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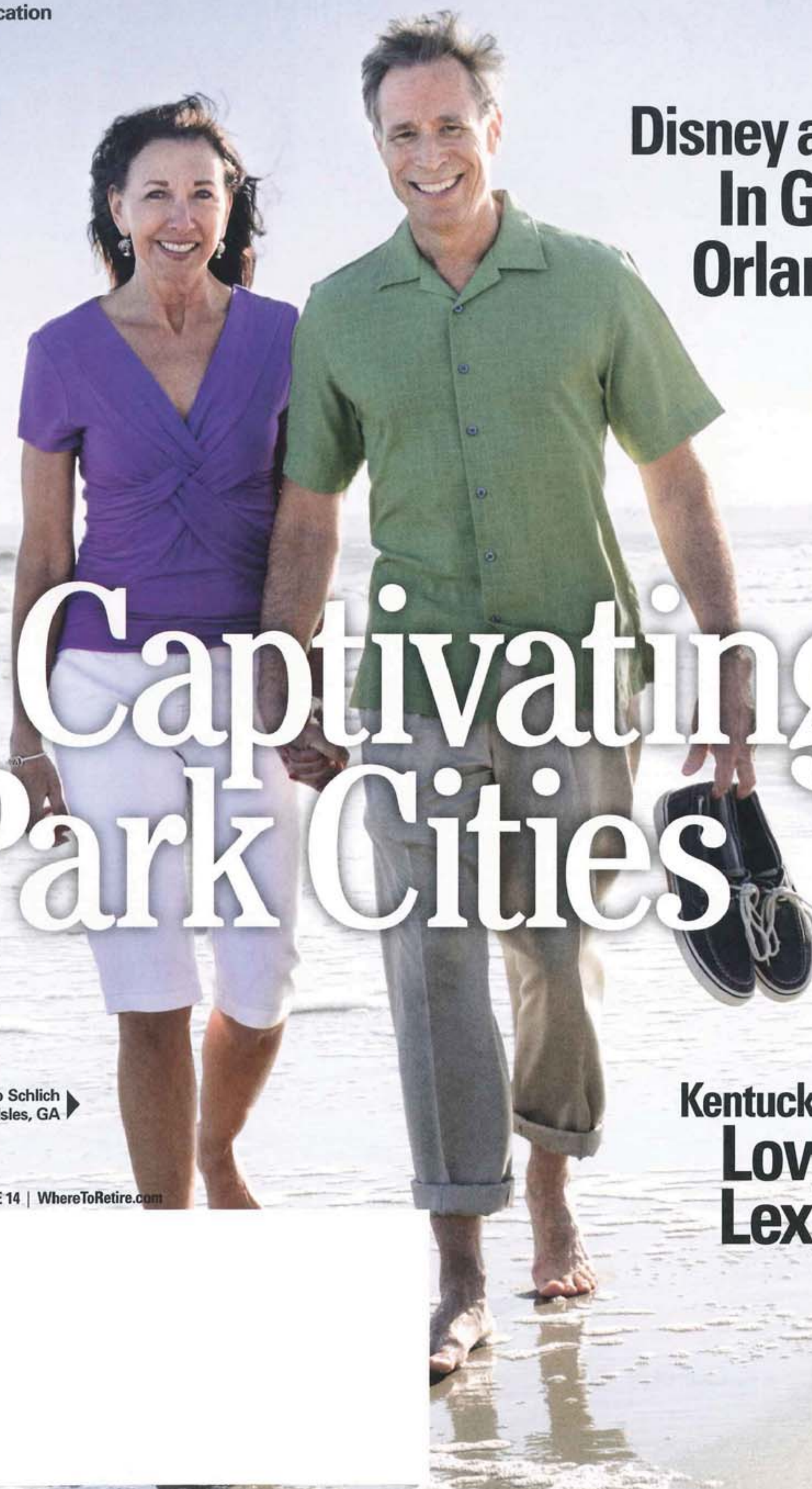

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BY MARC D. ALLAN

8 Tips for Evaluating A Reverse Mortgage

WHEN BOB AND NANCY SMITH started looking for a retirement home in South Carolina, their initial plan was to pay cash and keep expenses manageable. Then, at an open house, someone told them about home equity conversion mortgages, generally known as reverse mortgages.

Bob, 70, who ran an insurance agency for 35 years before retiring to Murrells Inlet, SC, in 2015, says he knew that reverse mortgages allowed a homeowner to take equity out of the home, but he had never heard about using one to buy a house.

"It enabled us to buy way more house for way less money," Bob says. "I've talked to friends about this and everybody agrees it's a home run."

Bob did some research and contacted Neil Sweren, vice president and area manager for Southern Trust Mortgage in Owings Mills, MD. What he found made him exceedingly happy.

He discovered the following about a reverse mortgage, if he and Nancy are co-borrowers:

> **Rather than paying cash** for their new house — around $300,000 — the Smiths only had to pay about $135,000. The rest of the money came from their reverse mortgage. That allowed them to keep $165,000 in their retirement account and let it grow.

> **If the Smiths chose to sell** the house, they still would get whatever equity is in the home minus what is owed on the reverse mortgage, which includes interest, mortgage insurance, finance charges and fees.

> **If Bob dies first,** Nancy, also 70, a former teacher who worked in his office later in her career, can live in the house as long as she wants. If she dies first, Bob can live there as long as he wants, too. When the last borrower dies, his or her heirs may be able to hold the home in their possession for up to a year — with no payments required. But they must be attempting to sell the home or arrange financing to buy it themselves. In all scenarios, they must work closely with the lender.

The vast majority of reverse mortgages are home equity conversion mortgages, or HECMs, which are federally insured loans allowing homeowners 62 and older to access a percentage of their home's value. They are called reverse mortgages because the lender pays the homeowner instead of vice versa. (Two less common reverse mortgages — proprietary and single-purpose reverse mortgages — are not insured by the federal government. This story specifically discusses the HECMs.)

What the reverse mortgage is not — or at least not what it's intended to be — is a cash machine, says Dan Hultquist, a Georgia-based training manager at Open Mortgage, a national lender. He also is the author of "Understanding Reverse."

"It's not a cash-out refinance for the desperate and needy," he says. "People have used it that way, but that's like cursing the screwdriver for not being a good hammer."

Payments from a reverse mortgage can come in several ways, depending upon whether the mortgage loan has a fixed rate or adjustable rate:

> as a lump sum in cash

> as fixed monthly payments for a set time

> as a line of credit to be tapped into when needed

> as a combination of these

The payments from the reverse mortgage are not taxed, as they are considered the equivalent of loans.

Reverse mortgages have been through many stages. At first, the financial vehicle gained a shoddy reputation due to unethical salesmen and a rocky start that included many defaults. But in 2013, regulatory changes tightened the procedures and some financial advisers began to approve of them.

For example, Scott Burns, the respected syndicated financial columnist who wrote for The Dallas Morning News, said in an October 2015 column that reverse mortgages "could be the most powerful tool most people have." Alicia H. Munnell, a former economic adviser for President Bill Clinton who now runs the Center for Retirement Research at Boston College, co-wrote a brief in January 2014 titled "The Government's Redesigned Reverse Mortgage Program." She concludes in the report: "A better customer experience combined with lower fees will also make reverse mortgages a more attractive option for retirees."

"It enabled us to buy way more house for way less money."

— **Bob Smith**

Over the past three years, homeowners have taken out an average of about 55,000 reverse mortgages a year, according to statistics from the U.S. Department of Housing and Urban Development. This year, the total number of reverse mortgages since 1990 is on target to surpass 1 million.

Here are eight essential points on reverse mortgages from Hultquist and other experts. ►

1 The homeowner — not the bank — always retains the title and ownership of the home over the life of the loan. Even when the homeowner dies, the bank does not automatically get the home. This is the most common misconception about reverse mortgages, says Lisa Piercefield, Indianapolis-based regional operations manager for Apprisen, a federal HUD-certified housing counseling agency. "It's a loan, so there is a lien against the property, just like a conventional mortgage, but the borrower keeps the title to the property," she says. "The difference is that with a conventional mortgage, you make a payment and the loan balance goes down. In a reverse mortgage, you don't make a payment on the loan and over time, with compounded interest rates and service fees, depending on how much money you might use, your balance is going to increase."

So how does the bank win? When the home sells in the future, the lien against the home for whatever amount the homeowner borrowed must be paid, plus interest to the bank and mortgage insurance to the federal government.

During the life of the loan, reverse mortgage holders must maintain the home and pay property taxes and insurance.

> "My kids don't need this house and the house is here to take care of me."
>
> **— Sharry Evans**

2 Unlike a conventional mortgage, a payment book or repayment plan does not exist, and the reverse mortgage holder will not be encouraged to make payments. In fact, just the opposite is true. "It's easy to withdraw funds and the lender wants you to do that," Hultquist says. "Everyone thinks that not making a payment is the greatest benefit to the reverse mortgage, but I believe the opposite is true. Making periodic payments has significant benefits that generally are not discussed."

Payments not only reduce the loan balance as with a forward mortgage, but they also boost the homeowner's line of credit and offer more control over the home equity nest egg, he says.

3 Reverse mortgages may serve those who are moderately well-off or wealthy — not because they need cash, but because the reverse mortgage offers multiple financial planning advantages. Some people are getting reverse mortgages as an alternative to buying long-term care insurance, for example. Others may be trying to avoid taking Social Security until age 70 to get the maximum benefit. Still others want to use the reverse mortgage as a line of credit.

"They want that line of credit to grow and in many cases, it will exceed that home's value," Hultquist says. "If interest rates go up, their line of credit is going to explode, and it's guaranteed by the federal government. They have a guaranteed growing source of funds if they ever need it. The reverse mortgage has so many advantages if you understand the technicalities of it."

Roger Roemmich, 68, understands those technicalities and will be getting a reverse mortgage when he and his significant other, Candace Fennell, purchase a house later this year. Roemmich, who holds a doctorate in accounting, is a financial planner and the author of "Don't Eat Dog Food When You're Old!" which emphasizes the importance of cash flow. To supplement Social Security, retirees can tap into a reverse mortgage to reduce taxes and let their retirement savings continue to gain interest, Roemmich says.

4 Concerning that line of credit: In some cases, reverse mortgage holders never use it, because a need or an emergency did not arise. What happens then? The available principal limit not used stays in the line of credit, which can be accessed at any time. It compounds. So if interest rates go up, the reverse mortgage holder wins.

Consider, for example, a 62-year-old taking out a reverse mortgage on a $250,000 home. He would be eligible for an approximate $131,000 line of credit, which, after fees and mortgage insurance, would leave about $121,000. That line of credit would increase as interest rates rise.

Hultquist says it doesn't pay to wait. When someone gets a reverse mortgage at age 62, he or she has a longer time for the line of credit to grow.

5 The borrower is not held responsible for any debt that accrues beyond the home's appraised value. That's called a nonrecourse feature. So if the value of the property declines, the homeowner doesn't have to worry about holding a so-called "underwater" mortgage. (That's one reason why the federal government tacks on an insurance fee.) The reverse mortgage cannot be frozen or eliminated if property values decline. ►

FOR MORE INFORMATION

Visit these sites and in the search box, type "reverse mortgages."

- OneFPA.org
- HUD.gov
- Consumer.FTC.gov
- ReverseMortgage.org
- CRR.BC.edu

6 **A new house can be paid for with a reverse mortgage, called an HECM for Purchase.** Let's say someone wants to relocate to be closer to family or a beach. Hultquist uses the example of someone making a lateral move from a paid-off $200,000 house to another, similarly priced home. Rather than using the full $200,000 from the sale of the older home to pay for the new one, the buyer would put $100,000 into retirement savings, put down $100,000 on the new house and take out a $100,000 reverse mortgage for the balance. "You buy the new house using the old house's proceeds, and you don't have a monthly payment," he says.

"It's not a cash-out refinance for the desperate and needy."

— Dan Hultquist

7 **One potential con of a reverse mortgage: The children (or heirs) do not get the full proceeds from the home.** This is where reverse mortgages gather some naysayers. Egberto Willies, a blogger and host of "Politics Done Right" at KPFT in Houston, says reverse mortgages have a tendency to make homeowners financially lazy and irresponsible. "We have been transferring wealth to our next generation through our homes for quite some time," he says. "People would normally make sacrifices. They wouldn't go on that extra vacation if they didn't have ready income. Now, with a reverse mortgage, they have that semblance of having that ready income that they can use for that extra vacation. That means there's nothing to transfer to the next generation. For a whole class of people, what it potentially does to that class is prevent any future assets from being sent to the next generation."

But sometimes the next generation doesn't need the assets. Consider the case of Sharry Evans, 76, a retired real estate agent from Dallas. She has been a widow for 15 years and lives in a house that has appreciated from $39,950 to around $270,000, but also needed repairs. Sharry looked into reverse mortgages, went through counseling with Dallas-based Transformance and talked to her certified public accountant. Her biggest concern was not being able to leave a paid-off house to her four children.

However, her CPA asked her: Are your children working? Do they have retirement savings? Do they have houses bigger than yours? She answered "yes" to all three questions. "My kids didn't need this house and the house is here to take care of me," Sharry says. "It has done that, and I cannot even describe to you the peace of mind that has brought me."

8 **Anyone considering a reverse mortgage should sit down with a financial planner to fully understand the benefits and drawbacks.** In fact, before getting a reverse mortgage, homeowners are required to talk to a counselor. This is done to protect older people who are on fixed incomes. HUD requires loan originators to provide a list of counselors, and the session can be done in person or by phone. There is a charge for the session.

Piercefield says reverse mortgage applicants are screened to make sure they meet the criteria. "Part of the counseling also is talking about alternatives," she says. "This way, they can make an informed decision about what works best for them." W

Marc D. Allan is a writer in Indianapolis.

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