When a Reverse Mortgage is a Great Idea – And When it's Not

Senior citizens can save a lot of money with the right reverse mortgage. But there are pitfalls and trapdoors to watch out for. This gets into both sides of that equation.

What is a reverse mortgage?

There's no shortage of definitions for a reverse mortgage, but let's start with one from the federal agency that oversees them. The FTC describes a reverse mortgage like this:

"It allows you to convert part of the equity in your home into cash without having to sell your home or pay additional monthly bills."

You can use a reverse mortgage to pay for home improvements, medical expenses, travel, or anything else you can think of.

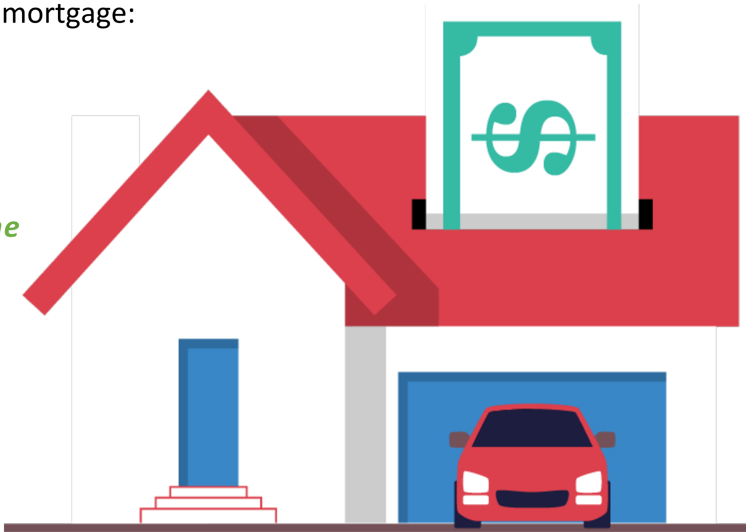
How does a reverse mortgage work?

If you have a mortgage now, you remember applying for a mortgage, getting a decent interest rate, paying lots of annoying fees, and then making monthly payments on, first the interest and then the principal of your home loan. Well, a reverse mortgage doesn't exactly reverse all of that, but it's close. The concept is clear: As the FTC says, "When you have a regular mortgage, you pay the lender every month to buy your home over time. In a reverse mortgage, you get a loan in which the lender pays you."

The problem is many people think a reverse mortgage is the complete opposite of a regular mortgage. They think, "Hey, remember all those fees I paid to get my regular mortgage? Well, I don't have to pay them on a reverse mortgage, right? Because it's the opposite!"

Not by a long a shot. When we cover the pros and cons of reverse mortgages below, you'll see that high fees are a definite con. But let's dispel the notion right now that a reverse mortgage is a 100-percent opposite thing from a regular mortgage. Before reading further, review the minimum requirements for even getting a reverse mortgage:

- ***You need to be at least 62 years old.***
- ***You need to own your own home.***
- ***It has to be your primary residence.***
- ***You need to have accumulated some equity in that home.***



Types of reverse Mortgages

Before the pros and cons, review the kinds of reverse mortgages you can get, because they're not all the same. Let's break down these three options.

1. Single-purpose reverse mortgage

A single-purpose reverse mortgage is pretty much what it sounds like. You can only use them for one purpose, and that purpose isn't up to you. It's up to the lender. For example, your lender might specify the reverse mortgage can only be used to pay for home repairs or to pay property taxes. But because of that, they're also the cheapest reverse mortgages you can get – if you can get them.

They're not offered everywhere for everyone. Some state and local government agencies offer them. So do some non-profit organizations. And it's quite common that you need to be a low or moderate-income homeowner to qualify.

2. Home Equity Conversion Mortgages (HECMs)

Home Equity Conversion Mortgages, or HECMs, are federally-insured reverse mortgages. They can be used for anything, but they come with many rules. First, you can get one only through a lender approved by the Federal Housing Administration. Second, you must meet with a counselor from an independent, government-approved housing counseling agency. Why? The government wants to make sure you know exactly what you're getting into, so you don't make a costly mistake.

3. Proprietary reverse mortgages

A proprietary reverse mortgage is the fancy way of saying it's a loan from a private company that's not insured by the FHA. They can make more of their own rules, although they still have to follow federal laws that protect your rights. In fact, some of these private lenders still require you to get counseling before they'll give you the loan.

Why would you want a proprietary reverse mortgage instead of an HECM? Well, the proprietary ones have no lending limits. Those HECMs cap out at just over $756,000, while proprietaries can run into the millions. So, if you have a small mortgage on an expensive house, you'll get more bang for your buck with a proprietary reverse mortgage.

That's just an overview of the three kinds of reverse mortgages, but you should know there are many more rules. Here's just one example: If you want an HECM, it must be a single-family home unless it's a four-unit rental property and you live in one of the units. You can also live in a condo as long as it's HUD-approved or a manufactured home as long as it's FHA-approved.

Pros and cons of reverse mortgages

Let's talk about the pros and cons of reverse mortgages, because there are some really big ones, and of course, you don't hear all about them from companies trying to sell you reverse mortgages.

The cons of reverse mortgages

Now usually, when you hear the term pros and cons, the pros come first. Well, we're discussing reverse mortgages, so we're going to reverse that and start with the cons.

Fees

Remember when you got your first mortgage? Remember how shocked you were at all the fees you had to pay – many you didn't even know existed before you started looking for a home? Well, a reverse mortgage doesn't reverse those fees. They're still there.

These fees depend on many factors, including the value of your home and what type of reverse mortgage you're applying for. But know this: You could spend thousands of dollars before you get thousands of dollars.

Thankfully, you can use the loan itself to pay for these fees, but as the federal CFPB warns:

"If you use your loan proceeds to pay for upfront costs, you won't have to bring any money to the closing, but the total amount of money you'll have available from the reverse mortgage loan proceeds will be less."

At the end of the day, between the interest rate, origination fees, mortgage insurance, appraisal fees, title insurance fees, and other closing costs, the total cost of your reverse mortgage could be as high as $40,000. Then again, consider this: A $300,000 mortgage at 4.5 percent over 30 years costs more than $245,000 in interest and fees. The conclusion here is this: Mortgages cost a lot of money, whether they're reversed or not.

Possibility of default

Here's a big problem with reverse mortgages that you don't see advertised in those enticing offers: If you fail to pay property taxes or even keep up with your homeowner's insurance, the lender can foreclose on your home. It seems like the crime doesn't fit the punishment, but it's true: Don't make these other payments, and you could lose everything.

There are ways to prevent this, called "set asides," and you'll learn all about those when you consult a housing counselor.

Less for your heirs

By definition, when you seek a reverse mortgage, you're taking out money now and leaving less for your heirs. If you want to leave your home to your heirs, they can still inherit the home, but they'd have to pay a mortgage debt that's been mounting instead of dwindling. The entire principal – plus accrued interest and service fees – must be paid in full to the lender before your heirs can take possession of the home. This debt might exceed the actual market value of the home. If they can't pay the debt, the lender has the right to foreclose and sell the property. Goodbye, inheritance.

No moving

Another restriction when you get a reverse mortgage: You can't move. If you do, you have six months to pay back the loan. This is true even if you need to move from your home to an assisted living facility because you can no longer take care of yourself. If you have a medical condition or illness, you have to repay the mortgage if you're out of the home for more than 12 months.

The pros of reverse mortgages

After all that negativity, let's review all the wonderful things a reverse mortgage offers.

Multiple options

You can choose a number of options for taking your funds. You can even mix and match among them, whether it's one lump sum, a line of credit you can tap as needed, or a steady stream of monthly advances for a set period of time. Again, it gets complicated, but it's much more fun to figure out the best ways to get money than pay money.

No more monthly mortgage payments

So this is the big difference between taking out a loan against your home and a reverse mortgage. Unlike, say, a home equity loan, a reverse mortgage actually ends your monthly mortgage payments. That's a sweet deal, right? You receive money without having to pay money. But like we warned earlier, you need to make sure you don't forget to pay your property taxes, insurance, and maintenance.

Keep government assistance

Seniors often worry about receiving new money because it might affect their Social Security and Medicare benefits. There are exceptions, but you don't lose your government assistance when you get a reverse mortgage. One of those exceptions is this: If you're on Medicaid or Supplemental Security Income (SSI), any reverse mortgage proceeds you receive must be used immediately. Otherwise, those funds could be considered an asset, which could impact your eligibility. Confusing, right? Yet another reason to consult a housing counselor before doing anything else.

Protected against falling home prices

A reverse mortgage is what's known as "non-recourse loan." That means neither you nor your heirs are personally liable if the amount of the mortgage exceeds the value of your home when the loan is repaid. To put that in plainer English: A reverse mortgage protects you against falling home prices. So even if the value of your home drops after you get your loan, it won't affect your loan. Even better, if the value of your home increases, you benefit. If your home *increases* in value in the future, you can refinance your reverse mortgage to access even more loan proceeds.

That home-value protection extends to your heirs. As the CFPB says, "If your loan balance is more than the value of your home, your heirs won't have to pay more than 95 percent of the appraised value. The remaining balance of the loan is covered by mortgage insurance." So you're not burdening your children. Conversely, after the loan is repaid, any remaining equity belongs to your heirs.

Avoiding scams and rip-offs

Some unscrupulous companies will urge you to take out a reverse mortgage and then invest your newfound funds with them. As the Federal Trade Commission says, "Resist that pressure." Reputable lenders help you secure a reverse mortgage for whatever you need the money for, not what they want.

Rather than describe all the different scams out there, let's focus on what they all have in common. Namely, they pressure you to make a decision right away. If anyone tries that with you, it's a huge warning. Better to ignore these people and consult a housing counselor who has your best interests in mind.

How to find the best reverse mortgage for you

Thankfully, there's no shortage of reputable online advice about reverse mortgages. Every question you could ever have is probably already answered by an expert. We've mentioned the Federal Trade Commission and Consumer Finance Protection Bureau as resources, but there are many more. And of course, there's us, too.

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