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Reverse Mortgage Loans

A reverse mortgage loan allows a homeowner to convert equity[3] in a home to cash. It is unlike a standard home equity loan where the money borrowed must be repaid during the term of the loan in regular monthly payments. A reverse mortgage loan does not become due and payable until the borrower sells the home, moves out of the home or dies. The cash is available to the borrower as a lump sum, as regular monthly payments for life, as a line of credit, or as some combination of the three. There are many situations in which a reverse mortgage can benefit a homeowner; for reasons explained in the box on page 2, it may be especially useful to homeowners who receive Supplemental Security Income (SSI) or who receive in-home services under the COPES program.

The total amount available to borrow with a reverse mortgage depends on the borrower's age, the home's value, the current interest rate, and the type of loan program. The total amount to be repaid at the end of the loan will not exceed the home's value, even if the outstanding debt is greater. If the debt is less than the value of the home, then the equity that remains at the time of repayment may be available to the borrower or to the borrower’s heirs. To be eligible for the reverse mortgage loans discussed in this bulletin, the youngest borrower must be at least 62 years old and the home must be the primary residence. A person may be eligible for a reverse mortgage even if there is an existing mortgage, depending on the amount owed on the mortgage and on the value of the home.

People most likely to benefit from reverse mortgage loans

For most homeowners, their home is a valuable asset – for many it is their most valuable asset. At the same time, many homeowners lack the funds to meet important monthly expenses or to do things they would

[1] This updates a bulletin prepared by Jim Kerney in 2000.
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[3] “Equity” here refers to the value of the home minus what is owed on it to a seller or lender or other creditor with a lien against the home.

like to do. If they have significant equity in their home, and are not opposed to using that equity during their lifetime, a reverse mortgage loan is something to consider. It may provide the monthly cash they need, or the funds required for a major expense. It may make it possible to remain in a home that would otherwise have to be sold.

Reverse mortgage loans are not good choices for everyone. For example, homeowners who are anxious to preserve the equity in their home to pass it on to their children will be unlikely to want to use up their home equity by borrowing against it and spending the money. Reverse mortgages also may not be a good choice for someone who may be thinking about selling a home soon because of the up-front costs of the loan.

For homeowners receiving assistance from such programs as SSI or COPES, reverse mortgages offer special opportunities. Money received as a loan – including a monthly payment under a reverse mortgage – does not count as income for purposes of SSI or COPES or Medicaid.[4] This means it will not affect the monthly SSI payment, and will not affect the COPES participation amount. If the loaned money is not used in the month in which it is received, then what remains of it in the following month will be counted as part of the individual's resources for purposes of COPES or SSI eligibility.

For example: Consider a single homeowner on SSI who has $1,800 in the bank on September 1st. She receives a reverse mortgage loan payment of $500 on September 10th. The $500 does not count as income in September, because it is a loan to her. Since resources are determined as of the first day of each month, it does not count as part of her resources for September either. If the $500 is spent during September, it will never be counted as either income or resource. If it is kept until October, then it will count as part of the individual's resources as of October 1st. In that case, the additional $500, added to the $1,800 already on hand will bring her resources over the $2,000 resource limit.

Types of loan products

There are three generally available reverse mortgage loan products. The U.S. Department of Housing and Urban Development (HUD) offers the Home Equity Conversion Mortgage (HECM). The HomeKeeper is offered by the Federal National Mortgage Administration

[4] See 20 C.F.R. §416.1103(f) ("Money you borrow . . . is not income.")

(FNMA or “Fannie Mae”). Finally, some private lenders offer reverse mortgage loans of their own. The programs differ in the maximum amounts they will loan and in the terms of their loans.

The HUD Home Equity Conversion Mortgage (HECM) is perhaps the best known reverse mortgage program. In Washington State, the maximum amount of home equity that will be considered for purposes of an HECM is currently (in March 2005) $288,700, and the maximum may be lower, depending on the county where the home is located. The maximum changes from time to time. To find out the maximum mortgage amount for your area, check with a lender or visit HUD’s website at www.hud.gov. The HECM loan is the only one that has a growing line of credit. The amount that is approved for lending, but not disbursed, increases at the same rate as the rate charged on the loan. This means that the actual cash available to be drawn out could, over time, significantly exceed the original loan amount.

> For example: If the original credit line is $60,000 at 7½%, and the homeowner draws out $10,000, the remaining $50,000 credit line increases by 7½ % annually, or more than $8,000 after only 2 years.

The FNMA (Fannie Mae) HomeKeeper program is currently capped at $359,650. Note that while the initial loan amount may be higher than HECM, the credit line does not increase.

> For example: If the original credit line is $60,000, and the homeowner borrows $10,000, the remaining available balance of $50,000 will not increase.

Some private lenders offer their own reverse mortgage loans. They will usually offer both the HECM and HomeKeeper loans in addition to their own loan product. The equity limits to borrow against can exceed $1,000,000. Some of these private lenders couple reverse mortgage loans with an offer of lifetime income through the purchase of an annuity. The income payments from an annuity can continue after the borrower moves out of the home.

A word about annuities

Some homeowners elect to borrow a lump sum (instead of monthly amounts) and to use it to purchase an annuity. One advantage of an annuity over monthly reverse mortgage loan payments is that it will continue to provide income even after the homeowner moves out of the home. (Reverse mortgages become due when the borrower dies or is no longer living in the home.)

A borrower considering purchase of an annuity should be careful to purchase an annuity that will earn enough money to offset the cost of the reverse mortgage. Most annuities pay 5% or 6%. The borrower should compare such a return on the annuity investment to the cost of the reverse mortgage. Initial costs and fees for a reverse mortgage can push the total annual loan cost to 10% or more in the early years of the reverse mortgage, although this percentage will get smaller over the life of the loan. (Loan costs are discussed in the next section.) It rarely makes sense to borrow money at 8% to 10% and invest it at 5% to 6%.

A borrower should also be careful to purchase an annuity from a reputable company. The annuity may not be guaranteed or insured and the company may go out of business, taking your money with it.

Additionally, the annuity may be considered a resource for COPES and SSI purposes. And annuity payments (unlike monthly reverse mortgage loan payments) will be counted as income for COPES and SSI purposes, and may result in a loss of those benefits.

Cost of the loan

The costs of loans vary between the programs. Origination fees are assessed at the beginning of the loan and are added to the amount borrowed. Likewise, any interest charged on the loan is added to the loan balance. A loan counselor can help you compare the costs of the different programs.

Loan counseling

The HUD HECM loan requires the borrower to consult with a housing counselor before the loan is made. The other two programs recommend counseling but do not require it. HUD can provide a list of certified counseling agencies, and borrowers are encouraged to contact them regardless of which loan program they are considering. The HUD Housing Counseling Clearinghouse can be called toll-free at 1-888-466-3487. A list of HUD approved housing counseling agencies can be found on the HUD web site at the following address:
www.hud.gov/offices/hsg/sfh/hcc/states/washington.txt.
Other sources of information about reverse mortgages include the AARP Home Equity Information Center Publication Order Line: (202) 434-6042.

and the National Center for Home Equity Conversion web site: www.reverse.org. In King County, counseling is available from the Fremont Public Association at (206) 694-6766 Monday, Wednesday and Thursday from 10:30a.m. – 4:30p.m., or from the Urban League at (206) 461-3697.

Paying back the loan

The reverse mortgage loan becomes due when the borrower sells the home, is no longer living in the home, or dies. The lender can only recover the lesser of either the amount of the debt or the value of the home. If the total amount owed on the reverse mortgage is more than the home is worth, the lender will not recover the difference. If the total amount owed is less than the home is worth, the equity left over after repayment could be available to the borrower or to the borrower's estate. A housing counselor or lender should be able to project the approximate net equity at any future time that the loan is repaid.