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Reverse Mortgage Cutback Slashes Cash for Seniors

By CNBC
 Published Sunday, 14 Apr 2013 9:08 AM ET
 By Mark Koba
 Senior Editor, CNBC

Seniors looking for a big cash payout from a reverse mortgage will have to look elsewhere for needed funds.

A small but increasing number of defaults on the loan product has prompted a crackdown by the Federal Housing Administration (FHA) on the biggest payout loan to homeowners.

The basic theory behind reverse mortgages — you must be 62 or older to apply — is that instead of making payments to a lender like in a traditional mortgage, the borrower receives non-taxable money from the lender, which does not have to be paid back as long as the person lives in the home.

Borrowers are now restricted in how they get one type of reverse mortgage known as the standard fixed rate Home Equity Conversion Mortgage Loan, or HECM.

The HECM has been the most popular with borrowers because it yields the greatest amount of money — often in the hundreds of thousands of dollars — in one lump sum. HECM loans are still available — but instead of having fixed mortgage rates, they are offered only with variable rates, which yield less immediate cash.

"The standard HECM loans have proven to have an unusual number of defaults," said Delores Conway, associate dean and professor of real estate at the University of Rochester. (Read more: [Obama's Budget Could Cap More IRAs in Future Years](#))

"By taking so much cash up front, homeowners have less money in later years to keep up with property taxes and other housing expenses they have to pay even with a reverse mortgage," Conway added. "That, and falling property values, have increased defaults."

Financial Lifeline

The FHA insures some 90 percent of reverse mortgages purchased from private lenders. It says about 58,000 loans — or nearly two percent of its reverse mortgages — were in default in 2012. That's up from 2 percent ten years ago.

The FHA says it faces some \$2.8 billion in losses from the defaults, which could force it to seek a bailout from the federal government next year.

By halting the fixed rate standard HECM, the FHA said in testimony before Congress late last year that it hopes to prevent more defaults in the future.

"This does limit an option for people thinking about reverse mortgages, but you can understand why the FHA is doing this," Conway explained. "There's some real concern about people spending their cash too soon and defaulting."

Reverse mortgages are often thought of as a financial lifeline for seniors, especially with medical costs rising for an explosion of retiring baby boomers. (Read more: [US Should Mandate Higher 401\(k\) Savings; Fidelity Exec](#))

The amount of the loan is based on the equity or sale value of the house, as well as the type of interest associated with the loan. Payments to borrowers are monthly for a specific time or as long as the borrower lives in the house.

The borrower retains title of the home, but the loan does have to be repaid when the person dies, sells the property or no longer uses the home as his primary residence.

Borrowers still have to pay property taxes, home owners' and mortgage insurance and any other home maintenance fees. Before applying, potential borrowers must meet with a government approved housing agency for counseling.

Critics of reverse mortgages say they come at too high of a price. Interest rates can be steeper than traditional loans — current rates are between 4 and 12 percent. There's also closing costs and up front fees, which can average anywhere between \$2,000 and \$15,000 depending on the lender and type of loan.

"Reverse mortgages are not a one-size-fits-all product," said Steven Weisman, an asset law attorney and professor at Bentley University.

"For people who are cash poor and need to cash out and need the money to stay in their homes, the product may be helpful," Weisman explained.

"However, reverse mortgages are a very expensive way to borrow money and should not be used as a first option when perhaps there are other, better options," argued Weisman.

"Reverse mortgages are touted as a financial planning tool for seniors, however, I do not recommend them for my clients," said Tara Wilson, general counsel at Wilson LF, a law firm specializing in estate planning.

"Not only are the transaction fees excessive, but they are usually a stopgap that leave seniors in a much worse financial position when they are exhausted of their funds from the loan," Wilson said.

Industry insiders say those critical of the loans don't really understand them or the potential benefits they provide.

"Reverse mortgages are very popular and have something for everyone," said Greg Smith, president of ORMA, a reverse mortgage firm which handled some 5,000 reverse mortgage loans last year.

"These loans are no more complicated than any other type of loan. It's a mainstream program and should be part of someone's financial planning," said Smith, whose firm uses actor Henry Winkler as its spokesman on TV commercials.

"They are a great cash flow tool even with the new restrictions. More people will take them out in the future," Smith said.

Lending for HECMs was down 25 percent in 2012. Only 54,691 loans were issued — the third straight year of falling loan volume and far below the peak year of 2009, when 115,000 loans were originated.

But more seniors are expected to apply for the loans in the years ahead. Seniors who need cash for health care and other expenses as they face limited retirement funds or job losses. (Read more: [Social Security Cuts 'Not Humane'](#))

The bottom line for Delores Conway is to proceed with caution.

"There could be better options but seniors should look at everything including reverse mortgages," said Conway. "For some people they are great. They get a monthly payment, get to stay in their home. It could improve their financial situation. It just depends on what they want to do."

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The_Mick | Apr 14, 2013 01:05 PM ET

A number of friends and acquaintances of mine are either considering reverse mortgages or consider them to be "insurance policies" in case they can't keep up with expenses in the future.

Some say "The reverse home is a simple decision to get all my assets before liquidated assets of the IRS, but I don't think they really need it. I need."

At any rate, for good (don't need one though, because of the new requirements, I'd probably need cash for it).

It's too bad that these reverse mortgages apparently can't require the inclusion of an expense account to cover insurance and property taxes like regular mortgages do. That way people wouldn't miss out on paying taxes or have the house foreclosed.

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DeaconBlue2 | Apr 14, 2013 07:22 PM ET

The Government should have gotten involved with this. Now the FHA is looking at 2.8 million dollars and will call for a loan backed. So now the has people to deal with again, but like when the Fed Gov lowered qualifications for home loans on people who couldn't really afford to buy a home could anyway. There weren't that many requirements then, very smart individual.

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