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# Reverse Mortgages

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## What are reverse mortgages?

Older individuals who own their homes often find themselves "house rich and cash poor." Developed to address this dilemma, a reverse mortgage provides funds--all at once or over time--to an older homeowner by drawing against the equity built up in the residence. Unlike "forward" mortgages, reverse mortgages are not repaid on a monthly basis. The total loan (including the accumulated interest) is repaid when the last surviving borrower sells the home, permanently vacates the property, or dies.

In most cases, the funds the homeowner receives may be used for any purpose: to supplement a fixed income, to pay for at-home medical care, or to see the world. For an individual facing a retirement income shortage or an increased dependency on medical care, reducing home equity with a reverse mortgage may be preferable to selling the home to raise much-needed cash.

A reverse mortgage can have drawbacks, however. The closing costs normally exceed those for a conventional mortgage, which can make the loan expensive if the homeowner remains in the home for only a few years. Additionally, under certain circumstances, the proceeds from a reverse mortgage could affect the homeowner's eligibility for some public-assistance programs such as Supplemental Security Income (SSI) or Medicaid. The reduction in home equity could also reduce the homeowner's estate.

There are three basic types of reverse mortgages: single-purpose, federally insured, and proprietary reverse mortgages.

## Single-purpose reverse mortgages

As the name suggests, a single-purpose reverse mortgage is designed to provide funds for a specific use. Such uses may include:

- Repairing the home
- Making home modifications that are necessary to accommodate a disability
- Paying property taxes or special assessments

In most cases, these loans are offered through state or local government agencies and/or nonprofit organizations. They are often earmarked for low- or moderate-income homeowners and/or for residences of limited value. Many do not charge any fees or mortgage insurance premiums, and the closing costs (if any) are usually minimal. If the mortgage charges interest (some don't), it's often at a low, fixed rate calculated on a simple, not compound, basis. In some cases, the loans need not be repaid at all if the homeowner remains in the residence beyond a specified term.

**Caution:** *Single-purpose reverse mortgages aren't available in all states, or in all areas within a state. For information about what's available, contact the local agency on aging, community development agency, or housing department.*

## Federally insured reverse mortgages

Available since 1989, the oldest and most popular reverse mortgage is the Home Equity Conversion Mortgage (HECM) which is offered through banks, mortgage companies, and other financial institutions. The federal government insures HECMs through the Federal Housing Administration (FHA), a division of the U.S. Department of Housing and Urban Development (HUD). The HECM program guarantees that, as long as they remain in their homes, homeowners will receive the loan advances initially promised them, even if their homes decline in value or the financial institutions that make the loans go out of business.

Generally, for reverse mortgages issued before October 2013, there were two variations of HECM reverse mortgages. Traditional HECM mortgages were called the HECM Standard option. A newer variation was called the HECM Saver option. The HECM Saver was the same as the HECM Standard except that the HECM Saver lowered the up-front insurance premium, but you could not borrow as much with the HECM Saver. The terms HECM Standard and HECM Saver are no longer used for new HECM reverse mortgages after September 30, 2013 (but the previous rules continue to apply to reverse mortgages assigned a case number before September 30, 2013, if closed on or before December 31, 2013).

## Eligibility requirements

To be eligible for a HECM, all parties to the property's deed must be age 62 or older, and at least one homeowner must use the

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property as a principal residence. The homeowners must receive reverse mortgage counseling from an agency that is approved by HUD. This counseling is designed to make sure that the borrowers have explored their housing options and understand the details and ramifications of the HECM program.

It's possible for a homeowner who has little or no income and a blemished credit report to qualify for a HECM. Because they are not repaid in the same way as other loans, homeowners are not required to have income to qualify for a HECM. Moreover, credit report reviews are limited to making sure that the borrower has not defaulted on any other debt owed to the federal government.

While not generally required, lenders can also consider additional financial capacity and credit assessment criteria, such as whether a borrower will be able to cover maintenance and repairs, homeowner's insurance, and property taxes.

For case numbers assigned on or after January 13, 2014, you must undergo a financial assessment prior to approval and closing on a reverse mortgage. Based on your assessment and as a condition of loan approval, you may be required to use proceeds from the reverse mortgage to fund a lifetime expectancy set-aside for payment of property charges or authorize the mortgagee to pay property charges from your monthly payments or your line of credit. Property charges include property taxes, hazard insurance, and flood insurance.

The property itself must also be a qualified property. It must:

- Be a single-family residence, part of a 2- to 4-unit dwelling, part of a condominium or planned unit development approved by HUD, or a manufactured home (not a mobile home) built after June 1976
- Meet minimum property maintenance standards established by HUD (proceeds from the HECM may be used to make any required repairs)
- Be free of other liens (proceeds from the reverse mortgage may be used to repay them), unless the holders of those liens are willing to subordinate the debts they represent to the HECM

## **Principal limits**

The principal limit is the maximum amount a homeowner may receive from a loan made under the HECM program. This limit is affected by four factors:

1. Age--While all borrowers must be age 62 or over, the amount a homeowner may receive is determined in part by the age of the youngest borrower. Older borrowers will receive higher principal limits.
2. Home value--The greater the value of the home, the greater the maximum principal limit, subject to the other determining factors.
3. FHA loan limits--Set by the FHA, these loan limits provide a "ceiling" on property valuations for HECMs. Fannie Mae's general mortgage limit for a single-family home is currently \$625,500.
4. HECM interest rates--The principal limit is affected by an amount estimated to be sufficient to cover the anticipated accumulating unpaid interest. Higher rates will mean lower principal limits.

Generally, for reverse mortgages issued before October 2013, the amount that you could borrow with the HECM Saver option was less than the amount that you could borrow with the HECM standard option.

Generally, for new reverse mortgages after September 30, 2013, the maximum amount that can be disbursed to you at closing or during the first 12-month disbursement period is equal to the greater of (a) 60% of the principal limit or (b) the sum of your mandatory obligations plus 10% of the principal limit (not to exceed 100% of the principal limit). Mandatory obligations include items such as the initial mortgage insurance premium, the loan origination fee, recording fees and taxes, credit reports, a survey, a title examination, title insurance, a property appraisal fee, fees for warranties or inspections, funds to pay any required repairs, and amounts used to discharge liens, debt, and taxes. Except in the case of a single disbursement lump-sum payment option, additional amounts can be disbursed in later years, up to 100% of the available principal limit.

## **Expenses**

Although obtaining a HECM does not require much money up front from the homeowner, these reverse mortgages can be expensive.

An application fee covers an appraisal of the residence and the minimal credit check mentioned above. This is often the only expense the homeowner must pay in cash. The remaining HECM fees are usually financed as part of the loan.

An origination fee covers the lender's expense to prepare and process the HECM. The fee is based on the home's valuation,

subject to the limitations of the general mortgage limit. The loan origination fee limit is the greater of \$2,500 or two percent of the first \$200,000 of the home's valuation, plus an additional one percent of any portion of the valuation above \$200,000. The total origination fee is also limited to \$6,000.

The insurance that guarantees HECM loan disbursements is financed by a premium charged to all HECM borrowers. Generally, for reverse mortgages issued before October 2013, the borrower was charged an initial fee of two percent of the lesser of the home's value or the HECM limit for HECM Standard and 0.01 percent for HECM Saver, and an annual fee equal to 1.25 percent of the mortgage balance. Generally, for new mortgages issued after September 30, 2013, an initial mortgage insurance premium fee of 0.5% of the maximum claim amount will generally be charged. The initial fee is increased to 2.5% of the maximum claim amount if required or available disbursements to you at closing or during the first 12-month disbursement period are greater than 60% of the principal amount. In either case, there is also an annual fee equal to 1.25% of the mortgage balance.

Other closing costs may vary by state or area, and by the value of the property. All these fees are most often financed, adding to the original outstanding mortgage balance (and reducing the principal amount that remains available to the homeowner).

The lender may also charge a monthly service fee. If this fee is financed as part of the loan, the lender initially reduces the principal limit available to the homeowner by a predetermined amount. As the fee is earned, the monthly amount is added to the homeowner's outstanding loan balance.

And of course there's the interest. A HECM may be taken with a fixed or an adjustable rate. Lenders are required to offer an interest rate that's adjusted annually. This rate can't increase more than 2 percentage points a year or more than 5 percentage points over the life of the loan. Lenders may also offer a (generally lower) monthly adjustable rate. This monthly rate is not limited over the loan's duration.

## Payment options

A HECM offers a variety of payment options. The borrower may elect any one option, or a combination of them. These options include:

- A lump sum payment
- A growing line of credit that may be drawn on at the borrower's discretion
- Monthly cash advances for a predetermined number of years (the term option)
- Monthly cash advances for as long as the homeowner occupies the residence (the tenure option)

**Caution:** A HECM may be structured as a reverse annuity mortgage, where an initial lump-sum payment is used to purchase an annuity that will provide a monthly income for the remainder of the homeowner's life even if he or she no longer lives in the property. In addition to being a relatively expensive choice, however, the income provided by a reverse annuity mortgage option might jeopardize a borrower's eligibility for Supplemental Security Income and/or Medicaid.

The HECM regulations allow a borrower to switch options at any time (subject to a fee), providing the outstanding mortgage balance is less than the original principal limit. Homeowners considering a reverse mortgage may wish to explore their payment options before making a choice by using the loan calculator located at the AARP web site ([www.aarp.org](http://www.aarp.org)).

## Repayment

A reverse mortgage usually becomes due when the last surviving borrower either vacates the property for 12 consecutive months (as might be the case if the borrower enters a nursing home) or dies. At such a time, the borrower (or the borrower's estate) can repay the reverse mortgage with funds from another source in order to keep the property. If this isn't done, the lender will require the sale of the property to secure repayment.

When a HECM is repaid, the lender receives the total amount of principal advanced to the borrowers, including any financed expenses or payments made on the borrowers' behalf, as well as the accumulated interest. If the proceeds from the sale of the property are greater than what's needed to repay the HECM, the remaining funds are remitted to the borrower or the borrower's estate. However, the repayment obligation is limited by the property's value; if the sale of the property doesn't bring in enough to repay the HECM in full, the borrower (or the borrower's estate) is not responsible for the difference.

Any reverse mortgage may become due and payable on demand if the borrower, either by action or inaction, undermines the value of the property that secures the loan. Some conditions of acceleration and/or default include:

- Not maintaining and/or repairing the home

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- Failing to pay property taxes
  - Failing to insure the property
  - Adding a new owner to the property's title
  - Incurring new debt that uses the home as collateral for the loan

## Proprietary reverse mortgages

Proprietary reverse mortgages are private mortgage instruments offered (and owned) by the financial institutions that develop them. Generally speaking, the eligibility requirements, payment options, and repayment obligations for proprietary reverse mortgages are similar to those for HECMs. Because they are not subject to the same regulations, proprietary reverse mortgages can often provide higher principal limits than those possible under the HECM program. However, proprietary mortgages are not federally insured, and they often are more costly to obtain and service than HECMs.

**Caution:** *Proprietary reverse mortgages may only be suitable for homeowners whose homes are valued substantially higher than the FHA loan limit, and who are willing to pay higher fees to obtain the greater benefits that may come with higher principal limits.*

## Make careful comparisons before you decide

Comparing reverse mortgage products can be complicated. Lenders who offer HECMs can analyze the projected costs of these loans. HECMs require reverse mortgage counseling through HUD-approved agencies; the mortgage counselors at these agencies can also help homeowners decide which type of reverse mortgage is best for their circumstances.

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