

A Reprint from *Tierra Grande*



Reversal of Fortune

By Jack C. Harris

Many retirees are feeling a pinch financially because the fixed-income assets they rely on are producing less income than anticipated while routine expenses, particularly health care, are rising. Reverse mortgages allow older homeowners to tap into accumulated equity for additional income. Borrowers generally use the proceeds of a reverse mortgage to pay off debt or purchase something to enhance their lifestyle, such as a recreational vehicle.

Today's reverse mortgage evolved from the reverse annuity mortgage (RAM) that emerged during the "creative financing" era of the early 1980s. When reverse mortgages were created, they could not be offered in Texas. According to the state constitution, with a few exceptions, a loan secured by a homestead was not a valid lien if the amount of indebtedness increased during the term of the loan.

In 1997, the Texas constitution was amended to allow both home equity loans and reverse mortgages. The leg-

islation included a long list of consumer safeguards for each of these loan types. However, some of the language in the provisions made the Texas version of the reverse mortgage so different from those offered in other states that the Federal Housing Administration refused to insure them, and Fannie Mae would not purchase them. Consequently, few reverse mortgages were written in the state until the constitution was amended in 1999 to remove the problem language.

In the 12 months ending Sept. 30, 2003, the volume of federally insured FHA reverse mortgages rose 39 percent from the previous year, which was 68 percent higher than the year before.

How They Work

A reverse mortgage is the opposite of a regular, or “forward,” mortgage. Ordinarily, a borrower gets a mortgage to buy or refinance a property. The lender advances funds to the seller at closing, and the borrower pays the accrued interest on the borrowed amount at the beginning of each month. Most mortgage loans are amortizing, so each payment includes repayment of some of the principal, causing the accrued interest to decrease over time. At the end of the loan term, the entire principal has been repaid.

With a reverse mortgage, the borrower either receives the proceeds as a lump sum payment at closing or arranges equal monthly payments over the loan term. With each disbursement and accrued interest, the principal balance of the loan increases. The borrower makes no payments during the loan term and, in fact, may pay all origination expenses from loan proceeds. So the reverse mortgage is a mirror image of a forward mortgage: the borrower receives — rather than makes — monthly payments, and the debt increases rather than decreases over the term. Because these loans are particularly appealing to older homeowners who have substantial equity in their homes, a reverse mortgage might be defined as “the bank pays and granny stays.”

The term of a reverse mortgage is indefinite. The loan comes due when the borrower no longer needs the home as a residence. In most cases, this is when the borrower dies, chooses to move or enters a health care facility on more than a temporary basis. The loan is fully repaid when the borrower sells the home. It is a nonrecourse loan, meaning that the lender may take the property pledged as collateral to satisfy a debt but may not take any other assets, no matter how large the loan balance becomes.

A borrower cannot be foreclosed upon for missing a payment, as there are no payments, per se. However, it is possible to default on a reverse mortgage contract and consequently precipitate the sale of the home. This could occur if the borrower commits fraud related to the loan (by providing false information to get the loan, for example), fails to keep the home in good repair, fails to pay taxes assessed against the home, fails

Comparison of Monthly Proceeds from Reverse Mortgage						
Value of Home	FHA HECM			Fannie Mae HomeKeeper Loan*		
	Borrower age			Borrower age		
	65	70	75	65	70	75
\$50,000	\$136	\$155	\$181	\$30 (\$16)	\$72 (\$38)	\$124 (\$72)
100,000	316	355	408	111 (86)	193 (111)	301 (193)
200,000	508	568	650	256 (207)	420 (256)	637 (420)

* The amount shown in parentheses assumes a spouse of the same age or older than the borrower.
Source: AARP

to insure the home or creates a lien with higher priority than the reverse mortgage (by failing to pay a repairman who then creates a vendor’s lien, for example). In any of these cases, the loan would become due immediately. The homeowner has the

option to repay the balance of the loan or let the lender sell the home to satisfy the debt.

Strangely enough, a reverse mortgage can be used to buy a home. Fannie Mae’s HomeKeeper for Purchase program allows a person over the age of 62 to purchase a home financed with a reverse mortgage. The purchase may require a substantial cash down payment, but there are no monthly mortgage payments for as long as the homeowner remains in the house. Check lenders or housing counselors to see if this product is available in your area.

Texas Reverse Mortgage Specifics

All property owners and their spouses must consent to the mortgage. Texas law requires all owners and their spouses to be 62 or older. The original threshold age of 55 was changed to comply with FHA and Fannie Mae requirements.

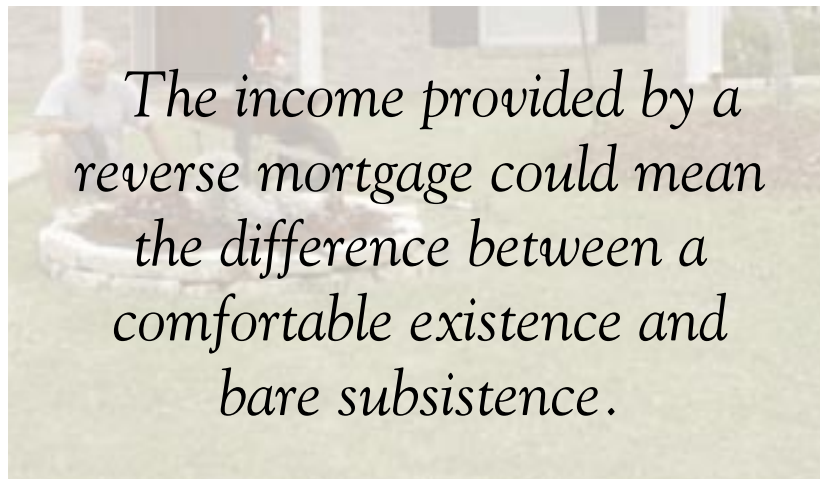
Reverse mortgages can be secured by either urban or rural homestead property. The amount of proceeds available is based on the borrower’s age and the value of their equity. Credit rating and intended use of the proceeds do not matter.

All payments are considered loan proceeds, not income, and therefore are not taxable.

The conditions that trigger acceleration and repayment of the loan must be disclosed to the borrower in writing. Borrowers must receive counseling on the conditions and the appropriateness of the loan to their needs and situations.

Loan proceeds may be distributed in several ways. A lump sum payment may be made at closing, or the borrower may receive payments at regular intervals, such as monthly.

Payments may be reduced at the request of the borrower but must not be discretionary; that is, a reverse mortgage cannot take the form of a line of credit. Reverse mortgage lines of credit are available in other states, but the Texas constitution prevents their use here. The lender is allowed to make special advances of funds needed to pay any expense that, if left unpaid, would jeopardize the loan, or to pay off any lien that has higher priority than the reverse mortgage.



The law expressly prohibits lenders from reducing payment amounts in response to an increase in the interest rate applied to the loan.

Most restrictions placed on home equity loans (such as the 80 percent limit on loan-to-value ratio and 3 percent limit on closing costs) do not apply to reverse mortgages. However, reverse mortgages must comply with federal law governing residential mortgages in general.

If there is a mortgage on the home, it can be retired from the proceeds of the reverse mortgage, even if the debt is considered a home equity loan.

FHA Versus Fannie Mae

All reverse mortgages are originated by private lenders. Two types of loans are available in Texas. The Home Equity Conversion Mortgage (HECM) is funded by private lenders but insured by the Federal Housing Administration (FHA). The FHA insures that the lender will be able to recover the full amount of principal and interest when the loan is terminated, and that the borrower will receive the contracted loan proceeds no matter what becomes of the lender. The borrower pays an insurance premium out of loan proceeds.

The second loan program is Fannie Mae's HomeKeeper program. Fannie Mae buys conforming reverse mortgages from originating lenders. These loans carry an origination fee and monthly servicing fee, both paid from loan proceeds.

In almost all cases, the FHA-insured HECM provides a larger monthly income than a Fannie Mae loan. Fannie Mae reduces the amount that can be borrowed if there is more than one homeowner. How much can a homeowner borrow? The amount varies by the borrower's age and the value of the home (see table). Older borrowers and those who are single get a higher amount because they are expected to keep the loan a shorter time.

Considering the difference in income, why would someone choose the Fannie Mae option? The FHA reverse mortgage amount is restricted by federal law, just as FHA forward mortgages are. The amount is generally lower than the limit on loans Fannie Mae can buy. So someone with an expensive home may receive a larger benefit with the Fannie Mae loan, which also can be applied to new homes and condominiums, unlike the FHA loan.

Another major difference in the loan programs is the way the interest rate is adjusted. There are no "fixed-rate" options. All reverse mortgages carry adjustable interest rates. With HECMs, the borrower may choose between annual and monthly rate adjustments. In either case, the interest rate is adjusted according to the current rate on one-year Treasury yields plus 1.5 percent for monthly adjustments and 2.1 percent for annual adjustment. HomeKeeper loans are pegged to certificate of deposit rates plus a margin of 3.4 percent. These particulars will not matter much to borrowers unless they want to pay off the loan and redeem the home in the future.

Special Considerations

While to many, getting a reverse mortgage may seem a "no brainer," serious consideration should go into the decision. The income provided by a reverse mortgage is not enough for most retirees to live on, but it could mean the difference between a comfortable existence and bare subsistence.

Who should consider getting a reverse mortgage? Anyone who plans on living in their present home for as long as they can. Those who have plans to move to another part of the country or believe they may need to enter a health-care facility in the next several years may not want to tie up their home in a reverse loan agreement. Because the line of credit option for reverse mortgages is not available in Texas, anyone who thinks they will need access to large amounts of money in the future may want to delay applying for a reverse mortgage until the need is imminent.

Some people are reluctant to consider a reverse mortgage because they wish to leave their home to their heirs. This is possible with a reverse mortgage, but the amount of equity bequeathed is reduced. The heirs have the option to pay off the reverse mortgage (possibly with a new forward mortgage) and keep the home or receive whatever proceeds are left from the sale of the home after the reverse loan is repaid. This may be a problem if the heirs are living in the home or plan to live in the home and are counting on inheriting it debt-free.

Anyone contemplating a reverse mortgage should seek advice from the professional who handles their estate planning and other financial matters. This type of financial decision should be coordinated with the homeowner's overall financial plan. Those who do not have access to such professionals should consult with a local housing counselor, possibly in conjunction with the counseling required to apply for the loan. ♣

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For More Information

FHA

www.hud.gov/buying/rvrmort.cfm

Fannie Mae

www.fanniemae.com/global/pdf/homebuyers/moneyfromhome.pdf

National Reverse Mortgage Lenders Association

www.reversemortgage.org

AARP

www.aarp.org/Articles/a2003-04-07-homemademoney.html

www.aarp.org/Articles/a2003-03-21-whatarecosts.html

To find a local reverse mortgage counselor

AARP Counseling Reference Line at 1-202-434-6082

For lenders that offer reverse mortgages in Texas

www.reversemortgage.org/Lenders%20Lists/States/texas.htm

For FHA-approved lenders

www.hud.gov/ll/code/llplcrit.html



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