How do Reverse Mortgages Work?

When you have a **regular** mortgage, you pay the lender every month to buy your home over time. In a **reverse** mortgage, you get a loan in which the lender pays *you*. Reverse mortgages take part of the equity in your home and convert it into payments to you – a kind of advance payment on your home equity. The money you get usually is tax-free. Generally, you don't have to pay back the money for as long as you live in your home. When you die, sell your home, or move out, you, your spouse, or your estate would repay the loan. Sometimes that means selling the home to get money to repay the loan. There are three kinds of reverse mortgages: single purpose reverse mortgages – offered by some state and local government agencies, as well as non-profits; proprietary reverse mortgages – private loans; and federally-insured reverse mortgages, also known as **Home Equity Conversion Mortgages (HECMs).**

If you get a reverse mortgage of any kind, you get a loan in which you borrow against the equity in your home. You keep the title to your home. Instead of paying monthly mortgage payments, though, you get an advance on part of your home equity. The money you get usually is not taxable, and it generally won't affect your Social Security or Medicare benefits. When the last surviving borrower dies, sells the home, or no longer lives in the home as a principal residence, **the loan has to be repaid**. In certain situations, a non-borrowing spouse may be able to remain in the home. Here are some things to consider about reverse mortgages:

- **There are fees and other costs**. Reverse mortgage lenders generally charge an origination fee and other closing costs, as well as servicing fees over the life of the mortgage. Some also charge mortgage insurance premiums (for federally-insured HECMs).
- **You owe more over time**. As you get money through your reverse mortgage, interest is added onto the balance you owe each month. **That means the amount you owe grows as the interest on your loan adds up over time.**
- **Interest rates may change over time**. Most reverse mortgages have variable rates, which are tied to a financial index and change with the market. Variable rate loans tend to give you more options on how you get your money through the reverse mortgage. Some reverse mortgages – mostly HECMs – offer fixed rates, but they tend to require you to take your loan as a lump sum at closing. Often, the total amount you can borrow is less than you could get with a variable rate loan.
- **Interest is not tax deductible each year**. Interest on reverse mortgages is not deductible on income tax returns – until the loan is paid off, either partially or in full.
- **You have to pay other costs related to your home**. In a reverse mortgage, you keep the title to your home. That means you are responsible for property taxes, insurance, utilities, fuel, maintenance, and other expenses. And, if you don't pay your property taxes, keep homeowner's insurance, or maintain your home, the lender might require you to repay your loan. A financial assessment is required when you apply for the mortgage. As a result, your lender may require a "set-aside" amount to pay your taxes and insurance during the loan. The "set-aside" reduces the amount of funds you can get in payments. You are still responsible for maintaining your home.
- **What happens to your spouse?** With HECM loans, if you signed the loan paperwork and your spouse didn't, in certain situations, your spouse may continue to live in the home even after you die if he or she pays taxes and insurance, and continues to maintain the property. But your spouse will stop getting money from the HECM, since he or she wasn't part of the loan agreement.

- **What can you leave to your heirs?** Reverse mortgages can use up the equity in your home, which means fewer assets for you and your heirs. Most reverse mortgages have something called a "non-recourse" clause. This means that you, or your estate, can't owe more than the value of your home when the loan becomes due and the home is sold. With a HECM, generally, if you or your heirs want to pay off the loan and keep the home rather than sell it, you would not have to pay more than the appraised value of the home.

Some notes to consider:

1. The fees are often high. Since a reverse mortgage is a loan, you are going to have loan-related fees. Origination fees and other fees on a reverse mortgage are typically rather high. A reverse mortgage is a home equity loan that isn't decided based on your income or your credit score. As a result, there are unique risks to the lender, and some of those risks are offset by charging higher fees at the outset.

2. High interest rate. The interest rate on a reverse mortgage is often higher than the rate for a more traditional home equity loan. Between the up-front fees on the reverse mortgage and the high interest charges, you might be surprised at how little money you actually end up getting. It's your equity, but the bank gets an awful lot of it.

3. Your heirs might not get the house. When you get a reverse mortgage, you aren't expected to make payments on the loan. Instead, the loan is paid off when you sell your home. So, if you die, the home is supposed to be sold so that it can cover the loan amount. This means your heirs can't have the house. It is possible for your heirs to keep the house if they pay off the reverse mortgage after you die. However, this usually means that the money has to come out of the estate, reducing the total that your children and grandchildren end up with. For someone hoping to leave a legacy, this can be a real drawback.

4. You have to repay the loan when you move out. Dying isn't the only way that repayment on a reverse mortgage is triggered. In order to avoid making payments on the loan, you have to be living most of the time in your primary residence. You are considered "moved out" if you haven't lived in the home for a year. **This includes if you enter a long-term care facility**. So, if you are no longer able to stay in your home, but you haven't died, you have to start repaying your reverse mortgage—at a time when money is likely already tight. This can put a real strain on your budget.

5. You're still responsible for home costs. Throughout all of this, you are still responsible for your home costs. You have to pay property taxes, keep up with the homeowners insurance, and pay for regular maintenance on the home. If you have enough equity, you can get a reverse mortgage big enough to cover all these expenses, but it can be a difficult situation nonetheless.

- Before deciding to get a reverse mortgage, carefully think through the situation. The high costs, combined with the difficulties that can arise if you want to move out of the house or leave property to your heirs, can make a reverse mortgage more trouble than it's worth. A better solution if you're strapped for funds is to set your retirement number and then look for creative solutions to help you retire without the negative baggage of a reverse mortgage.