Reverse Mortgages

When They Can Help You - When They Can Hurt You

Two Financially Powerful but Confusing Words

You've probably heard the term ***reverse mortgage***. You might know senior citizens can save a lot of money with the right reverse mortgage. But there are pitfalls and trapdoors to watch out for. Let's look at both sides of that equation.

Before we define a reverse mortgage, it's helpful to know this: It can be just as complicated as getting that first mortgage when you were younger and searching for your first home. Just like back then, you need to consult professionals. Fortunately, free help is available to you – starting with this publication.

What is a Reverse Mortgage?

The Federal Trade Commission – which regulates reverse mortgages – defines the term like this: "It allows you to convert part of the equity in your home into cash without having to sell your home or pay additional monthly bills."

You can use a reverse mortgage to pay for home improvements, medical expenses, travel, or anything else you can think of.

How Does a Reverse Mortgage Work?

Let's go back to the FTC: "When you have a regular mortgage, you pay the lender every month to buy your home over time. In a reverse mortgage, you get a loan in which the lender pays YOU."

Of course, that doesn't tell you very much about how reverse mortgages work. So, let's start by talking about regular mortgages. You remember applying for a mortgage, getting a decent interest rate, paying lots of annoying fees, and then making monthly payments – first the interest and then the principal of your home loan.

A reverse mortgage doesn’t exactly reverse all of that, but it’s close. The concept is clear: As the FTC says, “When you have a regular mortgage, you pay the lender every month to buy your home over time. In a reverse mortgage, you get a loan in which the lender pays you.”

The problem is that many people think a reverse mortgage is the complete opposite of a regular mortgage. They think, “Hey, remember all those fees I paid to get my regular mortgage? Well, I don’t have to pay them on a reverse mortgage, right? Because it’s the opposite!”

Not exactly. When we talk about the pros and cons of reverse mortgages, you’ll see that high fees are a definite con. Before we get there, let’s start at the beginning.

Who Qualifies for a Reverse Mortgage?

To get a reverse mortgage, you must:

- be 62 years of age or older
- own your home
- make it your primary residence
- have a lot of equity in it (or own it outright)

If you meet these requirements, it doesn’t mean you *should* get a reverse mortgage. It just means you *can* get one. Here’s where the complications begin because there’s not just one kind of reverse mortgage. There are three. Each is designed for a specific purpose...

1. Single-purpose reverse mortgages

A single-purpose reverse mortgage is pretty much what it sounds like. You can only use them for one purpose, and that purpose isn't up to you. It's up to the lender.

For example, your lender might specify the reverse mortgage can only be used to pay for home repairs or to pay property taxes. But because of that, they're also the cheapest reverse mortgages you can get – ***if*** you can get them. They're not offered everywhere for everyone. Some state and local government agencies offer them. So do some nonprofit organizations. And it's quite common that you need to be a low- or moderate-income homeowner to qualify.

2. Home Equity Conversion Mortgages (HECMs)

Home Equity Conversion Mortgages, or HECMs, are federally-insured reverse mortgages. They can be used for anything, but they come with many rules. First, you can only get one through a lender approved by the Federal Housing Administration (FHA). Second, you must meet with a counselor from an independent, government-approved housing counseling agency. Why? The government wants to make sure you know exactly what you're getting into, so you don't make a costly mistake.

3. Proprietary reverse mortgages

A proprietary reverse mortgage is a fancy way of saying it's a loan from a private company that's not insured by the FHA. They can make more of their own rules, although they still must follow federal laws that protect your rights. In fact, some of these private lenders still require you to get counseling before they'll give you the loan.

Why would you want a proprietary reverse mortgage instead of a HECM? One big reason: The proprietary reverse mortgages have no lending limits. While HECMs cap out at just over $756,000, proprietaries can run into the millions. If you have a small mortgage on an expensive house, you may get more bang for your buck with a proprietary reverse mortgage.

Scratching the surface

That's just an overview of the three kinds of reverse mortgages. There are many more rules. For example: If you want a HECM, it must be a single-family home – unless it's a four-unit rental property and you live in one of the units. You can also live in a condo as long as it's HUD-approved or a manufactured home as long as it's FHA-approved.

This is why it's recommended that you talk to a HUD-certified counselor to receive reverse mortgage counseling, even if the lender doesn't require it. You can learn how all of these specific rules will apply to you and your home.

The Pros and Cons of Reverse Mortgages

That leads us right into the pro and cons of reverse mortgages. Usually, when you hear the term “pros and cons,” the pros come first. However, we’re talking about reverse mortgages, so we’re going to reverse that and start with the cons. As you’ll see, “complicated” is the biggest con of them all.

CON: A reverse mortgage isn't free

Remember when you got your first mortgage? Remember how shocked you were at all the fees you required to pay? Many you didn’t even know existed before you started looking for a home. Well, a reverse mortgage doesn’t reverse those fees. They’re still there. These fees depend on many factors, including the value of your home and what type of reverse mortgage you’re applying for.

But know this: You could spend thousands of dollars before you get thousands of dollars:

- Up to $2,500 or 2% of the first $200,000 of your home's value
- 1% of the amount over $200,000
- HECM origination fees are capped at $6,000

Depending on your lender and the type of reverse mortgage you choose, other fees may apply.

PRO and CON: Pay your fees with your loan

Thankfully, you can use the loan itself to pay for these fees, but that can also pose a problem. According to the federal Consumer Financial Protection Bureau (CFPB):

“You can pay these costs in cash or by using the money from your loan. If you use your loan proceeds to pay for upfront costs, you won’t have to bring any money to the closing, but the total amount of money you’ll have available from the reverse mortgage loan proceeds will be less.”

This feature can create problems if you don’t budget carefully. Too often, people forget to subtract the fees from their loan, and they’re shocked at how little they have left. That’s because...

CON: The total cost of reverse mortgage can be up to $40,000

At the end of the day, between the interest rate, origination fees, mortgage insurance, appraisal fees, title insurance fees, and other closing costs, the total cost of your reverse mortgage could be as high as $40,000.

Then again, consider this: a $300,000 mortgage at 4.5 percent over 30 years costs more than $245,000 in interest and fees. So, the cost of a reverse mortgage is still less than the total cost of a traditional mortgage.

The conclusion here is: Mortgages cost a lot of money, whether they’re reversed or not.

CON: A reverse mortgage can go into default – for relatively minor things

Here’s a big problem with reverse mortgages that you don’t see advertised in reverse mortgage offers: If you fail to pay property taxes or even keep up with your homeowner’s insurance, the lender can foreclose on your home.

It seems like the crime doesn't fit the punishment, but it's true: Don't make these other payments, and you could lose everything. There are ways to prevent this, called "set-asides," and you'll learn all about those when you consult a housing counselor, which we'll discuss in more detail later in this book.

CON: Your inheritors will have less to inherit

By definition, when you seek a reverse mortgage, you’re taking out money now and leaving less for your heirs.

If you want to leave your home to your heirs, they can still inherit the home. However, they’d need to pay a mortgage debt that’s been created by your reverse mortgage. The entire principal plus accrued interest and service fees must be paid in full to the lender before your heirs can take possession of the home.

In some cases, the debt may exceed the actual market value of the home. If they can't pay the debt, the lender has the right to foreclose and sell the property. Goodbye inheritance. The FTC puts it bluntly: “A reverse mortgage can use up the equity in your home, which means fewer assets for you and your heirs.”

With that in mind, if your home is a family home or your children have sentimental reasons why they would want to keep it, then you may want to consider that carefully and talk to them before you move forward.

CON: You can't leave without paying

Another restriction when you get a reverse mortgage: You can’t move. If you do, you have six months to pay back the loan. This is true even if you need to move from your home to an assisted living facility because you can no longer take care of yourself. If you have a medical condition or illness, you must repay the mortgage if you’re out of the home for more than 12 months.

The CFPB is also blunt: "The loan must be repaid when the last borrower, co-borrower or eligible spouse sells the home, moves out of the home, or dies."

This is a serious consideration. However, keep in mind that if you were to leave the home for assisted living, you would most likely sell the home. The proceeds from that sale would typically cover the cost of repaying the loan.

PRO: Receive a lump sum, line of credit, or monthly advances while still living in your home

So, after all that negativity, let’s talk about all the wonderful things a reverse mortgage offers. You can choose a number of options for taking your funds:

1. You can withdraw a lump sum of cash all at once.
2. You can get a line of credit that you can tap and withdraw from as needed.

3. You can arrange for regular monthly advances for a set period.
4. You can even mix and match the above to use a combination that fits your lifestyle in retirement and your needs.

Again, it gets complicated, but it's much more fun to figure out the best ways to get money than pay money. Best of all, you retain title to your home.

PRO: No monthly mortgage payments for as long as you live in the home

This is the big difference between taking out a loan against your home and a reverse mortgage. Unlike, say, a home equity loan, a reverse mortgage actually ends your monthly mortgage payments. You receive money without having to pay money.

But like we warned earlier, you need to make sure you don't forget to pay your property taxes, insurance, and maintenance. Otherwise, this pro becomes a huge con.

PRO: Social Security and Medicare not affected

Generally speaking, a reverse mortgage loan will not affect Social Security or Medicare benefits.

Seniors often worry about receiving new money because it might affect these benefits. There are exceptions, but you don't lose your government assistance when you get a reverse mortgage.

One of those exceptions is this: If you're on Medicaid or

Supplemental Security Income (SSI), any reverse mortgage proceeds you receive must be used immediately. Otherwise, those funds could be considered an asset, which could impact your eligibility.

This is another reason to talk to a housing counselor. They can explain the ins and outs of how the loan may affect the benefits you receive.

PRO: A reverse mortgage loan is a "non-recourse loan"

A reverse mortgage is what's known as a "non-recourse loan." That means neither you nor your heirs are personally liable if the amount of the mortgage exceeds the value of your home when the loan is repaid.

To put that in plainer English: A reverse mortgage protects you against falling home prices. So even if the value of your home drops after you get your loan, it won't affect your loan. Even better, if the value of your home increases, you benefit. If your home increases in value in the future, you can refinance your reverse mortgage to access even more loan proceeds.

PRO: Protection for your heirs

That home-value protection extends to your heirs. As the CFPB says, "If your loan balance is more than the value of your home, your heirs won't have to pay more than 95 percent of the appraised value. The remaining balance of the loan is covered by mortgage insurance."

This means that while you may be reducing their inheritance, you will not be burdening your children if you get a reverse mortgage. Conversely, after the loan is repaid, any remaining equity belongs to your heirs.

Be Cautious about Reverse Mortgage Scams

Whenever there's a good idea that helps people, there are bad people who want to take your money.

Scam alert: Avoid investment pressure

Some unscrupulous companies will urge you to take out a reverse mortgage and then invest your newfound funds with them. As the Federal Trade Commission says, "Some reverse mortgage salespeople might suggest ways to invest the money from your reverse mortgage – even pressuring you to buy other financial products, like an annuity or long-term care insurance. Resist that pressure."

Reputable lenders help you secure a reverse mortgage for whatever *you* need the money for, not what *they* want. As the FTC says, "Resist that pressure."

Scam alert: Take your time

"Some salespeople try to rush you through the process," the FTC says. Why? Because they're hoping you'll sign something and not notice how it benefits them instead of you.

“Stop and check with a counselor or someone you trust before you sign anything,” the FTC says. “A reverse mortgage can be complicated and isn’t something to rush into.”

If anyone tries to rush you, it’s a huge warning. Better to ignore these people and consult a housing counselor who has your best interests in mind.

Where to Start

How do you find the best reverse mortgage for you? Do your research first!

Thankfully, there's no shortage of reputable online advice about reverse mortgages. Start by checking the Federal Trade Commission and CFPB websites at FTC.gov and ConsumerFinance.gov.

Then, contact a HUD-approved housing counselor for more information and to discuss your specific situation and needs.