REVERSE MORTGAGES

THE GOOD, THE BAD, AND THE UGLY

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For those who have special needs, or are caregivers for an individual with special needs, the promise of extra cash flow from a reverse mortgage may seem like a wonderful gift; however, be sure to read the fine print.

Reverse mortgages are a complex and often misunderstood product. Although they have been around for decades, reverse mortgages have recently received more attention as a financial planning vehicle as people are living longer and have insufficient assets and retirement income to maintain their lifestyles and pay for needed expenses. For many seniors, the "golden years" have been tarnished by the economic downturn, ill-timed sales of depressed stocks, the current low-interest rate environment, and the sky-rocketing costs of health and long-term care for themselves and their loved ones. For those who have special needs, or are caregivers for an individual with special needs, the promise of extra cash flow from a reverse mortgage may seem like a wonderful gift; however, be sure to read the fine print. In this article, we hope to shed some light on reverse mortgages that will help you make the right decision for you and your family.

WHAT IS A REVERSE MORTGAGE?

A reverse mortgage is a loan that a person age 62 or older, who owns their home outright or has paid down a considerable amount of debt on the home, may take out from a bank using the equity that they have accrued in their home as collateral. If the reverse mortgage applicant does not own their home completely free of debt, they may still qualify for the loan provided that they use a portion of the proceeds of the reverse mortgage to pay off the outstanding debt on the home. In order to qualify for a reverse mortgage, you must occupy the home as your principal residence.

A reverse mortgage allows you to convert part of the equity in your home into cash without having to sell the house. This means that you will receive money from the bank, either monthly, as a lump sum, or as a line of credit. With each payment you receive from the reverse mortgage, the bank is entitled to repayment of more money from you or your estate once the loan becomes due. With a conventional mortgage, you make monthly payments to the bank. In a reverse mortgage, you receive money from the bank and don't have to pay it back until you no longer live in the home. The amount of the loan you are able to obtain depends on a number of factors, including the age of the youngest borrower or non-borrowing spouse, the value of the home, the applicable interest rate, government lending limits and the mortgage insurance premium. Most, but not all, reverse mortgages are federally insured and are backed by the U.S. Department of Housing and Urban Development (HUD). For these types of loans (which will be the focus of this article), the borrower must meet with a counselor who explains the different types of reverse mortgages and how they work.

Be aware that the up-front or closing costs for a reverse mortgage can be significant; these include obtaining a third party appraisal, title search, origination fees or points, and other costs. Also, the interest rate is typically higher than it would be for a traditional home equity loan and most reverse mortgages are variable rate loans (this means that your interest rate may go up or down during the term of the loan, depending on market conditions). It is also important to note that the interest on a reverse mortgage is compounded, meaning that the borrower pays interest on the interest. This means that the amount of the loan may end up being far more than the home's value at the time that the loan is due. Moreover, the interest will not be tax-deductible each year since you are not actually paying it, it is simply accruing. Thus, if you are planning to stay in your home for only a short time, a reverse mortgage might not be the best option for you.

A REVERSE MORTGAGE IS A LOAN THAT A PERSON AGE 62 OR OLDER, WHO OWNS THEIR HOME OUTRIGHT OR HAS PAID DOWN A CONSIDERABLE AMOUNT OF DEBT ON THE HOME, MAY TAKE OUT FROM A BANK USING THE EQUITY THAT THEY HAVE ACCRUED IN THEIR HOME AS COLLATERAL.

All borrowers must now undergo a financial assessment prior to obtaining a reverse mortgage. You must have sufficient financial resources to continue to make timely payments of ongoing household expenses, such as property taxes, insurance, etc. The financial assessment includes a credit history and cash flow analysis. Nevertheless, it is generally much easier for someone living on a fixed income such as Social Security to obtain a reverse mortgage than a traditional mortgage since there are no monthly payment requirements to the bank. However, a bad credit score or other issues uncovered during the financial assessment may impact the terms of your reverse mortgage, causing a higher interest rate or limiting the amount of money you can borrow. You may also be required to set aside some of the money you borrow to pay for future household expenses such as property taxes. Moreover, if you are delinquent on any Federal debt, such as an unpaid IRS tax bill, you will not be able to obtain a reverse mortgage.

Be careful about attempts to cross sell you other products when applying for a reverse mortgage. You don't have to buy any other product in order to be eligible for a reverse mortgage. If the person you are dealing with says you need to purchase another product in order to qualify for a reverse mortgage, go somewhere else. Also, if someone approaches you to sell you a reverse mortgage but then steers the conversation in another direction or towards another financial product, get a second opinion from someone who is knowledgeable that you trust. You are under no obligation to buy anything. One common tactic is for a salesperson to convince you to take out a reverse mortgage so that you have money to purchase an annuity or another financial product which will generate a large commission for the salesperson. Be alert to these potential scams and seek independent professional help, if necessary.

Fortunately, a reverse mortgage is a "non-recourse" loan by law, meaning that the bank making the loan can never collect against the other assets of the borrower, aside from the house, and that they may not seek payment of the outstanding balance beyond the value of the house from the borrower's heirs. If your heirs, however, want to keep the house they may have to pay off the loan balance on your death. Otherwise, it is entirely possible that they will not receive the house upon your death.

It is important to keep your individual circumstances in mind when considering a reverse mortgage. For example, someone who has no intention of passing their home on to their children (or who has no children), and does not have anyone other than their spouse living in the home with them might not care that their heirs could receive nothing on their death. In any event, a borrower should be sure to borrow only what they need in order to meet their monthly expenses. This will prevent the compounded interest from quickly increasing the repayment amount that will ultimately be due.

SOMEONE WHO HAS NO INTENTION OF PASSING THEIR HOME ON TO THEIR CHILDREN (OR WHO HAS NO CHILDREN), AND DOES NOT HAVE ANYONE OTHER THAN THEIR SPOUSE LIVING IN THE HOME WITH THEM MIGHT NOT CARE THAT THEIR HEIRS COULD RECEIVE NOTHING ON THEIR DEATH.

The money received from the reverse mortgage can be used for anything you like, including paying for home improvements, healthcare expenses for you or a loved one with special needs, or simply making purchases which improve your or someone else's quality of life. For many, the proceeds from a reverse mortgage allow them to stay in their home instead of selling the house to raise money for caregivers or necessary home improvements. Keep in mind that you still own the home during the term of the reverse mortgage and you are responsible to pay for all household maintenance expenses. The loan must be repaid when the last surviving borrower (see discussion regarding married couples below), dies, sells the home, or no longer lives in the home as a principal residence. However, a borrower is permitted to reside in a nursing home or assisted living facility for up to 12 months before the loan must be repaid.

Since a reverse mortgage is considered a loan, the money received is not taxable and should have no effect on your Social Security, Medicare, Medicaid or other government benefits. However, for means-tested benefit programs the money received must be spent in the same month received; otherwise, it will count as a resource for Medicaid or SSI purposes and potentially disqualify an individual for those programs. As Medicaid is a jointly funded federal-state program, it is important to check with an attorney knowledgeable in these matters in your state with respect to the consequences of taking out a reverse mortgage on your government benefits. To find an attorney in your state, go to http://www.specialneedsalliance.org/find-an-attorney/.

WHAT WILL A REVERSE MORTGAGE MEAN FOR MARRIED COUPLES?

A new federal rule has recently taken effect which protects the surviving spouse of a reverse mortgage holder when the reverse mortgage holder dies. Here's how it works: As discussed above, you must be at least 62 years of age to take out a reverse mortgage. Until recently, if one spouse was under age 62, he or she could not be listed on the loan as a borrower. This actually allowed the couple to borrow more money form the bank since the older you are, the greater the amount of money the bank would allow you to borrow. However, if the older spouse died first, the surviving spouse would have to pay off the reverse mortgage in full or sell the home. This came as a great surprise to many surviving spouses, some of whom were sued by lenders in a foreclosure action and were facing eviction from their homes. It has been especially traumatic in recent years as many homes are now worth less than the outstanding balance of the reverse mortgage due to the downturn in the real estate market in many areas.

In response to these foreclosure actions, three surviving, non-borrower spouses, along with the help of AARP, fought back and sued HUD arguing that the surviving spouses should not be evicted from their homes. As a result, a new rule took effect on August 4, 2014 which provides certain protections for surviving spouses. The younger spouse (even if under age 62) may now be listed as a non-borrowing spouse on the reverse mortgage. If the older spouse dies first, the younger spouse may stay in the home provided he or she continues to meet the requirements of the reverse mortgage, such as paying the property taxes, etc. and within 90 days of the spouse's death, documents that he or she has a legal right to stay in the house (deed, lease, court order, etc.). Also, the couple had to be married at the time the reverse mortgage was taken out. Unfortunately, the federal government is taking the position that these new rules apply prospectively only. Thus, if the reverse mortgage was created prior to August 4, 2014, in the event that the loan becomes due, a non-borrower spouse may be forced to repay the loan either out of other assets, sale of the house, or another mortgage.

Even though the non-borrowing surviving spouse can remain in the home after the older spouse dies, for loans taken out after August 4, 2014, he or she cannot access any remaining funds from the reverse mortgage. Thus, if the older spouse is terminally ill, it might make sense to draw down the remaining balance of the reverse mortgage prior to death since that will not be an option once the older spouse dies. Keep in mind however, that the loan will continue to accrue interest until it is paid off.

WHAT WILL A REVERSE MORTGAGE MEAN FOR YOUR HEIRS?

For borrowers with heirs who do not live in the home that is subject to the reverse mortgage, the heirs need to decide whether they want to keep the house. Of course, one of the primary factors in that decision is how much the balance of the loan is relative to the fair market value of the home.

Once the loan becomes due, the lender must give the heirs at least 30 days to decide whether to keep the home or sell the home. The heirs may either pay off the loan by paying the lesser of the balance of the loan or 95 percent of the current appraised value of the property. Thus, if the borrower's heirs want to keep the house, and the fair market value of the house is worth more than the balance on the loan, the heirs must pay off the entire loan, either by a cash payment or securing a new mortgage. If the fair market value of the house is less than the balance on the loan, the borrower's heirs can keep the home by paying the lender an amount equal to 95 percent of the fair market value of the home.

SOME SURVIVING SPOUSES HAVE BEEN SUED BY LENDERS IN FORECLOSURE ACTION AND FACED EVICTION FROM THEIR HOMES. MANY HOMES ARE NOW WORTH LESS THAN THE OUTSTANDING BALANCE OF THE REVERSE MORTGAGE DUE TO THE DOWNTURN IN THE REAL ESTATE MARKET IN MANY AREAS.

On the other hand, if the heirs decide to sell the home and the fair market value of the property is greater than the balance of the loan, the lender is entitled to the entire balance of the loan after the sale of the home, and any amount remaining would go to the borrower's estate. If the fair market value of the home is worth less than the balance on the loan, the heirs may either execute a deed in favor of the lender to satisfy the loan, or sell the home and use the proceeds to repay the loan. It is important to note that if the proceeds from the sale do not cover the full balance, no other assets of the borrower, the estate or the heirs can be attached to satisfy any amount outstanding.

CONCLUSION

A reverse mortgage can be an excellent source of cash for people who wish to use the equity in their homes to supplement their financial needs and improve their quality of life and that of a loved one with special needs. However, this is a decision that can only be made after considering all of the relevant circumstances and consequences. We have attempted to highlight some of the more important points in this article. Due to the complexity of this product, please proceed cautiously and seek professional advice when appropriate. •

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