Points of Interest

10 Things You Should Know About Reverse Mortgages

By ANN I. WEBER, Esq.

If you watch TV these days, it's hard to avoid Fred Thompson, Robert Wagner, and a host of other actors encouraging you to consider a reverse mortgage if you are strapped for cash.

Although these financial tools can be useful, they are expensive, both in terms of bank fees and interest payments, and they can put your financial health, your home ownership, and your children's inheritance at risk.

Because of these problems, the default rate on reverse mortgages has been significant. In response, Congress recently passed the Reverse Mortgage Stabilization Act of 2013, which gives new powers to federal regulators to change the rules of the program "to improve … fiscal safety and soundness." As a result, most homeowners will no longer have access to large lump-sum payments up front, they may be required to set up escrow accounts for insurance and property taxes, and financial assessments will be required.

If you are thinking about applying for a reverse mortgage, here are 10 things you should know before proceeding.

Although these financial tools can be useful, they are expensive, both in terms of bank fees and interest payments, and they can put your financial health, your home ownership, and your children's inheritance at risk.

1. A reverse mortgage is a loan, which accumulates interest over the life of the loan. The homeowner remains responsible for ongoing taxes and home insurance.

A reverse mortgage is similar to a purchase mortgage in that it is a loan from a bank or mortgage company to an individual. However, instead of using the funds advanced by the bank for purchase of a residence, a senior homeowner (62 or older) can use a portion of his or her home equity as collateral and receive cash in return. Reverse mortgages have fees due upon origination and servicing fees annually, and the loan will have to be repaid with interest, which accumulates over the life of the loan. The principal and accumulated interest are due when the homeonwer dies or no longer lives in the home as their principal residence.

There are three types of reverse mortgages:

• Single-purpose loans for home repair, handicap access, etc. issued by state, local, or charitable agencies. These are usually the least expensive;

• Home Equity Conversion Mortgages (HECMs), issued by banks or mortgage companies that are approved Federal Housing Authority lenders. They are federally insured and regulated. These are the most common and have some consumer safeguards due to federal regulation; and

• Proprietary loans backed by the companies that develop them. You are on your own here, but greater amounts are frequently available from these lenders.

The home is still owned by the borrower, who remains responsible for upkeep, real-estate taxes, and insurance on the home. Failure to maintain these payments can result in default and foreclosure, and as a result, escrow accounts may be required under the new law.

2. Reverse mortgage loans can be structured in a variety of ways.

The loan can be structured to make equal monthly payments to the homeowner for as long as the homeowner lives in the home or over a fixed number of years. Alternatively, the loan can create a line of credit that the homeowner can draw down at any time until the line of credit is exhausted. Some reverse-mortgage companies offer a combination of the above options. The loan plus accumulated interest is due when the homeowner dies or leaves the home for 12 months or more.

Note that, as of April 1, 2013, the federal government will no longer allow standard fixed-rate HECM mortgages to offer a lump-sum payment. Smaller lump-sum payments are still available under the HECM Saver program, which pays out a smaller percentage of the equity value of the home.

3. The amount available depends on several factors.

The older the homeowner, the more the homeowner can borrow against the value of their home. HECM loan maximums are determined based on the age of the borrower, the equity in the home, and the current interest rate. Under federal law, loans may not exceed $625,500. However, under the new law, amounts available will be based on a lower percentage of equity, and borrowers with credit issues or little income may find that reverse mortgages are no longer a viable option for them because a financial assessment is now required.

4. Interest rates and fees are significantly higher than for conventional mortgages.

Interest rates for reverse mortgages are higher, sometimes significantly so, than for conventional mortgages, and reverse mortgages have frontloaded fees such as points, origination fees ($2,000 or 2% of the value of the home, regardless of the loan amount, whichever is higher), mandatory counseling, appraisal fee, financial-assessment fee, credit-report fee, pest inspection, flood insurance if applicable, as well as mortgage insurance. There may also be annual servicing fees charged over the life of the mortgage; $10,000 in fees is not unusual for an upfront fee even for a relatively modest loan.

5. The home should be mortgage-free.

While you may be able to borrow enough money to pay off an existing mortgage depending on your age and the amount of the existing mortgage, this will reduce the amount of cash that you can receive under the reverse mortgage. Consequently, it is generally more cost-effective to utilize a reverse mortgage with a home that is mortgage-free.

6. A reverse mortgage is not a good option if you are planning to sell or move in the foreseeable future.

Most reverse mortgages are not used over a short-term period due to the upfront fees. Therefore, a home-equity line or conventional mortgage may be more appropriate to provide liquidity over the short term. Also remember that the state or local government may have lower-cost loans for specific purposes.

7. Reverse mortgage payments are not taxable, nor are the payments considered countable income for purposes of MassHealth (Medicaid) eligibility.

However, lump-sum payments or any part of a monthly payment retained after the month of receipt will be part of countable assets. If you or your spouse are facing the possibility of long-term or nursing care, the monthly payments you receive under a reverse mortgage do not affect MassHealth eligibility. However, if you receive a lump sum or do not spend the entire monthly payment, the amount remaining after the month of receipt will be considered a countable asset.

Also, if you vacate your home for an extended period of time, usually 12 months or more for any reason, including a stay in a nursing home, the reverse mortgage may be called by the bank or mortgage company. If you do not have the funds to pay off the mortgage, the home can then be foreclosed upon and lost to the homeowner should he or she later be able to return home.

8. If the borrower is married, both spouses should be listed on the mortgage.

If only one spouse is listed on the mortgage, should the borrower spouse die, the survivor can be evicted if his or her name is not on the mortgage. In addition, problems have arisen for surviving spouses when only the deceased spouse is listed as a property owner on the deed. This situation can arise when couples opt to put a reverse mortgage in the name of the older spouse in order to maximize the loan's proceeds. The federal government is considering instituting provisions later this year to address this problem.

9. This probably should be the option of last resort.

If you have other sources of funds for your living expenses, it is generally better use those first before moving to the reverse mortgage because of the outlay in fees and accumulating interest. You may want to consult with an attorney to be sure you understand the rules and review all your options.

10. If a reverse mortgage seems right for you, calculate all the fees and shop around.

Closing fees can vary significantly among lenders, so vigilance in comparing vendors can really pay off. ■

Attorney Ann (Ami) I. Weber is a partner with Springfield-based Shatz, Schwartz and Fentin, and concentrates her practice in the areas of estate-tax planning, estate administration, probate, and elder law, and she has a particular interest in creative estate planning for authors, artists, farmers, and landowners. She is a board member and past president of the Estate Planning Council of Hampden County Inc., and is a former (and founding) board member and current member of the Massachusetts Chapter of the National Academy of Elder Law Attorneys. She has recently been named one of the Top Fifty Women Lawyers in New England by Super Lawyer magazine. She is a frequent author and speaker on issues regarding estate planning, (413) 737-1131; aweber@ssfpc.com