Reverse Mortgages for Seniors

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- Home equity is often a senior's largest untapped asset. For those seniors who have limited resources to meet their living expenses and who own their own home, a reverse mortgage can be one solution to generating additional income.

For many seniors the value of their home is their largest asset. Depending on the amount of their living expenses and their other financial resources, some seniors may find themselves "house rich and cash poor." One technique to generate additional retirement income is to obtain a reverse mortgage, which allows you to borrow from the equity in your home. Long considered a strategy of last resort, reverse mortgages have become more popular as their costs and seniors' financial resources have declined.

The Basics

In essence, a reverse mortgage allows you to convert your home's equity into cash. To qualify for a reverse mortgage, you must be at least 62 years old and your home should be your primary residence and have little or no mortgage. Your income and credit are not verified. The maximum amount of equity that may be borrowed is $625,000, but the available borrowing is dependent on several factors, including the home's appraised value, the interest rate, and the age of the youngest borrower. The older the youngest borrower, the more that can be borrowed up to the $625,000 limit.

The borrower elects how they wish to receive their cash: as a lump sum, a monthly payment, or a line of credit. However received, the cash is considered to be tax-free income and can be used for any purpose.

Repayment of the loan occurs only after one of the following occurs: (1) you no longer occupy the home as your principal residence, (2) the last remaining owner passes away, (3) the home is sold, or (4) you permanently move out. The amount that is ultimately owed on a reverse mortgage cannot exceed the underlying home's value.

Though a reverse mortgage may be seen as a panacea, there can be drawbacks. For example, while a reverse mortgage does not affect Social Security or Medicare benefits, it can impact Medicaid and other government-sponsored aid programs. You should consult with an elder law attorney to determine the impact a reverse mortgage could have on your situation. In addition, if you have equity in excess of the borrowing limit, you will not be able to borrow that excess equity. Finally, if you expect to move from your home within a few years, the cost of securing a reverse mortgage can make such a mortgage uneconomical.

The Costs

Costs incurred for a reverse mortgage are similar to those of a standard mortgage, are often capped by federal guidelines, and most may be financed as part of the mortgage. Most reverse mortgages fall under the FHA-insured Home Equity Conversion Mortgage (HECM) program, which charges a 2% origination fee on the first $200,000 and 1% thereafter, with a $6,000 cap. A minimum insurance premium (MIP) of 2% is also charged, plus an annual premium of 0.5% of the outstanding loan balance thereafter. The MIP provides a guarantee that if your loan servicer ever goes out of business, the federal government will continue to provide access to your funds. The other costs associated with a reverse mortgage, such as an appraisal fee and closing costs, are consistent with standard mortgages.

The HECM Saver option, introduced in October 2010, has significantly reduced origination and MIP fees. Under this program, some lenders have reduced or eliminated their origination fee and the MIP is now 0.01%, though the offset is less of your home's equity may be borrowed against.

For cash-strapped seniors who wish to remain in their home and who have significant home equity, a reverse mortgage can be one solution to meeting life's expenses.