REVERSE MORTGAGES

OVERVIEW

A reverse mortgage is a type of collateralized loan used to access the equity an individual has in his or her home. It allows them to use that equity to pay off debts, pay for health care, or general living expenses. As the name implies, a reverse mortgage is the opposite of a conventional mortgage, and the lender makes payments to the borrower. The loan does not need to be paid back until the home is sold or no longer the borrower's primary residence. After years of making conventional mortgage payments, one's net worth may be largely dominated by the value of their home making reverse mortgages an option to access the equity.

HOW THEY WORK

REQUIREMENTS

There are a few requirements that must be met in order for one to qualify for a reverse mortgage:

- All borrowers listed on the property's title must be at least 62 years old. A person with a spouse younger than 62 may obtain a reverse mortgage as long as the younger spouse's name is not on the title.
- A reverse mortgage must be the primary lien on a home. A prior mortgage must be paid prior to obtaining a reverse mortgage, or paid using the proceeds from the reverse mortgage.
- The home used as collateral for the reverse mortgage must be the borrower's primary residence.
- The borrower must remain current on the home's property taxes and insurance coverage.
- The condition of the property must be maintained to a specified level.

REQUIREMENTS

There are three types of reverse mortgages:

- Single-purpose – These are offered by some state and local government agencies and nonprofit organizations. They are the least expensive type, but are not available everywhere. As implied by the name, they are only used for one purpose, as specified by the lender.
- Federally-insured – These are known as Home Equity Conversion Mortgages (HECMs) and are backed by the U. S. Department of Housing and Urban Development (HUD). They are widely available and have no income or medical requirements.
- Proprietary – These are private loans are backed by the companies that utilize them. They may be more expensive and include higher upfront costs.

LOAN AMOUNT

The amount a borrower is able to borrow is determined by his or her age, the value of the home, and the interest rate. An appraisal of the home is required, and the value used in determining the loan amount must include any health or safety repairs that need to be made. The interest rate is determined by a specified index, such as the U.S. Treasury 1-year Treasury bill or LIBOR. A borrower's age is taken into account in order to estimate the length of time that payments will be made. The younger the borrower, the longer the projected payment term, and the less money he or she will receive.

PAYMENT OPTIONS

A borrower has multiple options for the length of time they will receive payments:

- A "term" option has fixed monthly payments for a specific time.
- A "tenure" option has fixed monthly payments for as long as the borrower lives in his or her home.
- A "line of credit" lets the borrower draw down the loan proceeds at any time.
- A combination of monthly payments and a line of credit.

LOAN REPAYMENT

A reverse mortgage comes due when the borrower dies, sells the house, or moves out of the house for more than 12 consecutive months. When one of these "maturity events" occurs, the borrower or heirs of the estate have an option to refinance the home and keep it, sell the home and withdraw any remaining equity, or surrender the home to the lender. If the borrower dies, heirs have six months to make this decision, although extensions may be granted.