Reverse Mortgage Nightmares Should Never Happen – Top 10 Misconceptions About Reverse Mortgages

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Searching online for information about reverse mortgages, I came across article after article about how reverse mortgages somehow became a financial nightmare for different seniors around the country. I was shocked to read something like that as I've been researching and writing about reverse mortgages lately, and I couldn't understand how they could possibly turn into any sort of "nightmare."

But, imagine this, as reported in the Miami Herald on July 12, 2013…

A reverse mortgage with an interest rate of 9.95 percent… plus a clause granting the lender a 50 percent share of any increases in the value of the home, plus an additional 2 percent for something called a "maturity fee" to increase the lender's payout even more.

And, as if those terms weren't egregious enough, on top of that the mortgage required the borrower to purchase a $33,000 annuity that would be added to the principal balance and that would both accrue compounding interest and reduce the amount that the lender would pay out to the homeowner in the future.

Good Lord. A nightmare? I'd say so. In fact, those are about the scariest mortgage terms I've ever heard in my life. I couldn't even imagine who would offer a mortgage of any kind with those sorts of terms and costs. That's not a "reverse mortgage" in my book… that's just a predatory lending scam that is illegal today as it certainly should be.

The point is that description has nothing in common with the reverse mortgages offered today, at least not the reverse mortgages offered by ethical and reputable lenders. The lesson that should be learned from reading the horror story above isn't so much about reverse mortgages. It's more that no one should ever do business with con artists and criminals.

Of course, that's not really "news," right? It's obviously always important that you only work with FHA-approved lenders with rock solid reputations for treating borrowers ethically at all times. And if you're not sure about the lender you're working with… simply slow down and check things out before you proceed. Reputable lenders won't mind you wanting to check things out. The problem is in large part coming from smaller brokers and former sub-prime lenders who have entered the reverse mortgage market since the meltdown in the mortgage market put an end to sub-prime lending.

Concerns about the multibillion-dollar reverse mortgage market echo those raised in the lead-up to the financial crisis when consumers were marketed loans — often carrying hidden risks — that they could not afford.
"There are many of the same red flags, including explosive growth and the fact that these loans are often peddled aggressively without regard to suitability," said Lori Swanson, the Minnesota attorney general.

Reverse Mortgages Yesterday and Today…

I've learned that the reverse mortgage is one of those products that isn't well understood at least as often as it is. Ask anyone what they think about reverse mortgages, and you'll get answers from one end of the spectrum to the other.

Some will say that they've heard about scams… others aren't as sure what they've heard exactly, but will tell you they've heard there have been some problems… or that the fees are too high… or that they result in people to lose their homes… or that you shouldn't use one unless you have no other options.

The thing is that unless you're dealing with some sort of scammer or unethical operator, none of those things about reverse mortgages are true today.

The first reverse mortgage was written in 1961. Back then they were unregulated and marketed under many different names, but in the early 1980s, the U.S. Senate Special Committee on Aging published a report about the need to regulate a reverse mortgage program at the federal level. Others followed, saying that to protect seniors, FHA needed to insure reverse mortgages and that uniform lending practices should be adopted.

Finally, in 1988, President Ronald Reagan signed the FHA Reverse Mortgage bill, and a year later the first FHA-insured HECM, or Home Equity Conversion Mortgage became available to homeowners over age 62.

Reverse mortgages today are regulated by the U.S Department of Housing and Urban Development, and they're insured by the Federal Housing Administration, or FHA. Today's reverse mortgages are just as safe and secure as any other government-backed mortgage loan and as a result, it should come as no surprise that the number of seniors that have taken advantage of what today's reverse mortgages have to offer has increased dramatically over the years.

Top 10 Misconceptions About Reverse Mortgages…

1. Taking out a reverse mortgage means you'll lose all the equity in your home.
Not true. A reverse mortgage is not unlike any other mortgage in this regard. Let's say your home appraised for $400,000, and so you and your spouse decided to borrow $200,000 through a reverse mortgage. Upon the death of the last surviving spouse, assuming the amount you owe on the reverse mortgage is less than the property's value, your heirs would inherit the difference.

2. Taking out a reverse mortgage means you can't sell your home.
Not true. Taking out a reverse mortgage, doesn't mean you can't sell your home, in fact you can sell it whenever you want to… there are no pre-payment penalties. And just like any mortgage, the proceeds from the sale would pay off the reverse mortgage, and you'd receive the balance.

3. Taking out a reverse mortgage means signing over your home to the bank.
Not true. Just like with a "forward", traditional mortgage, taking out a reverse mortgage doesn't change who owns your home or who is on title to your home. You still own your home and are responsible to continue paying your property taxes and insurance, just like you always have.

4. Reverse mortgages are very expensive.

Not true. The U.S. Department of Housing and Urban Development, HUD, regulates the costs and fees associated with reverse mortgages and most of the costs can be financed into the loan, so you won't need a lot of cash to get your reverse mortgage.

The origination fee can be up to $2,500 if your home is valued at less than $125,000… and if your home is valued at more than $125,000 lenders can charge 2% of the first $200,000, plus 1% of the amount over $200,000. However, HECM origination fees are capped at $6,000.

You will also be charged an initial mortgage insurance premium at closing. Borrowers who must take the maximum amount available to pay off a mortgage and/or other mandatory obligations must contribute 2.5% to the FHA insurance fund. For those who can meet all mandatory obligations using 60% of available proceeds or less, the initial mortgage insurance premium is one half of one percent (.5%) The initial premium is calculated on either your home's appraised value, the FHA HECM mortgage limit of $625,500, or the sales price (in the case of a HECM for Purchase)… whichever is LESS. Also, over the life of the loan, you will be charged an annual Mortgage Insurance Premium ("MIP") that equals 1.25% of the mortgage balance.

Lastly, there will also be some closing costs that cover things like the appraisal, title search, inspections, recording, mortgage taxes and credit checks… and there may be a monthly fee of $30 – $35 for the servicing of your reverse mortgage. My employer, Security One Lending, does NOT charge any servicing fees.

5. A reverse mortgage can reduce the amounts you receive from Social Security.
Not true. The funds you receive from a reverse mortgage are not considered income, so they are not taxable and cannot affect your Social Security income or benefits under Medicare.

6. People only take out reverse mortgages as a last resort.
Not true. There's absolutely no restriction on how you can use the money you receive from a reverse mortgage, and seniors today are using them for all sorts of reasons. Some are using reverse mortgages to pay for improvements to their homes, but unlike home equity loans, which require borrowers to make monthly payments, reverse mortgages don't. Others are using the proceeds from reverse mortgages to help pay for their grandchild's college education.

And remember… although you don't have to make any payments on your reverse mortgage during your or your spouse's lifetimes, there's nothing saying you can't. Seniors who want to reduce the amount owed on their reverse mortgages can decide to make interest only payments, while others elect to make payments of principal and interest
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7. You have to own your home free and clear or have a lot of equity to get a reverse mortgage.
Not true. The proceeds from a reverse mortgage can be used to pay off an existing mortgage, which means that you can use a reverse mortgage to eliminate the need for you to make monthly mortgage payments forever.

8. You need income and good credit to qualify for a reverse mortgage.
Not true. Neither your income, nor your FICO score have anything to do with your ability to qualify for a reverse mortgage today. HUD has announced plans to change that in early 2014 and requirements will tighten. The amount you can borrow through a reverse mortgage is based on your age and the value of your home, up to a maximum of $625,000. The older you are, the greater the percentage of your home's value you'll be allowed to borrow.

9. After the death of you and your spouse, your heirs will have to pay-off your reverse mortgage.
Not true. A reverse mortgage is a non-recourse loan, which means that you or your heirs will never be responsible for paying more than the home's value, even if you end up owing more than the home is worth. So, let's say you were to borrow $250,000 through a reverse mortgage and either you or your spouse went on to live for another 25 years.

After the death of the last surviving spouse, if your loan balance exceeds the value of the home, your heirs can simply walk away without owing anyone a nickel. In fact, that's why you pay the 1.25% annual FHA insurance premium, so no one will ever have to repay more than the home's value.

10. Only one spouse has to be over 62 years of age to get a reverse mortgage.
Not true. Both husband and wife have to be over 62 years of age and both must be listed as borrowers on a reverse mortgage. That way, the reverse mortgage doesn't become due until the last surviving spouse dies, sells the home, or doesn't use the home for 365 consecutive days, as could be the case in the event skilled nursing is required.

In Conclusion…

With home values having fallen in many areas since 2008, many seniors have had to change their plans for their retirement years, but through the use of a reverse mortgage, many are finding ways to get back on track and start enjoying their retirement years as they had hoped.

The simple fact is that there isn't anything else that works like a reverse mortgage. Basically, it's a federally insured loan that, depending on your age, allows you to convert some portion of your home's value into tax-free cash to use however you'd like.

Assuming you and your spouse are both at least 62, and you own a home or condo, reverse mortgages are very easy to get because there's no income or FICO score requirement to qualify. As mentioned, new qualifications will be imposed in Q1 2014. And reverse mortgages aren't a risky proposition, because they are federally insured, non-recourse loans, which means you can never be required to repay more than the value of your home upon the death of the last surviving spouse. So, even if you were to owe more than your home was worth at that time, your heirs could simply walk away owing nothing.

A Credit Line that Grows Every Year…

Even if you don't have a use for extra cash today, you may still want to take out a reverse mortgage and set it up as an open credit line, as opposed to receiving a lump sum or monthly payments. And with this option, the amount of credit that's available to you will increase each year. It is unlike any line of credit you have ever seen for many reasons.

For example, a 70 year-old borrower whose free and clear home appraises for $400,000, would have access to a credit line of roughly $215,000.

But, if that borrower didn't use that credit line for five years, the amount available will have increased to almost $285,000. And five years after that, approximately $412,000 would be available to be withdrawn… with no requirements that the loan be repaid until after the death of the last surviving spouse. The availability of those funds can never be reduced or eliminated no matter what changes may occur in the value of the property. This growing line of credit is the best savings account going. Peace of mind for any rainy days ahead. And this "stand-by" reverse mortgage is inexpensive to establish..

There's simply nothing that will do what a reverse mortgage can do. Since there's never a prepayment penalty, you can elect to repay the amount you borrowed at any time. And because reverse mortgages are non-recourse, you nor your heirs will ever owe more than the property securing the loan is worth.

It's tragic to consider, but in this country whenever there's real money involved, there can be criminals and con men around every corner waiting to take advantage of unsuspecting seniors. In the past, that has transformed reverse mortgages from being a way to make dreams come true into living nightmares.

But that's not the fault of the reverse mortgages… that's what can happen when people fail to make sure that their lender's reputation is beyond reproach.

Ask me for a list of clients that you can call and check me and Security One Lending out through NMLS or any other source.

Bob Adams