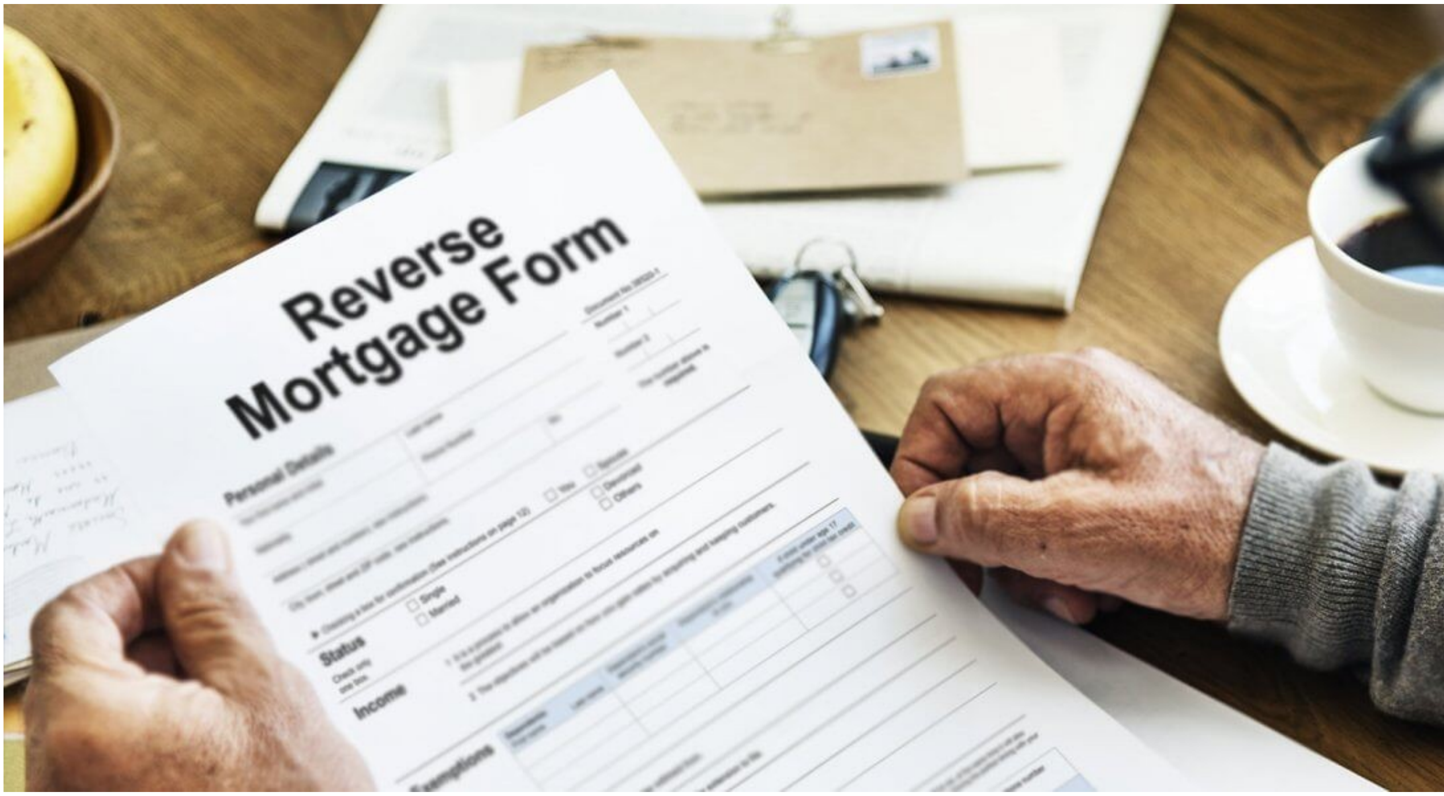
HOW DOES A REVERSE MORTGAGE WORK?

If you're nearing retirement age consider a reverse mortgage.

By David Peskin | Reverse Mortgage Funding



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If you're age 62 or older, a home equity conversion mortgage — commonly known as a reverse mortgage — is an important financial option. But what is a reverse mortgage? A reverse mortgage loan allows you to borrow against the equity you've built up in your home. Insured by the Federal Housing Administration, a HECM loan provides funds to help pay for the things you need or want — while you continue to live in and retain ownership of your home.

Reverse Mortgage vs. Conventional Mortgage

Unlike a conventional mortgage or home equity loan, a HECM offers a flexible repayment feature so you can better control your monthly expenses and cash flow. No minimum monthly loan payment is required; you can choose to pay as much or as little as you like each month. The loan doesn't have to be repaid until you sell the home, pass away or move out. But you can also pay down the loan at any time, with no penalty — the choice is yours.

If you have an existing first or second mortgage on your home, don’t be discouraged — you might still be eligible. In fact, many homeowners use a HECM as a way to continue owning and living in their home with greater financial flexibility.

Who Can Get a Reverse Mortgage?

You must meet a few requirements in order to qualify for a reverse mortgage. You must:

- Be age 62 or older
- Live in your home
- Own your home
- Pass a financial assessment to ensure that you can keep current with property taxes, insurance and maintenance.

Also, your home must be your primary residence and meet U.S. Department of Housing and Urban Development minimum property standards. Houses and most condos qualify, and homes with existing mortgages might, too.

Aside from meeting the aforementioned requirements, getting a reverse mortgage has other conditions. To get a reverse mortgage, you must:

1. Have a pre-loan consultation with an independent, FHA-approved reverse mortgage counselor
2. Fill out an application
3. Undergo a financial assessment

These consultations ensure that prospective borrowers understand whether a reverse mortgage is appropriate, and allow them to confirm their ability and willingness to meet loan obligations. Prospective borrowers should feel comfortable asking any questions so they can get information that helps them to understand exactly how a reverse mortgage works, and to determine if it is actually the best product for them.

Here are some questions to ask before taking out a reverse mortgage:

- How would a reverse mortgage help me accomplish my retirement goals?
- How would a reverse mortgage strengthen my retirement security?
- How long do I plan to live in my home?

Pros and Cons of Reverse Mortgages

In recent years, enhancements have been made to the HECM program. As a result, financial advisors and other trusted professionals have discovered that a reverse mortgage can be used in different ways as an effective part of a sound retirement funding strategy that can help people live with greater financial flexibility.

For example, today's HECMs can help homeowners aged 62 and older avoid tapping into their nest eggs in the early years of retirement. Using a reverse mortgage can significantly extend their retirement income, improve their lifestyles, help retirees maximize their Social Security benefits, and live the retirement they'd always imagined.

Advantages of a Reverse Mortgage

Reverse mortgages offer a number of positive features, including the fact that you can continue to own and live in your home. Before taking the plunge, understand all the advantages of such a financial plan so you can better see how it might work for you.

Here are some of the best aspects of a HECM loan:

- **Accessibility:** You can get your funds in a way that works best for you — a lump sum or a continuously accessible line of credit, for example.
- **Existing mortgage payoff:** You can use HECM funds to pay off your existing mortgage.
- **No monthly payments:** No monthly mortgage payments are required as long as you live in the home, continue to pay property taxes and homeowners insurance, and maintain the property.
- **Minimal out-of-pocket expenses:** With the exception of a counseling fee and an appraisal, most fees associated with a reverse mortgage can be financed with your loan. Closing costs and ongoing fees can be financed with the loan.

- **No extra taxes:** Generally, loan proceeds aren't considered taxable income. Consult a tax professional to make sure your situation meets the requirements.
- **Beneficial to heirs:** Research by Wade Pfau, Ph.D., CFA, shows that if used properly, a HECM could increase the amount of a client's retirement savings that could transfer to their heirs.
- **Access to more funds:** If the value of your home increases, you might consider refinancing your reverse mortgage to access even more loan proceeds.
- **Equity ownership:** After the loan is repaid, any remaining home equity belongs to you or your heirs.

To determine whether a HECM is the right solution for you, you should understand that challenges of this kind of loan. Here are some of the disadvantages to expect with a reverse mortgage:

- **Increasing balance:** The loan balance increases over time as interest on the loan and fees accumulate.
- **Decreasing assets:** A lien on your home will apply for the outstanding HECM amount, and as you use home equity, fewer assets are available. You can still leave the home to your heirs, but they'll have to repay the loan balance.
- **Higher fees:** Fees might be higher than with a traditional mortgage.
- **Effect on benefits:** Eligibility for needs-based government programs, such as Medicaid or Supplemental Security Income, could be affected. Consult a benefits specialist to find out details.
- **Sooner due date:** The loan becomes due and must be repaid when a "maturity event" occurs; maturity events include the last surviving borrower (or non-borrowing spouse meeting certain conditions) passing away; the home no longer being the borrower's principal residence; the borrower vacating the property for more than 12 months. The loan will also become due if the homeowner fails to pay his property taxes or homeowners insurance, or fails to maintain the property.
- **Required insurance:** Per FHA requirements, HECMs need mortgage insurance premiums.

As with any home-secured loan, you'll still be responsible for paying property-related taxes, HOA fees, homeowners insurance and other policies, and upkeep costs.

How You Can Receive Funds From a Reverse Mortgage

You have several options for how to receive your HECM loan funds. You can choose from the following arrangements:

- Lump sum
- Monthly advance — either for a fixed length of time, or as long as you live in the home
- Line of credit — the most popular option, because it gives you access to funds as needed. It's similar to a traditional HELOC, but with a number of additional advantages you won't find in a traditional HELOC.
- A combination of the three options

How you take your funds should be guided by how you plan to use them, according to Reverse Mortgage Funding LLC. Some effective ways to use reverse mortgage funds include putting the money toward:

- An emergency fund
- Monthly income
- Home improvements
- Healthcare costs
- In-home services
- Major purchases, such as a vehicle
- A more suitable home

Anyone already in or on the verge of retirement should ask their financial advisor about incorporating a reverse mortgage loan into their financial planning. A "retirement mortgage" can be a powerful tool that can help older Americans live the lifestyle they imagined and deserve, with greater financial flexibility, in the comfort of their own home.

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'When Reverse May Be the Right Direction, Get the Facts'

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