SILVERSAGE Planning Matters

REVERSE MORTGAGES –
WHAT SHOULD YOU AND YOUR PARENTS KNOW BEFORE APPLYING?

The number of reverse mortgages backed by the government jumped nearly 20 percent in March and April alone from the same period in 2008. At a time when seniors have seen their retirement assets depleted by market losses, tapping home equity has been a safety net. But it can be a risky one.

If your parents are at least 62 years of age and have significant equity in their home, a reverse mortgage can turn that equity into tax-free cash without forcing them to move or make a monthly payment.

If it's right for them, it's a worthwhile financial tool. If not, they could make some serious mistakes with their financial future.

A reverse mortgage gets its name because of the way it works. Instead of the borrower making payments to the lender, the lender releases equity to the borrower in a number of forms:

- A lump sum cash payment;
- A monthly cash payment;
- A line of credit (which tends to be the most popular option);
- Some combination of the above.

When the owner dies or moves away, the house can be sold, the loan paid off and any leftover equity value can go to the living owner or the designated heirs. Heirs don't have to sell the house. They can either pay off the reverse mortgage with their own funds or refinance the outstanding loan balance within six months with the option of two 90-day extensions that must be applied for.

There are three basic types of reverse mortgages:

- *Single-purpose reverse mortgages,* which are offered by some state and local government agencies and nonprofit organizations;
- *Home Equity Conversion Mortgages (HECMs)* are federally insured reversed mortgages backed by the U. S. Department of Housing and Urban Development (HUD);
- *Proprietary reverse mortgages* are private loans that are backed by the companies that develop them.

The size of a reverse mortgage is determined by the borrower's age, the interest rate and the home's value. The older a borrower, the more they can borrow, but the amounts are capped by the maximum FHA loan limit for each city and county.

Reverse mortgages have traditionally been chosen by older Americans who can't cover everyday living expenses or who otherwise need cash for such things as long-term care premiums, home healthcare services, home improvements or to pay off their current mortgage or credit card greater than their income can support. More recently, though, they've become popular with individuals who see them as a better alternative to home equity lines. Some use the proceeds to supplement monthly income, buy a car, fund travel and second homes and evaluate with the help of a financial adviser if reverse mortgage funds can be used to

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restructure estate taxes.

Elderly borrowers will have to consult with a financial advisor before they're granted this loan – that's one of the requirements. They should consider a Certified Financial Planner ™ professional to do this because reverse mortgages can be complex and risky. This step can be completed within the first few days of the process. The basic loan closing now takes place in about 30-40 days from the date of application. Generally the only out-of-pocket cost is an appraisal fee ranging from $300- $500.

Here are other things to consider:

Cost can be substantial: Reverse mortgages are generally more expensive than traditional mortgages in terms of origination fees, closing costs and other charges. The basic FHA-backed HECM loan finances these fees into the initial loan balance, and they can run between $12,000-$18,000. The loans are based on anticipated home value appreciation of 4 percent a year, so if the housing market is healthy, those costs are generally recovered in a short period of time. But if the housing market sours, it will definitely take longer to recoup those fees.

They'll need to make sure they're not endangering their Federal retirement benefits: The basic FHA HECM is designed as tax-free income to the senior receiving their Social Security income. However, if their total liquid assets exceed allowable limits under federal guidelines, they might endanger your benefits. This is another critical reason to work with a financial adviser on this decision.

Rates can be higher: Reverse mortgages have rates that are typically higher than those charged on conventional mortgages. Interest is charged on the outstanding balance and added to the amount they owe each month. Again, check the total annual loan cost.

Their mortgage can be called: The homeowner or estate always retains title to the home, but if they fail to pay your property taxes, adequately maintain their home, pay their insurance premiums, or change their primary residence, the lender can declare the mortgage due or reduce the amount of monthly cash advances to pay those overdue amounts.

The family needs to talk. If your parents' house is their major asset, getting involved in a reverse mortgage may not leave much to the next generation – if it appreciates, there may be some difference that the kids can have. That's why that in addition to discussing a reverse mortgage with a financial adviser, parents and their adult children need to talk with their family.

August 2009 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Jeffrey M. Garell, CFP® and Daniel D. Sands, CFP®, local members of the Orange County FPA.

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