

Reverse Mortgages Require a Close Look

For many seniors, home equity is roughly 30-40 percent of their net worth. If you and your spouse are both at least 62 years of age and have significant equity in your home, a reverse mortgage can turn that equity into tax-free cash without forcing you to move or make a monthly payment.

If it's right for you, it's a worthwhile financial tool. If not, you could make some serious mistakes with your financial future.

A reverse mortgage gets its name because of the way it works. Instead of the borrower making payments to the lender, the lender releases equity to the borrower in a number of forms:

- A lump sum cash payment;
- A monthly cash payment;
- A line of credit (which tends to be the most popular option);
- Some combination of the above.

When the owner dies or moves away, the house can be sold, the loan paid off and any leftover equity value can go to the living owner or the designated heirs. Heirs don't have to sell the house. They can either pay off the reverse mortgage with their own funds or refinance the outstanding loan balance within six months with the option of two 90-day extensions that must be applied for.

There are three basic types of reverse mortgages:

- *Single-purpose reverse mortgages*, which are offered by some state and local government agencies and nonprofit organizations;
- *Home Equity Conversion Mortgages (HECMs)* are federally insured reversed mortgages backed by the U. S. Department of Housing and Urban Development (HUD);
- *Proprietary reverse mortgages* are private loans that cover home values usually over \$600,000.

The size of a reverse mortgage is determined by the borrower's age, the interest rate and the home's value. The older a borrower, the more they can borrow, but the amounts are capped by the maximum FHA loan limit for each city and county. The amounts vary from \$200,160 in rural areas to \$362,790 in many major metropolitan areas. In Alaska, Guam, Hawaii and the U.S. Virgin Islands, the FHA mortgage limits can be adjusted up to 150 percent of the ceiling based on the area.

Reverse mortgages have traditionally been chosen by older Americans who can't cover everyday living expenses or who otherwise need cash for such things as long-term care premiums, home health care services, home improvements or to pay off their current mortgage or credit cards greater than their income can support. More recently, though, they've become popular with individuals who see them as a better alternative to home equity lines. Some use the proceeds to supplement monthly income, buy a car, fund travel and second homes. Evaluate with the help of a financial adviser if reverse mortgage funds can be used to restructure estate taxes.

You will have to consult with a financial planner before you're granted this loan – that's one of the requirements. You might consider a CERTIFIED FINANCIAL PLANNER™ professional to do this because reverse mortgages can be complex and risky. This step can be completed within the first few days of the process. The basic loan closing now takes place in about 30-40 days from the date of application. Generally the only out-of-pocket cost is an appraisal fee ranging from \$300- \$500.

Here are other things to consider:

Cost: Reverse mortgages are generally more expensive than traditional mortgages in terms of origination fees, closing costs and other charges. The basic FHA-backed HECM loan finances these fees into the initial loan balance, and they can run between \$12,000 and \$18,000. The loans are based on anticipated home value appreciation of four percent a year, so if the housing market is healthy, those costs are generally recovered in a short period of time. But if the housing market sours, it will definitely take longer to recoup those fees.

You'll need to make sure you're not endangering your federal retirement benefits: The basic FHA HECM is designed as tax-free income to the senior receiving their Social Security income. However, if your total liquid assets exceed allowable limits under federal guidelines, you might endanger your benefits. This is another critical reason to work with a financial planner on this decision.

Rates: Reverse mortgages have rates that are typically higher than those charged on conventional mortgages. Interest is charged on the outstanding balance and added to the amount you owe each month. Again, check the total annual loan cost.

Your mortgage can be called: The homeowner or estate always retains title to the home, but if you fail to pay your property taxes, adequately maintain your home, pay your insurance premiums, or change your primary residence, the lender can declare the mortgage due or reduce the amount of monthly cash advances to pay those overdue amounts.

Talk to your kids. If your house is your major asset, getting involved in a reverse mortgage may not leave much to the next generation – if it appreciates, there may be some difference that the kids can have. That's why that in addition to discussing a reverse mortgage with a financial adviser, seniors need to talk with their family.