Reverse Mortgages

A reverse mortgage (RM) is a topic that is becoming much more popular as our society ages. Many advisors have heard of a RM, but few truly understand how they work and the pros and cons for the client.

What is a RM?

A RM is a special kind of loan that is easy to obtain if you are at least 62 years of age (if married, the youngest must be at least 62) and own your own home, condo (planned unit development) or co-op (mainly in New York). A RM converts a portion of the value (equity) of a home into instant cash. The pool of money that is created by a RM can be received by a senior homeowner(s) in a variety of ways.

One other key feature to a RM is that there are **no income, asset, or credit requirements** to obtain the loan**.** That means you could have a client who has poor credit, no income, and no other assets besides a home with equity and the client could obtain a RM to raise money for a variety of needs.

The amount of money that can be created from a RM is dependent upon the program used. Generally speaking, it can be said that three things will determine how much a client can receive from a RM:

1. The age of the youngest borrower.
2. The value of the home (up to a certain limit for some programs).
3. The interest rate (for some programs).

The pool of money that is created from a RM can be received in lump sum, partial lump sum, monthly payment, line of credit, or any combination.

One of the key things that sets a RM apart from any other kind of loan is that it is a **non-recourse loan**. There is **no personal liability** to the borrower, their estate, or to their heirs (the house is the only collateral).

Another key thing that makes a RM loan special and different is that **monthly mortgage payments are not required**. Interest and servicing fees accrue over time. This means as with any negative amortization loan the amount that becomes due will be always increasing because mortgage payments are not required.

Why do clients gravitate to RMs?

For many, a RM is nothing short of a life changing event. Many of our clients never expected to live as long as they have. Many of our seniors did not plan for retirement, and the expenses today are sometimes overwhelming. Therefore, many clients have a need for immediate cash to pay for a variety of expenses (drug and health care costs being the most common). Seniors could sell their homes and raise cash to pay for expenses, but many clients have lived in their homes for over 30 years (which is why there is no or little debt). Their need for immediate money can be satisfied with at RM and they can **still stay in their home.** For many, this is a huge burden off of their shoulders; and, therefore, a RM is seen as a significant stress reliever for the elderly.

Why a RM works

It works because we are dealing with an asset (the home) that has carried the load of appreciating over the years. Now, after growing in value, the home is going to return its love to the owner. Part of the value of the home is paying most of the closing costs of a RM. If the client chooses, the only out-of-pocket expense is $450-$600 (depending upon the program). In return, a pool of money is thus created. It is the home that ultimately becomes responsible for paying the loan back. Remember, it is a non-recourse loan (**with an interest rate that is NOT fixed**).

Risk reversal

A RM is 100 percent risk free. First, no document requires that a borrower continue the process if they subsequently have a change of mind. **Second, every RM has a counseling component to it.** The purpose of the independent counseling is to insure that every senior understands the concept and is not coerced into action. Third, federal law provides that, even after signing the closing documents, every senior has three days to reconsider. If at that time they change their minds, then any funds that they paid out must be returned. This is a 100% risk free loan.

Things you might be told that are not true

RUMOR: You will be told that they have to make monthly mortgage payments.

TRUTH: You will never, ever make monthly mortgage payments.

RUMOR: You will be told that the bank will own the house.

TRUTH: You will continue to own the house. The bank will never own the home while the client is living.

RUMOR: You will be told that their heirs could become responsible for paying this loan back.

TRUTH: It is a non-recourse loan. There is no personal responsibility for the borrower, their estate, or their heirs.

RUMOR: The loan is due and payable when the first borrower dies.

TRUTH: The loan is not due and payable until the last surviving borrower dies, sells the home, or is not using the residence for 365 consecutive days. The loan must be paid in full when the youngest borrower reaches their 150th birthday.

Case Study

Assume you have a parent age 74 with a spouse age 74 and a house with an estimated value of $400,000. The parent's initial interest rate on the loan would be 4.39%, and that interest would accrue during the life of the loan. The parents could receive $108,000 from a HUD loan.

What does this mean to the parent? They could receive $108,000 up front or over time to spend as they see fit.

What do the numbers look like?

At the parent's age 85, there would be $180,855 owed on the loan.
At the parent's age 90, there would be $224,000 owed on the loan.

If the parents died at age 85, the home would be sold, the lender would be paid back $180,000, and the remaining equity would pass to the heirs. The debt becomes a debt of the estate, but the only recourse the lender has is against the home itself not the other assets of the estate.

Many advisors and clients will look at the numbers from a RM and will come to the conclusion that the loan is just too expensive. The question is who is it expense for? Not for the parents who received the money because they'll ultimately be dead. It could be very pricey for the heirs; but the question is, if a RM is not used, how are the parents going to pay to keep their quality of life high and still be able to stay in the home.

RMs are not for every older client who needs instant cash flow. However, RMs will be a good fit for some; and even if a RM is not a good fit for you or your parents or older friend, it is important to learn the topic so you can advise them.

Conclusion

Reverse mortgages can be a life saver for a client who really wants to stay in their house. A RM will eat up the equity in a home and will typically have high closing costs (which are financed with the equity of the home). Always first consider selling the home, downsizing, and taking the cash from the sale to use as you see fit. This will be a lot less expensive for your and your heirs. But again, if you DO NOT want to leave your house (or your parents don't want to leave their house), then a RM is one of the planning tools you'll want to consider.

If you would like an illustration on RM, please contact our office.