Understanding Reverse Mortgages

by Sue C. Quimby, CPCU, AU, CIC, CPIW, DAE

More and more baby boomers are reaching retirement age. At the same time, the coronavirus pandemic may have put a wrench in their investments and income stream. For some, a reverse mortgage can be an attractive option, as they may have built up significant equity in their homes. A reverse mortgage uses the equity in the home to provide an additional source of income to the homeowner. Helping clients understand the pros and cons of reverse mortgages, and how they impact the insurance on the home, is another value-added service of the professional insurance agent.

Reverse mortgages use the built up equity in the home to provide the homeowner with a monthly or lump sum payment. As with traditional mortgages, the homeowner retains the title to the home, and is responsible for payment of property taxes, utilities, insurance, and upkeep of the home.

Homeowners insurance, and flood insurance if applicable, is required - usually for the full amount of the loan. Additional coverage for personal property and third party liability, to protect the homeowner's other assets, is also recommended. Depending on the terms of the reverse mortgage, insurance premium payments may be made by the homeowner or by the reverse mortgage holder through use of a set-aside fund. Insurance premiums and property taxes must be paid on time in order to avoid possible foreclosure under the reverse mortgage.

Not all reverse mortgages are the same. There are essentially three different types: Home Equity Conversion Mortgages (HECM), Proprietary Reverse Mortgages, and Single Purpose Reverse Mortgages.

HECM is the most common reverse mortgage. Under the HECM, requirements for the borrower/homeowner include being 62 years of age or older, owning the home outright or having significant equity in the home, having the resources to pay ongoing taxes and homeowners insurance, no outstanding federal debt (e.g. taxes) and the home must be used as the principal residence. Homeowners cannot be forced out of their homes due to a reverse mortgage.

The HECM is the only reverse mortgage that is insured by the Federal Housing Administration (FHA). Homeowners must meet with a counselor prior to signing up for an HECM. The cost for this, as well as the closing costs and required premiums paid to the FHA for mortgage insurance premiums, can be paid in cash or as part of the reverse mortgage loan.

Single purpose reverse mortgages are offered by government agencies and some nonprofits. They are not available everywhere, and must be used for a specific purpose as determined by the lender. The purpose could be home maintenance or payment of taxes. Single purpose reverse mortgages are available to low to moderate income homeowners.

Proprietary reverse mortgages are offered at terms set by the lender, and are not insured by the government. Unlike HECM, these mortgages are not limited to the value of the home, but only by the amount of risk the lender is willing to accept. These are appropriate for homeowners whose homes are valued higher than the cap for HECM loans – approximately $680,000.

Interest is charged by the mortgage company on the money they pay the homeowner. The interest is added to the balance owed on the home, and the interest rate may change over time. So, unlike traditional mortgages, over time the homeowner with a reverse mortgage owes increasingly more money. However, by law, reverse mortgages are "no recourse" loans, meaning the homeowner is not responsible to repay any more than the home is worth.

Payments the homeowner receives are not usually considered taxable income, nor should they impact Medicare or Social Security status. The interest paid on the reverse mortgage is not tax deductible until the loan is paid off or the home is sold.

The reverse mortgage must be repaid when the homeowner dies or is forced to leave the home permanently. A spouse who is not a party to the reverse mortgage may be allowed to live in the house after the homeowner dies or leaves the home permanently.

There are pros and cons to reverse mortgages, and they are not for everyone. Homeowners considering a reverse mortgage need to do their homework to understand the process, and beware of scams that could leave unsuspecting seniors with no money and no home. Helping clients understand the intricacies of reverse mortgages is another sign of the true insurance professional.

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