What is a reverse mortgage? And should you consider one?

CLOSING THOUGHTS

By JIM YOUNG
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The famous, familiar, spokespersons appearing in the TV commercials promoting reverse mortgages sure seem confident that these loans are just what older Americans need to be as happy as they are.

You have to wonder what leads the mortgage companies to hire the particular people they do to tell us how wonderful these products are. Such highly recognized financial experts as Pat Boone, Robert Wagner, Fred Thompson and (God help us) Henry Winkler—"Fonzie" from the old sitcom "Happy Days"—very confidently tell us how much better our lives can be if we get a reverse mortgage.

I do believe Madison Avenue marketing firms (or wherever advertising is done these days) are very savvy about motivating us to do what they want us to do. So it is pretty depressing to learn that we older homeowners apparently assign serious value to whatever Fonzie has to say about financial affairs.

A reverse mortgage is a loan that allows older homeowners to turn some of the equity in their primary residence into cash. Funds can be received as lump sum distributions, monthly payments, or lines of credit. The option to take lump sums at fixed rates of interest appears to be the most costly type of loan, at least initially. We are told that the borrowers don't have to pay the loans back, and neither do their heirs. And that "they can never take your home away from you."

Most of us are pretty familiar with regular mortgages, or "forward" mortgages as they are referred to in the reverse mortgage world. We do not have the same level of knowledge about reverse mortgages, and they are considerably more complicated financial instruments than regular mortgages.

That they are more complicated does not mean that they are any better or worse than regular mortgages. It may be a good idea, or a bad idea, for any particular senior to get a reverse mortgage. In some cases, a reverse mortgage may present the only practical solution to a problem. But in other cases there may be less expensive, more suitable options available.

A senior considering a reverse mortgage needs to invest time and effort to become informed about the relevant details, costs, and options before committing to a reverse mortgage. It is true that a senior is required to get counseling from an approved counseling service before they are able to get a reverse mortgage, but some experts say this counseling is inadequate.

Seniors should consult with persons who do not have an economic interest in their mortgage decision. A certified financial planner or CPA, a trusted banker, or a financial advisor could be helpful in analyzing the options.

Attorneys who focus on elder law issues can also be an important source of information for a senior. They may be able to suggest ways to address the senior's problem in ways they have not considered.

The proceeds of a reverse mortgage are not taxed as income, and do not constitute income for purposes of Social Security. As of May 2010, Connecticut law says the proceeds of a reverse mortgage loan or other home equity loan shall not be treated as income or assets for the purposes of qualifying for eligibility, as long as the funds are kept in a segregated account and a Medicaid recipient does not transfer the funds for less than fair market value. However, the loan proceeds can affect eligibility for certain types of benefit programs, such as Supplemental Security Income.

The loans we mostly hear about are called HECM loans (Home Equity Conversion Mortgages) that are "federally insured" and offered by the Department of Housing and Urban Development Federal Housing Administration. Note should be taken that the federal insurance is protection to ensure that the lender will be repaid, and for this insurance the borrower must pay mortgage insurance premiums.

To obtain a HECM loan, one must be at least 62 years old; own his or her home free of mortgages, or have mortgages that can be paid off with the reverse mortgage loan proceeds; live in the home; participate in approved loan counseling; and apply for the loan from an FHA approved lender.

There have been little or no underwriting requirements to obtain these loans in the past. However, soon lenders will be required to put some underwriting requirements into effect. These requirements could mean that some borrowers who would have been eligible for these loans under the old rules may not be eligible any longer, or may see the amount they can borrow reduced. Some are urging seniors who have been considering reverse mortgages to get their applications in soon to avoid the more rigorous application process.

The new underwriting requirements are intended to decrease the likelihood that borrowers will get a reverse mortgage loan, but then default for failure to pay taxes or insurance. A borrower may also default by failing to maintain the home or live in it as his or her primary residence. Any of these conditions can cause the lender to foreclose on the property.

One problem which has arisen occurs when a non-borrower resides in the home. If the borrower dies or moves out of the home, perhaps to a nursing home, the non-borrower will be forced to leave the home if they cannot repay the loan.

In addition to traditional uses such as supplementing monthly income, reverse mortgages are marketed as a way for seniors to get money to take a vacation or even buy a new home! It appears some seniors have obtained reverse mortgages so that they could buy annuities or make other financial investments. It is in these complex waters where it is especially important for a senior to seek qualified, independent advice before making any commitments.

I recently learned that a property with a HECM reverse mortgage may be sold at any time for the mortgage balance or the appraised value, whichever is less. And if the mortgage is due and payable at the time the contract for sale is executed, the property may be sold for the mortgage balance or for five percent under the appraised value, whichever is less. This may be of interest to real estate agents, and it may offer a way out of an underwater situation short of a foreclosure.

Some experts suggest that under existing regulations one might get a reverse mortgage but never draw on it. Over the years, the maximum amount available to be borrowed may increase under inflation to an amount greater than the value of your home. At this point, you could draw down that maximum amount regardless of the value of the home and walk away from the home and loan without liability.

But I do remember some old saying about things that sound too good to be true.

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