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Reverse Mortgages

A project of Consumer Action

One of the major benefits of buying a home is the opportunity to build equity, or ownership, in the property. Older homeowners who have paid off their mortgages, or who owe very little, may have the option to borrow against their equity without having to sell their property or even make monthly payments. They can do this with a reverse mortgage.

This special type of loan might make sense for seniors who want to stay in their home but need additional income to make ends meet. By understanding how a reverse mortgage works and what it costs, senior homeowners can use their equity to their advantage.

Always compare reverse mortgage offers among a variety of lenders before entering a contract. Be aware that reverse mortgages can be very profitable for lenders—disreputable companies may exploit senior home owners with overpriced and inappropriate financial products and services. Offers are pushed on seniors in ads on TV and the Internet, in direct mail advertisements, flyers at senior centers and even door-to-door sales.

Some advertisers promote reverse mortgages as a way to buy expensive things like RVs or boats—which is not the best use of accrued home equity that often took years to build. Sometimes seniors are convinced to invest lump-sum payments in inappropriate and ill-advised investments, such as annuities. Often, there is nothing left for your heirs after you pass away.

To avoid trouble, compare multiple offers and review reverse mortgage terms with a trusted advisor ***before you sign***.

Reverse mortgages

What is a reverse mortgage?

A reverse mortgage is a special loan that allows senior homeowners to convert their home equity to cash, but does not require them to give up title to the property or make payments on the loan as long as they live in the home.

With a reverse mortgage, the lender makes payments to the homeowner rather than the other way around.

The loan must be repaid only when the last borrower permanently leaves the home.

A reverse mortgage is a “non-recourse” loan, which means that if the amount borrowed exceeds the value of the home at the time the loan becomes due, the lender, or insurer, must absorb that loss. The lender cannot try to get additional payment from the borrower to cover any shortfall between the loan balance and the home’s value.

If the value of the home exceeds the loan balance at the time the loan is due, the homeowner or his or her heirs get to keep the difference.

What is the difference between a reverse mortgage and a regular mortgage?

A regular mortgage:

- provides the money you need to purchase a home.
- requires you to qualify for the loan by meeting the lender's minimum requirements for things like earnings, assets and credit scores.
- requires you to begin repaying the loan immediately and consistently until the loan is repaid in full.
- enables you to build equity (ownership; the value of the home minus what you owe on it) as your debt decreases.
- allows the lender to foreclose (repossess the home) if you do not repay the loan.

A reverse mortgage:

- converts the equity in a home you already own to cash.
- does not require you to make monthly mortgage payments as long as you or any co-owner lives in the home.
- does not require you to have an income or a particular credit score to qualify.
- does not put you in jeopardy of foreclosure.
- creates more debt as you borrow against your equity.

What is the difference between a reverse mortgage and a home equity loan?

Both loans use the equity in your home. However, a home equity loan requires that you make monthly payments; a reverse mortgage does not.

Does the reverse mortgage lender take ownership of my home?

No. You retain ownership of your home and are responsible for maintaining and repairing it, and for paying the property taxes and insurance.

Where can I get a reverse mortgage?

Reverse mortgages are available throughout the U.S., though not all types of reverse mortgage are available in all states. Mortgage companies, banks and some other financial institutions offer the loans.

To find a reverse mortgage lender, contact the U.S. Department of Housing and Urban Development (HUD), a housing counseling agency, or the National Reverse Mortgage Lenders Association (NRMLA). *(See Assistance and information section for contact information.)*

Some state and local governments also offer a type of reverse mortgage.

The proceeds from these loans typically must be used for a specific purpose, such as paying property taxes or making home repairs. Contact your state and local governments to inquire if these loans are available where you live.

I saw an ad on TV for a reverse mortgage—is this a good way to find a loan?

No. Start your search for a loan by calling the U.S. Department of Housing and Urban Development (HUD), a housing counseling agency, or the National Reverse Mortgage Lenders Association (NRMLA). *(See Assistance and information section for contact information.)*

Eligibility

Who is eligible for a reverse mortgage?

Generally speaking, the following requirements apply:

- All borrowers must be 62 years of age or older. (Some conventional reverse mortgages may have different age requirements.)
- All owners of the property must apply for the loan and sign the loan documents.
- The property must be the borrowers' principal residence.
- The reverse mortgage must be a "first" mortgage, which means it must be recorded as the primary debt on the home (the one that gets paid off first when the home is sold).
- The borrowers must pay off any debt currently on the property, either before the reverse mortgage is taken or with a lump sum advance from the reverse mortgage.
- Applicants for a federally insured reverse mortgage must discuss the loan with a HUD-approved housing counselor. In some states, such as California, homeowners considering any type reverse mortgage must go through reverse mortgage counseling. The counseling fee is determined by the agency, but capped at $125. By law, lenders cannot pay for the counseling.
- Single-family homes are eligible for all types of reverse mortgage. Some loan programs also accept owner-occupied dwellings with two to four units, condominiums, and planned unit developments. And some accept manufactured homes built after June 1976. Cooperatives and mobile homes are, typically, not eligible (though at least one program will make loans on cooperatives in New York).

Are there any income or credit qualifications for a reverse mortgage?

No. Since borrowers don't make payments on the loan, the lender does not require a certain credit score or income.

Can I get a reverse mortgage on a vacation, or second, home?

No. You can only get a reverse mortgage on your primary residence, where you live most of the year.

I placed my home in a revocable living trust. Can I still get a reverse mortgage?

Probably. However, the lender will need to review your trust documents before committing to the loan.

Loan types

What types of reverse mortgage are there?

There are three types of reverse mortgage:

1. Home Equity Conversion Mortgage (HECM). Over 90% of all reverse mortgages are HECMs, which are insured by the federal government through the Federal Housing Administration (FHA), an arm of HUD. They are widely available from private lenders, such as banks and mortgage companies. For 2009, the home value limit for a HECM is $625,500. Congress may extend this limit into 2010. Otherwise, it will most likely revert to the previous limit of $417,000.
2. Uninsured proprietary reverse mortgages. Funded and backed by the private companies that develop them, these loans are not subject to a government-imposed lending limit. For this reason, they are most attractive to borrowers who own high-value properties and who want to access more than they could under the HECM home value limit ($625,500 in 2009).
3. Public sector reverse mortgages. Offered by state and local governments, these low-cost reverse mortgages typically are available only to homeowners with low or moderate incomes who need the funds to pay property taxes or make home repairs. They also are known as single-purpose loans.

A particular lender may offer more than one type of reverse mortgage.

Which type of reverse mortgage is best for me?

More than 90% of all reverse mortgages are HECMs. However, a HECM may not be right for you. A reverse mortgage counselor can help you determine which type of reverse mortgage is appropriate based on your needs.

Loan features and terms

How much can I borrow?

The amount of money you can borrow depends on:

- your age. (The older you are, the more cash you can get.)
- the home's value. (The more your home is worth, the more cash you can get.)
- the fees, closing costs and interest rate. (The more expensive the loan, the less that will be available to borrow.)
- the loan program you choose. (The federally insured HECM imposes a limit on how much borrowers can get.)

How will I get my money?

You can choose to take the proceeds from a reverse mortgage in the following ways:

- as a single lump sum
- as a scheduled monthly cash advance
- as a line of credit account that you can tap as needed
- as a combination of these options

If you choose to receive monthly cash advances, you can select term advances, which provide fixed monthly payments for a specific period of time, or tenure advances, which provide fixed monthly loan advances for as long as you live in the home.

If you choose a HECM line of credit, the unused portion of your line will increase each year by roughly the interest rate you are paying. For example, if you have $150,000 available credit remaining on a $300,000 credit line on which you pay a 6% interest rate, your credit line would increase by about $9,000 this year ($150,000 x 6% = $9,000).

Ask the lender how the loan servicer will keep you informed about your credit line increases.

What does it cost to take out a reverse mortgage?

Generally speaking:

- Reverse mortgages carry many of the same charges as purchase mortgages do: origination fees, appraisal, pest inspection, title insurance, closing costs, and so on.
- Insured mortgages also charge an insurance premium.
- The monthly servicing charge on a HECM reverse mortgage can be as much as $35, or several thousand dollars over the life of the loan.
- A HECM is more expensive than a proprietary loan upfront because you must pay for the insurance (currently 2% of the home's value or of HUD's home value limit, whichever is less, plus an extra half-percent added to the interest rate).
- You can finance your loan costs by paying them with the proceeds of your reverse mortgage.
- You only pay interest on the cash advances you take.
- Because loan payments are deferred, the total amount of interest

you owe increases significantly with time as the interest compounds.

- A reverse mortgage is most expensive over the short-term and becomes less expensive the longer you live in the home.
- Costs can vary from loan to loan, so it pays to shop around.

What is the "service fee set-aside"?

Federal guidelines allow the reverse mortgage loan servicer to charge a monthly fee. That fee, for a HECM, is between $30 and $35, which, depending on the borrower's age and life expectancy, could amount to several thousand dollars over the life of the loan.

The service fee set-aside, then, is the monthly fee times the predicted number of months in the loan term. This amount is excluded from the available loan proceeds at closing to cover the projected costs of servicing the account over the life of the loan.

To clarify, the amount is not actually taken out of your loan proceeds and you do not get charged interest on the full amount upfront. You are charged only the monthly service fee as each month passes. But you do not have access to the set-aside money for cash advances.

What is the interest rate on a reverse mortgage?

A reverse mortgage can charge a fixed or an adjustable (variable) interest rate, but an adjustable rate is more common. (You may have an option.)

The actual rate depends on which index (Libor or one-year T-bill, for example) the lender uses, and the amount of the margin (the percentage the lender adds to the index). HECM lenders have a choice, within federal guidelines, of which index to use and what margin to charge.

As with any adjustable rate mortgage, an adjustable rate reverse mortgage will specify an interest rate cap—a limit on the amount the interest rate may go up or down during a specified time period.

Remember that in shopping for the best loan, you'll want to look not only at the size of the loan you might get through different programs, and the interest rate, but the total effective rate after factoring in all expenses.

What is TALC?

To help consumers compare loans and make a wise decision, the federal Truth-in-Lending law requires lenders to disclose the total annual loan cost (TALC) for every reverse mortgage. The TALC disclosure converts all of a reverse mortgage's costs into a single average annual rate.

While TALC disclosures can be helpful, they are less accurate when projecting the costs of a credit line, since the true cost of the loan depends on the amount and timing of cash advances. TALC calculations assume that all borrowers will request one-half of their credit line at closing, and none later. TALC calculations also assume that the initial interest rate will stay the same for the life of the loan. That is unlikely if you have an adjustable rate reverse mortgage and interest rates are particularly low when you initiate the loan.

Can I refinance my reverse mortgage?

Yes. This could make sense if your home value increases significantly, the maximum loan limit is raised, or interest rates drop.

Repayment

How is my debt calculated?

Your debt is equal to all cash advances plus loan fees plus accrued interest.

When must I repay my loan?

You or your heirs must repay your entire loan balance when:

- the last surviving borrower passes away
- the home is sold
- all borrowers permanently move out (typically defined as not living in the property for one continuous year)

As with a purchase mortgage, a lender can also require repayment of your reverse mortgage at any time if you:

- do not pay your property taxes
- fail to maintain and repair your home
- allow your homeowner's insurance to lapse

Read the loan documents carefully to make sure you are aware of all the conditions that can cause your loan to become due.

What if I borrow more than my home is worth?

When calculating how much you can borrow, the lender takes into account your age and life expectancy, your home's value, and other factors. So, it would be possible to borrow more than your home's value if you live beyond your life expectancy or if your home depreciates.

Because a reverse mortgage is a "non-recourse" loan, however, a borrower or his or her heirs can never be required to repay more than what the home is worth at the time the loan becomes due. If the amount owed exceeds the property's value, then the lender, or insurer, must absorb that loss.

You or your heirs *could* owe additional funds for real estate agent commissions, closing costs and other costs of selling if the sales proceeds do not exceed the final loan balance by enough to cover these expenses. Before selling the home, be sure to leave enough equity to cover the costs of selling, or plan to pay them out-of-pocket.

If there is remaining equity after the loan is repaid, it belongs to the homeowner or the estate.

Will the lender take my home if I move out or pass away?

The lender will not take ownership of your home if you pass away or move out, but your loan must be repaid at that time.

In some cases, the borrower or his or her heirs pay off the reverse mortgage and keep the home. If the borrower or heirs do not have the cash to pay the balance due, they would have to refinance the reverse mortgage into a regular mortgage, if they can.

In other cases, the borrower or heirs sell the home and pay off the reverse mortgage and any sales expenses (agent's fees and closing costs, for example). If there is any money remaining, it is theirs to keep.

Will my equity always fall?

Not necessarily. While rising debt and falling equity is typical of a reverse mortgage, it is not the only possible scenario. For example, if you were to borrow very little against your equity and your house continued to appreciate rapidly, your equity could actually grow over the years, as your home's value increased.

Evaluating your options

How do I decide whether or not I should take out a reverse mortgage?

This is a personal decision. Only you can decide whether a reverse mortgage is the best option for you, based on your unique needs and circumstances. However, there are some things everyone should consider when weighing the pros and cons of a reverse mortgage:

- Because a reverse mortgage is a relatively expensive loan, you should consider whether or not it is your best source of funds. For example, if you plan to stay in your home for the long term and you will need additional income every month, a reverse mortgage may be worth the cost. On the other hand, if you generally have enough money but you need a one-time lump sum of cash to, say, buy a car, then there may be other less expensive financing options.
- With a reverse mortgage, you will use up some or all of the equity in your home. That means there will be less to leave to your heirs. In some cases, a borrower's heirs must sell the property to pay off the reverse mortgage because they can't afford to refinance it and make the monthly mortgage payments. Are you comfortable with these outcomes?
- Generally speaking, reverse mortgage advances are not considered

taxable income and do not affect your Social Security or Medicare benefits. However, if you receive state or federal benefits, such as Medicaid or SSI, you must spend your advance within the month you receive the money or it could jeopardize your eligibility for these programs. Consult a qualified adviser to make sure a reverse mortgage will not jeopardize your benefits.

Contact a reverse mortgage counselor for help evaluating your options.

When should I take out a reverse mortgage?

If you take a reverse mortgage out when you still have many years to live in the home, your loan costs are spread over a longer period and the loan becomes cheaper.

On the other hand, if you take the loan out very early, there is the possibility you will use a large part of your home's equity in the early years of the loan and won't have enough left when you need it later. This could be a problem, particularly if you have much higher medical or in-home care expenses later on.

If you don't really need the money now, consider waiting until you do.

What are my other options if I need money?

If you could easily make the monthly payments on a home equity loan or line of credit, those loans are much less expensive than a reverse mortgage.

A public sector reverse mortgage offered by your state or local government to pay for repairs or property taxes will also be much cheaper.

There may also be the possibility of selling your home and moving to a less expensive one.

Borrower's rights

What if I change my mind after I've taken out a reverse mortgage?

If you decide you do not want the loan, you can cancel it within three business days of closing. "Business days" includes Saturdays, but not Sundays or legal holidays.

If you decide to cancel, you must do it in writing; the lender will provide a form at closing. Your written cancellation must be delivered before midnight of the third business day.

Assistance and information

Where can I get more information about reverse mortgages?

AARP offers extensive information about reverse mortgages online at www.aarp.org/money/revmort/. The same information is available as a publication, *Home Made Money*. Order a free copy by calling 800-209-8085.

The National Reverse Mortgage Lenders Association offers *Just the FAQs: Answers to Common Questions About Reverse Mortgages*. Download the publication at www.reversemortgage.org.

Why am I required to speak with a reverse mortgage counselor?

It is very important that you consult with an independent third party—someone who does not make money or otherwise benefit from any decision you make—about taking out a reverse mortgage. Your counselor can present alternatives to a reverse mortgage, or, if you choose to take out a reverse mortgage, make sure you understand the costs and terms of the loan.

The cost of reverse mortgage counseling is capped at $125, though you may be able to find an agency that provides counseling free or at a lower cost. By law, lenders cannot pay for the counseling.

How do I find a reverse mortgage counselor?

You can visit HECM (Home Equity Conversion Mortgage) Resources site at www.hecmresources.org/network.cfm to find a reverse mortgage counselor in your state.

Or call AARP (800-209-8085), the National Foundation for Credit Counseling (866-698-6322), Money Management International (877-908-2227), or HUD (800-569-4287) to be referred to a reverse mortgage counselor.

In most cases, counseling may be conducted face-to-face or by phone. (North Carolina requires all reverse mortgage counseling to be done in person.)

How do I find a reverse mortgage lender?

Use HUD's online search tool at www.hud.gov/ll/code/llplcrit.html to find a reverse mortgage (HECM) lender in your state. (Select your state, check the HECM box, and then click the "Submit" button. Be sure to click on "Next" near the bottom of the page to view additional lenders for your state.)

Or, use the searchable database provided by the National Reverse Mortgage Lenders Association (NRMLA), at www.reversemortgage.org.

By phone, contact HUD at 800-569-4287.

In addition, your reverse mortgage counselor may be able to provide a list of lenders.

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