MortgageLoanPlace Your Resource for Everything on Mortgage Loans

Complete Guide to Reverse Mortgages

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I. What Is a Reverse Mortgage?

The reverse mortgage is a special type of home equity financing. Just as with home equity lines of credit or home equity loans, you are exchanging home equity for cash. However, as the name implies, reverse mortgages work almost exactly opposite to the way traditional (also called "forward") mortgages work.

With a traditional mortgage, you borrow a lump sum to purchase or refinance your home, then pay it back in monthly installments. A reverse mortgage turns that process around: The lender pays you instead. Over time, your mortgage balance increases as the cash payouts and interest accrue, and your home equity decreases.

Throughout the period of the reverse mortgage, you keep the title to your home. You don't repay the loan balance until you no longer live in the home (for example, if you sell the home) or you fail to meet certain requirements to maintain the property.

Reasons for taking out a reverse mortgage

Homeowners who take out reverse mortgages get cash proceeds – generally tax-free – to supplement their income. This can be for any number of purposes: to cover basic living expenses, to pay off medical or long-term care bills, to make home improvements and more. Reverse mortgage proceeds can sometimes help seniors stay in their homes for longer than they otherwise could. Many homeowners aren't aware that reverse mortgages can also be used to purchase a new primary residence – a transaction that is very helpful for seniors who want to relocate or downsize.

Differences between reverse and traditional mortgages

Because of the reverse nature of the cash flows in a reverse mortgage – i.e., the lender pays you and not the other way around – there are some significant differences between a traditional mortgage and a reverse mortgage. Here are some of the key ways in which these two types of mortgages differ:

- **Credit and income not important for qualifying.** To qualify for a traditional forward mortgage or a home equity loan, you must demonstrate that you handle credit responsibly and have enough income to pay your monthly obligations. In contrast, financial qualifications for reverse mortgages are minimal because you are not required to make monthly payments – so it doesn't matter if your credit is lousy or your income is low.
- **High home equity needed.** You may qualify for a traditional mortgage with very little to no home equity, and you can even purchase a home with nothing or nearly nothing down in many cases. For a reverse mortgage, however, because you are exchanging home equity for cash, you need a lot of home equity. You need to either own your home free and clear or have just a small mortgage balance.
- **Age restrictions.** Lenders of traditional mortgages are not permitted to discriminate against applicants based on age. However, most reverse mortgage lenders require borrowers to be at least 62 years old.
- **Primary residence only.** To qualify for a reverse mortgage, the property financed must be your primary residence. You cannot rent out a home with a reverse mortgage on it.

There's one similarity between the two types of mortgages that you should be aware of, though: You can end up in foreclosure with a reverse mortgage – not for skipping monthly payments, which are not required, but by failing to maintain the home, pay property taxes and buy homeowners insurance.

II. Where to Get Reverse Mortgages

How do you go about getting a reverse mortgage? You can look online to find lenders who offer these mortgages; sites like MortgageLoanPlace.com let you fill out a short form in which you provide basic information about you and your property and receive no-obligation quotes from lenders in return.

If you, like the vast majority of reverse mortgage borrowers today, choose to go with one of the FHA reverse mortgages – Home Equity Conversion Mortgages, detailed below in the section explaining types of reverse mortgages – you'll need to make sure that you are working with a HUD-approved mortgage lender.

Other sources of reverse mortgage loans are banks, insurance companies and mortgage companies.

III. Types of Reverse Mortgages

Reverse mortgages come in several flavors, and the types of loans available are always changing. Some products you may have heard of, such as Fannie Mae's HomeKeeper mortgage, no longer exist in the marketplace.

There are three different types of reverse mortgages: FHA reverse mortgages, which are funded by private lenders but guaranteed by the government; private reverse mortgages, which are funded by lenders in accordance with their own guidelines; and single-purpose loans, which are funded by charities or governments.

There are differences for these types of reverse mortgages, and you'll want to familiarize yourself with them before choosing a loan.

FHA reverse mortgages (Home Equity Conversion Mortgages)

The U.S. Department of Housing and Urban Development (HUD) oversees the Federal Housing Administration's (FHA's) reverse mortgage program. FHA reverse mortgages are officially called Home Equity Conversion Mortgages (HECMs). About 90 percent of all reverse mortgages are HECM loans.

Just as with traditional FHA loans, the fees and loan amounts for HECMs are limited by law. Also similar to traditional FHA loans, HUD requires that HECM borrowers pay for mortgage insurance, both an upfront premium and a monthly premium. The insurance protects you, the borrower, in case the lender can't make the agreed payments to you, and it protects the lender if your mortgage balance exceeds the property value.

There are two types of FHA reverse mortgages available. The HECM Standard upfront insurance requirement is quite high, based on 2 percent of your home's value or the maximum loan amount. (This translates to $10,000 in upfront insurance premiums for a $500,000 home.) FHA launched another program in 2010, called HECM Saver, which carries a far smaller 0.01 percent upfront premium ($50 for a $500,000 home), but allows for less money to be available to the borrower. The HECM Saver option is a good choice for those who don't need to borrow as much.

The annual mortgage insurance premium for both HECM Standard and HECM Saver is 1.25 percent of the outstanding mortgage balance.

HUD mandates that homeowners attend counseling sessions with HUD-approved reverse mortgage counselors before they take out an HECM. This is to ensure that the reverse mortgage borrower fully understands this type of complex loan, including its financial implications, obligations, costs and repayment conditions.

FHA reverse mortgage guidelines state that if you have been delinquent on any federal debt or have otherwise been excluded from participating in FHA programs, you won't be able to take out an HECM reverse mortgage.

Private reverse mortgages

Homeowners who don't like the restrictions of the HECM can choose a private program. For example, a homeowner with a $2 million property may want to borrow $800,000, and if the applicable HECM limit is $625,500, this borrower may seek private options. Private lenders with their own programs can make up their own guidelines for a reverse mortgage, such as

loan more money than the FHA would allow, loan to homeowners younger than 62, or enter equity-sharing arrangements.

Shared appreciation or shared equity provisions
Some reverse loans include shared appreciation or shared equity provisions. Such a provision means that, in exchange for a loan today, you may be charged some portion of your home's future appreciation. When attached to a reverse mortgage, the share of equity reduces the interest rate or even functions in lieu of interest.

For example, if you borrow $50,000 on a $200,000 property, you might agree to give the lender a 25 percent share in the appreciation of your property in order to get a very low 2 percent interest rate. Alternatively, you might even choose to exchange 50 percent of your home's future appreciation in order to pay no interest at all on your reverse mortgage balance.
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Single-purpose reverse mortgages

For homeowners with low incomes, single-purpose reverse mortgages can help pay for approved single purposes, such as property taxes or necessary home repairs or improvements. In many cases there are no fees, and interest, if charged at all, is very affordable. Qualification guidelines for this type of reverse mortgage are more stringent, because its purpose is to help those who would otherwise not be able to afford necessary expenses.

If you think you may qualify for this type of reverse mortgage, check with local nonprofit organizations working in elder community services, or state and local government entities such as departments of aging. You may also be able to find more information at the U.S.

Department of Health and Human Service's www.eldercare.gov website.

IV. Ways to Take Reverse Mortgage Proceeds

Part of the reverse mortgage process is choosing from several different ways to receive your funds. Here are the ways in which you can take reverse mortgage proceeds:

Lump-sum distribution. This means you take all of your funds at once. If you want a reverse mortgage with a fixed rate rather than a variable interest rate, this is your only choice. Beware: Taking a lump sum could disqualify you from certain government benefits by inflating your liquid assets if you don't spend the cash within a certain time period.

Line of credit. Some reverse mortgage borrowers want the security of being able to access money if they need to but have no pressing expenses to pay. These homeowners may choose to set up a line of credit to tap whenever they choose. If your home's value increases, your line of available credit may grow as well.

Term payments. You can choose to receive monthly payments for a specified time. For example, you could choose to receive monthly payments at age 62 for eight years, then elect to begin receiving Social Security payments at age 70. Limiting your payments to a number of years gets you higher amounts per month.

Tenure payments. In this form of taking proceeds, you get monthly payments for as long as you live in your home. Because of the uncertainty involved for the lender – which won't be able to predict exactly how long that will be – your monthly payments will be considerably smaller than term payments would be. But some borrowers like the security of receiving these payments as long as they are in their homes.

You can combine some of these ways of taking proceeds – for example, choosing a partial upfront lump sum in addition to a line of credit.

V. Reverse Mortgage Borrowing Limits

Reverse mortgage lenders use a complicated formula that determines your borrowing limit. The formula considers several factors:

- **The age of the youngest borrower.** All things being equal, older borrowers qualify for larger amounts than younger homeowners.
- **Current reverse mortgage rates.** The lower mortgage rates are, the more you qualify to borrow.
- **Your home's value.** The more valuable your home, the more you can borrow.
- **Your current mortgage balance.** If you have a mortgage on your property, the reverse mortgage proceeds will first be used to extinguish it (pay it off), and the remainder can be taken as you choose.
- **Reverse mortgage loan limits set by the government.** As of 2012, HECM loans are capped at $625,500.

VI. Using a Reverse Mortgage to Buy a New Home

Homeowners who want to downsize or relocate can use a reverse mortgage to buy a new home. The reverse mortgage improves their cash flow and, at the same time, can leave them free of monthly mortgage payments. To understand how this works, it helps to first think of a scenario without a reverse mortgage involved.

Let's say you own a $300,000 home free and clear and want to sell and buy another home for your primary residence, also worth $300,000. You could sell your first home, receive $300,000 from the transaction, then turn around and spend the entire amount on the new $300,000 property. But then you have used up all of your free cash, which may not leave you in the most comfortable financial position.

You could try to buy the new home with a traditional forward mortgage, by putting 20 percent down and taking a mortgage for the remaining $240,000. But you might not want to worry about regular mortgage payments now that you've been used to not making payments, or maybe you're worried that your income and credit might not qualify you for a traditional forward mortgage.

What if you could buy a new home with $150,000 down and a $150,000 HECM? After all, qualifying requirements for reverse mortgages are far less stringent than for traditional mortgages. That leaves you with $150,000 in cash proceeds to do with as you wish, and 50 percent home equity in your new home – with no monthly mortgage payments and the HECM reverse mortgage balance not due until you no longer use the home or fail to maintain the property.

This is, of course, a simplified example, but you see how a reverse mortgage can provide a great deal of flexibility in allowing homeowners to tap equity while switching properties. For many seniors, using a reverse mortgage to purchase a new home offers the best of all worlds.

VII. Repaying a Reverse Mortgage

Reverse mortgages can be repaid in several ways, depending on your wishes and circumstances. You or your heirs can:

- Sell the home. The reverse mortgage balance is repaid with the proceeds, and you or your heirs keep any remainder. Once you are not living in the home, you or your estate has three to twelve months to complete the reverse mortgage home sale and repay the loan.
- Refinance. You can refinance with a traditional forward mortgage (or in some cases, a new reverse mortgage) and repay the original reverse mortgage.
- Deed the property to the lender. If your reverse mortgage balance exceeds the home's value, you or your heirs have the option of deeding the property to the lender in full satisfaction of the loan balance. The mortgage insurance for which you've been paying premiums takes care of any shortfall.

VIII. Comparing Reverse Mortgages

To compare reverse mortgage offers from different lenders, you need disclosure forms that indicate the loan terms and allow you to evaluate the effective cost. However, reverse mortgage disclosures are different from those provided by mortgage lenders for traditional forward loans. The reason is that there are many factors that are different with a reverse mortgage: the balance grows over time and it's unknown how long you'll live in the residence, so the final balance and cost of financing can't be predicted with complete accuracy.

Total Annual Loan Costs (TALC)

What reverse mortgage lenders give you instead is an estimate of how much a loan costs in a variety of scenarios given variations in interest rates, in the length of time you keep the home, and in the way you choose to take your loan proceeds. The disclosure that displays these

scenarios is called the Total Annual Loan Costs (TALC), and that's what you'll use to compare reverse mortgage options from different lenders.

The TALC shows, under various scenarios, what the cost of your reverse mortgage would be as a percentage of the amount borrowed. (Note, however, that TALC rates are not the same as an annual percentage rate, or APR.) The projected total cost of your reverse mortgage must reflect all costs and charges to you, including origination charges, reverse mortgage interest and mortgage insurance. Reverse mortgages require almost no out-of-pocket charges, and all advances made for your benefit must be disclosed. Also included is any shared appreciation or equity that the lender is entitled to receive, as well as any limitation on your liability.

By federal law, TALC rates must be calculated based on at least three different loan terms: two years, the youngest borrower's life expectancy (according to standard life expectancy tables) and 1.4 times the youngest borrower's life expectancy. You may also see scenarios for different assumed home appreciation rates.

Minimizing reverse mortgage costs

Though reverse mortgages offer financial flexibility for many borrowers, this financial product carries fees that can in some cases be high for the proceeds. Typical fees that come with reverse mortgages are origination fees, interest on the mortgage balance, servicing fees, mortgage insurance premiums and other third-party charges for completing the loan. Understanding why you want a reverse mortgage can help you choose the right loan type and keep your costs down.

If your main goal is to set up access to funds "just in case," your cheapest reverse mortgage is almost certainly an HECM Saver, with its very low upfront costs and a line of credit. You'd only pay interest on the amounts used, and your available credit can grow over time if your home appreciates.

The amount of time you expect to remain in your home is another factor. If, for a standard HECM, you pay 2 percent for upfront mortgage insurance on a $400,000 home, or $8,000, then choose tenure payments of $1,000 a month and end up living in your home for 15 years, the upfront costs are spread over many years and you'll have taken proceeds of $180,000. But if you move after two years instead of 15, you'll have paid the $8,000 in upfront insurance only to receive $24,000 in proceeds – meaning your fees were effectively a third of your proceeds.

Planning ahead for these possibilities will help you make informed decisions about whether a reverse mortgage is a good financial move on your part, and also how to set one up if it is.

IX. Special Considerations

Avoiding foreclosure

When you sign for a reverse mortgage, you should fully understand the circumstances that can trigger a foreclosure. As mentioned before, there are no periodic payments required from you to the lender in a reverse mortgage, where the mortgage balance grows over time – so missing payments won't result in loan default as it will with a traditional forward mortgage. You do need to maintain homeowners insurance, pay property taxes and keep up the home's condition during the term of the reverse mortgage.

One controversial situation that has resulted in foreclosure action is less obvious, and it involves taking out a reverse mortgage in the name of one spouse only. This can happen if, for instance, one spouse is under the qualifying age of 62 at the time of the reverse mortgage, marriage occurs after one spouse has already taken out a reverse mortgage, or a couple decides to leave a younger spouse's name off the reverse mortgage in order to qualify for a larger disbursement – because an increase in age means higher loan limits.

There have been some cases in which a borrower died, and a surviving spouse who was not named on the reverse mortgage faced eviction. The issue of whether a surviving spouse who is not on the reverse mortgage but living on the property can be forced to move has not yet been fully settled by the courts. If you have any reason to consider placing only one spouse's name on a reverse mortgage, it's best to consult with multiple reverse mortgage experts, such as HUD counselors and/or an attorney with experience in elder issues.

Becoming an informed consumer

Because prospective reverse mortgage borrowers are seniors who are in control of a significant asset – their homes – reverse mortgages have sometimes been used by scammers to take advantage of homeowners. As the

New York Times financial reporter Ron Lieber put it in a 2011 article, "Charlatans looking to extract people's home equity and put that money into high-fee annuities and other questionable financial products sometimes used reverse mortgages to do it."

Of course, there are plenty of reputable lenders offering legitimate reverse mortgages, and the presence of fees certainly does not indicate that an offer is suspect. Indeed, most reverse mortgage borrowers seem satisfied by their decision. A 2006 survey by the AARP on reverse mortgage shoppers and borrowers found that, among those who had taken out a reverse mortgage, 94 percent said their reverse mortgage had given them peace of mind, and 83 percent said that their reverse mortgage "mostly" or "completely" met their financial needs.

Yet a reverse mortgage is still a complex financial transaction that some use as an underhanded way to get your money into another product or pay for a bundled service. The U.S. Federal Trade Commission (FTC) advises that homeowners get all the facts before cashing in on home equity. It counsels prospective borrowers to beware of offers for goods and services, such as home improvement services, that advertise reverse mortgages as an easy way to pay. The FTC also warns against reverse mortgage offers that come with high pressure to purchase other financial products, such as annuities.

One of the best ways to avoid falling victim to a reverse mortgage scam is to shop with different lenders and compare quotes. That way, you'll be able to sniff out terms that don't seem competitive. Read about how reverse mortgages work through guides such as this one or provided by the U.S. government and other trusted sources, and make sure you fully understand any loan's terms and obligations.

By becoming an informed consumer, you will greatly reduce the risk that you'll make the wrong decision about reverse mortgages.

Have a question about reverse mortgage loans?

Thank you for downloading and reading this Complete Guide to Reverse Mortgages. If you have questions or would like more reverse mortgage information, visit MortgageLoanPlace.com for more information. On our site, you can also submit a question to our experts.