The Reverse Mortgage: Financial Lifeline or Financial Trap?

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For many seniors, getting a reverse mortgage will be the last major financial decision they’ll ever make.

Reverse mortgages are not suitable for everyone or for every situation. If you are considering a reverse mortgage, make sure it is 100% suitable and you are 100% comfortable with your decision before going forward.

Providers of reverse mortgages often market these loans as a great way to get cash, without painting a clear picture of their risks. A United States Government Accountability Office study found that most reverse mortgage ads are false or misleading. Before you go through with a reverse mortgage, be 100% sure you understand the risks, which can include loan defaults, loss of public benefits, foreclosure, and homelessness, among others!

The California state legislature considers the perils of reverse mortgages so serious that it has made a legal requirement that loan providers offer potential borrowers a suitability worksheet. This pamphlet contains seven questions that you need to ask yourself before committing to a reverse mortgage loan.

Many seniors have tragically fallen victim to the often predatory reverse mortgage industry and have lost their homes. Nationally, one out of ten reverse mortgage loans are in default. It is in your very best interest, and in the interest of your family and loved ones, to consider the suitability questions as carefully as you can. The information and resources listed in this pamphlet are designed to help you make sure that you have made the right decision for your future.

If you find this pamphlet helpful, we ask you to share it with others - help us spread the word!
What is a Reverse Mortgage?

Reverse mortgages are loans that allow those 62 or older to borrow against the equity they hold in their homes.

Repayment of the loan is due on the death of the borrower or when the borrower moves, or is absent from the home, for 12 consecutive months.

They are non-recourse loans, so only the home is the guaranteed collateral for repayment. Because of this, the loan balance will never exceed the sale cost or appraisal value of the home when the loan is due.

Reverse mortgages do not provide borrowers with 100% of the senior’s equity in the home. They are very expensive interest-accruing, compounding loans. The loans include origination fees and require continuing payments of loan insurance that protect the lender, not the borrower.

Borrowers will have an ongoing responsibility to keep paying the insurance, property taxes and home maintenance for the loan to remain in good standing. Failure to keep up with these payments will lead to default and foreclosure.

Reverse mortgages were originally designed as a way to access ready money for seniors in debt, who have no other options. They now are being pitched as a way to “live the good life,” make gifts to family and friends, remodel homes or play the stock market. This may all sound like great fun, but beware of the many downsides! Reverse mortgages are not unlimited ATM machines. There is a limit to the equity that can be extracted. Always ask yourself, what will you do when you’re tapped out? What is your “Plan B”?
Seven Questions to Consider Before Getting a Reverse Mortgage Loan

1. What will happen to others living in your home after the borrower dies or moves out?

   • Who is currently living with you?
   • What will they do when you die or move out?
   • Have you discussed this with those living with you or any of your family members?
   • If your heirs can’t pay off the loan, the home will pass into foreclosure.

Example:

Margaret borrowed $200,000 and when she passed away, her reverse mortgage loan balance was $286,000 and it became immediately due. Margaret’s disabled son, Joseph, who was also living in the home, was supposed to inherit the home. Joseph could not raise $286,000 to pay off the loan. The home went into foreclosure and Joseph was evicted.
2. Did you know that you can default on a RM loan?

• What will you do once you’ve reached your equity withdrawal limit?
• Will you have the funds to keep up with taxes, insurance and home maintenance?
• Will you have the ability to finance alternative living accommodations, such as assisted living?

*Example 1:*

Sarah took out a reverse mortgage line of credit at the age of 65 and began taking monthly payments. By the age of 78, Sarah had reached her equity withdrawal limit and all the payments stopped. She was living on social security and could no longer afford to cover her costs. She fell behind on her property taxes and loan insurance. She defaulted on the loan and her home went into foreclosure.

*Example 2:*

When Juan was 71, he took out a reverse mortgage, took a world cruise, and made generous gifts to his children and grandchildren. At the age of 85, Juan’s health had declined to the point where he needed to move to an assisted living facility. The balance of his reverse mortgage was $350,000 and the market value of his home was $320,000. Juan now held no equity in the home, had no savings and was not able to afford to move into assisted living. Juan was forced to move into the home of one of his daughters.
3. Are you intending to use the reverse mortgage to purchase a financial product?

- How liquid is the financial product you’re considering?
- What are the commission rates, surrender fees and service charges for the product?
- The debt of a reverse mortgage will likely outpace the rate of interest generated by any financial product.

*Example:*

Boris passed away 10 years after taking out a $100,000 reverse mortgage and investing the proceeds in a stock portfolio. He was fairly successful in his investments and at the time of his death his portfolio was valued at $160,000. Unfortunately, at the time of his death, the balance on his reverse mortgage was $206,000. His heirs were unable to come up with the additional $46,000 to pay off the loan and had to sell the home.
4. Have you considered the impact a reverse mortgage loan might have on your eligibility for government assistance programs?

- If you move out of your home (for example, into a nursing home) for 12 consecutive months, the reverse mortgage becomes due and your house may have to be sold to pay for the loan.
- Proceeds from the sale may disqualify you from receiving Medi-Cal.
- A reverse mortgage interferes with your ability to transfer the home and avoid a Medi-Cal recovery claim.

Example:

Fatima had a bad fall and had to go into a nursing home. Because all of her assets were exempt for the purpose of qualifying for Medi-Cal, she was eligible for government benefits. After 12 months in the nursing home, her reverse mortgage automatically became due and the house had to be sold to pay off the balance. After paying off the loan, the remaining proceeds of the sale made her ineligible for Medi-Cal and she had to use the net proceeds from the sale of the house to pay out-of-pocket for her nursing home care.
5. If you have a spouse whose name is not on the property title, do you know that your spouse is labeled a “non-borrower spouse” with no automatic right to remain in the property after you die or permanently move from the home?

Example:

When Jiang moved permanently to a nursing home at the age of 77, his wife Ling, age 70 was also living in the home. When Jiang had taken out a reverse mortgage at the age of 62, Ling had only been 55 years old and was ineligible to have her name on the loan. Upon Jiang’s death, the loan became due and Ling had no rights to stay in the home. She had to move out-of-state to live with a relative.

6. Do you understand what will happen with your home when you die or it becomes necessary to move out of your home?

Example:

When Elisa died, her $450,000 reverse mortgage loan came due and her home went into foreclosure. Patrick, her non-borrowing spouse, did not have the means to pay off the loan as a lump sum and the lender was not obligated to set up a payment plan with him. Unable to meet the lender’s demands, Patrick was forced to sell the home.
7. Have you explored less expensive options?

- Alternatives to a reverse mortgage may include less costly home equity lines of credit, property tax deferral programs, government aid programs, downsizing or home sharing.
- Have you considered family lending plans or other contractual arrangements?

Example:

Instead of taking out a reverse mortgage from a commercial lender, Ben made a deal to borrow from three of his six children at a lower interest rate. Just like a reverse mortgage loan, he used his home equity as collateral. This enabled him to continue to live in his home for the last 5 years of his life without having to owe the high interest rate to the commercial lender. After his death, the home was sold and the proceeds were used to pay his debt to the lending children, with interest. The remainder of the proceeds from the sale of the home were split equally among all six siblings.

CONCLUSION

Not all reverse mortgage loans end in loss of the home. For those who are not concerned with leaving a home to family or heirs, a reverse mortgage may help in providing supplemental income or financial support to maintain the home while you are alive. However, reverse mortgages can be expensive propositions to those who are seeking easy access to cash. They may also trigger a foreclosure if you fail to maintain the property or fall behind on property taxes and insurance payments. Finally, they can be seriously detrimental to those wishing to pass the home to the next generation.
More information and resources

CANHR - Home Equity Protection Program
(Offers more detailed worksheet version of the seven questions in this pamphlet as well as an Inter-Family Loan Program)
http://www.canhr.org/hepp/
(800) 474-1116

Consumer Financial Protection Bureau
https://www.consumerfinance.gov/consumer-tools/mortgages/
(855) 411-2372

AARP Foundation
https://www.aarp.org/money/credit-loans-debt/reverse_mortgages/
1-800-209-8085

HUD’s HECM Program
https://www.hud.gov/resource/offices/housing/sfh/hec/mac/hec/mhome

National Shared Housing Resource Center
https://nationalsharedhousing.org/ (802) 863-5625

Where to Report Reverse Mortgage Fraud

• California Department of Real Estate
  www.dre.ca.gov/consumers/WhoDoYouCall.html

• Federal Trade Commission
  www.consumer.ftc.gov/articles/0192-reverse-mortgages
  1-877-FTC-HELP

• Consumer Financial Protection Bureau (CFPB)
  www.consumerfinance.gov/complaint/
  1-855-411-CFPB or TTY/TDD (855) 729-2372

• Office of the California Attorney General
  https://oag.ca.gov/contact/consumer-complaint-against-business-or-company