Reverse Mortgage

It Could Be the Most Useful Tool in Your Financial Toolbox

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Many seniors are self-sufficient and independent people with strong wills and character to match. However, it is not easy to maintain that feeling of independence when lying awake at night wondering how to make ends meet.

Like many older Americans, you may be property-rich and pocketbook-poor. Having a home or condominium that is owned free and clear, but not having savings or cash to access, causes dependency on fixed sources of income, such as Social Security, to meet the rising costs of living. Many Americans are experiencing a shortfall in their cash flow due to a low cost-of-living adjustment to their fixed source of income in comparison to the reality of exponentially rising costs of living in most parts of the county.

The financial toolbox for many is unlikely to include an income history necessary to support a traditional loan, but can include a home equity conversion mortgage (HECM). This is a federally insured reverse mortgage that can relieve the financial burdens experienced by a larger percentage of the over-70 population. Statistics from the Department of Housing and Urban Development indicate a dramatic increase in HECMs to this segment of the elderly population.

Many of you may be asking yourself, what is a HECM or reverse mortgage? Simply put, it is the use of your house or condominium for collateral against a loan that does not have to be repaid until certain conditions exist. Generally speaking, according to an AARP study, consumers turn to a reverse mortgage for a variety of reasons, including paying off an existing mortgage, paying for prescription drugs, and improving quality of life. For those who have given others power of attorney, paying for home care is the top reason.

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Recently, an 82-year-old woman closed a reverse mortgage on her single-family residence. She went from being unable to grocery shop on a regular basis and seeking financial assistance for heating oil and utilities to having a line of credit that she can draw upon to pay her bills, shop, and increase her quality of life.

The reverse mortgage allowed her to access the equity in her home without having to sell it or take out another type of loan. The lender pays her the equity when requested, and she does not have to repay the loan so long as she remains in the home. The loan will have to be repaid when she dies, sells the home, or moves out permanently. If she dies while still living in the home, her family will have to repay the loan to the lender plus interest that has accrued on the amount borrowed. However, the family is not personally liable for the payments. The loan will likely be repaid upon the sale of the home by the family.

In order to qualify for a reverse mortgage, one must be at least 62 years old and own their home. The home must be the borrower's primary residence, so a vacation or investment property would not qualify for the loan program. The lending criteria are different than the traditional loan scenario, as there are no income requirements. The borrower can also have an existing mortgage on the property so long as they are able to access enough money from the reverse mortgage to pay of the existing loan and make the reverse mortgage the first mortgage on the property.

Additionally, many borrowers find comfort in the idea that they still own and control the home. They remain responsible for the maintenance and upkeep of the home, as well as for the taxes (with any applicable abatement for age, health, veteran status, etc.) and insurance.

As with a traditional loan, the property is appraised and inspected. Then, depending on the home's value, location, interest rates, and the age of the younger borrower if there are co-owners, the amount the borrower is able to access is determined. Generally, a borrower can expect to access between 50% and 70% of the appraised value of the home; however, the appraisal, legal, origination fees, mortgage-insurance premiums, and monthly service fees come off the top before any funds are disbursed to the borrower.

Unlike a traditional loan, a borrower must undergo consumer counseling if they are participating in the federal HECM program. There are private reverse mortgages in the marketplace, however, that do not have federal mortgage insurance. Generally the HECM is the most versatile and best product for borrowers, but the private market does work better for borrowers with more expensive homes in certain circumstances.

Once the loan is closed, the proceeds can be taken in a lump sum, as monthly payments, as a line of credit, or as a combination of these two. Unused funds in a line of credit generally increase, allowing homeowners to borrow more money over time.

As with most anything, there can be a downside to reverse mortgages. Generally, it will cost the borrower between 6% to 8% of the home's value in fees. This is a deterrent to many borrowers who desire the extra money, but not at such a high price tag. Investing the money from these loans is an especially bad idea, because the loan is highly likely to cost more than you could safely earn. If anyone is trying to sell you something and recommending you use a reverse mortgage to pay for it, that's generally a good sign that you don't need it and shouldn't be buying it.

A borrower should carefully consider if there are other financial resources that could be utilized instead. If they do not, but could easily make the monthly repayments on a home equity loan or home-equity line of credit, these alternatives, which are much less costly than a reverse mortgage, may provide the answer to the financial need. Many state and local governments offer very low-cost loans for paying property taxes or making home repairs. Borrowers should also seriously consider the costs and benefits of selling their home and moving to a less expensive one.

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For borrowers with other options or choices, a reverse mortgage might not be the best financial tool. However, for the borrower who needs access to cash for quality-of-life issues, and cannot otherwise qualify for funds or resources, this is an essential tool for fixing their financial well-being.❖

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