retirement accounts. Some financial planners are using reverse mortgages to avoid selling depressed investments, create a bridge to Social Security (delaying taking Social Security in order to increase the benefit) or to lower tax bills.\(^{21}\)

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The advantages of taking out a reverse mortgage are that your heirs can never owe more than the value of the home even if the value of the home declines over the life of the loan, you can remain in your home as long as you maintain the home and continue to pay taxes and insurance, you can get your funds in a variety of ways and you can pay off any existing mortgage with the proceeds.\(^\text{22}\)

There are disadvantages as well. Those include that you will have less to leave as inheritance for your heirs, closing costs can vary between lenders, a long stay in a nursing home or assisted living facility (a year or more) can force you to repay the balance of the loan and you are obligated to keep your home in good repair and pay taxes and insurance (not doing so could result in foreclosure).

Before talking to lenders about getting a reverse mortgage, talk to a reverse mortgage counselor (mandatory anyhow) and your financial advisor. The National Council on Aging (NCOA) provides tools for consumers to determine whether it makes sense to look into a reverse mortgage. You can find their tools at http://www.ncoa.org/enhance-economic-security/home-equity/.


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About AgingOptions

**AgingOptions** is a holistic elder care company helping families plan for, pay for, and coordinate the long-term care of elderly loved ones.

**AgingOptions’** services are geared towards retirees and those thinking about retirement and concerned about:

- Losing independence & having to move to a nursing home.
- Losing your assets to uncovered medical or long term care costs.
- Becoming a burden on your loved ones.

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