Reverse Mortgages

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Educational Objectives
1. Describe mobility rates among older adults.
2. Define a reverse mortgage and Home Equity Conversion Mortgage (HECM), and their origins in Virginia.
3. Explain key HECM loan and counseling features.
4. Illustrate how these features may improve the lives of older Virginians.

Background
A frequently cited statistic from a recent AARP Public Policy Institute survey is that 89% of Americans over 50 want to remain in their homes and communities for as long as possible. It is, therefore, not surprising that a recent analysis of Virginia housing trends conducted by the Virginia Housing Development Authority (VHDA) cited 2006 American Community Survey data indicating that, as Virginians grow older, their willingness to move declines, with older households having the lowest mobility rates among all age groups (i.e., the share of households that moved in the previous year was 34.2% for households 25 to 29 years of age, 9.4% for 50 to 54, 8.0% for 55 to 59, 6.9% for 60 to 64 and 6.2% for 65 to 69 and 70 to 74). There was a slight increase to 7.3% for households 75+, which is attributed to moving into services-enriched housing due to increasing frailties (Virginia Housing Development Authority, 2008). Unfortunately, many homes in which older adults live may need costly accessibility retrofits in order to allow them to age in place. Given the more stringent lending standards since the late 2007 housing “bust,” early retirements from job losses, and reduced retirement and other savings due to the recent recession, the diminished household income and home equity of many older adults may disqualify them for conventional home equity loans. Reverse mortgages may help.

What Is a Reverse Mortgage or an HECM?
A very simple definition of a reverse mortgage is a loan in which an older homeowner borrows money from the equity in the principal residence and receives income from the lender as a lump sum payment and/or by drawing income over time. Homeowners are approved to borrow a portion of the equity in their home, with the share based on their remaining life expectancy, that is, older adults can borrow larger shares of their equity than can younger counterparts. This arrangement continues for as long as the homeowner continues to occupy the home as the principal residence and there is remaining unused borrowing authority. The lender is then paid back the principal and accrued interest from the sale of the home when it no longer is the borrower’s principal residence.

An HECM, or Home Equity Conversion Mortgage, is a reverse mortgage insured by the U.S. Department of Housing and Urban Development (HUD) that is made by a HUD-approved lender. This mortgage insurance is an important feature in that HUD guarantees that the loan will continue even if the lender goes out of business or the
loan principal and accrued interest grow to exceed the equity in the home. Importantly, an HECM borrower will never owe more than what the house is worth. A second key feature is that HUD requires potential borrowers receive impartial counseling from HUD-approved, public or private non-profit counselors to help ensure that the borrower understands the product, its costs, and if an HECM loan is the best choice for personal circumstances. Although other reverse mortgage products exist, HECM loans are estimated to account for 90 to 95 percent of the reverse mortgages made today.

Reverse Mortgages and HECMs in Virginia

According to a 1992 report to the Governor and General Assembly, “Virginia first became involved in reverse mortgages in 1985 when the Virginia Department for the Aging received funding from the U.S. Administration on Aging for a 15-month pilot project to provide education to older homeowners on home equity conversion and to test the market for various types of potential home equity conversion products” (Virginia Housing Development Authority and Virginia Department for the Aging, 1992, p. 2). Following the pilot and due to a lack of interest by private lenders, the Virginia Department for the Aging (VDA) and VHDA joined to offer the “Virginia Senior Home Equity Account” program to demonstrate the feasibility of, and demand for, reverse mortgages in Virginia. Loans were made to homeowners ages 62 and older who agreed to continue occupying the home as their principal residence. These loans were made available through 24 of the 25 area agencies on aging. By October of 1988 when program publicity ended, over 900 interested persons had contacted VHDA and, after just an eight week application period, over $3 million in loan requests were received. Of these, VHDA closed 139 loans totaling $2.6 million during the following 12 months. Clearly, Virginians were interested in reverse mortgages; however, private lenders and capital were needed to satisfy future demand.

In 1990, Congress passed the National Affordable Housing Act, which authorized HUD to pilot the Home Equity Conversion Mortgage (HECM) Insurance Demonstration. In 1991, this demonstration was opened to all HUD-approved mortgage lenders. Given the initial lack of lender interest, VHDA directly offered HECM loans, while making numerous outreach efforts to lenders. Concurrently, VHDA and VDA partnered with AARP to train area agency on aging staff to become HUD-approved HECM counselors. Eventually, the number of HECM lenders and counselors grew to the point that the private and non-profit sectors satisfied the HECM lending and counseling demands and VHDA and VDA no longer were needed, although VHDA continues to pass on some funds to HUD-approved counseling agencies that provide HECM counseling.

HECM Loan Features

Note that some, but not all, HECM features are listed below. Readers will find additional resources at the end of this article.

Borrower(s) must: 1) Be 62 years of age or older (all persons on the deed must qualify; loan amount based on the life expectancy of youngest borrower and increases with age). 2) Own the property outright or have a small mortgage balance (any existing mortgage is paid-off with HECM loan proceeds at closing). 3) Occupy the home as the borrower’s principal residence and not vacate the home for more than 12 months. 4) Not be delinquent on any federal debt. 5) Participate in, and understand, an HECM counseling session (in person or by phone and may bring a trusted advisor to aid in understanding) offered by a HUD-approved counselor. (The counseling agency may charge a fee up to $125, which may be paid directly to the agency or added to closing costs). 6) Remain current in paying real estate taxes, homeowners insurance, other assessments, and maintain the home.

Financial requirements: 1) No income or credit qualifications are required as loan proceeds are paid TO the borrower. 2) No repayment is required as long as the borrower occupies the home as his/her principal residence. 3) Closing costs may be financed in the mortgage. (A common concern is that closing costs are high, e.g., origination fee of $2500 to $6,000 depending on the loan amount, HUD’s upfront mortgage insurance premium of 2.0 percent of the loan amount, and typical fees for appraisal, title search, etc.; however, these are one-time payments and the relative proportion of these costs to loan amount declines over time as more loan proceeds are disbursed). HUD is addressing this high HECM loan costs.
fee issue by implementing a second option, HECM Saver. As of October 2010, HUD renamed the traditional HECM program “HECM Standard” and created “HECM Saver,” which reduces the upfront mortgage insurance premium from 2.0 percent to 0.1 percent for the HECM Saver option. Although HECM Saver borrowers will pay a smaller upfront mortgage insurance premium, they also will see a reduction in the amount they can receive from a HECM loan. 4) While loan proceeds generally are not considered taxable income, they may affect public assistance benefits or have other ramifications; the borrower should consult with a tax advisor in these cases.

Home must: 1) Be a single family or one- to four-unit home with one of the units occupied by the borrower or a HUD-approved condominium or manufactured home. 2) Meet HUD’s property standards and flood insurance requirements, if applicable.

Lender must: Neither contact an HECM counseling agency on a borrower’s behalf, nor take an application before the borrower successfully completes an HECM counseling session and receives a counseling certificate issued by the HUD-approved counseling agency. Note that other interested parties such as real estate agents, appraisers, and financial product salespersons are similarly restricted.

Mortgage amount based on: 1) Age of youngest borrower. 2) Current interest rates (can be a fixed or adjustable rate). 3) Lesser of appraised value or HUD’s current maximum mortgage limit for the area, currently fixed for HECM at $625,500 until December 31, 2010.

Loan proceeds up to the total loan amount may be taken as: a total lump sum payment (also may be used for home purchase or refinancing of a primary residence if the borrower has cash on hand to pay the difference between the sales price and the HECM loan plus closing costs), or one of five payment options. These are: 1) Tenure: equal monthly payments. 2) Term: equal monthly payments for a fixed number of selected months. 3) Line of Credit: unscheduled draws as needed. 4) Modified Tenure: combination of line of credit and scheduled monthly draws. 5) Modified Term: combination of line of credit and monthly draws for a fixed period of months.

Loan paid off: Lender sells the home after it no longer is occupied by the borrower and recoups principal and interest paid to the borrower over the life of the loan. Note that a common concern is that the borrower’s estate no longer inherits the home; however, the estate can refinance the home to repay the lender and own the home. As part of the HECM application and loan closing documents, the HECM borrower names a contingent contact person whom the lender would notify when the loan becomes due and payable.

Reverse Mortgage Fraud

As with other fraud schemes, older adults are potential targets for reverse mortgage scams. One scheme is for a senior to be solicited for HECM information and services for a fee, such as finding an HECM counselor and/or lender for a percentage of the HECM loan. Although HUD-approved HECM counselors may charge a fee and HECM lenders also may charge a loan origination fee, HUD requires that these two steps be totally independent, with the senior homeowner free to select the counselor and separately shop for an HECM. Another scheme is for an older homeowner to be solicited by a person representing himself or herself as a “financial advisor” who encourages the senior to purchase an annuity, risky investments, a living trust or other estate planning tools using HECM loan proceeds. A third example is the “financial advisor” who is teamed with a contractor selling home improvements. In all of these examples, the best deterrent is for the older adult to become an educated consumer and learn about HECM loans and the process through a HUD-approved HECM counselor.

Case Study #1

Frank and Edie, ages 72 and 62, own and live debt free in a suburban split level home, which they learned, when unsuccessfully seeking a home equity loan, has an appraised value of $356,000. Frank had retired with a small pension and Social Security. Four years ago, he injured his back while cleaning the gutters and his injury worsened to where he has difficulty with bathing and uses a walker. Edie quit her job to be his caregiver; however, she has had to return to work part-time as they depleted much of their savings for Frank’s medical bills. She takes home about $600 per month from her job. Now that she is working, Frank
needs home care. At the physical therapist’s suggestion, they contacted a National Association of Home Builders “Certified Aging-In-Place Specialist (CAPS)” contractor to help assess what accessibility modifications and Universal Design features could be made to their home to assist with their current and future mobility needs. The estimate for the modifications was $24,000 but, in addition, Frank has not been able to maintain the house as he had been, so it now needs new sheathing and new roof shingles costing $6,000.

They saw a newspaper advertisement for an HECM loan and began calling HUD-approved lenders listed in the telephone directory. These lenders indicated that they would, on their own, need to select a HUD-approved HECM counseling agency and successfully complete a counseling session before they could have any further discussions with them.

Frank and Edie met with a non-profit HECM counseling agency which followed HUD’s mandatory HECM counseling protocol. This included a comprehensive intake revealing the above facts, as well as their detailed household budget; reverse mortgage features, costs, and financial/tax implications; Frank and Edie’s responsibilities as HECM borrowers; other financial and social service resources as alternatives to a reverse mortgage; and warnings about potential reverse mortgage and insurance fraud schemes and elder abuse. Throughout the session, the counselor asked HUD-prescribed questions to gauge whether they understood what was being discussed. After reviewing computer print-outs of various HECM loan scenarios that are part of the mandatory HECM package they received, all agreed that a HECM loan was their best course of action and the counselor issued the HECM Counseling Certificate allowing them to apply for an HECM loan from a lender of their choice. In addition, the counselor told them about Virginia’s maximum $2,000 “Livable Home Tax Credit” that may reduce their out of pocket costs for eligible accessibility improvements. (The Virginia Department of Housing and Community Development (DHCD) administers this program whereby Virginians may receive up to a $2,000 credit on their state income tax for retrofitting to state-defined standards an existing residential housing unit with either accessibility features or sensory modifications. Note that the current year appropriation for this tax credit is capped at $1 million and so applicants may receive a lesser, prorated amount if there are more than $1 million in credits requested. Also note that this tax credit is available for new construction. The link to DHCD’s Livable Home Tax Credit Program web site is www.dhcd.virginia.gov/HousingPreservationRehabilitation/Tax_credit_program.htm). The following figures are based on the National Reverse Mortgage Lenders Association’s Reverse Mortgage Calculator (National Reverse Mortgage Lenders Association, 2010). Given current interest rates at that time, Frank and Edie qualified for a lump sum withdrawal of between $57,150 to $161,250 after deducting financed closing costs and the home modification and repair costs, depending on whether they chose a fixed or adjustable interest rate, and whether the adjustable rate changed monthly or annually. Given the $30,000 needed for accessibility and roof repairs, they decided to withdraw that amount at closing and use the Tenure feature to withdraw $30,000 and use the Tenure feature to receive a monthly income of approximately $445 or $798, again depending on whether the loan adjusted monthly or annually. This amount approximated what Edie had been receiving from her part-time job on an after tax basis.

Case Study #2

Thelma and Loisette, sisters aged 67 and 60, inherited their rural home. Social Security is Thelma’s only income and Loisette stopped working within the last six months when a local business closed. Their home is a one story bungalow on well and septic, and with an assessed value of $89,000. Approximately three months ago, the septic system drain field failed and the Health Department is requiring them to install an advanced system costing $19,000. In addition, their shallow well has intermittently gone dry during drought periods. Their trusted minister, who also advises them on financial matters, suggested they contact a certain non-profit HECM counseling center to explore an HECM loan, and he accompanied them to the counseling session at their request. The HECM counselor also followed the HUD-required counseling protocol similar to Case Study #1, including generating print-outs of the various HECM loan options.

Given their failing septic system,
problems with the well, and low household income, Thelma and Loiise were asked if they had ever applied for the Virginia Department of Housing and Community Development’s “Indoor Plumbing Rehabilitation Program” (www.dhcd.virginia.gov/HousingPreservationRehabilitation/IndoorPlumbingRehabilitationProgram.htm) offered through the local Community Action Agency, as it appeared to the counselor that they may qualify for this 10-year, 0% interest, forgivable loan. Thelma and Loiise agreed that they preferred this option to an HECM loan and left the counseling session with information on how to apply. In addition, they had demonstrated an adequate understanding of the information discussed during the counseling session and were issued a HECM Counseling Certificate, just in case they wished to pursue this option. The counselor also pledged to contact them in a few weeks to determine if they needed any further assistance, a counseling follow-up action also required by HUD.

Conclusion

These case studies demonstrate the potential value of HUD’s HECM loan product and process. Older adults have demonstrated a preference for remaining in their homes and communities. However, many may be challenged, for most homes are not designed and equipped for decreasing mobility and other impediments to aging-in-place. Given the recent recession, many older adults may have diminished or depleted the savings that they were planning to use for retirement, and this exacerbates the problem of finding financing for retrofitting their homes. The mandatory HECM counseling process may be of critical assistance for seniors to explore their options, and the HECM loan product may allow them to continue living in their homes and communities, with dignity, for a longer time.

Study Questions

1. What are the prevailing mobility trends among older adults?
2. How do reverse mortgages and HECM loans address emerging needs among older homeowners?
3. Can you describe the key HECM loan and counseling features?

References


Resources

FHA Reverse Mortgages (HECMs) for Consumers, found at www.hud.gov/offices/hsg/sfh/hecm/hecmabou.cfm.

National Association of Homebuilders Certified Aging-In-Place Specialist (CAPS), found at www.nahb.org/page.aspx?category/sectionID=686.


Virginia Livable Home Tax Credit Program administered by DHCD, found at www.dhcd.virginia.gov/HousingPreservationRehabilitation/Tax_credit_program.htm.

About the Author

Bruce DeSimone is the Community Housing Officer for Seniors Housing at the Virginia Housing Development Authority. Prior to joining VHDA, he created and managed a housing department at a 10-county area agency on aging in Virginia. He earned a Master of City and Regional Planning degree from Rutgers University, is a member of the American Institute of Certified Planners, and is certified as a Housing Development Finance Professional by the National Development Council.