Reverse mortgages don't always work

By Christine Dugas, September 14, 2011

Trusted celebrity pitchmen such as Henry Winkler, Robert Wagner and James Garner do a good job telling older homeowners about the benefits of a reverse mortgage. Here's what they don't tell seniors: Reverse mortgages are expensive, complicated and always changing.

The government-insured program, which is available to homeowners who are 62 and older, has helped many seniors tap their home equity for living expense. But it's not a lifeline for everyone. It hasn't prevented seniors from defaulting on their taxes and homeowners insurance and possibly losing their homes to foreclosure. Delinquency has grown in recent years.

Adding to the confusion: During the economic downturn, some providers have left the business, while a new type of reverse mortgage has emerged.

Nelly Rush doesn't want to be part of the delinquency statistics.

Rush and her husband, Richard, got a reverse mortgage in 2006 from Seattle Mortgage Co. The money allowed them to pay off their $30,000 mortgage, fix their house in Inverness, Fla., and hook up to the city water line. But Rush, 75, says they didn't understand that it was an expensive proposition.

"We didn't know that we had to pay over $11,000 in closing costs," she says. And they're still responsible for caring for the house, and paying property tax and home and flood insurance.

Rush's husband died 16 months ago. She relies on Social Security and a small pension to pay the bills. She doesn't have extra cash to pay for home repairs. And she can't afford to sell the home, repay what she owes on the reverse mortgage and move closer to her family.

"I hope some people will think twice before they jump into something they don't understand," she says.

Altered realities

Retirees have often relied on their home appreciation to help fund their retirement. But now, plummeting home values make it hard to sell a home or take out a home-equity line of credit. Even reverse mortgages aren't as helpful as they were in the past.

Falling home values reduces the amount of cash that a retiree can get from a reverse mortgage. And those who already have a reverse mortgage may no longer have any equity, because their home has dropped in value. That can make it harder to sell the home.

That's not a problem if the homeowner wants to stay in the home and can afford maintenance, taxes and insurance. But cash-strapped seniors who use much of their savings to pay for the closing costs may eventually fall behind on their tax and insurance bills. About 30,000 of borrowers' reverse mortgage loans are in default, out of about 600,000 outstanding loans, says Peter Bell, president of the National Reverse Mortgage Lenders Association.

Reverse mortgage borrowers don't have to repay their loans unless they sell their homes or move, so the term "default" seems contradictory. But because the program is insured by the Federal Housing Administration, the loans are considered in default when the tax and insurance bills are unpaid.

Rising delinquency could put FHA-insured reverse mortgage programs at risk. And if a senior's outstanding bills are not resolved, the debt can trigger home foreclosure. But that should be a last resort, the FHA says.

The U.S. Department of Housing and Urban Development has instructed lenders to set up a repayment structure. Reverse mortgage lenders and HUD also have developed a remedial counseling program to help borrowers in default solve their problems. "With the vast majority of them, we can easily work out something with the lender," says Cathy Davis, a counselor based in Tupelo, Miss., for Money Management International.

Industry is changing

This year, the largest reverse mortgage lenders, Wells Fargo and Bank of America, said they'd stop offering the loans. Wells Fargo said it was exiting the business because declining home values have increased the risk that borrowers will default or go into foreclosure.

Other lenders have remained in the business. MetLife, which is now the top lender, says it has no plans to stop offering reverse mortgages.

To address the changing needs, HUD last year introduced a low-cost reverse mortgage called HECM Saver. "It provides individuals with about 15% to 20% less in proceeds than the HECM Standard, but at significantly reduced cost," says Craig Corn, vice president of reverse mortgages at MetLife Bank.

The HECM Saver tends to attract more upscale borrowers who want to draw down a smaller amount of money, lenders say. "It is primarily for people who have a great deal of equity in their home, but they don't necessarily want to tap into all of it," Davis says.

With the traditional HECM Standard, borrowers take out as much cash as they can to help pay off their mortgage and manage their cash flow, Corn says.

Fixed-rate reverse mortgages, which require borrowers to withdraw the full amount at closing, are now the most popular type of HECM Standard, according to an AARP report in February. Although some seniors may need the total withdrawal to save their home from foreclosure, cash-strapped retirees are often vulnerable to bad advice, financial planners say.

"Unscrupulous mortgage brokers will dangle that in front of an elderly couple, and they see stars in their eyes and fall for it," says Herb Montgomery, a fee-only financial planner in Orleans, Mass. But a monthly payment plan might be better for some seniors, because it can be less expensive and prevents them from putting money into risky investments.

Before homeowners sign up for a reverse mortgage, they must go through pre-loan counseling, a program that HUD beefed up last year. Rush says that when she and her husband applied in 2006, they didn't learn anything from the counseling she received.

"It lasted about five minutes," she says. "And they asked two or three questions on the phone."

Surviving spouse lawsuits

Loan default is not the only cause of foreclosure. In 2008, HUD, without notice, issued a letter changing the rule that allowed surviving spouses and heirs of a reverse mortgage borrower to buy the home at the appraised value. Instead, as home values were falling, HUD required widows, widowers and heirs to pay the full loan balance to keep the home.

This year, AARP filed two lawsuits to block foreclosure and eviction of survivors who couldn't afford to keep the home under the new rule.

The change could affect many people. The paperwork is sometimes signed by one spouse because the home was purchased before the marriage, or couples were told that they'd get more money if only the oldest spouse is listed in the application.

Robert Bennett and his wife, Ophelia, took out a reverse mortgage on their Annapolis, Md., home in 2008. They were struggling to pay their bills, Bennett says, "and they made it sound so good." It was filed only in Ophelia's name, and she died a month later. Bennett, 69, a retired cook at the U.S. Naval Academy, was then told that he had one year to stay in the home before he had to pay the full mortgage balance.

He is willing to pay the appraised value but says that he can't afford the full balance. Although AARP says HUD agreed to withdraw the controversial change, Bennett's foreclosure remains on hold until one issue in the case is resolved. But he still hopes he can keep the home he and his wife built in 1975.

http://www.usatoday.com/money/perfi/housing/story/2011-09-12/reverse-mortgages/50373520/1