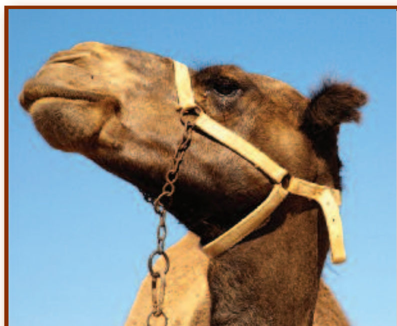
SCHWARTZ *Report*

April, 2016

DIRECT: 302-234-5202 • OFFICE: 302-239-3000
www.charlieschwartz.com

HECM



I have heard it said that a camel turned out to be a horse designed by a government committee. That may sound like wry humor. However, for its utility and indispensability in some parts of the world; if the camel did not exist it would need to be created. Every incongruity of its appearance serves a purpose. Long treks over arid land could not have been accomplished in pre-modern times without it. The HECM is another type of animal, this time a financial one, which if it did not exist in its various forms, would need creating. It too serves a useful purpose.

The acronym HECM stands for home equity conversion mortgage. HECM's are the most commonly available form of reverse mortgage. They are federally insured and are backed by the U. S. Department of Housing and Urban Development (HUD) and administered by the Federal Housing Administration (FHA). There are other types of reverse mortgages, of course, such as single purpose reverse mortgages and proprietary reverse mortgages which are backed by private companies and often used for higher valued homes. Some can even be used to buy or build a new home. Like the camel, the HECM has its foibles and incongruities but its purpose is sound.

Now that I have dumped the Alpha Bits on the breakfast table once again; let me first review the landscape on which a reverse mortgage would be most useful. With longevity increasing, investment vehicles designed to give an acceptable stream of income throughout a lifetime are failing to keep pace. The cost of health care is rising at an alarming rate. Many seniors are finding that they cannot rely on their investments and Social Security payments alone. For example, the consumer price index is reported to have risen only 0.4 percent in 2015 so there are unlikely to be cost-of-living adjustments to Social Security checks this year. To survive this desert like lay of the land in front of them, seniors are looking for another vehicle to help them along their way. During a lifetime of homeownership seniors dump 30 to 40 percent of their income into their homes. There is no reason not to take advantage of this investment in retirement. They like where they are living and want to stay there as long as possible so selling the family home, getting a smaller place and investing the remaining equity might not be their best course of action. The purpose of a HECM is to take what otherwise is an illiquid asset and turn it into a liquid one.

Home prices nationally increased by 5.76 percent in 2015. Projections are for a 3.30 percent average increase each year for the next five years. So the value of their home is increasing faster than that of their savings account. Converting a portion of that home equity into cash or a monthly income, while still being able to live there, is a nice option. Here is how HUD describes how to qualify for a HECM reverse mortgage: "To be eligible for a FHA HECM, the FHA requires that you be a homeowner 62 years of age or older, own your home outright, or have a low mortgage balance that can be paid off at closing [using] proceeds from the reverse loan, have the financial resources to pay ongoing property charges including taxes and insurance, you must live in the home…" Generally speaking, the older you are, the more equity that you have and the less you owe, the more of a reverse mortgage you can get. How much is that? With HECM's it is a percentage of the lesser of the appraised value of the home or the HECM FHA limit of $625,500. This applies to single family homes or a two-to- four-unit building where the owner occupies at least one of the units.

As mentioned earlier, if there is an existing loan on the property, it must be paid off before the reverse mortgage goes on just as if a borrower was refinancing. That is because the reverse mortgage must be in first position and thus not subordinate to any other lien. As payments are made to the home-

Cont. from pg. 1

owner, interest is charged (usually at an adjustable rate) and added to the reverse mortgage balance. So what is owed on the reverse mortgage grows over time. This is the "reverse " of what happens with a normal self-amortizing purchase mortgage where each payment by the borrower reduces the mortgage balance. However, unlike the purchase, or shall we say forward, mortgage; the reverse mortgage usually has a non-recourse clause in it whereby you can't owe more than the value of your home when the loan becomes due and the home is sold.

Some notes of caution: Counseling is required as the lender must conduct a financial assessment of every reverse mortgage borrower to ensure they have the financial capacity to continue paying mandatory obligations and keep up the property. If you are not planning on staying in the home for an extended period of time, read here years-not a year, a reverse mortgage is probably not for you. Also if you do not have the wherewithal to pay the taxes, maintain the necessary insurance (including flood insurance if applicable) and keep the property in good repair on an ongoing basis; you are probably better off selling now and downsizing. Even though the reverse mortgage is considered a non-recourse loan, it becomes due, depending on circumstances, between six and twelve months after the last borrower passes away or leaves the property. Abandonment of the property is a cause of default on the loan and can trigger foreclosure or at the very least a short sale. In the case of death, the decedent's estate can sell the home to repay the balance of the reverse mortgage with the heirs receiving the net proceeds if any remain. The estate is not liable for any additional reverse mortgage debt if the home sells for less than the payoff balance. Care for a camel ride?

Charlie Schwartz
Patterson-Schwartz
7234 Lancaster Pike, Suite 100A
Hockessin, Delaware 19707
302-239-3000