BALANCE℠

FINANCIAL FITNESS PROGRAM

A Guide to Reverse Mortgages

You may have heard about reverse mortgages on television or from a friend and are not quite sure what they are, or you may already know what a reverse mortgage is and are not sure if it is right for you. You may be interested in a reverse mortgage but have fears about what will happen to your house. Maybe you are wondering if a reverse mortgage would work for your parents.

Whether or not to get a reverse mortgage is a serious decision. It may or may not be the best option for you, depending on your situation. Knowing more about reverse mortgages and how they work can help you to make an informed decision.

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Chapter 1: The Basics

What is a reverse mortgage?
Many seniors find themselves with a limited income, but a significant amount of equity in their homes. A reverse mortgage is a tool that allows you to take the equity out of your house without having to sell it or make payments. Like the name implies, a reverse mortgage is the reverse of a traditional mortgage. The value of your house is divided into equity (the amount of the house that you own) and debt (the amount of the house that the lender owns through a mortgage loan provided to you). With a traditional mortgage you make payments on your loan to the lender each month, increasing your equity and decreasing your debt. Eventually, if you stay in the home, you will own it free and clear.

With a reverse mortgage the lender gives you money instead. Essentially, you are getting back the equity in your house through a loan. Thus, a reverse mortgage reduces your equity and increases your debt. (Eventually you could have no equity in your house.) While you are in the home you do not need to make any payments to the lender, and you get to keep the title to your house. The most common type of reverse mortgage is the Home Equity Conversion Mortgage (HECM). *(Because the HECM is the most common reverse mortgage program, and its rules and features are set, while other programs can have varying features, it is what is primarily discussed here. Unless otherwise noted, the term reverse mortgage refers to a HECM. Other options are described on page 6.)* While you get a HECM directly from a private lender, it is insured by the federal government through the Federal Housing Administration (FHA), which is part of the Department of Housing and Urban Development (HUD).

Most people get a reverse mortgage on a home they already own and live in. However, you can also get a reverse mortgage to purchase a new home, assuming you will make the home your primary residence. If you sell your old home and have the cash to purchase a new home, why would you want to get a reverse mortgage? Many people don't want to tie up all of their money in a house in case they have unexpected expenses, like medical bills, but also don't want (or can't afford) to make a smaller down payment and get a traditional mortgage. Of course, you could always purchase the home with cash and get a reverse mortgage later, but it can be convenient to do both at the same time.

Who can get a reverse mortgage?
There are several qualifications that you need to meet in order to get a HECM.

1. All individuals on the title of the home must be at least 62 years old.

2. The home must be your primary residence.

3. You must own your home free and clear or have a significant amount of equity in your house. Reverse mortgage lenders require that their mortgage is the first mortgage on the home (meaning that they are the first ones that get paid if your house is foreclosed on). If you have a traditional mortgage on your house you need to be able to get enough from the reverse mortgage to pay it off.

4. Your house must be a single family residence, two to four unit home with at least one unit occupied by you, condominium, or townhouse. You usually cannot get a reverse mortgage on a mobile home or cooperative.

5. The home must be completely constructed and have a certificate of occupancy.

6. Your home's condition cannot be below HUD's minimum property standards.

7. You must complete counseling with a HUD-approved counseling agency.

Unlike with a traditional mortgage, your credit score and income have no effect on whether or not you are able to get a reverse mortgage, since you are not making monthly payments.

Chapter 2: Payments and Costs

Payment amounts and options

How much money you can get from a reverse mortgage depends on how old the youngest person on the title is (the older you are, the more you can get), the amount of equity in your house (the more equity in the house, the more you can get), the interest rate you are charged on the reverse mortgage (the higher the interest rate, the less you can get), and your location. You can get an estimate of how much you could receive from a reverse mortgage on the AARP's website at www.rmaarp.com.

Remember, if you already have an existing traditional mortgage you need to pay it off with the reverse mortgage, so this will reduce the amount of money you can actually receive. Depending on the amount that you can get from the reverse mortgage and the amount you have left on your regular mortgage it is possible that you will only get enough money to pay off the existing mortgage. In this situation you will no longer have a mortgage payment, but you will not directly get any money. However, not having any mortgage payment by itself can be a great benefit, if you are struggling to pay all of your expenses now.

There are five different payment options for reverse mortgages (although some loan products may not offer all of them):

1. **Line of credit.** You can take the whole amount at once, or whatever amount you want whenever you want until you have withdrawn the whole credit amount available. With a HECM the amount that is available to you grows over time, based on the interest rate that you are charged on the loan.

2. **Term.** You receive set payments each month for a specific number of years. The longer the term is, the less you will receive each month.

3. **Tenure.** You receive set payments each month for as long as you live in the home. You receive less from this than from a term plan.

4. **Modified term.** You receive a set payment each month for the term you choose and have a line of credit as well. The higher the line of credit is, the less you will receive in set payments.

5. **Modified tenure.** You receive a set payment each month for as long as you live in the home and have a line of credit as well. The higher the line of credit is, the less you will receive in set payments.

Once you choose your plan and get your reverse mortgage you can switch to another plan for a $20 fee.

Costs of a reverse mortgage

Because a reverse mortgage is a loan you will be charged closing costs, interest on the money borrowed, and a servicing fee. For closing costs you generally need to pay an origination fee to the lender for processing the loan and fees to third parties for such services as an appraisal, title search, survey, inspection, and recording the transaction. Once the loan is closed the lender or servicer of the loan generally will charge a servicing fee, which cannot exceed $35 a month for HECM loans. You also have to pay a mortgage insurance premium. This insurance is collected to ensure that all borrowers will receive the funds promised to them, regardless of how long they live, and to compensate lenders for their losses if, when the loans are repaid, they receive less than what was loaned. Most of the costs can be financed with the reverse mortgage so you don't have to pay for them out of pocket.

While fixed-rate programs are available, most HECM lenders charge a variable interest rate. The interest rate is determined based on the current U.S Treasury Security Rate or London Interbank Offered Rate (LIBOR) plus a specific margin. You can choose an interest rate that adjusts once a month or once a year. The interest rate with a monthly adjustment is usually lower than for

a yearly adjustment, but the cap (the amount the interest rate can change) is higher. With a monthly adjustment the cap is a ten percentage point increase over the life of the loan. With a yearly adjustment the cap is two percentage points per year and five points total over the life of the loan. A lender must disclose to you the total annual loan cost (TALC). Because your balance grows over time due to not making payments, the interest you are charged grows as well. This is opposite from what happens in a traditional mortgage, where the interest charged decreases over time because the loan balance declines.

Chapter 3: Repayment of Loan

In general, while you are living in the home you do not have to make any payments on the reverse mortgage loan. The loan is not due until everyone on the title of the house has not lived in the house for six consecutive months (or twelve months if gone for medical reasons) or died. It is standard for the lenders to give the borrowers or heirs six months to repay the loan or sell the house before starting foreclosure proceedings. However, in some special circumstances your loan may become due while you are still in the house. These circumstances can include:

1. Failure to pay property taxes or insurance. (You are still responsible for paying these items even if you have a reverse mortgage, although you can certainly pay for them with the proceeds from the reverse mortgage.)

2. Failure to maintain and repair home.

3. Donation, condemnation or abandonment of home.

4. Declaration of bankruptcy.

5. Perpetration of fraud or misrepresentation.

6. Renting out part or the entire home.

7. Adding a new owner to the home's title.

8. Changing the home's zoning classification.

9. Taking out new debt against the home.

Be sure to read your loan documents or ask your lender what the circumstances are that will cause your loan balance to be due in full.

Reverse mortgages are non-resource loans. What that means is that the lender legally cannot collect from you or your heirs more than the value of the house at the time the loan is due and payable. If you move out of the house and sell it for $300,000 and the loan balance is $320,000, the lender has to take a $20,000 loss. However, this only holds true if the home is sold at fair market value or given back to the lender. If you die and your heirs want to keep the home they must repay the full loan balance.

Chpater 4: Other Reverse Mortgage Programs

While the HECM is the most common reverse mortgage used, there are other types of reverse mortgages available:

Deferred Payment Loans
These are one-time, lump sum reverse mortgages provided by some local and state governments. Usually these programs are only available to homeowners with low or moderate income, and they may require a minimum borrower age. The deferred payment loan can only be used for specific repair projects allowed by each particular program. The interest rate is usually fixed, and in some programs all or part of the loan is forgiven after you have lived in your home for a certain number of years.

Property Tax Deferral Loans
Like deferred payment loans these loans are offered by some local and state governments. These loans can only be used to pay your property taxes.

Proprietary Reverse Mortgages
These are reverse mortgages created by private companies (who may let several lenders offer their programs) and not insured by the federal government. In general, they are still restricted to homeowners 62 and over, but the companies have more control over what features they offer than with the HECM. Homeowners with highly-valued homes may be able to get more money from a proprietary reverse mortgage than a HECM. However, proprietary reverse mortgages tend to cost more, and for the line of credit option the amount available usually does not grow over time, unlike with the HECM.

Should I Get a Reverse Mortgage?

Only you will be able to answer that question, but there are several factors that you should consider:

1. **How long are you planning to live in the home?** If you are planning to sell your house in a few years usually a reverse mortgage does not make sense, since a large portion of the money you received will have actually gone towards closing costs. If you think you may have to go to a nursing home soon getting a reverse mortgage does not make sense either, since you have to pay it back if you leave your home.

2. **Have you considered moving as an option?** Even if you have not thought about moving it is a good option to consider. Moving is a way to take the equity out of the house without taking out a loan, and it could also make sense if you are having difficulties maintaining the home. Of course, moving will only save you money if you purchase a cheaper home or rent. See what other living options are out there.

3. **How will this affect your heirs?** If you want to leave your home to your children, or anyone else, a reverse mortgage will complicate the situation. If your heirs want to stay in the home they will have to pay back the reverse mortgage, or if they want to sell it the reverse mortgage will reduce the amount of money they receive.In general, a reverse mortgage can be paid off by refinancing with a traditional mortgage, so your heirs do not necessarily need to have a large amount of cash on hand to be able to keep the house. Your heirs will not be held responsible for more than the value of the house at the time of repaying the loan.

4. **Can you afford payments on a traditional mortgage or home equity line?** If you have the money to make the payments on a traditional mortgage or home equity line that may be a better option, since the fees are usually lower and you do not have to worry about repaying the full balance if you leave the house.

5. **Do you really need the money?** Do you need extra money to help pay for medical bills, or do you want to take a vacation? A reverse mortgage is an expensive way to finance purchases.

6. **Will you need the money more later?** Remember, with a reverse mortgage the amount of money that you are going to be able to get is limited. If you use all the money you will not have it later, when you may need it more.

7. **Have you looked for other ways to increase your income?** Are you able to get a part-time job or rent out a room in your house instead?

8. **Have you looked for assistance?** If you have a limited income and are over 65 you may be able to get additional income from SSI (Supplemental Security Income). For more information you can call 800-772-1213. You also may qualify for food stamps. (Contact your county's social service agency.) You local Area Agency of Aging (which can be found by calling 800-677-1116) can help you find programs in your area that provide assistance with utilities, food, prescriptions, and transportation.

Often it is helpful to discuss your options with family members, trusted friends, or a legal advisor. Be especially wary of anyone trying to sell you a product and pushing a reverse mortgage as a way to finance it.

Chapter 5: Getting Started

If you have decided that you want to get a reverse mortgage the first step is to find a lender. You can find FHA-approved HECM lenders by going to www.hud.gov or calling (800) 225-5342. You may want to talk to several lenders before choosing one. Who offers the lowest interest rate and closing costs is an important consideration, but it is also a good idea to choose a lender who treats you with respect and explains things in a clear manner. Avoid lenders who make you feel pressured.

In order to get the loan you will need to go through counseling with a HUD-approved housing counseling agency. During the session the counselor will go over the basics of reverse mortgages, an estimate of how much you can receive from the reverse mortgage and how much equity you will have left in your house, and other options besides a reverse mortgage. This is a good time for you to discuss any questions or reservations you may have. If after getting a reverse mortgage you decide that you no longer want it you have three business days to cancel it, in writing. You should be given a form at closing that you can use to cancel it.

People take out reverse mortgages for many reasons. While it may work for some it is not necessarily right for others. A careful examination of your situation and options will help you to determine if a reverse mortgage is right for you.