wtop news

Using your home’s value to protect your retirement fund

Sarah Jacobs | sjacobs@wtop.com
August 5, 2022, 5:45 AM

A reverse mortgage is a product that was once considered a “loan of last resort,” but is now one of the most-developed loans in the mortgage industry that borrowers can even use as a hedge against inflation.

Reverse mortgages allow qualified homeowners to tap into their home’s equity while retaining homeownership. They’re called reverse mortgages, because instead of making monthly payments to a lender, the lender pays the borrower.

Qualified borrowers can receive those payments in a variety of ways: as cash up front, in monthly installments, or in a line of credit to be used strategically, if and when it’s needed.

Steven Sless is president of the reverse mortgage division at Primary Residential Mortgage, Inc., with offices in Maryland.

“When reverse mortgages were developed way back in the ’60s, they were really meant to be a product that would allow folks to leverage their housing wealth, but not necessarily take large portions of cash out,” Sless said.

Over the years, the loans were marketed and promoted as loans of last resort, though they were never designed to be that way.

“For most folks, their home is their largest asset, and the reverse mortgage was developed to be able to introduce housing wealth into the overall retirement picture,” he said.

But up until 2015, Sless said, qualifying for a reverse mortgage was way too easy.
"Prior to 2015, if you were over the age of 62 — and quite frankly, if you had a pulse — we could give you a reverse mortgage," Sless said. "There was no income qualification, and we didn't even need to run a credit report, as crazy as that sounds."

A lot of retirees were finding that after they took out a reverse mortgage, their funds were exhausted, and many were foreclosed on for failure to meet the loan obligations, he said.

But in 2015, the Department of Housing and Urban Development and the Federal Housing Administration stepped in and tightened up the loan requirements. Now, it's more difficult to qualify for a reverse mortgage, which Sless says is a good thing.
"It's no longer a loan of last resort. It's a loan that is designed to provide folks with greater flexibility as they age in place, in the comfort of their home," Sless said. "In fact, many of our clients are referred from financial advisers."

In addition to the financial loan qualifications, reverse mortgage borrowers are required to pay property taxes and homeowner's insurance, maintain the home and live in the home as their primary residence.

For people at or near retirement age, the bulk of their net worth is often tied up in their home equity — about 74% of the average American retiree's net worth, Sless said. They could access it through a home equity line of credit — or HELOC — but there are some risks. A HELOC can be suspended, reduced or frozen at the discretion of the lender at any time, as many retirees learned during the recession between 2007 and 2010.

But a reverse mortgage is federally insured, guaranteed by the FHA and HUD, and it can never be frozen, suspended or reduced, regardless of the economy or the value of the borrower's home.

The loan amount for which a borrower qualifies is based on the value of the home, the age of the youngest borrower, and the prevailing interest rates, but Sless said a general rule of thumb is about 50% of the home value. So, simple math, with a $400,000 home, the borrower would qualify for about $200,000.

"Now, you may also have a $100,000 traditional mortgage, in which case we would pay off the mortgage, eliminating your monthly payment, and on top of that, you'll be qualified to receive $100,000," Sless said.

A reverse mortgage is still a loan, however, and it must eventually be paid back, but there is flexibility in how that happens. Borrowers may choose to make payments on their own schedule or not at all. They can defer paying back the loan, including interest and any applicable mortgage insurance, until they permanently leave the home.

Deferring payment could cause the value of the home to drop as the interest accrues, but another important feature of the reverse mortgage is they are “non-recourse.” That means the borrowers’ heirs and estate will never be left with a debt, even if the reverse mortgage balance is greater than the home value.

“Best case scenario, the heirs sell the home, repay the reverse mortgage and walk away with the additional proceeds,” Sless said. “Worst case scenario [if the balance is more than the home is worth], they just simply turn in the keys and walk away.”

Sless notes that older homeowners are concerned about outliving their money, especially as inflation persists, the stock market fluctuates and they see the bottom line on their retirement accounts shrinking. A reverse mortgage can help soothe the pain of inflation while protecting and prolonging the retirement nest egg.

“Understanding how to use a reverse mortgage to strategically and tax efficiently incorporate those funds into their retirement plan just may be the key to them living a more comfortable retirement without being so stressed about inflation.”

While there can be advantages to a reverse mortgage, there are drawbacks, as well. The terms of the mortgage can be complex.

Reverse mortgages can come with extra costs and high fees, including origination fees and mortgage insurance, according to Forbes.

The federal Consumer Financial Protection Bureau says origination fees can not exceed $6,000, but borrowers should keep in mind that they also have to pay real estate closing costs, which may include appraisals, title searches and other recording fees. Another cost, the agency says, is the initial and annual mortgage insurance premium that is charged. Those costs can be rolled in the loan, but the loan will then be smaller.

Forbes also reports interest rates can be variable. Interest is not tax deductible. And, if you fail to uphold the terms of the loan, you may have to pay it off early.

For those on Medicaid and Supplement Security Income, Forbes says reverse mortgage funds can impact eligibility.

The Consumer Financial Protection Bureau lets you search for counseling agencies to help you with your decision and offers a list of questions to ask