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Reverse mortgages provide more seniors with a safety net

Amid the loan market crisis, more seniors are turning to reverse mortgages.

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IMAGINE a scenario in which, instead of struggling to come up with the money for a mortgage payment that's resetting to a higher level, you could tap the unused equity in your home not only to pay off that loan but also to have money for living expenses, remodeling, traveling or even investing in a vacation home. For seniors, there is such an option: the reverse mortgage.

And that's exactly what 73-year-old Betty Jenkins chose after being laid off from her job with a health maintenance organization. Unable to afford the $1,500 monthly payment on the Chatsworth home she bought in 1988 after a divorce, Jenkins signed up for a reverse mortgage through Financial Freedom, a unit of IndyMac Bank and the nation's largest provider of such loans. Not only did she keep her home and retire her existing mortgage, but she also was able to remodel her kitchen, pay her property taxes and insurance, maintain her car and keep her two dogs enjoying the lifestyle to which they'd become accustomed.

"It seemed too good to be true," said Jenkins, who shares her home with companion Eddie Applegate, 72. But after talking with the Federal Housing Administration and the Department of Housing and Urban Development, the couple found out it was for real. "We would not have to pay loan payments ever again." That's because this type of loan truly does work in reverse: Instead of the homeowner paying the lender each month, the lender gives the owner money upfront and takes the existing home equity as collateral.

Fortunately for the couple, with less than a $200,000 balance on the existing mortgage and a home worth close to $500,000, the remaining equity was more than enough to also provide for a modest $25,000 credit line, which can, depending on home values and interest rates, be reduced or increased throughout the life of the loan.

Such flexibility is one big reason why reverse mortgages have grown extremely popular. Of the 345,762 reverse loans insured to date by the FHA, nearly one-third were made in 2007, according to the AARP Public Policy Institute and HUD, and 27% of those were in California.

With traditional home equity credit lines increasingly difficult to get in a time of declining home values and tight underwriting standards, eligible seniors older than 62 are finding that one benefit of reverse mortgages -- other than no pre-payment penalties and no credit or income qualifications -- is the ability to get rid of the sub-prime and other adjustable loans facing payment increases.

Reverse mortgages are also gaining popularity in upscale areas such as Newport Beach, where $2-million homes are commonplace, said Wells Fargo loan agent Alyson Lloyd. Unable to qualify for traditional home equity loans because of low credit scores but wanting to remain in place for a long time, some house-rich but cash-poor borrowers are now able to tap equity gains to avoid foreclosure and even to leverage these funds as investments in second homes.

"It has become an investment tool, allowing people to leverage their money," Lloyd said. For example, homeowners over age 62 could take the net proceeds from downsizing to a smaller home and then pay off the new purchase loan with a reverse mortgage. Or, assuming the homeowners live in their primary residence at least 50% of the time, they could obtain a reverse mortgage and use the proceeds as a down payment on a second home.

Although the loans have been available in various forms since 1961, it wasn't until the late 1980s that Congress allowed the FHA to insure what become known as home equity conversion mortgages and safeguards were put into place to protect both borrowers and lenders, starting with mandatory consumer counseling for all applicants.

Homes that may qualify

In general, eligible properties for the FHA program must be a principal residence and can include single-family homes, condominiums, manufactured homes built after 1976 or even two- to four-unit multifamily properties. Besides borrowers retaining ownership of the home for the duration of the loan, cash advances can be used for any purpose and don't count as income against Social Security or Medicare benefits -- although it can affect Medicaid and other state or federal assistance, so it's definitely best to check details with an attorney or local expert.

As reverse mortgages have become more commonplace, both the demographics of borrowers and their cash needs have changed.

"When they first started, the typical borrower was a 77-year-old widow who needed it for medical bills and upkeep of lifestyle, but today we're seeing fewer people with the property debt-free," said Richard Pittman, director of housing and counseling for ByDesign Financial Solutions, a HUD-approved credit counseling agency. "I just went through 15 files, and the average client was 74, had an income of $1,618 per month and owed $106,000 on their mortgage. Not a single one had any savings, half had credit card debts, 25% needed major home repairs and 25% needed money for cars, vacations and helping families."

As promising as they sound, however, reverse mortgages do have limitations. Since borrowers need to be at least 62, it can get complicated when one spouse is younger than that. Although some borrowers have solved this problem by transferring the ineligible spouse's interest in the home into a trust, such a plan can backfire when the eligible spouse dies, which would require the original loan amount, all interest charges and fees to be repaid.

Homeowners who are currently in bankruptcy do not qualify, neither do owners of most mobile homes, co-ops or homes on leased land. And even for those owning eligible property types, there has to be sufficient equity remaining in the home after other mortgages and home-equity lines are paid off to close the deal, in which case a traditional home-equity line may suffice. Consequently, experts often counsel applicants to discuss options with their extended families before moving forward.

"It's a fabulous program for some, the worst thing for others," said ByDesign's Pittman. Fees can amount to 5% of the loan amount. "With $14,000 to $18,000 in upfront costs, you'll hopefully take a pause and consider what you're using the money for."

He suggests that before signing up for a reverse mortgage, owners also consider alternatives such as downsizing to something more affordable, splitting up the house into shared housing with lockable areas or even selling the home to adult children and then renting it back from them on a long-term lease.

Other experts suggest first looking into grants and no-interest loans from local governments or nonprofits if, for example, applicants are simply looking to repair homes or defer property taxes.

Yet for borrowers facing immediate cash shortages, a reverse mortgage can be a financial lifesaver. For Myrna Reese, the cash proceeds and timing of the reverse mortgage on her home in San Diego County's Rancho

Bernardo were perfect. She and her husband, Lou, had shared the home since 1980. When health problems prevented the couple from running their advertising and public-relations agency full time, a mortgage-broker friend suggested a reverse mortgage that ended up closing one month before her husband died.

"I was so glad we were able to do it because I wanted to stay in the house, and this way, the mortgage would be paid off," she explained. "I would never do this without the government behind it."

Today, however, government-insured mortgages are no longer the only option for those hoping to live on untapped home equity. Given strict HUD lending formulas, which cap the amounts that can be borrowed, and high costs added to the loan balance -- such as 2% of the loan amount and another 2% for mortgage insurance -- lenders such as Financial Freedom and Countrywide recently introduced "jumbo" reverse mortgages offering higher loan limits and lower upfront costs. Fannie Mae has offered its own HomeKeeper program since 1996.

But since the FHA still insures nine out of 10 reverse mortgages, industry experts anticipate the agency will protect its turf by making its home equity conversion mortgages more cost-competitive. And for many seniors, the FHA-insured program is the only one they'd choose.

Many more eligible

"We still have only tapped 1% of eligible households, and this has been around since about 1990," said Jeff Taylor, vice president of the Senior Products Group with lending giant Wells Fargo. Taylor defends the high fees of the FHA-insured program, which are sometimes cited as a hurdle to participation. "People want to jump on the costs, whereas it's the ability to provide an annuity without the obligation for repayment, should the market go south."

For Jenkins and Reese, such upfront costs are worth the peace of mind that their reverse mortgages are providing. Both have children who agreed that a smaller potential inheritance was a small price to pay for happy, independent parents. Added Reese: "It helps when kids don't have to think about what's going to happen to their parents."

Still, due to the rapid growth of reverse mortgage programs that are not insured by the federal government, some experts urge caution and advise applicants and their families to choose brokers who specialize in these types of loans.

Liliane Choney, who was the founder of the nonprofit ReVisions Resources nearly 20 years ago to provide services and information to older adults and their families and now runs the group's Reverse Mortgage Experts program, said consumers should look for loan experts willing to spend time addressing family members' questions and concerns.

"One of the myths is that these loans are for the indigent, frail homeowner with no family and no other resources," she said. "But it's becoming a mainstream financial solution to make retirement possible -- almost like today's version of 'burn the mortgage.' "

If a borrower falls ill and needs to stay in a hospital or a nursing home, most reverse mortgages don't come due until 12 months after the property is no longer a principal residence. That gives families time to plan for other options such as selling the home or refinancing with a traditional mortgage to repay the loan in full. And, since reverse mortgages are "non recourse" -- meaning the borrower and any heirs will never owe more than the market value of the home at the time it is sold -- the estate is protected if the homeowner outlives the projected life of the loan or the market value of the property plummets.

If you ask Rancho Bernardo's Myrna Reese, it's that kind of financial security that also provides some psychological benefits.

"What's the point of paying off a mortgage when you're older?" she asked. "This is a way for people to grow older and it's not a hardship on anyone. Don't use the money to invest or try to make money -- it's much better for just maintaining a lifestyle."

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