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Debunking Myths about Reverse Mortgages

By Alberta Lim +Follow June 18, 2015 8:30AM

There is a good chance you may have heard the term "**reverse mortgage**" on at least one occasion in the past. Perhaps a colleague or friend has mentioned applying for this type of loan, or maybe you've caught a commercial on TV describing its benefits. And if you've ever read an article that explores how to access your home equity, it wouldn't be complete without at least a mention of this powerful retirement planning tool. Designed for senior homeowners age 62 and over, reverse mortgages offer the chance to access a portion of your home's equity in non-taxed cash, without having to sell your home or take on a monthly mortgage payment. Because of features like these, this loan has been gaining the curiosity of seniors entering retirement since its inception in the early 1960's.

History of Reverse Mortgages

For many years before this unique loan was introduced, the possibility of being able to access equity without selling the house was an unfulfilled concept. Homeowners basically had two options available to them: (1) to sell the home or, (2) to take out a home equity loan, also known as a second mortgage. However, both alternatives carried drawbacks that many homeowners wished to avoid.

Selling the property was not an option for those individuals who held a strong sentimental or emotional attachment to their house, and for others who wanted no monthly mortgage payment, a new home equity loan was not ideal. At that point, there was no other option for senior homeowners who wanted the combination of being able to remain living in their homes, while accessing home equity and not having a monthly mortgage payment.

In 1961, it all changed. The first reverse mortgage loan was written for a widow in Maine, to help her afford to stay in her home despite the loss of her husband. For the next three decades, the idea of this "actuarial mortgage plan in the form of a housing annuity" continued to gain traction. Then, in 1988, President Ronald Reagan signed the reverse mortgage bill into law, establishing the loan as federally-insured for the first time.

Common Misconceptions

Although a reverse mortgage loan offers features that can be useful to many seniors, it is still a relatively different product that is not always completely understood. Those with little knowledge of this financial product have deemed its unique loan features as "too good to be true," and without proper understanding of the loan, a series of common misconceptions continue to be repeated today. However, further research into the reverse mortgage facts has led me to pinpoint these common misunderstandings:

Misconception:"I will lose title of my house."

As a reverse mortgage borrower, you keep the title and ownership of your home as long as all agreed-upon obligations of the loan are met (such as paying taxes, maintenance and insurance). Assuming your continued compliance, the lender or bank does not take the title from you. At loan maturity, you may sell the property to repay the loan, but during the life of the loan the lender does not own your property.

Misconception: "I will be responsible for the difference if my loan balance exceeds my home's value."

Home Equity Conversion Mortgages (HECMs) are reverse mortgages that are non-recourse loans insured by the Federal Housing Administration (FHA). What that means for you is that if your loan balance ever exceeds your home's value, you will not be liable for the difference. Whatever your home sells for will be used to repay the loan, and insurance will cover any difference. In addition, no asset besides your home can be used by your lender to repay the loan.

Misconception:"My heirs will lose their inheritance."

Heirs will receive all remaining home equity after the reverse mortgage loan is first paid back. Typically, when a borrower permanently leaves the home and the loan becomes due, funds from the sale of the home can first pay back the loan, and heirs receive all remaining equity after that.

If heirs are emotionally attached to the home and do not want to sell it, they do have the option to pay back the loan by refinancing or using other financing options. Doing so will fulfill the loan obligations and allow family members to inherit the property.

Misconception:"I may lose my Social Security, pension, and Medicare benefits if I take on a reverse mortgage."

Social Security, pension, and Medicare benefits are typically not affected by reverse mortgages because the proceeds are not considered income. However, certain needs-based benefits such as Medicaid and Supplemental Security Income may be affected. We urge you to consult with your accountant or financial advisor to discuss your needs-based benefits prior to obtaining a reverse mortgage.

Misconception:"I may have to pay a monthly mortgage payment."

A reverse mortgage loan, unlike traditional mortgages, requires no monthly mortgage payment. Though you can make payments towards your balance at any time, mandatory repayment of the loan usually occurs only when all the borrowers permanently leave the home or fail to pay taxes and insurance. Otherwise, you are not required to repay monthly.

Misconception:"I have no responsibilities under a reverse mortgage loan."

Although benefits include no monthly mortgage payment, there are still financial obligations to fulfill in order to avoid defaulting on a reverse mortgage. You must continue to pay homeowners insurance and property taxes as well as maintain all basic home repairs and comply with all of the loan terms.

Now that you've learned more about the reverse mortgage loan, you may have one more important question: Is a reverse mortgage right for me? For your answer, you may want to speak with a reverse mortgage professional to ask more questions and determine if a reverse mortgage is the right fit for your particular situation.

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