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WHAT IS A REVERSE MORTGAGE? An Overview and Utilization Guide

In a Reverse Mortgage The borrower(s) retains full title and disposition rights to their property. Loan proceeds are not considered income by the IRS and therefore do not affect any benefits currently received by the borrower (i.e., Social Security, Medicare, or any other federal or state assistance programs). There are no income, asset or credit requirements to qualify. Based on the qualified loan amount, the homeowner(s) may be eligible for a Reverse Mortgage even if they still owe money on their first mortgage.

The property must be a primary residence (i.e., 1-4 family home, condominium, co-op, manufactured housing, mobile-home) in order to qualify for a Reverse Mortgage. Another benefit of these loans is that they are "non-recourse" which means that no matter how large the loan balance may grow over time, the borrower (or their heirs) can never owe more than the home's sale price. The loan is not due and payable until the borrower(s) no longer occupy the property as their primary residence (i.e., the last surviving borrower sells, moves out permanently or passes away).

The tax-free proceeds from a Reverse Mortgage are available as a lump sum, fixed monthly payments, a line of credit; or any combination of these options (for as long as the borrower(s) live in the property). These funds can be used to pay for any legal purpose: i.e., daily living expenses; home repairs and improvements; medical bills and prescription drugs; the pay-off of existing debts; education; travel; long-term care or life insurance premiums; retirement, financial and estate tax planning; funding gifts and trusts, etc.

The amount of the loan for which a borrower will qualify, will depend upon their age at the time they apply for the loan, the type of Reverse Mortgage program chosen, the value of the home, current interest rates, and for some products, where the property is located. As a general rule, the older one is and the greater the home value, the larger the Reverse Mortgage loan will be.

While Reverse Mortgage programs do not require monthly interest payments, the borrower may repay any portion of the interest charged and this repayment may be deductible against annual income (as is any traditional mortgage). If the interest is allowed to accrue, when the property is sold, and the loan repaid, a deduction of the interest may be made against the sale price at that time. Prepayment of any portion of the principal loan balance can be made at any time without prepayment penalties, on most Reverse Mortgage programs.

The costs associated with getting a reverse mortgage are similar to those with a conventional mortgage. These include the appraisal and inspection fees, title insurance policy, attorney/closing agent fees and other normal closing costs.

There are also minimum origination fees and, in some cases, mortgage insurance fees associated with Reverse Mortgage programs. All of these costs are typically financed from the gross proceeds of the Reverse Mortgage and do not require the borrower(s) to bring a check to the closing. The FHA/HUD also requires that every Reverse Mortgage applicant participate in a counseling session with an independent credit counselor during the process of applying for a loan. This counselor's job is to review the borrower's current and future budget needs; provide information about other possible options available; and to assist the senior homeowner in determining which particular Reverse Mortgage product would best fit their needs when selecting a program. This counseling session is at no cost to the borrower and can be done in person or, more typically, over the telephone.

REVERSE MORTGAGES - GOVERNMENT AGENCY AND NON-GOVERNMENT PROGRAMS

There are two government agencies offering Reverse Mortgages – FHA (Federal Housing Authority) whose two programs are named Home Equity Conversion

Mortgages [HECM] offering a monthly adjustable rate program and an annually adjustable rate program. FNMA (Federal National Mortgage Association) whose program is named Home Keeper® offering a monthly adjustable rate program.

The amounts of the initial Reverse Mortgage loans offered are affected by current interest rates, the age of the youngest borrower, and the value of the home up to the FHA or FNMA Maximum Claim Amounts*.

*The Maximum Claim Amounts are maximum home value caps that FHA and FNMA have created in order to equalize their lending programs nationally. Both agencies review and adjust their caps annually. THE FHA uses demographics and county maps when setting limits for their HECM products (i.e., each county has a prescribed value limit). FNMA uses their conforming single-family residence [forward] mortgage cap for the Home Keeper® program. Currently, the loan amounts for the FHA HECM programs are approximately 50% - 85% of the home value (up to a \$290,750.00 Maximum Claim Amount for 2004). The FNMA Home Keeper® loan amounts are approximately 10% - 65% of the home value (up to a \$333,700.00 Maximum Claim Amount for 2004). These percentages are based upon the age of the borrower(s) 62+ years old - i.e., the older the homeowner(s), the higher the percentage and therefore, the larger the loan amount. These government agencies' programs base their respective lending rates on nationally recognized indexes:

FHA utilizes the Weekly Average Yield on the United States Treasury Securities

Adjusted to a Constant Maturity of One Year (plus a margin) and resets the HECM rates weekly.

FNMA utilizes the Weekly Average of the One-Month Secondary Market CD Index rate (plus a margin) and resets the Home Keeper® rate monthly.

There are also non-government Reverse Mortgage programs available. These loan programs are typically designed for higher valued homes where the agencies' Maximum Claim Amounts may be too restrictive in providing adequate lending capability. Typically, these non-government programs are utilized for financial and estate planning purposes (not just to provide some extra cash flow, as is currently the use by borrowers for many of the government agency programs). These Reverse Mortgage programs can lend significantly larger amounts to the homeowner(s) and offer a greater opportunity for meaningful estate-asset restructuring.

THE RISKS OF SERIOUS ILLNESS AND REVERSE MORTGAGES

Seniors worked hard all of their lives to create a financial estate from which they had planned to live their retirement years to the fullest and leave a significant legacy to their beneficiaries. Among the primary issues threatening this goal for senior homeowners today are the costs and management of a serious illness and the way it may affect their current lives and future plans. For a married couple, the anxiety surrounding the incapacity of one spouse and their sudden dependence on the other can be disquieting and often overwhelming. For all seniors, the hope of living longer combined with the fear of outliving their finances is becoming a startling reality as expenses continue to rise and savings rates continue to fall (or remain historically low). Senior homeowners may face any of the following circumstances regarding the costs of long-term health and medical care should serious illness befall them:

- **the possibility of losing their home**
- **the choice between a nursing home vs. preferred in-home care**
- **the rapid depletion of their financial security**
- **the inability to leave a legacy to those they love**

- A Reverse Mortgage is the one financial instrument that can help to address many of these uncertainties. Through the withdrawal of some of the equity in a senior homeowner's primary residence and the proper investment of those funds, a number of factors are changed which significantly improve the state of affairs regarding the potential risks of a serious illness.
- Reverse Mortgage is a lien against the value of a primary residence. Therefore, any obligations based upon the value of assets must subtract this lien. This lowers the current and future value of the estate while enhancing fiscal liquidity.
- Funds from a Reverse Mortgage can be used to purchase long-term healthcare insurance, thereby addressing the concern about future health and medical care costs.
- Funds from a Reverse Mortgage can be used to supplement monthly income to provide for preferred in-home health or medical care, as well as increases in the cost of living.
- Funds from a Reverse Mortgage can be used to purchase second-to-die life insurance (for a couple) or personal life insurance (for an individual), thereby assuring a legacy to beneficiaries that may even exceed the value of the original estate.
- A Reverse Mortgage can offer senior homeowners the ability to strengthen their financial future. When a senior homeowner utilizes these funds to purchase investments that protect their health and well being and enhance the total worth of their estate, the value of a Reverse Mortgage is truly realized.
- A Reverse Mortgage Can Financially Strengthen Both the Present and Future of a Senior Borrower

A Reverse Mortgage can provide an infusion of cash - that little extra money each month - many senior homeowners are finding they need just to make ends meet. Increases in everyday living expenses such as property taxes, homeowner's insurance, heating costs, property maintenance, not to mention medical and pharmaceutical bills, food, automobile expenses, etc., are all exceeding the limits of even the best laid [retirement] plans.

A Reverse Mortgage can provide the resource for the funding of Long-term Care Insurance premiums - an expensive, but more and more often necessary bit of security. According to recent statistics, 40% of the population over 65 will require some form of long-term healthcare services during their remaining lifetimes. A senior's average stay in a professional care facility averages 2.5 years and the costs can easily exceed \$80,000 annually (Similar illnesses treated in the home, supported by home-healthcare providers, can also average approximately \$70,000 annually). Most Americans recognize the need for a long-term care insurance program to both protect their assets and relieve any potential burden on their families. But, many seniors do not have the monthly income necessary to pay the premiums for Long term Care coverage and most are not comfortable utilizing their savings for this purpose. A Reverse Mortgage can solve this issue and in fact, the American Homeownership and Economic Opportunity Act of 2000 (H.R.5640) signed into law on December 27, 2000, supports the use of Reverse Mortgage proceeds for Long-term Care.

When tax-free monies from a Reverse Mortgage are used for the purpose of funding insurance products, it gives senior homeowners, particularly those with substantial equity built up in their homes, the comfort of having more control over their estate and assuring the legacy they leave retains its value. If the senior homeowner uses some of the equity released from a Reverse Mortgage to purchase additional life insurance for their heirs, the net result would be larger death benefits for the beneficiaries without affecting the current (and many times, limited) income stream of the borrower. When the insurance policy pays the benefits to the heirs, they receive tax-free dollars. Upon the sale of the property, any equity over the Reverse Mortgage loan amount will be subject to estate taxes, but ultimately, still revert to the heirs. With the unknown nature of the future real estate markets, the use of a Reverse Mortgage provides for greater control of the legacy assets by the senior homeowner.

The full value of a home owned outright (mortgage free) is subject to estate tax, but a Reverse Mortgage lien against the property reduces its value - thus effectively lowering the estate taxes. A Reverse Mortgage must be repaid when the borrower permanently leaves the property. At death, the full value of the property would not be included in the estate valuation for tax purposes because the accumulated debt of the Reverse Mortgage would not yet have been repaid, thereby reducing the property value. This should lower any applicable taxation. In addition, accrued interest in the Reverse Mortgage may be available as a tax deduction to the estate upon the repayment of the loan (just as mortgage interest is deductible against income.) [NOTE - it is recommended the borrower consult their tax advisor]

MEDICAID AND REVERSE MORTGAGES

Medicaid is a program of medical assistance provided through a States' Department of Social Services (DSS). This program pays medical bills for certain categories of people whose income and assets have become too low to cover their medical bills. If you go into a nursing home and need Medicaid, your house is not counted as an asset if you intend or are expected to return to it. If you go into a nursing facility and don't expect or intend to return home, you will have to make an effort to sell your house to qualify for Medicaid. The state puts a lien on the house while you are trying to sell it. When the house is sold, DSS takes from the proceeds of the sale what it has paid for you in the nursing home up to that time. You will then go off Medicaid until you have spent the rest of the money from the sale of the house and have only a nominal amount of total remaining assets.

If a Reverse Mortgage is established, your equity in the property is reduced by the amount of the lien (thereby reducing the available equity in the home for the state claim). If these Reverse Mortgage monies are withdrawn and invested, they will be at risk as an asset. But if the monies are taken as a line-of-credit or distributed as a monthly tenure, the Reverse Mortgage reduces the equity in the property by the amount of the total loan available, while the funds received are not considered income. NOTE - if a portion of the money withdrawn from the Reverse Mortgage is used to purchase a long-term care insurance policy, the closing costs for some Reverse Mortgage programs are cut by forty percent.

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