FocusOn: Reverse Mortgages Demystified

Borrowing the Equity in Your Own Residence Can Provide Financial Security

By Julie Dialessi-Lafley, Esq.

Formerly known as reverse annuity mortgages, reverse mortgages are becoming more and more common in today's estate planning and retirement planning scenarios. The reverse mortgage, a mortgage where homeowners convert the equity in their home into cash, while retaining ownership of their property, is fast becoming a very popular means for creating financial stability for the aging segment of our society. The beauty of this mortgage is that homeowners do not make monthly payments on the mortgage but instead receive them.

For older Americans, a reverse mortgage can deliver greater financial security to supplement Social Security income (SSI), meet unexpected medical expenses, obtain in-home care, make home improvements and repairs, travel, consolidate debt, buy a new vehicle, pay property taxes, and much, much more. The proceeds from a reverse mortgage are tax-free; there are no minimum income requirements, and the money can be used for any purpose that borrowers desire. This special type of home equity loan is not due or payable as long as homeowners occupy the home as their primary residence. Homeowners tap into the equity of their home; the equity in the home is then returned to the homeowners as needed, and the cash is tax-free.

Reverse mortgages are designed for either individuals and couples who are at least 62 years of age with moderate to significant equity in their homes. The only type of real estate that qualifies for a reverse mortgage is the primary residence of the applicant for the reverse mortgage. Vacation homes or other secondary residences, mobile or manufactured homes not attached to a permanent foundation, rental properties of more than four units, and homes leased on lands do not qualify for a reverse mortgage. The property of the homeowner must also be owned by the borrower, must be free of debt, or must have a low mortgage balance remaining on the property.

Property owners who have retained a life estate in their real property (life estate holder) but have transferred the future interest in the property to another person in an effort to protect their assets (remainder interest holder) from long-term care or to accomplish an estate planning goal can still take advantage of a reverse mortgage. Remainder interest holders in the property must simply sign a deed that delivers their interest in the real property to the life estate holder at the time of the closing of the reverse mortgage loan. Likewise, homeowners who have placed their property in "trust " can usually take out a reverse mortgage if the trust allows for it. A review of the trust is required to determine if the reverse mortgage is permissible.

Once it is determined that a property is allowed as the basis of the loan, homeowners generally want a determination of how much money can be accessed from the real property. The amount of money homeowners can obtain through a reverse mortgage depends on a few factors: the age of the borrowers, the market value of the home, and current interest rates. These three factors are evaluated to determine the maximum amount of money and disbursement options available to borrowers.

It may be nice to hear that the older the homeowners, the better it is for them. Based on life expectancies, the older the borrowers, the greater the percentage of equity borrowers may access in the property under a reverse mortgage.

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Regardless of age, there are lending limits set for counties or geographical areas within the state and federal lending programs. The lending limit is the maximum amount of money that can be lent within a specific time frame. In determining the amount available to be borrowed, the value of the property is determined and compared to the maximum lending limit of the Housing and Urban Development Corporation; whichever amount is less is available to be borrowed.

Finally, the interest rate, which is tied to the current market rates, effects the amount of money homeowners can borrow. The higher the interest rate, the lower the amount of money homeowners can access, despite advanced age and a high value in the home. The interest rate is not deducted from the monthly payment, but it is used to determine the amount of cash borrowers can access at the time of the loan.

It should be duly noted that income and credit scores do not play a role in this type of loan as the equity in the home already belongs to the borrowers. So homeowners do not need to have income, and they do not need to have a good credit history to partake in this loan program.

If there are existing mortgages on the property, they will be paid off at the closing of the reverse mortgage loan. The proceeds of the reverse mortgage can be used for that purpose.

The amount of money one receives in a reverse mortgage does not affect SSI, Medicare, or other pension benefits because the money received is not considered income to the homeowners. Medicaid and SSI could be affected if the homeowners do not completely spend the monthly cash advances and this cash accumulates in the homeowners' account, making the homeowners ineligible for SSI and Medicaid benefits until the monies are spent down in some organized and detailed manner.

The closing for a reverse mortgage is much the same as a closing for a forward mortgage where the borrowers pay at the closing of the loan the origination fee and closing costs, which include charges for title, title insurance, property insurance, attorney's fees, and recording costs, for example.

Monies received from a reverse mortgage can be paid out in one of four ways:

- Equal monthly payments for a fixed period of time that homeowners select
- Equal monthly payments for life as long as homeowners occupy the home as a primary residence
- A portion of the equity as a line of credit or lump sum and the balance in the form of monthly payments for a fixed period selected by homeowners
- A portion of the equity for a line of credit or lump sum payment with homeowners receiving the remainder in equal monthly payments for life as long as they occupy the home as a primary residence

So how does this all get paid back? For most people this is good news; the monies borrowed do not get paid back until homeowners no longer occupy the house as a primary residence. If homeowners move out or die, monies are paid back by the sale of the home, a refinance of the reverse mortgage, or with other assets such as life insurance dollars. Because reverse mortgages are nonrecourse loans, borrowers can never owe more than the value of the home, regardless of the loan balance. The remaining assets are protected, and heirs will not be burdened.

To determine if a reverse mortgage is suitable, homeowners should speak with an attorney who focuses on estate planning and who is familiar with reverse mortgages. Then homeowners should speak to a loan counselor who specializes in this type of loan to ensure that they understand the loan, its options, and the effect this loan will have on their financial situation. If homeowners determine that a reverse mortgage is not suitable at this time, they can still consider it a future possibility; that is, homeowners do not need to use this loan until they need it. ■.

About the Author

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Julie A. Dialessi-Lafley, Esquire, is a multifaceted attorney with the law firm of Bacon & Wilson, P.C., who focuses her practice in business law, real estate, estate planning and administration, and family law. She is committed to community service, serves on several charitable and organizational boards, and has been honored as a SuperLawyers Rising Star in *Boston Magazine* for the past two years. Julie is a frequent lecturer on legal topics and has written numerous articles that may be found on her website, bacon-wilson.com.

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