Chicago Tribune

New rules change costs associated with reverse mortgages

By Elliot Raphaelson November 20, 2017

In October, new regulations went into effect regarding reverse mortgages. The reason for the changes was that the federal Department of Housing and Urban Development was facing large losses associated with their guarantees to reverse mortgage borrowers and lenders.

One of the things borrowers like about reverse mortgages is that the lender can never recover more than the fair market value of the home, regardless of the amount of money owed on the mortgage.

Borrowers may stay in their home as long as they maintain the property and pay the required real estate taxes and homeowner's insurance. If they fail to do any of these things, or if they voluntarily leave the home (or vacate the property for 12 months, for health reasons or for any other reason), the lender takes possession and may sell the home.

One of the things lenders like about reverse mortgages is that if the outstanding loan exceeds the fair market value of the property, the lender does not incur a loss on the transaction. HUD bears the loss.

HUD has been facing larger losses recently, so it has made the following changes:

--Previously, HUD charged an upfront insurance premium of 0.5 percent for borrowers who took less than 60 percent of the maximum loan amount, and 2.5 percent of for those who took more than 60 percent. It now takes 2 percent for all loans.

--Previously, HUD imposed an annual mortgage insurance premium (MIP) of 1.25 percent of the loan outstanding. Now new borrowers pay an annual insurance fee of 0.5 percent.

--The maximum loan amount has also been reduced. Previously, a borrower could borrow 60 or 70 percent of the property value; now that maximum is based on the applicant's age, the mortgage rate and the property value. It is estimated that the amount that can be borrowed now is approximately 5 percent less than what was available before the new regulations.

One strategy for using a reverse mortgage is to take advantage of the growth of the available line of credit. (Some call this taking a "standby" reverse mortgage.) The credit line grows based on the loan rate plus the annual insurance premium. Since the annual insurance premium has been reduced, the line of credit will now grow at a slower pace.

In summary, borrowers will now find that they can borrow less under the new regulations, and the line of credit will grow more slowly.

On the other hand, the reduction in the annual MIP to 0.5 percent means that the homeowner's loan balance will increase much more slowly, and accordingly the equity in the home will be retained.

The changed regulations are not a "game-changer" regarding the benefits of obtaining a reverse mortgage. However, they are factors to take into consideration. If you are obtaining a reverse mortgage in order to take advantage of the flexibility of the line of credit, you should understand how the line of credit is computed and how large it will be based on how long you expect to reside in the home.

For those borrowers planning to get cash up front, reverse mortgages may still be advantageous. Front-end costs and interest rates vary between lenders, so you have to comparison shop. In addition, do not base your decision solely on the mandated review/approval of a certified HUD adviser. You should have the proposal or contract reviewed by your own financial adviser or attorney. Any decision should be consistent with your long-term financial plan.