CASTLE WORKS REALTY INC.

REAL ESTATE OPTIONS FOR AGING

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REVERSE MORTGAGE AS A LOAN OPTION

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Is a Reverse Mortgage right for you and your family?

The Reverse Mortgage can be a valuable source of cash flow particularly during retirement years. Tapping into home equity can help supplement retirement income, consolidate debt, make improvements to the house, maintain a standard of living or manage a serious health crisis. In order to determine if a Reverse Mortgage is right for you and your family, it is essential to clearly understand the benefits of the Reverse Mortgage, as well as the obligations associated with this type of loan.

What is a Reverse Mortgage?

The Reverse mortgage is a government insured loan. It is available to homeowners 62 or older who have substantial equity in their homes. These loans are structured to provide payment in several ways: (1) a lump sum payment, (2) fix monthly payments or (3) a line of credit. Unlike a traditional mortgage there is no repayment until the owner/borrower sells the home, moves away permanently, or dies. It is important to understand that this type of loan is federally regulated, and the amount of the loan cannot exceed the fair market value of the property.

This is because the borrower or the estate will not be responsible to repay the amount over the fair market value at the time of the sale. Any excess amount above the fair market value will be covered by Federal insurance.

Example: Mary Jones, borrower, has a $300,000 Reverse Mortgage. At the time of the origination of the loan the property was worth $450,000. She received the loan payments for 20 years on a monthly basis. At the time of her death the total outstanding principal and interest was $550,000. The fair market value of the house was $525,000. The $25,000 shortfall will not be the responsibility of the estate and federal insurance will cover the gap.

Another scenario might involve a decrease in market value.

Example: Mary Jones borrowed $300,000. At the time of the origination of the loan the fair market value is $450,000. When she sells 10 years later the fair market value has decreased from $450,000 to $400,000. The total value of the loan at the time of sale is $500,000. Federal insurance will cover the $100,000 gap. In order to cover the anticipated shortfall as most lenders will not issue a mortgage greater than 50% of the fair market value at the time of application.

Example: Mary Jones has a home valued at $500,000. The most she could expect in a reverse mortgage would be $250,000.

How does the Reverse Mortgage work?

The Reverse Mortgage is structured so the homeowner receives payments from the equity of the home as opposed to a traditional mortgage where the homeowner re-pays the lender in regular installments. The homeowner can elect to receive these payments in several ways. They include a lump sum installment or a credit line.

When the homeowner receives payment the interest on the payments continue to accumulate but the homeowner retains title to the property on the Reverse Mortgage. However, over time as the life of the loan increases, the home equity will decrease. It is important to note that these payments are not taxable as income, and they do not count as income for Medicaid eligibility.

Upon the death of the borrower, or if the borrower sells the home or no longer lives in the house, the home must be sold and the loan must be satisfied. The outstanding loan will consist of principle plus interest.

Example: Mary Jones received the sum of $100,000 from her reverse mortgage monthly over five years. At the end of the five years the outstanding loan will consist of $100,000 plus interest and the origination fees incurred when the loan was created. Consumers should carefully review the interest calculation and all of the origination costs because they can be substantial.

How is the Reverse Mortgage paid?

The most common reverse mortgage is the home equity conversion mortgage (HECM). This mortgage is offered for homes valued below $765,600. If the home value is greater, it may be possible to obtain a Jumbo Reverse Mortgage or Proprietary Reverse Mortgage.

When you take out a reverse mortgage you can choose to receive the proceeds in one of six ways:

(1) Lump Sum. Here the consumer receives all proceeds at the time of closing. The interest is fixed for these loans. It is the only type of reverse mortgage that provides for a fixed interest rate. All other loans established as adjustable interest rate loans.

(2) Equal monthly payments also known as annuity. Under this payment structure, the consumer receives payment for as long as at least one borrower lives in the home as the principal residence. Here the lender will continually make regular payments to the borrower.

(3) Term Payments. The lender gives the borrower equal monthly payments for a set period of the borrowers choosing, such as 10 years. Regular payments are made to the borrower during the established term.

(4) Equal monthly payments plus the line of credit. Here the lender provides steady monthly payments for as long as at least one borrower occupies the home as a principal residence. If the borrower needs more money at any point, they can access the line of credit.

(5) Term payments plus a line of credit. Here the lender gives the borrower equal monthly payments for a set period of the borrowers choosing, such as 10 years. In addition, if the borrower needs more money during or after the term they can access the line of credit.

What are the advantages and disadvantages of the Reverse Mortgage?

In order to be eligible a borrower must be 62 or older. This type of mortgage can provide much-needed cash to meet basic living expenses and the Reverse Mortgage allows people to continue to live in their homes and pay off or consolidate debt. They can also satisfy a conventional mortgage.

It is important to remember that the borrower must keep up with property taxes maintenance and repairs as well as homeowners' insurance. However, the Reverse Mortgage can be expensive and will likely consume most of the home equity. This is likely to result in the loss of an inheritance for any heirs. Consequently, people without income or poor credit may still qualify. It is important to conduct a thorough financial analysis. If the Reverse Mortgage will only fix a short-term problem, as opposed to a long-term problem, the cost may outweigh the benefit of taking out the Reverse Mortgage.

Please note, once the borrower no longer lives in the home, all other occupants must leave including friends, relatives, roommates, etc. This may also extend to a non-borrowing spouse if the borrower outlives them.

What are the rules and procedures and how can a person apply for a Reverse Mortgage?

If the person is 62 or older and the owner of a house, condominium, townhouse or manufactured home built on or after June 15, 1976, they may be eligible for a Reverse Mortgage. Cooperative apartments do not qualify for Reverse Mortgages. In New York only 1 to 4 family residences and condos qualify.

There are no income or credit score requirements. However, in order to borrow, the owner must own the home free and clear of any mortgage or have at least 50% equity in the house. They must pay an origination fee upfront as well as insurance premiums. There will be ongoing mortgage insurance premiums as well as loan servicing fees and interest on the loan. These fees are limited and regulated by the federal government through HUD, which is the Department of Housing and Urban Development. Insurance provides that if the house is underwater or exceeds the value of the home, the lender cannot seek indemnification from the borrower or the borrowers' heirs.

The heirs can also decide to repay the full value of the loan and keep the house or allow the lender to sell the house. However, the law requires that the heirs be given a reasonable amount of time to make that decision after the death of a loved one.

All prospective buyers must participate in a HUD approved counseling session that lasts about 90 minutes and cost $125. This program is designed to help the borrower to understand the consequences and obligations of Reverse Mortgage loans and help them to decide if such a loan is appropriate.

Once the loan is in place the borrower must stay current on property taxes and homeowners' insurance. The homeowner must also keep the house in good repair. If a person stops living in a home for more than one year, even if they are in a long-term care facility, the home must be sold.

Costs include the following:

The upfront premium is 2% for every $100,000 borrowed. Therefore, if the loan is $300,000, the upfront fee will be $6,000. Additionally, the mortgage insurance premium is .5% annually, which is $750 per $100,000 borrowed. If the loan is a lump sum the interest-rate will be fixed. All the lines are adjustable, and they are tied to the London Interest Offered Rate also known as LIBOR.

How much can be borrowed?

The total proceeds are based on the age of the youngest borrower. If the borrower is a spouse, then the younger spouse's age will be used to calculate the loan even if that spouse is not the borrower. The younger the borrower, the higher the proceeds.

The higher the appreciated value, the higher the amount that can be borrowed. If the borrower receives a strong mortgage financial assessment the proceeds will also increase because the lender would not require the use of the proceeds to pay property taxes and homeowners insurance from the loan proceeds. This will insure that more funds are available to be borrowed.

For people with more stressed financial circumstances, the lender will require that the taxes and homeowners' insurance be paid out of the loan. This will result in less funds available for use by the consumer.

It is also important to understand that borrowing is limited to a schedule that is established by HUD. The schedule is adjusted annually. For example, in 2018 the average initial principal limit was $211,468 and the maximum was $412,038. Additionally, the full value cannot be borrowed in the first year; only 60% may be borrowed in the first year. However, if the funds are being used to pay off a mortgage, additional funds can be used.

If the borrower chooses a lump sum, they will only get the one time payment. However, a credit line can grow overtime provided there is unused funds. When spouses are involved, both must consent to the loan even if one is not the borrower. It is always important to note that if the borrower ceases to live in the house the other spouse (non-borrower) maybe displaced. Borrowers must always maintain the house and keep it in good repair and they must pay all real estate taxes and homeowners' insurance. If they don't the bank made foreclose. Foreclosures for failing to pay property taxes or insurance accounted for 20% of all foreclosures of Reverse Mortgages for the years 2009 to 2017.

SUMMARY

Reverse Mortgages can help some senior homeowners financially by providing additional income, debt consolidation and the opportunity to maintain a current standard of living. However, it is important to understand how the Reverse Mortgage loan works and what the pros and cons are regarding this special type of loan. Consumers should consult with a knowledgeable financial and/or legal professional before entering into this type of mortgage arrangement.

For further information regarding Reverse Mortgages contact Dr. Frank G Dangelo, JD, PhD. He can be reached at Castleworks Realty INC (516) 873-0536 and FGDangelo@castleworksrealty.com

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