

## **Reverse Mortgages**

If you are age 62 or older and are "house-rich, cash-poor," a reverse mortgage (RM) may be an option to help increase your income. However, because your home is such a valuable asset, you may want to consult with your family, attorney, or financial advisor before applying for an RM. Knowing your rights and responsibilities as a borrower may help to minimize your financial risks and avoid any threat of foreclosure or loss of your home.

This brochure explains how RMs work. It describes similarities and differences among the three RM plans available today: FHA-insured; lender-insured; and uninsured. It also discusses the benefits and drawbacks of each plan. Each plan differs slightly, so be careful to choose the plan that best meets your financial needs. Organizations and government agencies that offer additional information about RMs are listed at the end of this brochure.

### **How Reverse Mortgages Work**

A reverse mortgage is a type of home equity loan that allows you to convert some of the equity in your home into cash while you retain home ownership. RMs work much like traditional mortgages, only in reverse. Rather than making a payment to your lender each month, the lender pays you. Unlike conventional home equity loans, most RMs do not require any repayment of principal, interest, or servicing fees for as long as you live in your home. Funds obtained from an RM may be used for any purpose, including meeting housing expenses such as taxes, insurance, fuel, and maintenance costs.

### **Requirements and Responsibilities of the Borrower**

To qualify for an RM, you must own your home. The RM funds may be paid to you in a lump sum, in monthly advances, through a line-of-credit, or in a combination of the three, depending on the type of RM and the lender. The amount you are eligible to borrow generally is based on your age, the equity in your home, and the interest rate the lender is charging. If you owe more than your home is worth, the chances of obtaining a reverse mortgage are dependent on how much you may have to pay to bring the equity in line with current market values. It is recommended that you work with a reputable realtor and mortgage professional to review your options.

Because you retain title to your home with an RM, you also remain responsible for taxes, repairs, and maintenance. Depending on the plan you select, your RM becomes due with interest either when you permanently move, sell your home, die, or reach the end of the pre-selected loan term. The lender does not take title to your home when you die, but your heirs must pay off the loan. The debt is usually repaid by refinancing the loan into a forward mortgage (if the heirs are eligible) or by using the proceeds from the sale of your home.

## **Common Features of Reverse Mortgages**

Listed below are some points to consider about RMs.

- \* RMs are rising-debt loans. This means that the interest is added to the principal loan balance each month, because it is not paid on a current basis. Therefore, the total amount of interest you owe increases significantly with time as the interest compounds.
- \* All three plans (FHA-insured, lender-insured, and uninsured) charge origination fees and closing costs. Insured plans also charge insurance premiums, and some impose mortgage servicing charges. Your lender may permit you to finance these costs so you will not have to pay for them in cash. But remember these costs will be added to your loan amount.
- \* RMs use up some or all of the equity in your home, leaving fewer assets for you and your heirs in the future.
- \* You generally can request a loan advance at closing that is substantially larger than the rest of your payments.
- \* Your legal obligation to pay back the loan is limited by the value of your home at the time the loan is repaid. This could include increases in the value (appreciation) of your home after your loan begins.
- \* RM loan advances are nontaxable. Further, they do not affect your Social Security or Medicare benefits. If you receive Supplemental Security Income, RM advances do not affect your benefits as long as you spend them within the month you receive them. This is true in most states for Medicaid benefits also. When in doubt, check with a benefits specialist at your local area agency on aging or legal services office.
- \* Some plans provide for fixed rate interest. Others involve adjustable rates that change over the loan term based upon market conditions.
- \* Interest on RMs is not deductible for income tax purposes until you pay off all or part of your total RM debt.

## **How Reverse Mortgages Differ**

This section describes how the three types of RMs -- FHA-insured, lender-insured, and uninsured -- vary according to their costs and terms. Although the FHA and lender-insured plans appear similar, important differences exist. This section also discusses advantages and drawbacks of each loan type.

\* **FHA-insured.** This plan offers several RM payment options. You may receive monthly loan advances for a fixed term or for as long as you live in the home, a line of credit, or monthly loan advances plus a line of credit. This RM is not due as long as you live in

your home. With the line of credit option, you may draw amounts as you need them over time. Closing costs, a mortgage insurance premium and sometimes a monthly servicing fee is required. Interest is charged at an adjustable rate on your loan balance; any interest rate changes do not affect the monthly payment, but rather how quickly the loan balance grows over time.

The FHA-insured RM permits changes in payment options at little cost. This plan also protects you by guaranteeing that loan advances will continue to be made to you if a lender defaults. However, FHA-insured RMs may provide smaller loan advances than lender-insured plans. Also, FHA loan costs may be greater than uninsured plans.

\* **Lender-insured.** These RMs offer monthly loan advances or monthly loan advances plus a line of credit for as long as you live in your home. Interest may be assessed at a fixed rate or an adjustable rate, and additional loan costs can include a mortgage insurance premium (which may be fixed or variable) and other loan fees.

Loan advances from a lender-insured plan may be larger than those provided by FHA-insured plans. Lender-insured RMs also may allow you to mortgage less than the full value of your home, thus preserving home equity for later use by you or your heirs. However, these loans may involve greater loan costs than FHA-insured, or uninsured loans. Higher costs mean that your loan balance grows faster, leaving you with less equity over time.

Some lender-insured plans include an annuity that continues making monthly payments to you even if you sell your home and move. The security of these payments depends on the financial strength of the company providing them, so be sure to check the financial ratings of that company. Annuity payments may be taxable and affect your eligibility for Supplemental Security Income and Medicaid. These "reverse annuity mortgages" may also include additional charges based on increases in the value of your home during the term of your loan.

\* **Uninsured.** This RM is dramatically different from FHA and lender-insured RMs. An uninsured plan provides monthly loan advances for a fixed term only -- a definite number of years that you select when you first take out the loan. Your loan balance becomes due and payable when the loan advances stop. Interest is usually set at a fixed interest rate and no mortgage insurance premium is required.

If you consider an uninsured RM, carefully think about the amount of money you need monthly; how many years you may need the money; how you will repay the loan when it comes due; and how much remaining equity you will need after paying off the loan.

If you have short-term but substantial cash needs, the uninsured RM can provide a greater monthly advance than the other plans. However, because you must pay back the loan by a specific date, it is important for you to have a source of repayment. If you are unable to repay the loan, you may have to sell your home and move.

## **Reverse Mortgage Safeguards**

One of the best protections you have with RMs is the Federal Truth in Lending Act, which requires lenders to inform you about the plan's terms and costs. Be sure you understand them before signing. Among other information, lenders must disclose the Annual Percentage Rate (APR) and payment terms. On plans with adjustable rates, lenders must provide specific information about the variable rate feature. On plans with credit lines, lenders also must inform you of any charges to open and use the account, such as an appraisal, a credit report, or attorney's fees.

## **For More Information**

If you are interested in obtaining a current list of lenders participating in the FHA-insured program, sponsored by the Department of Housing and Urban Development (HUD), or additional information on reverse mortgages and other home equity conversion plans, write to:

AARP Home Equity Information Center American Association of Retired Persons 601 E Street, N.W. Washington, D.C. 20049

For additional information, you also may contact the:

National Center for Home Equity Conversion 7373 - 147 St. West, Suite 115 Apple Valley, MN 55124

This organization requests that you send a self-addressed stamped envelope.

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