



Secrets of Tax-Free Reverse Mortgage Income for Senior Citizen Homeowners

A Special Report From Real Estate Expert Bob Bruss

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A few weeks ago, I was fortunate to be invited as a guest speaker at real estate editor Harold Bubil's annual "Ask the Real Estate Experts" event, sponsored by the **Sarasota Herald-Tribune**. Before the interview program began at 1 PM, we speakers had an hour to talk one-to-one personally with some of the several hundred attendees at the beautiful Lakewood Ranch Country Club. Among those who asked me questions, I especially remember a sweet white-hair lady who said she was "about 80."

She began by stating she was "house rich but cash poor." Her \$2 million oceanfront home has no debt, but she needs income to pay its maintenance and to improve her lifestyle. *The question was "Should I get a home equity loan or a reverse mortgage?"* Then she explained she already consulted a representative of a reverse mortgage lender, but the up-front fees seemed so high she then started looking into home equity loans which have virtually no up-front costs.

Before answering the question, I asked her a question: "If you take a home equity credit line, how will you pay the monthly payments?" She replied she would borrow enough extra to be able to make the payments from the borrowed money. "But you look like you're in very good health. What if you live to be 110? Will you be able to keep borrowing and borrowing?" I asked.

She didn't have an answer. *I think she then understood why a reverse mortgage would solve the problem without her ever having to worry about having adequate financial resources for the rest of her life.* The balance of this newsletter special report will discuss the reverse mortgage pros and cons which every senior citizen homeowner like that nice lady should consider.

WHAT IS A REVERSE MORTGAGE AND WHY HAVE THEY BECOME SO POPULAR? A reverse mortgage lender pays money TO the senior citizen homeowner – it is the exact opposite of a traditional "forward" mortgage where the homeowner repays borrowed money TO the lender.

To qualify for a reverse mortgage, the homeowner must be at least 62. In the case of husband and wife, both co-owners must be 62 or older. If one co-owner spouse is not yet 62, he or she can renounce home ownership by signing a quit claim deed to the other spouse who is 62 or older. If title is held in a living trust, the trustor-beneficiary cannot be less than 62, although subsequent beneficiaries can be younger.

According to Peter Bell, President of the National Reverse Mortgage Lenders Association in Washington, DC, reverse mortgage originations increased by 76% in 2003 compared to 2002. The reasons for their growing popularity are many, including (1) need for increased senior citizen monthly income, (2) stock market, pension, health benefit, and retirement fund declines, (3) large senior citizen home equities, and (4) desire to have sufficient retirement income to spend on luxuries such as travel.

There are no restrictions on how reverse mortgage tax-free income can be spent by the homeowner. Nor are there any credit or income requirements – however, the homeowner cannot have any unpaid federal obligations and must not be involved in bankruptcy.

Reverse mortgages are non-recourse with no personal liability for repayment. *In addition to receiving tax-free income, the other major reverse mortgage advantage is the senior citizen homeowner has no personal liability – repayment only comes from the residence, not personally from the homeowner. No repayment is required during the period the qualified homeowner lives in the principal residence at least six months each year – if the homeowner vacates the home for more than 12 months, such as while living in an assisted living center, the reverse mortgage “matures” and becomes due. Of course, if the homeowner dies or sells the residence, then the reverse mortgage and its accrued interest must be repaid.*

Contrary to widespread misbelief, the lender does not “own” the title to the residence which is security for the reverse mortgage. *Even if the residence declines in market value below the reverse mortgage balance, the homeowner can never be forced out, except for failure to pay the hazard (fire) insurance or the property taxes. After the homeowner dies, the heirs usually elect to sell the residence, pay off the reverse mortgage including its accrued interest, and keep the remaining equity. However, if the heirs want to keep the residence, they can pay off the reverse mortgage balance by refinancing with a traditional mortgage.*

THERE ARE FOUR BASIC TYPES OF REVERSE MORTGAGES. Senior citizen homeowners can choose a reverse mortgage (1) credit line to be used whenever the homeowner wishes and for any purpose (this is the most popular choice – except in Texas, where it is not available), (2) lifetime tenure monthly income, (3) term monthly income (such as for 10 years), (4) up-front lump sum for the reverse mortgage maximum (no repayment is required until the homeowner dies, sells, or moves out), or (5) any combination of the above. During the reverse mortgage term, the homeowner can change their choice, or combination.

There is an additional “choice” where the homeowner chooses the lump sum alternative to buy an annuity which will pay lifetime income to the annuitant, even after the homeowner sells the residence and moves elsewhere. Still another alternative is to use all or part of the reverse mortgage proceeds to purchase lifetime convalescent home care (which is not covered by Social Security).

Reverse mortgages don't affect Social Security or Medicare payments, but they might affect your SSI (Supplemental Security Income) or Medicaid (Medi-Cal in California). *Because reverse mortgage income is non-taxable, it has no effect on Social Security or Medicare payments to senior citizens.* However, if you are receiving SSI and/or Medicaid, if you don't spend your entire reverse mortgage payment received each month, your SSI and/or Medicaid payments can be reduced – for details consult your local Area Agency on Aging (phone 1-800-677-1116, or visit <http://eldercare.gov>).

Are all owner-occupied residences eligible for a reverse mortgage? No. Single-family houses (including manufactured homes attached to a foundation on a separate lot), most condominiums and townhouses (unless more than 50% of the condo complex is occupied by renters), modular homes, and one-to-four unit rentals (where the owner occupies one apartment), and New York City co-ops are eligible. However, mobile homes located on non-owned lots (with limited exceptions for long-term leased land), second or vacation homes, houseboats, commercial properties, agricultural properties, and most cooperative apartments (except in New York City) are not eligible.

If I have an existing mortgage and/or a home equity loan, am I eligible? Maybe. Just because you have an existing home mortgage and/or a home equity loan secured by your otherwise eligible residence, don't despair. A reverse mortgage must be recorded as a first mortgage. That means any existing encumbrances and/or liens affecting your title must be paid off.

However, you can use a reverse mortgage lump sum to pay off those secured obligations. *Obtaining a reverse mortgage lump sum can be a great way to get rid of your mortgage payments, even if you don't need or want to increase your income.* However, if you have large obligations secured by your home in relation to its market value, a reverse mortgage probably won't work.

THE THREE MAJOR NATIONWIDE REVERSE MORTGAGE LENDERS – HOW MUCH CAN A SENIOR CITIZEN HOMEOWNER BORROW? Presuming you own and live in one of the above types of qualified residences, the next step is to consider which reverse mortgage lender is best for you.

1 – FHA HOME EQUITY CONVERSION MORTGAGE (HECM). Approximately 90% of new reverse mortgages being originated today are insured by FHA. Called HECM loans, these reverse mortgages have low FHA loan limits which vary by county (currently \$160,176 in low housing cost counties up to \$290,319 in high cost areas for 2004). There are higher limits for two, three, and four-family owner-occupied buildings, as well as in Alaska, Guam, Hawaii, and the U.S. Virgin Islands. FHA/HECM reverse mortgages are available in all states (except the credit line alternative is not available in Texas).

FHA/HECM reverse mortgages have adjustable interest rates, tied to the one-year U.S. Treasury bill index. The borrower can select annual or monthly adjustments; the

annual adjustment is the T-bill rate, plus 2.10%, whereas the monthly adjustable uses the T-bill rate plus 1.36%.

EXAMPLE: If the T-bill rate were 2%, the FHA/HECM annual rate would be 4.10%. But the monthly adjustable rate would be 3.36%. These rates have maximum 2% annual increases and maximum 5% lifetime increases. Either choice is a “good deal.”

FHA/HECM loans incur an origination fee of 2% of the approved amount, with a \$2,000 minimum, plus annual mortgage insurance premiums (MIP), closing costs, monthly servicing fee not more than \$35, and accrued interest. Up-front fees at the time of borrowing usually include an appraisal fee, credit report charge, title insurance, recording charges, property survey, termite inspection clearance, repairs (if needed), and septic system, gas line, or well inspections. *Most of the up-front costs can be financed to avoid out-of-pocket payments, except for fees paid to third parties, such as for the appraisal and title insurance.*

2 – FANNIE MAE “HOME KEEPER” REVERSE MORTGAGE. The primary advantage of Fannie Mae reverse mortgages is the higher \$333,700 maximum loan limit for 2004. This limit changes each January, based on nationwide home sales prices. The Fannie Mae advantages include the higher loan limit and no FHA/HECM expensive MIP insurance premiums. Closing costs are similar to FHA/HECMs.

The Home Keeper index is the one-month secondary market CD index, plus a margin, with a lifetime maximum of 12% above the initial interest rate. A disadvantage is there is no growth rate for lines of credit as there is for the FHA/HECM. Fannie Mae’s reverse mortgages are available in all 50 states (but the credit line is not available in Texas).

Fannie Mae “Home Keeper” Reverse Mortgage for Home Purchase. A unique variation is Fannie Mae makes reverse mortgage loans for senior citizens to purchase homes with no monthly payments required. Fannie Mae is the only lender with this type of reverse mortgage. It is ideal for a senior citizen who has some cash for a substantial home down payment, such as proceeds from the sale of a previous residence.

EXAMPLE: In 1997, Fred and Marion Vallier, then age 89 and 86, of Ames, Iowa obtained the first Fannie Mae “Home Keeper” reverse mortgage for home purchase. They bought their new \$154,000 house with a \$93,000 Fannie Mae reverse mortgage which requires no monthly payments. The balance of their purchase price, about \$61,000, came from the sale of their previous residence. Their reverse mortgage need not be paid off until after the surviving spouse dies, sells, or decides to move out of the home.

3 – FINANCIAL FREEDOM PLAN REVERSE MORTGAGES. These reverse mortgages have no limits so they are usually the most desirable for residences with high valuations. *However, they are not available in all states.* This non-

government lender offers two “cash account” choices: the standard option and the zero point option.

The standard option has an up-front 2% origination fee, an open-end credit line, annual growth rate on unused funds, and a \$500 minimum draw payment. But the zero point option has no origination fee, maximum closing fees, annual growth rate on unused funds, and a \$500 minimum draw payment. However, 75% of the maximum available zero point option funds must be withdrawn initially and partial prepayment is not allowed during the first five years.

Financial Freedom Plan’s adjustable interest rate is tied to the LIBOR (London Interbank Offering Rate), plus a margin. The lifetime maximum increase cap is 6% above the starting rate.

HOW MUCH REVERSE MORTGAGE MONEY CAN BE OBTAINED?

The exact answer depends on (a) your age and (b) your home’s appraised (fair market) value. As a very general rule, your maximum reverse mortgage will be between 25% and 65% of your home’s current market value. To be more specific and to obtain your personal estimated calculations for all three reverse mortgage types of loans, the best source is the www.financialfreedom.com website.

The younger you are, the less you will be able to obtain from your reverse mortgage. But there’s a very sound reason. Not only must lenders consider the actual principal amount advanced to the homeowners, but also the accrued interest which will build up over the term of the reverse mortgage. A 65-year old “young whippersnapper” has a life expectancy of 14 years for men and 18 years for women. But a 90-year old “old geezer” has only a life expectancy of 3.9 years for men and 4.7 years for women. *However, as reverse mortgage lenders have learned, nobody is average and homeowners tend to live longer than non-homeowners.* For that reason, they presume everyone has a 100-year life expectancy!

HOW MUCH WILL A REVERSE MORTGAGE COST IN UP-FRONT FEES? A major stumbling block for most reverse mortgage borrowers, and their adult children, is the up-front costs. Although reverse mortgages aren’t as bad as traditional mortgages for unexpected junk or garbage fees which some lenders try to impose on borrowers, reverse mortgage lenders are far from perfect.

Over the years, there have been many lawsuits against dishonest reverse mortgage lenders. *Fortunately, all those early reverse mortgage lenders with “shady” operations are now out of the reverse mortgage business.* However, occasionally you’ll still hear about them because their loan servicing was taken over by several reverse mortgage lenders which are in business today.

As a very general rule, the up-front costs of obtaining a reverse mortgage will be about 5% of the maximum reverse mortgage available. About 2% of this is the lender’s loan origination fee. To illustrate, on a \$200,000 reverse mortgage, the origination fee

will be around \$4,000 and total charges shouldn't be more than \$10,000. Although that might seem like a lot of money, all or most of it won't be cash out of the homeowner's pocket because most of the up-front fees become part of the reverse mortgage balance which is paid after the homeowner dies or sells the home.

Don't get a reverse mortgage if you expect to stay in your home less than five years. Every reverse mortgage lender is required by federal law to provide the senior homeowner with a Total Annual Loan Cost (TALC) written estimate based on the borrower's age(s) and the residence value. This computerized TALC estimate chart considers annual home appreciation rates of 0%, 4%, and 8%, as well as the first two years (VERY expensive as a percentage), at the borrower's life expectancy (more reasonable), and at 40% beyond the borrower's life expectancy.

There are so many variations, it is impossible here to show meaningful TALC calculations for your personal situation. Later, I'll give you Internet websites where you can obtain TALC estimates. *Before a homeowner obtains a reverse mortgage, the lender must provide an exact TALC chart for the homeowner's personal situation.*

To generalize, if you don't expect to stay in your home at least five years, a reverse mortgage will be very expensive for you, as a percentage of the funds you actually receive (even if you take the lump sum choice). *You might be better off with a home equity loan if you plan to stay in your home less than five years.*

Of course, none of us knows when we will die – wouldn't it be awful if we knew in advance when we will die and how? Also, if I might become a philosopher for a moment, wouldn't it be horrible if we didn't die? That would mean the world's greatest people would still be alive, and the world's worst people would still be causing trouble. There would be little room available for innovators because the world would be so crowded!

HOW TO FIND A LOCAL REVERSE MORTGAGE LENDER. A frequent type of question to my syndicated "Real Estate Mailbag" newspaper column asks where senior citizen homeowners (or their adult children who are often extremely concerned about their parents not having adequate retirement income) can obtain reverse mortgage information.

EXAMPLE: I recall one reader writing recently to say that his banker thought he was out of his mind when he asked about obtaining a reverse mortgage. It is shocking how uneducated most traditional mortgage lenders are about reverse mortgages. Also, they are losing tremendous profits by not offering reverse mortgages.

Fortunately, there are many enlightened lenders who offer reverse mortgages to senior citizen homeowners. Nationwide, the biggest reverse mortgage lenders are Financial Freedom Plan (the largest), Wells Fargo Mortgage, Seattle Mortgage, and GMAC. Dozens of smaller regional lenders also offer reverse mortgages.

The best place to find a reverse mortgage lender in your area is to go on the Internet to www.reversemortgage.org. Then click on your state for a list of lenders and the types of reverse mortgages they offer. FHA/HECM and Fannie Mae reverse mortgages are available in all 50 states (except credit lines are not available in Texas).

Financial Freedom Plan now offers its “jumbo” reverse mortgages for luxury homes in most states. By calling the toll-free 800 numbers listed on the website, you will quickly be in touch with a local reverse mortgage representative. Just as you would shop among several traditional mortgage lenders for the “best deal,” don’t hesitate to consult several reverse mortgage lenders in your area to compare their terms for different loan types.

If you don’t have access to a computer, the Reference Department at your nearby public library will be glad to help you find this superb website which is operated by the National Reverse Mortgage Lenders Association.

WHAT ARE THE PROS AND CONS OF A REVERSE MORTGAGE?

When I was in Sarasota at the “Ask the Real Estate Experts” event, somebody in the audience asked about reverse mortgages and their disadvantages. I sensed they were worried their children and grandchildren would criticize them for spending their home equity on themselves. I hope the TV camera caught my important remark that the senior citizen homeowners deserve to enjoy their home equity and nowhere in the Bible (or anyplace else) does it say “Thou shalt leave a huge inheritance to thy heirs and thou must never enjoy thy home equity.”

Statistics show most inheritances are spent by the heirs within five years after the decedent’s death. In his best seller **Die Broke** book, Stephen Pollen advises senior citizen homeowners to obtain a reverse mortgage and spend their home equity on themselves. Maybe that’s why I saw so many bumper stickers in Florida on those huge luxury motor homes which said, “We’re spending our children’s inheritance!”

Why is it so many senior citizens won’t spend their money on themselves?

Reverse mortgage lenders report over 50% of inquiries they receive are not from senior citizen homeowners, but from their adult children who are worried and want to be sure their parents enjoy their retirement years.

Yes, a few selfish children discourage mom and dad from obtaining a reverse mortgage, knowing the parents will be spending the offspring’s inheritance. Fortunately, most adult children want their parents to enjoy their golden years and they realize reverse mortgages are a great way to accomplish that purpose. That’s why they research reverse mortgages as much as their parents do.

BEWARE OF DISHONEST “FINANCIAL PLANNERS.” Unfortunately, a few dishonest “financial planners” encourage senior citizen homeowners to obtain a reverse mortgage, take the maximum lump sum available, and then “invest” that money

in a product the so-called financial planner has for sale. Fortunately, FHA and Fannie Mae refuse to be involved with reverse mortgages which involve such organizations. But whenever somebody suggests obtaining a reverse mortgage to use the proceeds for an annuity, health care, or other alternatives, the potential for financial abuse exists.

REVERSE MORTGAGE FINANCIAL COUNSELING HELPS PREVENT ABUSES. Fortunately, FHA/HECM and Fannie Mae require homeowners to obtain counseling before their reverse mortgage will be approved. These trained counselors are independent from the lender and they do not charge for their services. Reverse mortgage lenders can refer you to these individuals in your area. If you have difficulty locating an independent reverse mortgage counselor, phone AARP at 1-800-424-3410, Fannie Mae's Homepath service at 1-800-732-6643, or FHA-HUD's Housing Counseling Clearinghouse at 1-888-466-3487.

FOR MORE INFORMATION. Excellent recent books about reverse mortgages include **Reverse Mortgage Handbook** by Tara Ballman (Jawbone Publishing Co., Kissimmee, FL), 2004, \$12.95, 92 pages; and **Reverse Mortgages for Senior Homeowners** by Rob LaFay and Doris Barrell (Dearborn Real Estate Education Co., Chicago, IL), 2004, \$16.95, 67 pages. Both books are available in stock or by special order at local bookstores, public libraries, www.amazon.com. Excellent reverse mortgage websites include www.reverse.org, www.reversemortgage.org, and www.financialfreedom.com.

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