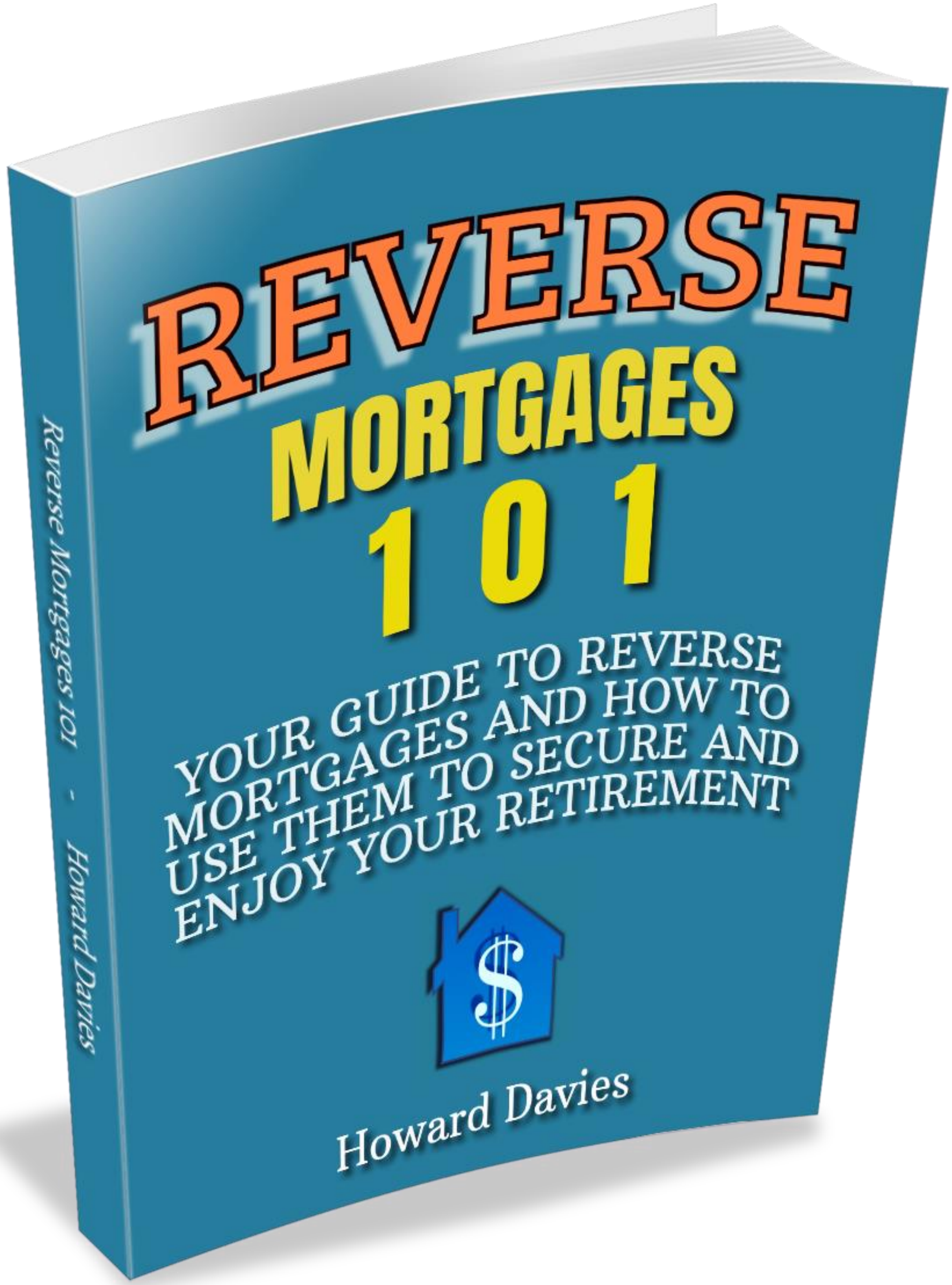
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YOUR GUIDE TO REVERSE MORTGAGES AND HOW TO USE THEM TO SECURE AND ENJOY YOUR RETIREMENT
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Howard Davies
Reverse Mortgages 101 - Howard Davies

For information please contact:
Howard Davies
email: howard@howardedavies.com
Phone: (408) 533-2467

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CONTENTS

INTRODUCTION

Since 1961 reverse mortgages have helped thousands of homeowners enjoy financial freedom, giving them the opportunity to feel more secure, contented and happy in their golden years.

Reverse mortgages were signed into law in 1987 by Ronald Reagan and since then there have been many improvements especially regarding protection of homeowners rights.

In 2001, the US Department of Housing and Urban Development (HUD) partnered with American Association of Retired Persons (AARP) to test and train reverse mortgage counselors.

In 2013 HUD released updated policies and added more checks and balances to make them safer and stronger in 2015. They also added non-borrowing spouse protections. The most popular reverse mortgages are Home Equity Conversion Mortgages (HECM's) which are fully insured by HUD and the Federal Housing Administration (FHA).

As beneficial as HECMs are, there are still some misconceptions. This book will give you a better understanding of them so you'll be a more educated and better equipped consumer to make wise choices for you and your family.

There are many reasons savvy retirees consider HECMs. According to Health View Services Financial in 2019, many retirees can expect to spend $387,000 on health care costs during retirement. HECMs can help offset some, or all, of those costs.

According to IbisWorld.com (industry analysts formed in 1971) the number of HECMs in 2022 are expected to increase by 12.5% in the USA alone.

There are so many financial benefits it's hard to list them all but one example is that many people work with a Retirement or Financial Planner to help them offset taxes incurred as a result of minimum withdrawals from a 401K. In my opinion they are one of the best financial planning tools ever.

Whether you are a mortgage professional, homeowner, financial or retirement planner, tax professional, realtor, or other interested party, I believe this book will help you better understand HECMs.

CHAPTER 1

What is a HECM?

A HECM is just a mortgage. That's it! The main difference between a HECM and a traditional mortgage is that you are not required to make monthly payments (although you can if you choose).

Because HECM's are insured by the federal government, HECM lenders offer very attractive terms.

HECM's are a **federally insured** loan product that allows homeowners aged 55 or older to access a portion of their home equity in monthly payments, cash, or an **automatically growing** line of credit. One of the many benefits of a HECM is that it is a **non-recourse** loan. We will discuss this fantastic feature later in this book.

When I say "federal government" I am referring to:

1. FHA: Federal Housing Administration
2. HUD: US Department of Housing and Urban Development, a division of HUD

A HECM is similar to a traditional mortgage in that it is a lien placed on your home. The major difference is the direction of the money flow.

On a traditional mortgage you make a payment every month which is made up of principal plus interest. The principal portion increases the amount of equity in your home, but for most borrowers this is 'untapped equity' that can only be released by either selling the home or accessing it via a Home Equity Line of Credit ("HELOC"). Unfortunately, HELOC's have many drawbacks, unlike HECM's which are a much safer and cheaper alternative.

HECM's require no payments for the rest of your life, or the life of any other borrower. The interest simply accrues for the duration of your life(s).

Because they are **federally insured,** HECM's are an attractive proposition for senior homeowners but not widely understood.

HECM's are loans made to older homeowners with no expected repayment until the last borrower exits the home, usually at the time of death.

Unlike a traditional mortgage, in which the balance declines as borrowers make monthly payments, the balance on a HECM grows over time with the accrual of interest and fees.

On the flipside, borrowers can save, spend or invest all the money they would have paid on the traditional mortgage payment. With smart investments, the money saved could more than offset the accrued interest.

Federal insurance on HECM's, through the Federal Housing Administration (FHA) and mutual mortgage insurance fund (MMI) is what protects borrowers and lenders from negative equity.

As you read this book, I think you'll agree that homeowners who convert their home equity into an automatically growing line of credit which incurs no interest on until drawn, and even then requires no payments during their lifetime, are in a better position to diversify the equity that would have been tied up in their home and manage risk during retirement.

Contrary to some uninformed opinions most of the homeowners who have a HECM are not 'desperate' but are financially savvy retirees who chose to enhance their golden years by relieving themselves of a monthly mortgage payment.

Many also chose to release the previously dormant equity in their home for investment or self-insurance medical expenses and many other good uses.

As a matter of disclosure I am licensed to originate and give mortgage advice in California (only) so if you live in California and have any questions during or after reading this book please call, email, or text me using the information at the back of this book.

CHAPTER 2
How HECM's Work

HECM's give senior homeowners age 62+ (55+ for proprietary reverse mortgage products) the opportunity to not only eliminate their mortgage payments for the rest of their lives, but also to **free up the untapped equity in their home.** They can receive the released equity in one of the following three ways:

*Single lump sum payment

*Traditional monthly payments

*Credit line account

The amount of money you can access depends on several factors including: your age, home location, and your home's current value.

Pros And Cons Of HECM's

Like every financial decision, anyone considering a HECM should consider the pros and cons. Let's take a look:

PROS:

- **Peace of Mind**
  You will be protected and fully insured by Federal insurance, this includes protection in the unlikely event that your home becomes worth less than what you owe on it.

  The money received from a HECM is **not income** as far as the IRS and your state are concerned, therefore, it is **not taxable**. And, to qualify, unlike a traditional mortgage, you don't have to prove much in the way of income. A financial assessment is required but it's much easier to qualify for than a traditional refinance.

- **No restrictions on Use of Cash**
  You can spend the (optional) cash you get from a HECM however you like. You can use it to make home improvements or repairs, pay for someone's college education, travel the world, visit relatives and friends, pay off debt, buy a second home, start a business, or invest for monthly income. The sky is the limit.

- **Extensive Payment Options**
  You have a choice to receive the funds in the form of annuity, a lump sum, a credit line or a combination.

- **Independence**
  Having a HECM allows you the luxury to have full occupancy of your home, the ability to maintain and modify it according to your likes, **and the right to retain it.**

- **Automatic Credit Line Increases for the Rest of Your Life**
  Built into every HECM is an *automatic* **annual line of credit increase**. For most homeowners this eliminates the need to refinance into a new HECM later on. That said, there is nothing to stop you doing so if you choose and you qualify – and with no prepayment penalties.

  You never need to apply for the line increase, and unlike a conventional HELOC with an average Life Cap of 18% which can be decreased or canceled, the HECM Line of Credit can never be canceled or reduced and comes with an average 10% cap.

  The other advantages of a HECM is that it will never convert from an interest-only adjustable rate to fully amortized fixed rate - as HELOC's have built into their contract. For a homeowner, unaware of this feature, they could be in for a massive payment shock when they convert. This can never happen with a HECM.

- **Built in Retirement Planning with Almost Unlimited Scope**
  Many seniors take out a HECM to avoid paying for long term care insurance or other health costs in their golden years.

  Homeowners with HECM's who are savvy enough to hire a good Financial or Retirement Planner, can benefit from advanced strategies like offsetting the taxes on 401K minimum withdrawals or delaying social security income to increase their benefits.

  Imagine borrowing money on untapped equity in your home that you never pay back during your lifetime, and then investing it for monthly income. That's just one way to take advantage of this incredible wealth building product. The options are almost endless!

  HECM's can be an important source of liquidity for the growing share of older adults with a substantial portion of their wealth tied up in the equity in their homes.

HECM's can also play a counter-cyclical role in providing access to home equity when other channels of mortgage borrowing are constrained. For example, uncertainty regarding home values and income shocks associated with the 2020 COVID19 pandemic and the financial crash in 2008 led many large banks to halt originations of home equity loans and HELOC's.

CONS:

- **Not a short-term solution**
  If you think you may sell your home within a couple of years and paid application fees then a HECM may not be your best option. That said, if fees *are* incurred most homeowners roll them into the loan, and they would eat into the profits upon sale of the home. In some cases it is possible to avoid fees altogether.

- **Potential Loss of Government Assistance**
  You may obtain a hefty sum from a HECM but this could cause you to lose *low-income assistance* from the government like Medi-Cal, Medicaid, *Supplemental* Social Security Income or SSI. Therefore, It is advisable that you check if your loan will have an adverse effect on any support that you are currently receiving.

- **Restrictions on Eligibility**
  If you have two or more houses, **only the primary residence is eligible for HECM's**; a vacation home or a mobile home do not qualify either. Furthermore, the youngest borrower has to be at least **62 years old to qualify** (55 for lender proprietary reverse mortgages).

  HECM's, like every other financial move carry risks — HECM borrowers are required to occupy the home as a principal residence, keep up with required repairs, pay property taxes, and maintain homeowner's insurance. If they fail to meet these obligations, the loan is considered to be in "technical default," triggering a series of actions that in the most extreme cases can result in foreclosure.

CHAPTER 3

Dispelling The Myths

There are many HECM misconceptions which are primarily created by poor marketing. And despite many articles written by the American Association of Retired Persons (AARP), some misconceptions unfortunately persist.

The situation has not been helped by well-meaning friends and family who lack the knowledge to form informed opinions about HECM's.

The most common myths are as follows:

- **"The borrower can lose their home**"
  This is one of the biggest misconceptions of all. Unless the borrower fails to pay property taxes and insurance, or maintain the home to where it is at least liveable, they and their heirs are protected by HUD and FHA insurance - irrespective of the value of their home.

- **"When the last borrower passes away the house goes to the lender"**
  Nothing could be further from the truth.

  Here's an explanation for illustration purposes:

  65 year old Joe owes $300,000 on his home worth $1.2 Million. Joe qualifies for a $500,000 HECM. And, just like a traditional refinance the HECM lender pays off his existing $300,000 mortgage leaving Joe with $200,000 cash *and no mortgage payment for the rest of his life.*

  5 years later Joe passes away, and the house value has not changed. Joe has accumulated $50K in interest on the HECM. *This leaves Joe's heirs with the remaining $650K equity*, and depending on what Joe did with the $200,000 cash, that amount may also go to the heirs or perhaps more if he invested it wisely.

  Who knows, Joe may have invested all the mortgage payments he saved for an even larger nest egg for his heirs. He could have course have spent it also.

- **"HECM's are without protections"**
  There are many safeguards and strict regulations that the federal government has in place to protect HECM borrower's. The last thing any lender wants to do is take advantage of seniors because they are a protected class and any mistreatment of them could put them out of business. If there ever are any issues HECM lenders normally bend over backwards to find a solution to help the homeowner.

- **"I won't qualify if I have an existing mortgage balance on my home.**"
  Not true. The main requirement is that your home has sufficient equity. If you currently have a mortgage that will be paid off at closing, just like any other refinance. Except this time you'll have no mortgage payments for the rest of your life.

- **"HECM income or lump sum payments are taxable and could affect my Medicare or Social Security.**"
  Because the proceeds you get are not considered income, but a loan, any income or cash from a HECM is not taxable.

  It is, however, recommended to consult with your Medicaid (or state equivalent) or disability programs if they are means tested to see if they will be affected or not. It won't affect your Social Security or Medicare programs.

- **"If the value of my home goes down, to where I owe more money than my home is worth, it can cause issues.**"
  Again, not true. This can never happen because of the safeguards, protections, and insurance provided by the federal government's mortgage insurance pool. Even if the housing market crashes and you end up owing more money than your home is worth, there is no way the lender can force you to sell your home or come after the deficit from your estate when you pass away. On the contrary, that might be an issue on a traditional mortgage for the heirs, but not with a HECM.

CHAPTER 4

What is a Non-Recourse Loan?

One of the unique features of a HECM is that it is a "non-recourse loan." A non-recourse loan provides the ultimate security for the borrower.

Non-recourse means that the ONLY security the lender has against the HECM is the home itself. This means that the HECM borrower(s) or their estate will never owe more than the loan balance or value of the property, whichever is less.

The exact definition as noted in HUD Handbook 4235.1 Chapter 1-3 (C) is:

"FHA guarantees that neither the borrower nor their heirs will owe more than the home is worth at the time it is sold."

These words should help HECM borrowers and their heirs feel comfortable and provide assurance that however long the borrowers live, interest rates rise, or property decreases in value FHA will pay the lender for any deficiencies they cause.

If your first reaction that this is too good to be true it is important to know this is exactly why FHA collects mortgage premiums. In some instances HECM loans come with no insurance premiums but the borrower and their heirs are still protected by money in the pool.

This is a good time to clarify that mortgage insurance premiums are never paid monthly by the borrower. Just like the interest they simply add to the remaining balance. Of course, just like the interest they can optionally be paid by the borrower, but it is not a requirement.

In rare instances where the HECM amount owed is higher than the value of the home the lender can NOT call the loan due and foreclose on the property. This also applies if the last borrower or non-borrowing spouse passes away.

You may also find it of interest that in other countries a HECM is called an "Equity Release Mortgage" meaning the equity is simply released from the home.

CHAPTER 5
Types of HECM’s

As discussed, the most common is the Home Equity Conversion Mortgage (HECM). This is effectively a refinance - but payments are optional.

When you refinance into a HECM you can choose to receive the proceeds in a number of ways, these are the most common.

1. **Equal monthly payments:** for as long as at least one borrower lives in the home as their primary residence.

2. **Lump sum:** you get all the cash proceeds at the time of the refinance at a fixed rate (all the other options come with an adjustable rate.)

3. **Term payments:** the lender gives you the cash proceeds over a set period, for example 15 years.

4. **Line of credit:** you can borrow money as needed. You only pay interest on money you actually draw from the credit line. The credit line also GROWS over time automatically even if the value of your home drops dramatically.

There are other options as well which can be explored with your mortgage professional depending on your personal situation. These products do take some understanding, but they are not complicated.

In the end “It’s just a mortgage” where you borrow a chunk your homes untapped equity as a line of credit (which cannot be canceled regardless of real estate values.).

You ONLY pay interest on money you actually draw so if not used it can be kept in the background in case needed in an emergency.

CHAPTER 6
How to Apply for a HECM

If you are ready to consider a HECM, do your homework and research as thoroughly as possible. For more information call a qualified and licensed mortgage professional in your state.

They will answer all your questions - and if you'd like to apply they will take your application and provide you with a list of required documents. If your property is in California ask the person who gave you this book if they know a reverse mortgage professional who can help. Feel free to reach out to me also.

The first part of the process after the application is mandatory counseling to answer all your questions, clear up any misconceptions you may have and make sure you fully understand the product.

Your home will then be appraised and your loan officer will advise you if any additional documents are needed.

A processor or your loan officer may contact you if any additional documents are needed.

The underwriter is the final decision-maker and evaluate your loan package.

At the end of the process, you will sign the loan documents in front of a notary public at a location of your choice. You will then have three business days to cancel the loan if you wish.

If you have existing loans placed on your home, the title company or attorney, depending on what state you live in, will coordinate the payoff, just like they would on a traditional refinance.

Your HECM will be serviced in a similar fashion to your current mortgage if you have one.

You will receive a monthly statement either in the mail or online just like a traditional mortgage.

CHAPTER 7

Frequently Asked Questions

Are HECM's only for desperate people?

No. In fact *most borrowers apply before they have any immediate need* especially when prices are high as it maximizes the size of credit line. They see it as a form of self insurance in case of a medical or other emergency. No interest will be incurred unless the money is actually drawn?

Will this cut into my heir's inheritance?

Yes, and no. Here's the simple version:

Let's say your HECM helps you avoid $250,000 in interest over the next 10 years and you incur let's say $300,000 in interest on the back end. In this scenario it depends what you do with the $250,000 you saved.

You could invest the $250K into a business or other investment vehicle and if that is left to your heirs it could INCREASE their inheritance.

You could spend the money on perhaps a healthcare emergency which would have depleted the amount going to your heirs whether you had a HECM or not.

Another alternative is you could spend the $250K on living expenses which again would have depleted your heirs inheritance whether you had a HECM or not.

And finally, you could simply use the $250K for fun, like travelling the world or pursuing your favorite hobby. Only you can decide if you should deprive yourself of fun in your golden years to maximize the amount of money going to your heirs.

Could the bank foreclose on my house?

The first thing to know is that the bank does NOT own your house. It is yours and always will be. The only time they could foreclose is if you say you are living in it when you are not, or if you don't pay your taxes or insurance or the house becomes unlivable. These stipulations have some similarities to those of traditional mortgages.

CHAPTER 8

What's Next?

Do your due diligence. Look up HUD's Handbook 4235 for more information. I strongly advise you to work with an NMLS licensed mortgage professional who is licensed in and resides in your state.

The Consumer Financial Protection Bureau has a great document on the HECM's. Reach out to me if you'd like me to send it to you. Also, there is some good information on the topic at Financial Planning Association.

I also recommend you make sure to work with a Retirement or Financial Planner and CPA to help maximize this incredible retirement product. If you'd like referrals to any of the above, I'd be happy to help.

All of the details and nuances regarding HECM's will be explained in your mandatory FHA counseling session so you'll be informed and understand everything should you decide to move forward and of course I can explain also.

Speaking personally my goal with every client is they fully understand every step of the process and I will give as much time as they need to feel comfortable.

Consider this book a good starting point on your road to financial freedom in retirement. Between now and 2030, approximately 73 million Baby Boomers will be making key decisions on how to live their best lives in retirement. I hope to help you realize your dreams and let you know of the many financial options you have at your fingertips.

If you have any questions about HECM's please call me at the number below. I'd be happy to take your call and provide any help you need.

About the Author

Howard Davies moved to the US from England in 1991 and has been licensed to originate California loans since 1997. In his first year, he closed 90 mortgage transactions with a volume of over $25,000,000 making him the runner up in the annual Mortgage Originator Magazine "Nationwide Rookie Of The Year Award".

Howard is affiliated with American Family Funding Group in San Jose, CA. They have access to numerous California reverse and traditional mortgage lenders as well as conventional, FHA and VA loans. He works with a handful of top Realtors®, CPA's, Retirement and Financial Planners.

For FREE California reverse or traditional mortgage advice, call Howard at: **(408) 533-2467** or email him at: howard@howardEdavies.com

www.howardEdavies.com

www.linkedin.com/in/howardericdavies

www.tinyurl.com/Howard-google-reviews

www.FreeReverse101Book.com

Howard Davies | Reverse & Traditional Mortgage Advisor
Questions? Call Howard at **(408) 533-2467**

Email: howard@howardedavies.com