Reverse Mortgages:

Pleasures and Pitfalls

Top to bottom: Bill Braun of Evergreen Mortgage in Southold;
Steve Conroy of Financial Freedom Senior Funding Corporation;
Monica Whelan of Par East Mortgage Company, reverse mortgage specialists in Riverhead.

Photos by Barbaraellen Koch

By Joseph Finora Jr.

In a world of rising costs, many seniors live on fixed incomes. Medical insurance, prescription drugs and long-term care come with a hefty price. Many seniors find themselves in the awkward position of being house-rich but cash-poor. Their real estate may hold the key to unlocking a powerful financial asset.

A local reverse mortgage provider recently advertised that a Suffolk County homeowner around age 70 could receive a monthly check of $1,326 or a lump sum of $203,020. What's not to like?

Will a reverse mortgage help seniors solve their financial problems or create others? Some seniors find the idea of tapping into their home equity frightening and even unthinkable at this stage of their lives. Many celebrated the day when they made that last mortgage payment and they're not comfortable with the prospect of taking on new debt. On the flip side, more reverse mortgages are issued each year.

"I'm hearing more requests for information about them," said Shaun Golden, a certified retirement planning counselor at AG Edwards & Sons in Riverhead. "Under certain circumstances they can be a viable way for seniors to meet expenses."

That view was seconded by Stephen Conroy, a reverse mortgage specialist at Financial Freedom Senior Funding Corporation in Garden City. "A growing number of seniors have used reverse mortgages to help generate the cash needed to assist with a wide variety of financial needs," he said. "Last year [reverse mortgages] helped over 39,000 seniors enjoy a more comfortable lifestyle. This year, the industry is on pace to close a record 55,000 loans."

James Preston, a certified public accountant based in Cutchogue, acknowledged that curiosity about reverse mortgages is growing. He recommended that anyone contemplating this kind of loan first conduct a financial needs analysis. For those who plan to stay in their homes about seven more years, a reverse mortgage may make sense, he said. "If you plan to stay in your present home for a relatively short time period — three years or less — I would not recommend a reverse mortgage. In such cases a home equity line of credit may be a more sensible choice."

"A reverse mortgage is a tax-free event," said Ed Gallagher of Choice Home Mortgage Services in Patchogue. "The borrower is not receiving [taxable] income, yet is tapping into equity built up in their home. The loan is only secured by the home. No other assets are involved."

Some advisers are more skeptical.

"Reverse mortgages are not properly regulated," said James Duffy of The Granite Financial in Cutchogue. "People are usually emotionally invested in their homes and there are often front- and back-end fees plus high closing costs that people are reluctant to see but are priced into the loan. Borrowing against one's home is almost never advisable. Often there are other, more

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reasonable alternatives."

While reverse mortgages offer special appeal to older adults because the loan advances are not taxable and generally do not affect Social Security or Medicare benefits, there's a great deal of misunderstanding surrounding these loans. Seniors exploring such a course need to be sure all other avenues have been considered and they fully understand the risks and rewards of this type of loan.

The Basic Blueprint

Reverse mortgages, which were introduced in the late 1980s, allow homeowners 62 and older to convert the equity in their primary residence into cash that can be used for almost any purpose: to supplement income, pay medical bills or other expenses, or make home improvements. Vacation homes or other secondary residences, mobile or manufactured homes not attached to a permanent foundation, rental properties of more than four units and homes on leased lands do not qualify for reverse mortgages. A homeowner who has put his home in a living trust can usually take out a reverse mortgage subject to review of the trust documents.

Loan maximums depend on the borrower's age, amount of home equity, the property's value and prevailing interest rates, but the amount of the loan cannot exceed the value of the home. Loan proceeds can be taken as a line of credit, lump-sum payment, fixed monthly payment, or some combination of these.

"The older you are the more you can usually borrow," said Bill Braun of Evergreen Mortgage in Southold. "A senior can stay in their home and not move to a less-desirable or smaller one and make no monthly payments of any kind on proceeds distributed during their lifetime."

These loans allow homeowners to retain title to their homes until they permanently move, sell, die or reach the end of a preselected loan term. In most cases a move is considered permanent when the homeowner has not lived in the home for 12 consecutive months. A person can relocate to a nursing home for up to 12 months before the reverse mortgage would be due. A homeowner can never be forced to move from his property.

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Helpful Web Sites

The following organizations offer free basic information on reverse mortgages:

- AARP: www.aarp.org/revmort
- The National Center for Home Equity Conversion: www.reverse.org
- U.S. Department of Housing and Urban Development: www.hud.gov/offices/hsg/sfh/hecm/rmtopten.cfm
- Federal Trade Commission Consumer Response Center: www.ftc.gov
- National Reverse Mortgage Lenders Association: www.reversemortgage.org

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The lender holds some of the home's equity, which serves as collateral. A reverse mortgage can be taken out if there is already a conventional mortgage on the home, but existing mortgages must be paid off at closing, when the loan funds become available; reverse mortgage proceeds may be used to pay those fees.

Any equity remaining after the loan is repaid — assuming it is not paid off before the death of the borrower — goes to the borrower's heirs. In most cases the heirs sell the home after both parents are deceased and pay off the outstanding balance to the lender. Any increase in home value since the date of the loan is credited to the homeowner or heirs, not the lender.

Reverse mortgages are "non-recourse loans," which means that the borrower can never owe more than the home's value. Also consider that reverse mortgages tend to be more costly than traditional loans because they are "rising-debt loans," meaning the interest is added to the principal balance each month. The total amount of interest owed significantly increases over time as the interest compounds. In addition, the typically high fees are usually folded into the loan, adding to the principal amount.

An exception to the rising-debt loan is a credit line Home Equity Conversion Mortgage, backed by the U.S. Department of Housing and Urban Development. In a reversal of rising debt, HECM credit

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lines actually pay the borrower interest on the untapped loan principal until all the proceeds are withdrawn. HECMs also offer traditional lump-sum loans and monthly cash advances. Before applying for this federally insured program, prospective borrowers are required to meet with a trained HECM counselor. HECMs are available through banks and mortgage companies.

There are no asset or income limitations on borrowers receiving HUD-backed reverse mortgages, nor are there any limits on the value of homes qualifying for them. However, the amount that may be borrowed is capped by the maximum Federal Housing Authority mortgage limit for the area, which is pegged to local housing costs. Owners of higher-priced homes can't borrow any more than owners of homes valued at the FHA limit. For Suffolk County the value is currently capped at around $362,000, but this may change.

Reverse mortgages are also offered by private lenders. These loans, called proprietary reverse mortgages, come with higher fees but without the lending limits of government-backed loans.

Any homeowner considering a reverse mortgage needs to do a lot of homework, seek expert advice and carefully consider all the options before making a decision that will affect their family's financial future for better or worse.

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