Real Deal on Reverse Mortgages

From the Office of Minnesota Attorney General Lori Swanson

With the cost of everything going up—from living expenses to health care to utilities—many senior citizens find themselves financially squeezed like never before. And with the baby boomers growing older, there are a lot more senior citizens than ever before.

Seeing these trends, some companies are marketing the "reverse mortgage" as a way for seniors to convert some of the equity in their home to cash to pay other bills. Reverse mortgages are now a $20 billion industry.

For some seniors, a reverse mortgage may be a suitable loan, but for others it is not. If you are considering a reverse mortgage, be sure to find out the "pros" and the "cons." Carefully evaluate whether a reverse mortgage is suitable given your needs and circumstances and consider whether there are other alternatives that may be more suitable for you. Steer clear of predatory lenders and scam artists who may want to steer you into a high-cost loan or sell you a reverse mortgage in order to get at your money.

In February, 2008 the U.S. Senate Committee on Aging held a hearing on reverse mortgages. Testimony showed that, in the face of the subprime mortgage crisis and with other investment sales tactics coming under criticism, some bad actors have switched to convincing seniors to purchase a reverse mortgage and then tie up the proceeds in long-term deferred annuities or bad investments, or sell the senior unwanted products. Make sure this doesn't happen to you.

What is a reverse mortgage? In a regular mortgage, the lender makes you a loan to buy a home, and you immediately begin to pay the loan back through monthly payments to the lender. A reverse mortgage is different. The lender loans you money based on the equity you have built up in your home. In a reverse mortgage, you essentially convert the equity in your home into cash. The cash may be paid to you in installments or a lump sum. You typically don't need to pay anything back as long as you live in your home. Rather, the loan generally must be repaid only when you die or move.

There are different kinds of reverse mortgages. Some, called Home Equity Conversion Mortgages, are federally insured by the U.S. Department of Housing and Urban Development. Others, called private reverse mortgages, are backed by private companies. Yet others, called single purpose reverse mortgages, are offered by government agencies or nonprofits.

Who qualifies for a reverse mortgage? You must be at least 62 years old to qualify for a federally insured reverse mortgage. You also must live in your home. There are no income or credit qualifications, because the loan is based upon other factors, like your age and the value of your home.

How much can I borrow? The amount of money you may borrow through a reverse mortgage depends on several factors, including your age, the type of product, the value of your house, and how much you owe on your house. Generally, the older you are, the more your house is worth, and the less you owe on your current mortgage, the more you can borrow through a reverse mortgage.

When must a reverse mortgage be repaid? You generally do not need to repay a reverse mortgage while you are living in your home. You must generally repay it when you or the last surviving borrower dies, moves, or sells your house. If you are the only borrower and you have lived in a nursing home or assisted living center for 12 months or more, your reverse mortgage must then be repaid.

How does interest accumulate? The amount you owe on the reverse mortgage will grow the longer you live in your home. Interest charges are added to the amount of the loan each day that you hold it, so that the total amount you owe may substantially grow over time. This may come as a surprise to some seniors. For example, a senior may take out a reverse mortgage loan for $200,000 and find that they owe over $400,000 ten or so years later. When you take out a federally insured reverse mortgage, you or your estate will not owe more than your home is worth when the loan is repaid. The reverse mortgage may grow to equal the value of your home, however, leaving you with nothing left in your house for you or your heirs. Because you still own your home, you are responsible to pay the property taxes, insurance, and costs of upkeep to your home.

REVERSE MORTGAGE TIPS

If you are considering a reverse mortgage, consider the following tips:

1. Consider your other options. If you need some cash, you may have other and better options. Have you looked into taking out a traditional home equity loan or line of credit, for example? Because of the high cost of reverse mortgages, if you only need to borrow a small amount of money for a short period of time, these types of loans may be a better option for you.

2. High up front costs. Reverse mortgages are not cheap. Lenders charge up front origination fees and closing costs. A reverse mortgage can be expensive, especially if you only plan to live in your home a few years. Make sure you understand all fees and costs. Don't think that you aren't paying high costs just because these expenses are paid out of the loan proceeds. Beware of agents who steer you toward high cost loans in order to make a profit for themselves.

3. Understand the product. Many seniors feel increased financial pressures as they age. If you spend all your home equity now, however, you will have even less to spend later, when your health care or living expenses may be even higher. Because you are deferring repayment of the reverse mortgage until you move out of your home or die, the amount you owe will grow substantially over time. This may mean that there will be little or no home equity left for you to pay long-term care expenses if you sell your house.

4. Beware of sales gimmicks. Be extremely cautious if anyone tries to sell you something—be it a new roof or another financial product like an annuity or long-term care insurance—and suggests that you pay for it with a reverse mortgage. There have been tragic cases around the country where aggressive agents convinced seniors to take out reverse mortgages and then put the proceeds into dubious investments, like long-term annuities. Some of these cases were discussed at the February, 2008 hearing before the U.S. Senate Committee on Aging, where stories were told of seniors whose assets were depleted and put out of reach. Taking out a reverse mortgage in order to buy long-term care insurance, an annuity, or to make an investment is almost always a bad idea, because the cost of the loan is usually more than you could earn on any prudent investment.

5. Beware of fear tactics. Some unscrupulous agents use fear to push their products. Be skeptical of agents who use fear of going into a nursing home or running out of money to sell you a reverse mortgage. Also beware of lenders or agents who tell you that the government has somehow endorsed the sale of reverse mortgages. Beware too, "educational seminars" by agents about reverse mortgages where the real purpose of the seminar is not to "educate," but to sell a reverse mortgage.

6. Beware of people who charge you to find a mortgage. In some cases, companies may charge you a fee to help you find a reverse mortgage. You should avoid such companies. They do for a fee what you can do on your own for free or little cost.

7. Get legitimate help. The law requires you to undergo counseling before anyone sells you a reverse mortgage. Some counseling is better than others, however. Some counseling is just over the telephone and may be by someone who is paid by the lender. Because a reverse mortgage is a complicated product and can have serious financial consequences, you should consult an independent attorney or trusted advisor before you enter into the transaction. Make sure any advice that you get is real and meaningful and addresses what you intend to do with the proceeds of the reverse mortgage and whether you have considered other options. Beware of "counselors" who don't spend adequate time to make sure that you really understand the product and have evaluated whether it is suitable for you based on all of your financial needs and circumstances. Beware of sales agents who tell you that counseling is only a formality and that you should ignore the counselor's advice.

8. Slow down. Remember, as in all consumer transactions, if it sounds too good to be true—it probably is. If your head is telling you "no," slow down and get help from a trusted independent advisor.

For more information, contact the following agencies:

United States Department of Housing and Urban Development (HUD)
Minneapolis Field Office
International Centre
920 Second Avenue South, Suite 1300
Minneapolis, MN 55402-4012

You may find a HUD-approved counseling agency by calling HUD at 1-800-569-4287 or by going online at: www.hud.gov

Minnesota Department of Commerce
85 East Seventh Place, Suite 500
St. Paul, MN 55101
(651) 296-4026
1-800-657-3602
www.commerce.state.mn.us

Office of Minnesota Attorney General
Lori Swanson
1400 Bremer Tower
445 Minnesota Street
St. Paul, MN 55101
651-296-3353
1-800-657-3787
TTY: 651-297-7206
TTY: 1-800-366-4812
www.ag.state.mn.us

Attorney Referral Service
Minnesota State Bar Association

If you can not identify an attorney to advise you, the Minnesota Bar Association's Attorney Referral Service is available online at:
www.mnfindalawyer.com

Additional attorney referral services are available at the county level in the following counties:

Hennepin County Bar Association
Referral Service
(612) 752-6666

Ramsey County Bar Association
Attorney Referral Service
(651) 224-1775

Dakota County Bar Association
Referral Service
(952) 431-3200