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Reverse mortgages offer financing options for seniors, retirees

Loan has several safeguards, no recourses

By Samantha Henry, The Daily Transcript
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Some seniors who were looking forward to blowing out 62 candles on their birthday cake and qualifying for a reverse mortgage were surprised to find out they didn't qualify for one because the value of their home dropped.

When home prices were falling in San Diego County, John Olbrich, president of **American Security Mortgage**, said "fewer were eligible because they didn't have the equity required."

"That's just as important as being 62 years of age is that you need to have equity," Olbrich said. "The FHA (Federal Housing Administration) needs to know that they've got an asset that's covering their loan."

The equity in a home affects the loan more than the senior's age. The older a senior ages, the more they qualify for.

"Seniors were finding that they were able to qualify for less, even ones who checked into it a couple years earlier to see how much they could qualify for. They checked in a couple years later and were wondering why, even though they're older, they were qualifying for less," Olbrich said.

Olbrich has experienced a steady flow of seniors opting for reverse mortgages with a slight increase each year, and has yet to see a big influx from the baby boomer generation. He sees homeowners leading up to 62 years old and planning on getting the reverse mortgage, as well as those who have been retired for 10 to 15 years and are tired of making a mortgage payment. There isn't a particular age group that comes into Olbrich's office for a reverse mortgage, and he said he hasn't seen any changes recently.

Those interested in reverse mortgages are typically "asset rich but income poor," said Michael Lea, director of the Corky McMillin Center for Real Estate at San Diego State University. He said the homeowners "should have a need" for the reverse mortgage to maintain a standard of living.

"They're sitting on a lot of housing equity, going into retirement and got a cut back in earnings," Lea said.

The reverse mortgage allows seniors to consume the equity in their home. The most common type of reverse mortgage is the Home Equity Conversion Mortgage (HECM) offered by FHA, which Olbrich said accounts for about 90 percent of the market. There are no income, medical or credit requirements for the loan.

The amount a homeowner receives in the reverse mortgage is calculated using the borrower's age and the amount of equity in the home. They can receive the loan in one lump sum, in monthly payments, through a credit line or a combination of monthly payments and a credit line.

The credit line works like a standard line of credit, in which the borrower draws out money they need, for whatever they want. The unused credit portion will grow by the amount of the interest rate of the loan.

A combination of the credit line and monthly payments would allow the borrower to receive a smaller amount in monthly payments and a smaller credit line.

According to Olbrich, the standard cost for a reverse mortgage, including insurance, is around $13,000 to $14,000. The cost gets rolled into the initial loan amount to be paid off when the borrower dies. There is no income tax on the loan because it's not considered income, and there are no restrictions on how the loan is used.

About two years ago, the Home Equity Conversion Mortgage Saver program was implemented, which allows borrowers to not incur a lot of upfront costs by not paying for the insurance premium, which is about $5,000 to $6,000, Olbrich said. This program may be advantageous for those who don't plan to keep the loan for very long. The borrower receives less money than with the traditional HECM program.

If a married couple owns the house at the time of a reverse mortgage, the loan will be paid until the last of the two dies, Olbrich said.

“One of the common questions is, ‘When I pass, are my heirs going to have less equity than I have because my loan has grown?’” Olbrich said. “The home value should outpace the amount the loan has grown.”

The loan is a smaller amount than the actual value of the house. If standard home appreciation were at 4 percent, the standard appreciation over 20 years should be more than the amount the loan grows with the interest rate and accumulating payments, according to Olbrich.

But Lea said home prices have typically followed inflation, which has been at about 2.5 to 3 percent, and heirs would “absolutely” receive less equity if a reverse mortgage is used.

Once the homeowner dies, the heirs typically have up to 12 months to either sell or refinance the reverse mortgage into a standard loan. The home still transfers the same way as if there were no reverse mortgage taken out.

There is no recourse with the reverse mortgage, Olbrich said.

“Let’s say, for example, they go for the lump sum option and they get paid out $300,000. And let’s say the market crashes and the value of the home is now $200,000. It doesn’t matter. They get to keep that extra money,” Olbrich said. “They’re protected. When their heirs get the house, they can see that the house is underwater and they can opt to give the house to the bank — they’re not required to pay the deficit. So there’s no recourse to any additional monies the senior gets if the house loses value, or if the senior lives way belong the anticipated years.”

There are safeguards built into the loan, said Lea, and “if you exhaust the equity you don’t get kicked out of the house.”

The only way for the house to be foreclosed on is if the homeowner doesn’t pay property taxes and insurance payments, said Olbrich, which he said does happen.

“The lender does require that you make your property taxes and your home insurance payments and, sadly, for whatever reason — maybe just forgetfulness or I’m not sure — hopefully it’s not too often, although I do hear that it does happen, seniors can lose their house,” Olbrich said.

Even with a standard loan, a homeowner can lose their house to the state if property taxes aren’t paid.

The reverse mortgage is a “financial option or tool that can be very beneficial. It can stave off last resort options,” Lea said.

Olbrich said he’s seen how a reverse mortgage can turn someone’s life around.

“I became a real believer,” Olbrich said. “I’ve seen how it has changed lives. I’ve had clients call who were just barely getting by and they call me up and say, ‘My financial worries are gone.’”