Featured Article ::
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Should You Consider A Reverse Mortgage?

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Trying to predict whether our parents will be able to stay in their homes long-term is perhaps the most anxiety-producing variable of all, as health changes tend to wreak havoc on an otherwise well thought out decision.

Are rising energy and health care costs strangling your parent’s cash flow? Think you’ll just convert their home’s equity via a simple reverse mortgage? Think again, as reverse mortgages are anything but simple even without the havoc wreaked by recent legislation.

Let’s explore the various considerations so that you’ll know if this is a viable alternative. In its simplest terms, a “Reverse Mortgage” (hereafter interchangeably referred to as RM) is merely leveraging what your folks have (home equity) for what they lack (current income). Reverse Mortgages can generally only be taken on principal residences in which all of the home's owners are at least 62 years old. (In the case of Reverse Mortgages for joint homeowners - related or not, the amounts available are calculated using the youngest borrower’s age.)

Most of us are familiar with “forward mortgages” on real estate, where we make monthly payments to a financial institution and the debt on our home decreases and equity increases over time. A Reverse Mortgage (RM) requires no monthly payments, but instead pays (lends) us money. As a result, our home’s (or more likely, that of our parent’s) equity decreases and the debt increases over time. The RM lender will be the first lien holder, so any existing mortgages (and possibly Medicaid liens) would be paid off with the loan proceeds.

No matter how long our parents live, and how much money they receive from a RM, these are “non recourse” debts, which means they (nor their estate or heirs) will never be liable for loan amounts in excess of the value of the home. As RM applicant your parent(s) retain title to the home.

Reverse Mortgages are repaid when the last surviving borrower dies, or does not live in the home for 12 consecutive months. While the outstanding RM debt can be repaid by selling the home, heirs can choose to repay the reverse mortgage with other funds, and retain ownership of the home.

Created in 1987 by the Department of Housing and Urban Development, Reverse Mortgages provide enhanced financial independence to qualified borrowers. While a plethora of financial institutions offer reverse mortgages, there are three basic types:

1. Federally Insured Home Equity Conversion Mortgage (HECM) – Lending Limits range from $200,160 to $362,790 depending on location. These mortgages apply to principal residences which are defined as a single family, or 2- 4 unit building, a federally approved condominium or a Planned Unit Development, otherwise known as a PUD. (Generally speaking co-ops and certain mobile homes are excluded from RM eligibility.)

2. Financial Freedom - Fannie Mae's Home Keeper Mortgage - Maximum Lending limit is $417,000.
☐
3. Cash Account Plan or Private/Proprietary, non-FHA - No Max home value or loan limit & 2nd homes MAY be eligible (Co-ops are only eligible in New York's 5 Boroughs)

Each type loan offers three options for how funds may be received:

1) Lump sum – entire amount is paid on the date of the loan
2) Credit line - allows borrower to take ad hoc cash advances until available equity is exhausted.
3) Monthly payments – may be a set amount for a predetermined number of years, or for as long as your parents live in their home,

or;

Any combination of these three options.

There is also a Single Use/Federally Insured/Proprietary Loan which is generally only available for low income applicants, and earmarked for a single use (e.g., installing a ramp, paying taxes or a large medical bill, etc.)

Applicants will need to make two determinations - which type of Reverse Mortgage best fits their particular need(s); and which financial institution/lender offers that at the lowest net cost for the selected loan. For the purposes of this article we'll focus on the first type, FHA/HECMs, which account for over 90% of all RMs.

Since the HECMs are backed by the Federal Housing & Urban Development (HUD) the Federal Government has instituted measures that require each applicant to meet with a counselor from a HUD-approved counseling agency to determine if a reverse mortgage is a viable option. If the answer is yes, counselors will also determine if the applicant qualifies for any non-profit or government sponsored or single use or proprietary products available in the applicant's geographic area.

This counseling also protects lenders against the risk of seniors making decisions when they may not be sufficiently cognitively competent. This should allay fears of mom or dad "happening upon" their local bank some day and walking out sporting a new, and perhaps ill-advised, RM. Because these loans are very labor intensive, loan officers also want assurance that the applicant is serious about taking a RM before completing an application that could rival War and Peace in thickness!

(There are several online resources that might be helpful for you. They include two Fannie Mae publications – Considering a Reverse Mortgage and Money From Home The National Council on Aging website and Carteret's Reverse Mortgage site. There are also online calculators available to let you work through "what if" scenarios from organizations like AARP and Carteret.)

As caregivers, we have the daunting job of determining how much cash will be needed and for how long. The answers will depend on what objectives we've established:

•☐To supplement monthly Social Security and pension income for a short time if our parent is ill?

•☐To renovate our folks' home for increased safety/accessibility or to improve their standard of living?

•☐To pay a large one-time expense?

•☐To provide a long-term (or lifetime) inflation-adjusted supplemental income stream for our healthy parents?

The amount of funds available will be based on the current and appreciating equity in your parent's home. Let's say their available principal limit is $130,000 and your folks choose to use $90,000 of that to generate a $600 monthly payment (called the Remaining Cash/Creditline amount). The remaining $40,000 in equity is left untouched to appreciate. The cash that is not withdrawn in the early years, remains as what is called the Creditline Request which will grow at one-half percent higher than the interest rate charged on the loan. These funds are then available later, perhaps when your parents need it most.

Well informed applicants will not only look at the amount of credit line available at closing, but also the amount of accelerated and compounded credit remaining for use in later years. This can provide an emergency fund assuming all of the annual "growth" was not withdrawn in the early years. Internet calculators can illustrate the future credit availability in 5, 10, and 15 years presuming no monies have been withdrawn initially.

Who should consider Reverse Mortgages?

•☐Those needing extra monthly income during retirement

•☐Early retirees who may not have saved adequately to maintain their lifestyle throughout retirement, given the rising costs of energy, prescriptions and health care costs in general.

•☐Persons who wish to receive a lump sum to pay off their mortgage to enhance their monthly cash flow.

•☐Those wishing to purchase a Long Term Care Policy by making a single payment and avoiding the risk of the policy lapsing due to increasing annual premiums.

•☐Those wishing to remain independent and avoid borrowing from their family or assuming increased debt to maintain their lifestyle.

•☐Persons facing foreclosure on their existing home's mortgage or Home Equity Line of Credit.

•☐Persons needing cash to modify their existing home to "Age in Place" more safely and gracefully.

Who should NOT consider Reverse Mortgages?

•☐Persons anticipating relocating either geographically, or into a retirement community or assisted living within a short period of time.

•☐Homeowners wanting small amounts of cash. Since HECM loan costs are based on the home value and not on the amount borrowed, closing costs would be disproportionately higher on low loan amounts.

•☐Homeowners who have accrued little home equity, since costs will be high compared to the amount available to borrow.

•☐Young retirees who have adequate investment portfolios and/or pension and Social Security incomes.

Who should NOT consider a total lump sum payment Reverse Mortgage?

•☐Persons who cannot invest their money wisely enough to ensure it will outlast them (which includes many of us). I trust that is warning enough!

Alternatives to Reverse Mortgages include:

•☐Selling your parent's home outright and buying a less expensive home/apartment or entertaining assisted living.

•☐Applying for a conventional Home Equity Line of Credit, and if your parent can't afford to pay the interest monthly, allow it to accrue and compound to be repaid upon the eventual home sale.

RMS may help your folks to:

•☐Remain in their known neighborhood and maintain long-term friendships and support groups.

•☐Get monthly income if their credit is otherwise poor, as a credit check isn't necessary for a RM unlike with a traditional Home Equity Line or Home Equity Loan.

Generally speaking, RMs will pay out the most to older applicants with

higher valued homes during a low interest rate environment. Monthly adjusted HECMs provide the largest loan at the lowest interest rate, but the annually adjusted HECM's 5% interest rate cap actually reduces future interest rate risk, as the interest rate cap on the monthly adjusted HECMs is 10%.

Typically the RM costs are amortized over the life of the mortgage, resulting in reduction of the net equity at the end of the RM, or at the death of the last surviving home owner. Many of the costs are similar to those of forward mortgages (e.g. Appraisal and Pest Inspections) but RMs also carry a minimum monthly Service Fee of approximately $30.00.

The Federal Truth in Lending Law requires that lending institutions project all the costs and benefits of each type of Reverse Mortgage and provide a disclosure figure that most closely approximates the average annual loan cost, otherwise referred to as the Total Annual Loan Cost (TALC). However, lenders are not legally required to divulge the TALC costs until after the applicant signs (WHAT were they thinking?) so ask for these before the application is finalized. The TALC cost estimator is the single best equalizer of all types of RM costs, but it is not without some limitations. Because it equates all the costs as if they were being levied like an Annual Percentage Rate, when in reality, the costs vary, as does the timing of same, depending on the type of RM obtained - each type of RM gets it's own TALC, and depends on the appreciation of the home.

If your parent were to decide to take a total lump sum (or part of their combination payout in a lump sum) to buy an annuity that would pay them for the rest of their lives, steer clear of annuities with a commission, unless they don't mind giving away a chunk of their hard earned nest egg. Fee-only advisors will recommend no-load annuities, either variable or fixed, that have very low annual expenses, to maximize monthly distributions. Remember, many annuity salespeople are selling RMs very aggressively but their reasoning may not align with your parent's best interests.

Similarly, commissioned salespeople will market single-premium long term care policies, to be paid from the RM lump sum payment. Again, while I strongly believe most people should carry long term care coverage, encourage your folks to do their homework shopping for competitively priced policies, issued by reputable Long Term Care insurance carriers, obtaining side-by-side quotes and then selecting a plan that best fits their circumstances. If your folks can't afford the premiums, consider buying it for them. It potentially could be one of your single BEST investments!

Remember, as harrowing as the prospect of requiring long term care is, not everyone will need it. So, if your parents are healthy enough,

consider buying life insurance on them now, or take over their premiums for an existing policy, on which you are the beneficiary. The game plan is for you to finance their care initially via your own sources (home equity loans, etc.), and then be repaid with the life insurance proceeds upon their passing. In this way, you are assured that at least some of the dollars spent on premiums will be returned to you unlike the risk of paying long term care premiums. Please note that some of our parents might not be healthy enough to qualify for Long Term Care insurance, yet still may qualify for life insurance.

THE TAX MAN COMETH

Finally, a warning that if your folks are currently eligible for Medicaid or Supplement Security Income (SSI), beware of the annuity option/receipt of monthly withdrawals, as either could jeopardize their future eligibility. Lifetime Cash Advances reduce SSI benefits dollar-for-dollar, but Social Security and Medicare are not affected by RM payments. Otherwise, loans are not considered income, so your folks' income taxes won't be exacerbated by taking a RM payment whether taken as a lump sum or ad hoc cash withdrawals.

Please note: Under the Deficit Reduction Act of 2005, Medicaid can require individuals (not married couples if one spouse remains at home) to tap their home equity in excess of $500,000 to pay for long term care and be denied Medicaid eligibility. So, single homeowners who have otherwise delighted in their wildly increasing home valuations of late, will be well advised to ink their signature on a long term care policy application sooner rather than later, provided good health, of course.

Income from an annuitized annuity - one that is not simply accruing, but one that is currently paying out a lifetime income stream - is paid out according to the annual exclusion ratio and is partially taxable. Additionally, the Deficit Reduction Act of 2005 requires one's state to be named remainder beneficiary of annuity contracts, lessening the attractiveness of annuities going forward.

In conclusion, this may be one of the largest dollar decisions we will make, so it will behoove us to leave no stone unturned before our parent signs on the dotted line. Note that in a rising interest rate environment (which may be short lived, depending on when Bernanke blinks again), the loan officer will typically lock in the rate at which the lending ratios will be calculated, so if your parents are seriously contemplating a RM, schedule their counseling appointment sooner rather than later. If the lending rate drops during the underwriting process, which can extend to 30 days, they will generally be given the lower rate.

Trying to predict whether our parents will be able to stay in their homes long-term is perhaps the most anxiety-producing variable of all, as health changes tend to wreak havoc on an otherwise well thought out decision. This is life, of course. Your parent's cash flow, tax considerations, and future health and income needs all affect their RM decision. Encourage them to ask as many "what if" questions as both they and you can imagine, to quantify the various results and trade-offs. However, especially with the new Medicaid Law, beware that your parent could lose their home to Medicaid and have care provided in a facility where they least want to reside, in the absence of a Reverse Mortgage.

And once they've secured their RM (or not) urge and support their continuous efforts to take care of their health, so all of you can smile all the way to the bank for many years to come!

Good luck and God Speed!

Editor's Note: This article is published solely for informational purposes. Nothing contained in it should be construed as financial advice. As always, we recommend that you consult your own professional to address your personal matters.