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Reverse Mortgages

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§14.1 I. INTRODUCTION TO REVERSE MORTGAGES

With the return of real estate values in most geographical areas from the Great Recession, older people—and especially retirees—may find it tempting to tap into their home equity. For many elders, home equity is the most stable, and sometimes only, source of retirement funding outside of Social Security. Indeed, almost half of Americans facing retirement plan to use their home equity to make ends meet. See Carrns, *Many Relying on Home Equity for Retirement*, NY Times (Feb. 5, 2013), available at <http://bucks.blogs.nytimes.com/2013/02/05/many-relying-on-home-equity-for-retirement>. With housing prices in most areas of California now fully recovered, it is expected that this trend will continue.

Because home equity also represents the retiree's residence, using more traditional methods of tapping into equity—by selling the property, renting it out, or obtaining a traditional mortgage—most often means searching for an alternate housing solution as well—no small inconvenience. Obviously, the method of accessing home equity has consequences that must be given careful consideration and deserves professional counsel. Reverse

mortgages are one method of accessing otherwise unavailable equity while retaining use of the home. However, they are hardly risk free.

As in all retirement planning, families need to allow for the unexpected or at least indeterminate expenses that are likely to occur in retirement. For example, one of the most significant yet unpredictable expenses is the expanding cost of health care. Any catastrophic illness can dramatically increase the need for greater cash flow. It is estimated that approximately 50 percent of bankruptcies result at least partially from health care expenses. See Himmelstein, Warren, Thorne & Woolhandler, *Marketwatch: Illness and Injury as Contributors to Bankruptcy*, Health Affairs Web Exclusive W5-63 (Feb. 2, 2005), available at http://www.pnhp.org/PDF_files/MedicalBankruptcy.pdf.

Loss of income and erosion of wealth during retirement years translates into a reduction in security and quality of life because clients no longer have as much ability to replace assets. In light of the need for a predictable stream of cash, it is not surprising to find that home equity is still considered a reasonable source of retirement funding, especially now that housing prices have recovered. Financial advisors traditionally counseled that home equity should secure the home in which the client lives and advised against viewing home equity as an investment. But when such a high percentage of personal savings is represented by property assets (see Iacoviello, *Housing Wealth and Consumption* (Aug. 2011) (Federal Reserve International Finance Discussion Papers No. 1027), available at <https://www.federalreserve.gov/pubs/ifdp/2011/1027/ifdp1027.pdf>) and when few additional resources exist, more and more families (and advisors) are looking at strategies to tap home equity as part of a retirement solution.

Until the 1960s, when the first reverse mortgages appeared, the only methods available to tap home equity involved either sale of the home, rental of all or part of the home, or conventional mortgages and lines of credit. Each of these methods has certain advantages and disadvantages. This chapter briefly examines the three more traditional approaches to tapping equity and then examines a fourth, relatively new but now fairly common option: reverse mortgages.

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II. EVALUATING ALTERNATIVES

§14.2 A. Sale of Home

An outright sale of the home is the most traditional method for accessing home equity. Of course, this choice may be driven by more than the need to access the home's equity. For example, some retirees whose children have grown and left home may decide that their home is too large for their needs and wish to downsize. Any decision to sell, however, may be limited by the availability of affordable alternative housing in their own community or the need for proximity to family or other resources. Unless the owner is looking at other, less expensive living situations, sale of the family home may not only fail to release any net equity but also may reduce current and future wealth as a result of the following:

- *Potential recognition of accumulated capital gains and loss of capital gains step-up.*

EXAMPLE 1: A single individual plans to sell a principal residence worth \$750,000 and use the proceeds to buy a less expensive home (\$500,000) and free up funds to partially fund retirement. If the home had an adjusted basis of \$100,000 and produced net proceeds from the sale (after expenses) of \$700,000, after adjusting for the \$250,000 capital gains exemption (provided ownership and occupancy requirements are satisfied) (IRC §121(b)(1)), the sale would produce capital gains of \$350,000 (\$700,000 less \$250,000 less \$100,000), subject to capital gains tax (IRC §1221). Assuming a combined federal and state capital gains tax rate of 25 percent (actual rates would depend on the seller's other taxable income), this would produce a tax liability of approximately \$87,500 (25 percent of \$350,000), reducing final proceeds from the sale by a like amount. The remaining proceeds (\$612,500) would fund the purchase of the new home, leaving only \$112,500. These funds would be further reduced by any amounts needed to retire any remaining mortgages or other liens against the property.

These effects are minimized if (1) the basis is relatively high (because of a shorter ownership period or a step-up because of the death of an owner; see IRC §1014), (2) the sale is by a couple (IRC §121(b)(2) (\$500,000 capital gains exclusion for married couple filing jointly on sale of principal residence)), and (3) there are low or no mortgage obligations.

- *Increased property taxes* because of the loss of assessed value limits under California's Proposition 13 (Cal Const art XIII A).

EXAMPLE 2: Assume the previous example. Property taxes are based on a property's assessed value and the state and local property tax rate. Actual tax rates differ between local jurisdictions (and large differences may exist if the new property is purchased outside of California), but for this example, assume that both the previous home and the new home are subject to a 1.25 percent property tax rate. If the assessed value of the original property is similar to its adjusted basis (\$100,000) (see Cal Const art XIII A, §2(a)–(b) (absent change in ownership, increase in assessed value of home for property tax purposes limited to 2 percent per year maximum permitted inflation adjustment)), property taxes would have been \$1250 per year. The new property would be subject to the same tax rate but applied against the new assessed value (unless an exemption applied; see Note below), which is generally equal to the purchase price (in this case, \$500,000), generating a tax of \$6250 (\$500,000 times 1.25 percent). As a result, even though the new property is valued at 33 percent less than the original property, the annual property tax would increase by 500 percent! This tax increase of \$5000 annually would represent a 4.4 percent rate of return on the \$112,500 remaining after the property sale (assuming no mortgages or other liens), which, unless higher returns are realized or principal is invaded, could negate any effective gain resulting from the sale.

NOTE: Under Rev & T C §69.5, a person over age 55 who sells his or her principal residence may transfer the base year value of that property for property tax purposes to a purchased replacement residence of equal or less market value in the same county or another county under certain circumstances.

- *Expenses of relocating.* Other expenses, such as moving costs, will also impact the remaining assets intended to offset the costs of retirement.

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§14.3 1. Mover's Regret

It is not unusual (particularly in California, where homes have traditionally held high values) for a family to include the sale of their residence and relocation to a less expensive community as part of their retirement plan, whether as a financial tool or just part of downsizing. However, many planners have seen their clients make this choice only to decide shortly afterward that they wish to return to their original community to be closer to friends, family, or the surroundings in which they were comfortable. Unfortunately, many find the path back impassable.

The difficulty of returning to the original community is often a result of the reduction of usable wealth due to the costs of selling and moving, including sale costs, potential capital gains taxes (see §14.2), and relocation expenses. Frequently, difficulty in returning is the result of differing rates of appreciation and depreciation of housing in the new community compared to the original community (the new community often having a lower rate of appreciation than the original community). The cost of returning to the original community is further increased by the possible increased cost of property taxes as a result of the loss of the benefits from Proposition 13 (see §14.2).

EXAMPLE: If, in Example 1 in §14.2, the homeowners had moved out of state and later decided to return to California, they would no longer have the \$750,000 value of the original property. Moreover, if California real estate had appreciated at a higher rate than the new home, or depreciated less than real estate in their new state, they would have lost additional ground against their ability to return. On returning, their property taxes would be based on the new fair market value of their home and not on their original assessed value. Cal Const art XIII A, §2(a).

PRACTICE TIP: One helpful idea, if financially possible, is to recommend that a family rent property in the new location for 6 months to a year before selling their California property in order to better evaluate if the move will be successful.

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§14.4 2. Intra-Family Home Sales

Intra-family sales offer some significant opportunities that are not otherwise available in a home sale to a third party. These may include the possible preservation of the Proposition 13 assessed value limits (see Rev & T C §63.1 (exclusion from reassessment under Proposition 13 for parent-child and grandparent-grandchild transfers)), the potential of discounted transfers for partial interests (see *Propstra v U.S.* (9th Cir 1982) 680 F2d 1248 (upheld minority interest discount for undivided one-half community property interest in real property)), and preservation of step-up or partial step-up in basis in certain situations (*e.g.*, when retained ownership rights may expose property to estate tax consideration on death; see IRC §§1014(b)(9), 2036(a)).

If children have significant resources to buy the home, a sale also provides an efficient way for them to help parents who do not want to feel that they are receiving charity from a child. A sale can also preserve family harmony by avoiding a situation in which a child might feel taken advantage of by siblings who do not contribute. Additionally, although parents commonly do not want to change an estate plan that distributes their estate on the second death in equal shares to their children, in reality this creates an unequal distribution if only one child has made substantial gifts to the parents. A sale preserves the intended equal distribution.

NOTE: Many advisors suggest a sale/leaseback arrangement. The children can buy the property and rent it to the parents, releasing the equity and creating an income stream for the children along with the tax benefits. In addition, some advisers maintain that the rental price can be up to 20 percent below market rate before getting into trouble with the IRS, although technically any below market pricing can create a tax problem. Alternatively, the children can "pay" the rent by gifting it to the parents, up to the IRS limits.

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B. Rental of Home

§14.5 1. General Advantages and Disadvantages

Renting the client's home to a third party is another option. Because no sale or transfer occurs, rental of the home does not result in property reassessment or possible recognition of capital gains tax. However, renting the entire home obviously requires the homeowner to find a replacement living situation, and rent recognized from a home rental may not be sufficient to fund alternative housing and the ongoing expenses needed to maintain the original property. In addition, a family may be unprepared or unwilling to take on the management aspects of acting as landlord.

On the other hand, rental of just a part of the home allows the owners to retain a place to live and may be a particularly attractive alternative for seniors who have a compatible child or other relative or friend to whom they might rent. Newer rental arrangements, such as Airbnb, may also provide an avenue for income without the need to move out of the home entirely, particularly in attractive coastal communities. It is still too early to tell how these short-term rental schemes might impact seniors and whether local municipalities will restrict the short-term rental market.

WARNING: Rental of real property in jurisdictions subject to just cause for eviction ordinances (normally part of a rent control or rent stabilization ordinance) may present an additional disincentive for rental of the entire home. Many just cause for eviction ordinances do not allow for eviction due to the death of the property owner or the owner's financial hardship, and some require relocation payments to the tenants for owner move-in

evictions. These factors may increase the transactional cost or lower the sales price if sale of the home is required, either to provide funds for retirement or care, or as part of administration of a decedent's estate.

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§14.6 2. Interaction With Medi-Cal Rules

Home rental may also be a viable method to obtain additional income when an individual requires institutionalization for an extended period of time because it may aid the preservation of an asset generally exempt for purposes of Medi-Cal eligibility. See 42 USC §1382b(a); Welf & I C §14006(b).

NOTE: While the home is generally exempt for Medi-Cal eligibility purposes (see chap 10 for changes under Welf & I C §14006.15(b)), Medi-Cal does not allow any nonrental income to be retained to cover the costs of maintaining the principal residence. See 22 Cal Code Regs §50605(b)(3) (home maintenance expenses not deductible from nonrental income without verified medical determination that Medi-Cal beneficiary will return home within 6 months of date long-term care status was established). Thus, such expenses as property tax, insurance, maintenance, and debt service create a dilemma for the Medi-Cal applicant.

Although rental income is countable for purposes of the share of cost (SOC) calculation, only net rental income (*e.g.*, after deductions for maintenance, taxes, and income payments on debt) is counted in the calculation. 22 Cal Code Regs §50508. Thus, while any excess rents may impact SOC, rental income can first be used to meet the ongoing expenses of maintaining the principal residence. See chaps 9 and 11 for discussion of share of cost.

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§14.7 C. Traditional Mortgage

Traditional mortgages are another common method of tapping equity in a home. However, traditional mortgages, like all forms of leverage, are often a risky method to use to fund retirement and health care expenses. The simple reason is debt service.

NOTE: California is a so-called "deed of trust" state—real mortgages are extremely rare. While there remain some differences between mortgages and deeds of trust, for most practical purposes they are identical. The more common term "mortgage" will be used throughout this chapter.

In a traditional mortgage, a borrower or borrowers usually receive a lump-sum payment (although sometimes a "line of credit," often referred to as a Home Equity Line of Credit (HELOC), is arranged instead of a lump sum), which is secured by the equity in their home. The borrower(s) are obligated to immediately start making payments, usually consisting of interest and principal, which are calculated to pay off the mortgage over a fixed period of time, typically 15 or 30 years.

One of the reasons that so much consumer equity exists in homes today is the working of a traditional mortgage. In a traditional mortgage, the amount that is owed decreases over time as principal payments are made. As the loan balance declines, the borrower's equity increases absent a decline in property values. At the same time, the borrower receives the full benefit of any appreciation in the value of the property (or suffers a loss if value declines).

In a traditional or "forward" mortgage, money is borrowed and payments begin immediately. Most loans require payment of both principal and interest, while some loans require payment of interest only, with principal payment(s) due at some future date. In both cases, however, current payments must be made. In some cases, homeowners' payments are paid out of the loan proceeds. This can easily result in a vicious cycle of increased debt and increased interest that may make such a loan unsustainable over a relatively short period of time. It is the equivalent of using one credit card to make the minimum monthly installment payment on another credit card. It is hardly a recommended long-term financial strategy.

There may be short periods during which borrowing from the principal residence is appropriate, such as when funds are needed to pay for an unusually large or unexpected expense. But borrowing, even in these situations, is only a good choice when there are resources other than the loan proceeds available to service the loan. The danger is most acute for seniors as they rarely will be in a position to expect a growing source of future income.

Another danger that became apparent after the start of the Great Recession was the form that lines of credit required for repayment. These credit lines commonly had a draw period, often for 10 years, during which the borrower could borrow up to the limit of the credit line. During the draw period, the borrower paid only the interest on the amount borrowed. When the repayment period started, the line became fully amortizing over 10 to 20 years, greatly increasing the monthly payment. Also, creditors can freeze lines of credit, which many lenders did during the recession, with little warning or justification provided to the borrower, making HELOCs an unreliable source of funds. Some predicted that there would be an explosion of defaults on HELOCs as so many began resetting in 2015. However, the predicted large number of defaults, for many reasons, have yet to appear in this market. See Harney, *What Home Equity Bomb? Borrowers Focused on Paying Debt*, Chicago Tribune (July 14, 2015), available at <http://www.chicagotribune.com/classified/realestate/ct-mre-0719-harney-20150714-column.html>.

NOTE: Anecdotal evidence suggests that HELOCs originating in the mid-2000s are being sold into fairly large investment portfolios and the new owners are making efforts to collect on the HELOCs by foreclosure. Often, the borrowers have not received a statement in years, may believe the HELOC was satisfied by refinance of the property subsequent to the HELOC, and are unable to obtain information from the originating institution or subsequent owner of the HELOC. However, it is too soon to determine if foreclosure of such "stale" HELOCs will become a widespread issue.

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§14.8 D. Diagram: Decreasing Equity With Line of Credit

The problems inherent in using a line of credit or traditional mortgage to provide retirement income are clearly demonstrated by the following chart. Assume there is a monthly need for \$2500, an expected inflation rate of 3 percent, and an available unlimited line of credit loan at 6.5 percent annual interest (in actuality, these loans typically would have an adjustable interest rate). The chart shows the speed at which the balance of such a loan would increase over just a 15-year period.

At the end of 15 years, the 3 percent inflation rate would have increased the monthly income need from \$2500 to more than \$3500. More significantly, interest would be accruing at a rate of approximately \$4950 per month, and the balance of the loan would have reached more than \$922,000. For this reason, an equity line, at best, is a short-term solution. In reality, a lender would have stopped lending long before negative home equity occurred.

In addition, as all who have lived through the Lesser Depression now know, there is no guaranty that the value of real estate will always increase. A decrease in value could leave the borrower with little or no equity as well as the inability to fund future expenses by means of the equity line. Adding the ability of lenders to freeze credit lines without warning demonstrates the insecurity of using lines of credit for retirement planning.

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§14.9 E. A Reverse Mortgage That Is Not a Reverse Mortgage

A few products have been developed that look like reverse mortgages but function quite differently. Their promoters are often quick to point out that these products are not reverse mortgages, or even loans at all, but borrowers may have a hard time discerning the difference.

Like reverse mortgages, these products offer payments in a variety of forms, including lump-sum payments, monthly payments for life, or a line of credit. However, "interest" is calculated, at least in part, as a shared percentage of the home's appreciation. In one program, this "interest" or "equity share" could have allowed the promoter to capture as much as 50 percent of the appreciation of the home's value.

In exchange, the borrower may receive a small portion of the current value of the property as cash. On sale, the borrower would first pay back the amount received as a loan plus any fees associated with establishing the contract and then pay a percentage of the change in property value to the lending company.

On the other hand, as the companies offering these programs emphasize, if the value of properties fall, they share in the depreciation as well. This is less likely to occur because the issuer protects itself by lending only a percentage of the market value, lending only on properties likely to appreciate, requiring a minimum loan period of 5 years, and sometimes even insuring the original loan amount. In addition, some of the earlier products contractually assume that the property appreciates a specified amount each year, whether or not it does so.

The usefulness of this type of program may be limited for most homeowners, because the value available from the issuer may be less than expected. For example, one issuer calculates that if a borrower owned a \$500,000 property with no existing debt and chose to share 50 percent of the change in equity values with the issuer of the loan, the borrower would only be eligible to receive a loan of up to \$62,500 or 12.5 percent of the current equity on the home. Harvesting additional equity from the property would become difficult because any future lender's claim to collateral would be limited by the now existing loan on the property.

In addition, if the borrower chose to sell the house, he or she would, by definition, owe both the original loan amount and the value of any shared appreciation. This can result in a very large effective rate of interest. Using the above example, if the value of the house appreciated by \$100,000 (to \$600,000) and the house was then sold, the borrower would be required to pay back \$112,500 to the lender, *i.e.*, the original \$62,500 loan plus \$50,000 based on the 50 percent interest in the appreciation of the property.

The "equity partner" acquires a potentially significant equity interest at a substantially discounted price. And while a "partner" with regard to property appreciation, the equity partner has no responsibility for upkeep, insurance premiums, property taxes, or other expenses of maintaining the property. These types of products virtually disappeared during the Great Recession but reemerged when values stabilized. Companies such as FIRST Rex, Nestworth, and Equity Key started to advertise aggressively in California with these "new" programs, with differing terms and triggering events for default. It is unclear if this niche market will continue to exist, since at least one of the lenders in the field has dropped its product and the others seem to do little business. These are very risky methods for turning equity into cash and must be considered a last resort, if considered at all.

PRACTICE TIP: Any unusual or untested product should always be evaluated carefully and, in almost all cases when there is a more traditional alternative, probably rejected. This is particularly true of these types of products which, by their very nature, make it impossible to calculate the cost of the loan until much later. At the very

least, each such product must be very carefully scrutinized to ensure, at a minimum, that homeowners do not risk losing their homes.

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§14.10 III. REVERSE MORTGAGES

Considering the disadvantages of the traditional methods of converting home equity, along with the relative value of equity as a percentage of household wealth, it is not surprising that other tools would be developed to allow a homeowner to have access to his or her home equity. Reverse mortgages were among the first such tools available and there has been considerable interest in them.

Reverse mortgages are designed specifically to eliminate the main disadvantage of traditional mortgages: debt service. Although the basic concept of a reverse mortgage is relatively simple to understand, the consequences of using this product may be quite complex.

Marketing efforts portray reverse mortgages as a means by which retirees can tap their home equity through the safety of a mortgage with no obligation for repayment and thus no true liability exposure during the retiree's lifetime. This is only partly true, and only if the loss of the home is not considered a liability. Indeed, in some cases, reverse mortgages may provide a good solution; however, like all financial options using the equity in the client's residence, they are far from a perfect solution and in many situations not even a good solution. Advisors should be prepared to provide education and advice about these complex instruments.

NOTE: The advertising and general information given to seniors can be confusing and misleading. In a 2015 study, the Consumer Financial Protection Bureau (CFPB) found that many consumers did not understand reverse mortgages at all after being shown many common advertisements for the products. See *A Closer Look at Reverse Mortgage Advertisements and Consumer Risks* from the CFPB's Office for Older Americans, available at https://files.consumerfinance.gov/f/201506_cfpb_a-closer-look-at-reverse-mortgage-advertising.pdf.

NOTE: The market for reverse mortgages declined when the Great Recession began, as property prices fell precipitously, and declined further when Bank of America and MetLife exited the market in 2011 and 2012, respectively. More recently, there has been a rebound in reverse mortgage volume, reflecting the improving housing market and the economic recovery.

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A. Types of Reverse Mortgages

1. Home Equity Conversion Mortgages (HECMs)

§14.11 a. Authorizing Legislation

The current growth of reverse mortgages was made possible in 1988 when President Reagan signed legislation authorizing Federal Housing Administration (FHA) insurance for reverse mortgages. Housing and Community Development Act of 1987 (Pub L 100–242, 101 Stat 1908; codified at 12 USC §1715z–20). This legislation resulted in the development of the reverse mortgage program, called the Home Equity Conversion Mortgage (HECM), by the Department of Housing and Urban Development (HUD) in 1989. See 24 CFR §206. HECMs are still the most common reverse mortgages and currently represent approximately 90 percent of the reverse mortgage market. <https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin08/siwinter08-article2.pdf>. For more information regarding reverse mortgages from the Consumer Financial Protection Bureau (CFPB), see <https://www.consumerfinance.gov/ask-cfpb/are-there-different-types-of-reverse-mortgages-en-226/>.

The primary sources of HECM requirements are the authorizing legislation, 12 USC §1715z–20, and HUD's implementing regulations, 24 CFR §206. HUD Handbook 4235.1 Rev-1 (Home Equity Conversion Mortgages

(Nov. 18, 1994), hereinafter cited as HUD Handbook 4235.1 Rev-1), updated with HUD Mortgagee Letters, describes the HECM program and provides instructions for HUD staff, participating lenders, and HUD-approved counseling agencies. The HUD Handbook and Mortgagee Letters are available at https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsggh and https://www.hud.gov/program_offices/administration/hudclips/letters/mortgagee, respectively.

NOTE: The HUD Mortgagee Letter website currently lists Mortgagee Letters superseded by the Single Family Policy Handbook (HUD Handbook 4000.1). That handbook notes that the section on HECM is reserved for future use and notes that FHA-approved reverse mortgages (HECMs) must continue to comply with all existing handbooks, mortgagee letters, notices, and "outstanding guidance." HUD Handbook 4000.1 §III(B). The handbook and mortgagee letters are combined in the FHA Single Family Housing Policy Library available at <https://www.allregs.com/tpl/Home/GetIndex?Id=62ab7b5e-4613-45e7-b5a8-dddb8f34a66c>. A link to a PDF version and other supplemental materials is available at https://www.hud.gov/program_offices/housing/sfh/handbook_4000-1.

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§14.11A b. Subsequent Legislation

In response to substantial stress in the Home Equity Conversion Mortgage (HECM) program, Congress enacted the Reverse Mortgage Stabilization Act of 2013 (RMSA), Pub L 113–29, 127 Stat 509, that amends §255(h) of the National Housing Act, 12 USC §1715z–20(h), to allow for the Secretary of Housing and Urban Development (HUD) to establish additional or alternative requirements under the HECM program. Under authority granted by the RMSA, HUD issued HUD Mortgagee Letter 2013–27 (Sept. 3, 2013). The letter set out new limits to the amount of money that a borrower could withdraw in the first year, effective September 30, 2013. For example, if the borrower is eligible to withdraw \$200,000, the maximum he or she can now take at closing is \$120,000, or 60 percent, in the first year. However, if the borrower has an existing mortgage or other liens on the property, the borrower can also withdraw an amount sufficient to pay these obligations, plus another 10 percent of the maximum allowable amount, resulting in an extra \$20,000 under the example (10 percent of \$200,000). 24 CFR §§206.19, 206.25.

The letter also announced changes to the initial Mortgage Insurance Premium (MIP) pricing options and changes to the Principal Limit Factor Tables used to determine the amount of mortgage proceeds that will be available to borrowers. Specifically, effective September 30, 2013, HECM Standard and HECM Saver initial mortgage insurance pricing options are no longer available. As long as the borrower takes no more than 60 percent of the available funds in the first year, the MIP will be limited to 0.50 percent of the appraised value of the home. If the borrower takes more than 60 percent, the upfront MIP will be 2.50 percent. HUD Mortgagee Letter 2013–27 (Sept. 3, 2013).

Effective January 13, 2014, mortgagees must complete a financial assessment of all prospective borrowers before loan approval and loan closing, including a credit history analysis and a cash flow/residual income analysis. Specific guidelines for completing the financial assessment are set forth in HUD Mortgagee Letter 2013–28 (Sept. 3, 2013).

In addition, borrowers are no longer required to take all of the loan proceeds available to them. HUD has created a HECM "mini" option that allows borrowers to take a single disbursement equal to 60 percent or less of the amount they would otherwise be entitled to borrow. A borrower who utilizes the "mini" option may not, however, access additional funds at a later time without refinancing.

The HECM program also underwent significant changes in 2008 with the passage of the Housing and Economic Recovery Act of 2008 (HERA) (Pub L 110–289, 122 Stat 2654) and the American Recovery and Reinvestment Act of 2009 (ARRA) (Pub L 111–5, 123 Stat 115), commonly referred to as "the Economic Stimulus Package" or "the stimulus package."

Significant changes include the following:

- **Mandatory counseling:** The requirements for mandatory counseling were revised to establish new standards for counselors, including the requirements that counselors be independent third parties not compensated by or associated with a party connected to the transaction (12 USC §1715z–20(d)(2)(B)) and that the HUD Secretary establish standards and protocols (within 12 months of enactment) to ensure that adequate counseling is provided to borrowers (12 USC §1715z–20(f)).

NOTE: We have attempted to retain much of the history of the pricing and other changes because these loans are often not examined until after the borrower has died, sometimes many years after origination. All current rules might not be applicable to reverse mortgages originated in past years. Practitioners should always check the HUD Handbook and the Mortgagee Letters website for the relevant information (https://www.hud.gov/program_offices/administration/hudclips/sfhsuperseded).

- **Limit of loan:** The national FHA loan limit for a HECM, originally provided for in Pub L 111–5, §1204, 123 Stat 115, is \$765,600 in 2020 (150 percent of the national conforming limit of \$510,000). The loan limit is effective for all HECMs assigned an FHA case number on or after January 1, 2020, through December 31, 2020. See HUD Mortgagee Letters 2019–19 and 2019–20 (Dec. 3, 2019), available at https://www.hud.gov/program_offices/housing/sfh/lender/origination/mortgage_limits. For current FHA mortgage limits, as well as current information on the entire program, see <https://www.hud.gov/FHAFAQ>.
- **Purchase transactions:** The law now permits the use of reverse mortgages in purchase transactions. Previously, a HECM could not be used to directly fund the purchase of a residence but only to access equity or to refinance an existing loan. 12 USC §1715z–20(m); HUD Mortgagee Letters 2008–33 (Oct. 20, 2008), 2009–11 (Mar. 27, 2009). See §14.26A.
- **Consumer protection:** Individuals participating in the origination of a HECM may not have any involvement with, or incentive to provide the borrower with any other financial or insurance product; the law also prohibits any requirement that the borrower purchase other financial or insurance products, specifically including annuities (except title insurance, hazard, flood, or other peril insurance) as a condition of obtaining a HECM. 12 USC §1715z–20(n); HUD Mortgagee Letter 2008–24 (Sept. 18, 2008).
- **Cooperative housing:** The law clarifies that the types of properties eligible for reverse mortgages include cooperative housing arrangements. 12 USC §1715z–20(b)(4).
- **Fee limit:** Origination fees are limited to \$2500 for mortgages with a maximum claim amount up to \$125,000, and thereafter limited to 2 percent of the maximum claim amount of the first \$200,000, plus an additional 1 percent for amounts exceeding \$200,000; the origination fee is capped at \$6000 (adjusted for increases in the Consumer Price Index (CPI)). 12 USC §1715z–20(r). However, these fees are subject to review based on a future analysis of the costs to mortgagors and the impact on the reverse mortgage market. Pub L 110–289, §2122(d), 122 Stat 2654.

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§14.11B c. HECM Saver

NOTE: Effective September 30, 2013, the HECM Standard and Saver initial mortgage insurance pricing options were no longer available. HUD Mortgagee Letter 2013–27 (Sept. 3, 2013). See §14.11A.

On September 21, 2010, HUD released HUD Mortgagee Letter 2010–34 establishing a new form of HECM reverse mortgage named the HECM Saver. This form of mortgage was a response to the high front-end costs of traditional HECM loans, referred to as HECM Standard. HUD Mortgagee Letter 2010–34 (Sept. 21, 2010).

While HECM Standard mortgages charged an up-front mortgage insurance premium (MIP) of 2 percent of the maximum loan amount, HECM Saver mortgages charged only 0.01 percent. HECM Savers also charged an ongoing MIP at an annual rate of 1.25 percent of the loan balance, applied monthly for the life of the loan. HECM Standard mortgages previously charged an ongoing monthly MIP at an annual rate of 0.5 percent, which was raised to equal the HECM Standard rate of 1.25 percent. ML 2010–34.

However, on January 30, 2013, HUD released HUD Mortgagee Letter 2013–01 announcing the elimination of the HECM Standard mortgage for fixed-rate mortgages and the consolidation of new fixed-rate mortgages into the HECM Saver. The change was made effective for new cases established on or after April 1, 2013.

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§14.12 2. Other Reverse Mortgage Options

In response to the HECM program and with the encouragement of HUD, private lenders have developed their own reverse mortgage programs to compete with HECM loans. The most well known of these programs was Fannie Mae's "Home Keeper" loans. However, in response to the passage of the Housing and Economic Recovery Act of 2008 (HERA) (Pub L 110–289, 122 Stat 2654), Fannie Mae discontinued its loan program.

Previously, other proprietary programs competed with HECM loans by offering higher loan amounts or other provisions that increased their marketability. However, the extension of HECM loan limits to \$765,600 has limited the advantage of these private lender loans, though some lenders may still offer limits exceeding the HECM caps. These private reverse mortgages, commonly called jumbo reverse mortgages, virtually disappeared in the Great Recession. Whether they resurface remains to be seen. Keep in mind, however, that private lenders are still participating in this market and that they may offer less favorable interest or loan terms, which can only be determined by evaluating each loan program. While traditional mortgage borrowers often shop solely on the basis of the effective interest rate of the loan, a reverse mortgage borrower must carefully consider all the terms of each loan, including, *e.g.*, fees and default triggering events. Comparison of loans can be quite complex.

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B. Elements of a Reverse Mortgage

§14.13 1. Eligibility Requirements

Current reverse mortgages require that the youngest borrower must be at least age 62 (12 USC §1715z–20(b)(1), (d)(2)(A); 24 CFR §206.33), thus placing some constraint both on the amount to be loaned in the case of tenured mortgages and on the life of the contract in all but term mortgages. On tenured and term mortgages, see [§14.14](#). The borrower must own, or be purchasing, his or her property or paid down a significant amount of any prior mortgage (24 CFR §206.35) and occupy it as the primary residence (12 USC §1715z–20(d)(3); 24 CFR §206.39). The property must be one of the following:

- Single family home or one-to-four-unit home with one unit occupied by the borrower (12 USC §1715z–20(d)(3); 24 CFR §206.45(b)), or
- HUD-approved condominium (24 CFR §§206.45(b), 206.51).

The property must also meet FHA property standards (24 CFR §206.47(a)) and flood requirements (24 CFR §206.45(c)).

The mortgage must be on real estate held in fee simple, or on a leasehold under a renewable lease for at least 99 years, or under a lease with a remaining period of at least 50 years beyond the date of the 100th birthday of the youngest mortgagor. 24 CFR §206.45(a).

Because there are no payments on the loan, as there are for traditional mortgages, the borrower used to need only general credit standing satisfactory to HUD (24 CFR §206.36); that is, have no delinquent federal debt (see HUD Handbook 4235.1 Rev-1, chap 4–2). However, due in part to rising delinquencies caused by unpaid taxes and insurance, effective January 13, 2014, mortgagees must complete a financial assessment of all prospective borrowers before loan approval and loan closing, including a credit history analysis and a cash flow/residual income analysis. Specific guidelines for completing the financial assessment are set out in HUD Mortgagee Letter 2013–28 (Sept. 3, 2013). See also the HECM Financial Assessment and Property Charge Guide (Nov. 10,

2014), available at <https://www.hud.gov/sites/documents/14-22ML-ATCH2.PDF>. The concerns about the ability to pay taxes and insurance have resulted in something akin to an escrow account for borrowers without adequate resources, called Life Expectancy Set Asides, which require lenders to evaluate the financial capacity of borrowers and set aside a portion of funds for future payment of taxes and insurance. See HUD Mortgagee Letters 2013–28 (Sept. 3, 2013), 2014–22 (Nov. 10, 2014), 2015–06 (Feb. 26, 2015), 2015–09 (Mar. 27, 2015).

PRACTICE TIP: The age requirement has proven problematic for many people. Often, a younger spouse is simply taken off the title so that the older spouse can qualify. But then if the older spouse died, it was entirely possible that the surviving spouse would not be able to stay in the property. The issue was the subject of both litigation and lobbying and finally resulted in revised rules for nonborrowing spouses. See §14.19A.

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§14.14 2. Payment Options

A reverse mortgage can provide funding for the purchase of a new residence (12 USC §1715z–20(m); see §14.11A), a line of credit against which the homeowner can borrow either a lump sum in the amount of the line of credit (see HUD Handbook 4235.1 Rev-1, chap 5–9), or as needs arise until the credit line maximum is reached (24 CFR §206.19(c); HUD Handbook 4235.1 Rev-1, chap 1–5). In addition to these options, the borrower might also elect a "term" mortgage, under which the borrower receives a stream of scheduled payments over a set period of time (24 CFR §206.19(a)), or a "tenured" mortgage, under which the borrower receives payments over the borrower's entire lifetime (24 CFR §206.19(b)). These term and tenured mortgages are what most people think of when first considering a reverse mortgage, and it is where these mortgages got their name. Instead of the borrower making immediate scheduled payments to the lender, the reverse is true: The lender is obligated to make scheduled payments to the borrower.

If the amount borrowed has not exceeded the maximum limit of the loan, borrowers may be allowed to restructure the method of future loan payments, *e.g.*, convert the remaining value of a line of credit into a tenured loan. 24 CFR §206.26.

PRACTICE TIP: In evaluating income needs, the homeowner-borrower should keep in mind that a tenured product is unlikely to make sufficient, if any, adjustment in loan payments to compensate for inflation. As noted throughout, this a critical concern, particularly in consideration of the borrower's health care costs incurred as he or she ages.

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§14.15 3. Amount Borrowed; Only Primary Loans Allowed

The maximum amount of the reverse mortgage is a variable based on the age of the youngest borrower, the current interest rate, and the lesser of the appraised value or the FHA insurance limit. 24 CFR §206.3.

As discussed in §14.11A, the amount that can be borrowed through a HECM loan through December 31, 2020, is now based on a maximum home value of \$765,600. See Pub L 111–5, §1204, 123 Stat 115; Pub L 111–88, §104, 123 Stat 2904; HUD Mortgagee Letters 2019–19 and 2019–20 (Dec. 3, 2019). (The amount is typically changed by HUD in a Mortgagee Letter circulated toward the close of each year.) However, the amount available is limited not only by the HECM cap but by debt-to-equity ratios and other considerations of the lender, *e.g.*, property value, location of the property, and the age of the owners, with older owners eligible for relatively larger loans. In addition to the HUD website, simple calculators to estimate the amount that can be borrowed through a HECM loan are available at <https://www.reversemortgage.org/About/Reverse-Mortgage-Calculator>.

Although traditional mortgages may be offered as primary or secondary loans, HUD-insured reverse mortgages are only offered as primary loans (24 CFR §206.3) to protect the security of the loan. At the same time, a lender will lend less, often significantly less, in a reverse mortgage than in a forward mortgage for the same property

value. For example, if a borrower owns a home worth \$1 million, a traditional lender will usually offer a loan based on a percentage of the equity. With a HECM, lenders are unwilling to lend as much as a forward loan because no loan payments are scheduled to be made during the life of the loan and compounding of unpaid interest creates a risk that there will be insufficient equity to adequately secure the loan.

HUD may also insure a mortgage given to refinance an existing HECM. 24 CFR §206.53(a).

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§14.16 4. Costs

Interest is only part of the full cost of a loan. Both traditional and reverse mortgages charge fees at the time the loan is established. Many of these fees, such as appraisal and closing costs, are, in fact, the same for both types of loans. However, some fees are unique to reverse mortgages. Most important are origination, insurance, and loan servicing fees. See §14.18. These fees are added to the loan balance at the beginning of a loan and on a monthly basis. A \$150,000 loan, *e.g.*, may begin with fees exceeding \$15,000 immediately added to the loan. In the case of an equity line or periodic payment loan, this means that the borrower would owe \$15,000 even if no proceeds are actually paid when the loan is established. For current fees and costs, see https://www.hud.gov/program_offices/housing/sfh/hecm/hecmabou.

PRACTICE TIP: Because fees are high compared with other types of loans and they are immediately added to the loan, it might be better for the homeowner who only wants to borrow a small amount for a short period of time, *e.g.*, to pay for an unexpected one-time expense, to secure a different kind of loan. In this case, a home equity line of credit might be the better option if unsecured credit—almost always a better option—is unavailable.

Unlike a traditional mortgage, the costs of which are relatively easy to evaluate, it is impossible to calculate the true cost of the reverse mortgage without making a number of assumptions about future home appreciation, the future living situation of the homeowner, loan servicing issues, and the borrower's life expectancy. This makes comparing the terms of one loan to another, with differing terms and conditions, particularly challenging and complex.

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§14.17 a. Interest

Interest is charged on the new loan balance and compounded over the life of the loan. See 24 CFR §§206.21, 206.25(e); HUD Handbook 4235.1 Rev-1, chap 1–8. As interest accrues, equity is reduced by the increasing loan balance. The rate charged for interest in a traditional loan is almost always less than that charged on a reverse mortgage. Further, on a traditional mortgage, interest paid is deductible (within certain limits) for federal and state income tax purposes. However, because interest is only deductible when paid, there are no income tax deductions over the life of a reverse mortgage. Only at termination of the loan, when interest is paid, may a tax deduction be realized. Rev Rul 80–248, 1980–2 Cum Bull 164.

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§14.18 b. Insurance and Origination Fees

Similar to a traditional forward mortgage, a reverse mortgage is subject to fees on initiation. 24 CFR §206.31. In a forward mortgage, fees are usually discussed in terms of "points" charged when the loan is funded. A "point" represents 1 percent of the amount borrowed and is often paid out of loan proceeds.

As noted, reverse mortgages also have loan fees. One of the fees funds the insurance risk assumed by the FHA (guaranteeing both the payment of loan advances to the borrower and the eventual repayment of the lender).

PRACTICE TIP: This aspect of a reverse mortgage is often one of the most misunderstood by consumers. The loans are indeed "federally insured," a fact often trumpeted in advertising. However, the insurance runs to the

lender, not to the consumer, who just pays for the insurance.

Another fee funds the loan originator. Previously, a reverse mortgage originator could charge as much as a 2 percent initial mortgage insurance premium (MIP) based on the maximum claim amount (24 CFR §206.105(a); HUD Handbook 4235.1 Rev-1, chap 1–10) and a 2 percent origination fee on the first \$200,000 of the maximum claim amount plus 1 percent on the amount exceeding \$200,000, capped at \$6000. 24 CFR §206.31; HUD Mortgagee Letter 2008–34 (Oct. 31, 2008). HUD Mortgagee Letter 2013–27 (Sept. 3, 2013) announced changes to the initial MIP pricing options, effective September 30, 2013. The MIP limits were tied to the amount of funds received. (If the borrower took 60 percent or less of the available funds in the first year, the MIP was limited to 0.50 percent of the appraised value of the home. Otherwise, the upfront MIP was 2.50 percent.) The MIP rates changed again effective October 2, 2017. HUD Mortgagee Letter 2017–12 (Aug. 29, 2017). The initial MIP is now set at 2 percent of the maximum claim amount regardless of the amount or time of any disbursement, and the annual MIP rate is now 0.50 percent of the outstanding mortgage balance. See §14.11A. Origination fees are limited to a cap of \$6000. 24 CFR §206.31(a)(1).

Unlike a traditional mortgage, which pays such fees out of the loan proceeds, in a reverse mortgage, these amounts are immediately *added* to the loan balance if not paid in cash by the borrower at closing, even before any loan distributions have been made. 24 CFR §206.31 (origination fee); HUD Handbook 4235.1 Rev-1, chap 1–10 (MIP). In addition to the initial MIP, a monthly MIP, based on the mortgage balance, is assessed throughout the life of the loan and also added to the mortgage balance. 24 CFR §206.105(b).

Further, the fee is not calculated on the basis of the amount initially borrowed but the "maximum claim amount" on the loan. HUD Mortgagee Letter 2008–34 (origination fee); HUD Handbook 4235.1 Rev-1, chap 1–10 (MIP). The reason for this is fundamental to a reverse mortgage. If the mortgagor is making monthly payments, the amount initially borrowed could be very low compared to the amount obligated by the loan. Thus, a fee based on the initial loan could fail to fairly compensate the originator or develop enough premium to fund the risk taken on by the FHA.

This treatment can result in surprisingly high fees. For example, assume a couple wishes to establish a reverse mortgage on their house with a fair market value of \$800,000 but find that they are limited to a maximum loan of \$500,000. This maximum loan amount of \$500,000 is the maximum claim amount. Even if they actually borrow less, say \$100,000, fees will still be based on the maximum claim amount of \$500,000 and not the \$100,000 actually borrowed. Thus, the origination fee could be as high as \$6000 (2 percent of the first \$200,000 plus 1 percent of the remaining \$300,000 = \$7000 but capped at \$6000 (see §14.11A)). This amount could then be increased by a \$10,000 insurance fee (2 percent of \$500,000), for a total fee as high as \$16,000. This would result in a fee as high as 16 percent of the amount actually borrowed (\$16,000/\$100,000).

Even though the Housing and Economic Recovery Act of 2008 (HERA) (Pub L 110–289, 122 Stat 2654) lowered the origination fee percentage and capped it at \$6000 (12 USC §1715z–20(r)), because the fee is based on the maximum claim amount, which was increased both in 2008 and 2009, it is possible that in an individual case fees might actually increase.

PRACTICE TIP: It is very difficult to compare loan products when the mix includes reverse mortgages because reverse mortgages have unknown variables, the most important of which is how long the borrower will live. As illustrated by the costs and fees discussed in §§14.16–14.18, reverse mortgages are rarely a good option if the borrower's life expectancy is less than 5 or even 10 years.

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§14.19 5. Payoff Triggering Events

The actual date that the loan must be paid off varies depending on several possible circumstances. The loan is due and payable at death (24 CFR §206.27(c)(1)). However, and contrary to the belief of many borrowers, death of the borrower is not the only event that will trigger repayment. For example, loans also become immediately due and payable if the home is sold (24 CFR §206.27(c)(1)) or if no borrowers remain living in the home (24

CFR §206.27(c)(2)(i)). In the case of a temporary absence, *e.g.*, if the need for institutionalized care becomes necessary, the loan will generally accommodate up to a 1-year absence before it is called. However, after the year has passed, the loan is subject to cancellation and is immediately due. 24 CFR §206.27(c)(2)(ii).

PRACTICE TIP: If the potential older adult borrower is likely to require permanent institutionalized care or is likely to move, *e.g.*, in 5 years or less (*e.g.*, to be closer to children), a reverse mortgage should probably be avoided. The high costs immediately added to the loan can result in extremely high repayment requirements on a forced sale of the home.

NOTE: The 1-year period differs from the Medi-Cal test for continuing eligibility for Medi-Cal nursing home benefits; under traditional Medi-Cal rules, the home continues as an exempt asset of the institutionalized beneficiary as long as the owner indicates a subjective intent to return home. See 42 USC §1382b(a); Welf & I C §14006(b); 22 Cal Code Regs §50425(c)(3).

Other events will also trigger cancellation of the loan, such as a failure to maintain insurance, make property tax payments, or other stated conditions specified in the individual loan agreement. 24 CFR §206.27(b)(6), (c)(2)(iii). For example, some loans call for cancellation as a result of the borrower renting out part of the home.

PRACTICE TIP: It is a common misconception that reverse mortgages eliminate all payment obligations, especially for taxes and insurance. For this reason, nonpayment of taxes and insurance are two of the most common events leading to a declaration of default by the lender. Such increased costs may be offset by the new set-asides on some loans, although the purpose of the set-asides is to help on the income side of the equation. See §14.13. Although property taxes and insurance are the most important and most common problems, only by examining the terms of the specific loan agreement will the borrower be alerted to all of the events that will trigger the loan being called.

If possible, the practitioner should also consider and attempt to deal with what can be considered one of the normal risks of aging. It is not surprising to consider that as people age, even if they do not have financial difficulty, they might not open all the mail, might misplace a bill, forget to pay taxes, or ignore a request to certify that they still live on the premises. It may be very worthwhile to consider using a bill-paying service, asking a relative to handle mail, or exploring some other solution, since it can be quite simple to fall into default without meaning to at all. In late 2017, borrowers became able to designate alternative contacts for services to notify in an attempt to remedy this problem.

The consequences of default and early termination of a loan can be traumatic. It requires that the full outstanding loan balance be paid off immediately (see 24 CFR §206.27(c)), which will usually force a sale of the property. A borrower who was depending on the income from a reverse mortgage will see those income payments vanish. Even when the problem can be fixed fairly easily (*e.g.*, in the situation of a failure to respond to a request to verify occupancy), foreclosure proceedings might begin, causing trauma and possibly extra costs as foreclosure costs are added to the mortgage balance. 24 CFR §206.124(a)(3).

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§14.19A 6. Warning to Heirs and Beneficiaries About Repayment

Reverse mortgages usually terminate at the death of the last borrower and are payable from the proceeds of the borrower's property. As with many other mortgages, reverse mortgages are "nonrecourse" loans secured only by the underlying property. 12 USC §1715z-20(d)(7) (which requires that a reverse mortgage provide that the homeowner shall not be liable for any difference between the net amount of the remaining indebtedness of the homeowner under the mortgage and the amount recovered by the mortgagee). See also HUD Handbook 4235.1 Rev-1 (Home Equity Conversion Mortgages). Therefore, if the balance on the loan exceeds the value of the underlying property, the lender is unable to claim additional estate assets to satisfy the excess debt. The house would then usually be sold, and the net proceeds from sale would be all that the lender could claim.

Previously, HUD Mortgagee Letter (ML) 2008–38 (Dec. 5, 2008) interpreted the nonrecourse provision to mean that the obligation to repay the debt is not satisfied by payment by heirs or other nonborrowers of an amount equal to the value of the property securing the note if the value of the property was less than the outstanding loan obligation. In other words, under HUD's treatment, the value of the house if paid through a foreclosure would satisfy the loan, but not otherwise.

Now, satisfaction of the reverse mortgage occurs if the property is sold for at least 95 percent of the appraised value, or by offering a deed in lieu of foreclosure. 24 CFR §206.125. This may provide the opportunity for heirs to acquire the property at slightly below market price. Depending on the current home values at the time of death, this option may make a lot of sense.

WARNING: The time to arrange a purchase to satisfy the mortgage is short, and heirs need to quickly contact the loan servicer. Usually, there is a 30 day window to complete the required appraisal. See 24 CFR §205.125(b). However, most time deadlines can be waived with HUD approval.

If there is a surviving nonborrower spouse, the value of the house would be sufficient as long as the surviving spouse moves out. If, however, the surviving spouse wished to remain, he or she had to either (1) continue on the loan if he or she was on the loan to begin with or (2) pay off the full value of the loan, which could be much greater than the value of the property.

Many reverse mortgages have been written naming only one spouse as the borrower. While common when one spouse is not yet 62, another possible explanation for this practice is that if only one spouse is named on the note, the life expectancy is lower (because a single life expectancy is less than a joint life expectancy). Thus, the salesperson by naming only one spouse as owner lowers the life expectancy and increases the monthly payment, which may make it easier to sell the loan. What the salesperson may not mention to the potential client is that naming only one spouse on the loan may leave the non-borrower spouse with no home and no continuing income when the loan is called at the first death.

On March 8, 2011, three plaintiffs and the AARP sued HUD over the treatment of HECM loans under ML 2008–38. Each plaintiff was a widow of a HECM mortgagor, none of whom was listed on the deed nor on the HECM her spouse had signed. The HECMs on the plaintiffs' homes became due on their spouses' deaths. As a result, the plaintiffs were the subject of foreclosure actions brought by HECM mortgagees. In the suit, the plaintiffs alleged that ML 2008–38 reflected a change in long-established federal rules and violated protections for surviving spouses. The plaintiffs also argued that ML 2008–38 was in direct conflict with the original enabling legislation and previous policy. *Bennett v Donovan* (D DC 2011) 797 F Supp 2d 69, rev'd (DC Cir 2013) 703 F3d 582.

In *Bennett*, HUD argued that the plaintiffs lacked standing because their injury (being displaced from their homes) was the direct result of contracts entered into by the plaintiffs' spouses and private sector lenders but not the result of the action of any party. Agreeing with HUD, on July 8, 2011, the court dismissed the suit without prejudice. 797 F Supp 2d at 74. On January 4, 2013, the circuit court reversed the district court, holding that the spouses had standing because HUD had statutory authority to accept assignment of the mortgage, pay off the balance of the loans to the lenders, and then decline to foreclose against the plaintiffs. *Bennett v Donovan* (DC Cir 2013) 703 F3d 582, 588. Because the district court refused to certify a class on remand, the circuit court's ruling is only applicable to the named plaintiffs. Based on *Bennett* and a similar case, *Plunkett v Castro* (D DC 2014) 67 F Supp 3d 1, HUD issued two clarification letters stating that, although HUD was not obligated to provide any relief, it would allow an assignment to the surviving spouse if certain, somewhat unlikely, factors were met. See ML 2015–03 (Jan. 29, 2015) and ML 2014–07 (Apr. 25, 2014).

A great deal of lobbying and hearings ensued, resulting in HUD's adoption of the Mortgagee Optional Election (MOE) Assignment, which allows for non-borrowing spouses to remain in the property after the death of the borrowing spouse if the lender or servicer agrees and the following conditions are met (ML 2015–15 (June 12, 2015), available at <https://www.hud.gov/sites/documents/15-15ML.PDF>):

- The reverse mortgage was assigned an FHA case number before August 4, 2014.

- He or she is current in making timely tax and insurance payments.
- He or she maintained the property under the terms and conditions of the HECM.
- He or she was legally married to the borrowing spouse at the time of the loan closing or was engaged in a committed same-sex relationship with the borrower akin to marriage but was prohibited under state law from legally marrying the borrower at the time of the loan's origination but became legally married before the borrower's death.
- He or she currently resides and resided in the property as his or her principal residence at the origination of the HECM and throughout the duration of the HECM borrower's life.
- He or she has, or can obtain within 90 days following the last surviving borrower's death, good, marketable title to the property or a legal right to remain in the property for life. This requirement has proven critical. Without legal authority to represent the estate, it can be very difficult to proceed. The nonborrowing spouse should be added to title as soon as possible, through whatever instrument is best in the particular state. Many practitioners in California recommend a revocable trust for which the cotrustee is the nonborrowing spouse. This also avoids probate costs and time. A borrower can add another to the deed as long as he or she retains a fee interest as well. 24 CFR §206.27(c)(1).
- He or she meets all other terms and conditions of the original mortgage contract.
- He or she makes the request within 120 days of the borrower's death. This requirement is often waived on request.

NOTE: The surviving spouse is not a borrower, thus he or she will not be allowed to draw any more funds. Also, because lenders must account for this change in originating new loans, the amounts available when there is a younger spouse may be less than before. The nonborrowing spouse typically must now sign off on a certificate at closing of the original reverse mortgage, acknowledging all of the above conditions.

WARNING: As of the cutoff dates of the 2020 edition of this publication, this area remains in flux. HUD previously set up a special program to allow surviving spouses to remain in the home subject to the reverse mortgage. However, the program was set to expire March 21, 2020. It remains to be seen if HUD will extend this program. See <https://www.nclc.org/issues/fact-sheet-nbs.html> and https://www.hud.gov/program_offices/housing/sfh/hecm/facts_snbs_8-4-14_after.

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§14.19B 7. Special Note on Foreclosure

Like a traditional mortgage, a reverse mortgage can be foreclosed on, either judicially or nonjudicially. In California, almost all residential foreclosures are conducted nonjudicially with a trustee conducting the sale at auction. Notice and timing of such foreclosures are subject to strict statutory requirements, most of which are set forth in CC §§2924–2924c. A discussion of those requirements is outside the scope of this book, but an awareness of certain special rules applying to reverse mortgages is required, so that if an issue does arise, the practitioner will know where to begin an analysis. For fuller discussion of nonjudicial foreclosure, see California Mortgages, Deeds of Trust, and Foreclosure Litigation, chap 2 (4th ed Cal CEB).

Specifically, HUD-insured reverse mortgages, like other federal loans, have an entirely separate system of foreclosure available to the servicers. A servicer can opt to foreclose under the Single Family Mortgage Foreclosure Act of 1994 (12 USC §§3751–3768). The foreclosure remedy envisioned by Congress is entirely nonjudicial; it has been declared efficient, and the discretion to use it is exercised solely by the Secretary of HUD. 12 USC §§3751(a)(5), 3753.

The process is concisely described by the trial court in *Nelson v United States Secretary of Hous.* (MD Fla, Nov. 4, 2011, No. 3:10–cv-1118–J-37MCR) 2011 US Dist Lexis 128088, *3:

If the borrower breaches a covenant or condition in the mortgage agreement, HUD may direct a designated "foreclosure commissioner" to file and serve a "Notice of Default and Foreclosure Sale" and commence a non-judicial foreclosure sale. 12 U.S.C. §§ 3755(a), 3756, 3757.

"Service" is loosely defined under the Single Family Mortgage Foreclosure Act. The notice is "deemed duly given upon mailing, whether or not received by the addressee and whether or not a return receipt is received or the notice is returned." 12 USC §3758(2)(C).

As long as the commissioner complies with a few statutory requirements, the foreclosure commissioner may proceed with the foreclosure sale at the place and time designated in the notice. See 12 USC §3760(a) (prescribing location, manner, and time for foreclosure sales). The foreclosure commissioner has wide discretion to proceed with, cancel, or adjourn the foreclosure sale. 12 USC §3760. Once a foreclosure sale is complete, the foreclosure commissioner distributes the proceeds of the sale (12 USC §3762), transfers title to the property to the purchaser (12 USC §3763), and records the foreclosure and sale in the official property records of the county in which the property is located (12 USC §3764).

The final, recorded documents contain statements which, by statute, are prima facie evidence of the following (12 USC §3764(a)):

- The date, time, and place of the foreclosure sale;
- That the mortgage was held by the Secretary;
- The particulars of the foreclosure commissioner's proper service of the notice of default and foreclosure sale;
- The date and place of filing the notice of default and foreclosure sale;
- That the foreclosure was conducted in accordance with the Single Family Mortgage Foreclosure Act and with the notice of default and foreclosure sale; and
- The sale amount.

The sale is conclusive. The Single Family Mortgage Foreclosure Act bars all claims on or with respect to the property sold for (1) any person to whom the notice was mailed, (2) any person claiming any interest in the property subordinate to that of the mortgage if that person had actual knowledge of the foreclosure sale, (3) any person claiming any nonrecorded interest in the property that arose before the filing date of the notice, and (4) any person claiming an interest in the property under a statutory lien or an encumbrance that arose after the filing of the foreclosed mortgage. 12 USC §3765.

Significantly, challenging the foreclosure process may be difficult and different from what many practitioners are used to doing in regular foreclosures. The practitioner must be aware of the Quiet Title Act (28 USC §2409a), which is the exclusive means to bring challenges to federal foreclosures because the United States, as a sovereign, cannot be sued at all without its consent. *Hercules, Inc. v U.S.* (1996) 516 US 417, 422, 116 S Ct 981.

One other condition imposed by the Quiet Title Act is that claims challenging the United States' title to real property must be brought in federal court. Federal district courts "have exclusive original jurisdiction of civil actions under section 2409a ... to quiet title to an estate or interest in real property in which an interest is claimed by the United States." 28 USC §1346(f). See also *Cummings v U.S.* (5th Cir 1981) 648 F2d 289, 292 (under §1346(f), state court had no jurisdiction to hear plaintiff's claim).

Thus far, such foreclosures seem to be rare in California.

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§14.20 8. Loan Amount Increases and Equity Interest Decreases Over Time

In a reverse mortgage, the loan amount increases as monthly interest, service fees, insurance fees, and principal payments to the borrower are added to the balance. At the same time, interest is charged on the increasing loan balance and is compounded over the life of the loan. As interest accrues, equity is reduced by the increasing loan balance. In addition, some loans provide that the lender participate in the future gross appreciation of the property, thus further reducing the equity retained by the homeowner.

PRACTICE TIP: If, after establishing a reverse mortgage, an individual decides to sell his or her home, pay off the mortgage, and obtain alternative housing, he or she may be surprised by another unanticipated consequence of these loans. Due to compounding mortgage balances, the person will likely owe more on the loan than expected. This is true not only because the loan amount increases and the equity decreases over the life of the loan but also because taxable gains are measured by comparing the property's adjusted basis (including the exemption amounts) to the net proceeds of the sale without any adjustment for the loan balance to be paid. Unlike a traditional mortgage, in which principal owed on the loan decreases slowly over the life of the loan, principal owed in a reverse mortgage increases substantially as the loan and interest compound. After subtracting closing costs, taxes, and the final payoff of the reverse mortgage, there may be few, if any, funds left to the former homeowner.

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§14.21 9. FMA 2007 [Deleted]

This section has been deleted because the proposed legislation discussed in this section was not enacted.

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§14.22 C. Chart: Comparison of Traditional and Reverse Mortgages

The following chart summarizes some of the principal differences between a traditional and reverse mortgage that have been discussed in this chapter.

	Traditional, Forward Mortgage	Reverse Mortgage
Amount Borrowed	Fixed amount, determined at loan origination	May be a fixed or variable amount, depending on the type of loan and length of life of borrower
Repayment	Repayment of interest and principal, or at least interest, normally begin immediately, and final payment is date certain (or earlier)	Payment of all principal and interest occurs after death of last borrower or after property is no longer occupied by borrower
Security	Property is secured by ability of borrowers to make payments, plus underlying value of property	Property is secured by value of property at loan termination

	Traditional, Forward Mortgage	Reverse Mortgage
How Borrower Receives Funds	Lump sum Line of credit	Lump sum Line of credit periodic payments for period certain Periodic payments for life (Tenured) Combinations of above
When Loan Is Due	After scheduled period of time during which loan is slowly retired On sale of property At death of last borrower On default	On sale of property At death of last borrower When borrower requires long-term (greater than 1 year) institutionalized care When loan restrictions are violated
How and When Paid Off	Monthly payments of interest and principal Lump sum on early termination of loan	Lump sum, usually from proceeds of sale of home
Debt Balance	Decreasing	Increasing
Equity Balance	Often increasing due to property appreciation plus debt reduction	Often decreasing due to increasing debt and potential lender participation in property appreciation
Interest Charges	Fixed or variable Usually lower than reverse mortgage Tax deductible (as permitted by law)	Line of credit loans variable; term and tenured loans often fixed Usually higher than traditional mortgage Deductible only on termination of loan (as permitted by law)

	Traditional, Forward Mortgage	Reverse Mortgage
Other Costs	Application (<i>e.g.</i> , appraisal) Origination fee Mortgage insurance in some cases	Application (<i>e.g.</i> , appraisal) Origination fee Servicing fee Insurance

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§14.23 D. Possible Uses of Reverse Mortgage

A reverse mortgage may be an appropriate tool in certain limited circumstances, allowing a retiree to remain in the family home when it otherwise might be impossible. But without careful analysis, a reverse mortgage could be a trap, with hidden and unexpected costs, and could even result in the loss of the very home these plans are designed to protect. Further, the complexity of these financial devices and the rapid growth in the marketing of these products greatly increase the potential for mistakes and abuse.

In considering a reverse mortgage, the possible uses and pitfalls discussed in §§[14.24–14.30](#) should be evaluated on a case-by-case basis.

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§14.24 1. To Provide Retirement Income

Often, reverse mortgages are considered as a last resource for retirement income, and this may be a practical use in certain situations. However, there are risks. A reverse mortgage may not make sufficient income available, or unanticipated expenses may overwhelm available funds.

In evaluating income needs, the borrower should keep in mind that a tenured product (see §[14.14](#)) is unlikely to make sufficient, if any, adjustment in loan payments to compensate for inflation. This may force the homeowner to seek other options and could potentially result in the forced sale of the property.

For example, a reverse mortgage that pays the borrower \$600 per month would have to increase future payments to more than \$1080 per month to maintain the original purchasing power over a 20-year period (assuming a 3 percent inflation rate).

PRACTICE TIP: Any recommendation to use a reverse mortgage, particularly over a longer period of time, should be based on an evaluation of the risk of a change in the client's financial situation, such as unanticipated expenses, which might force the client to liquidate the property and close the loan. The average life expectancy of 20 or more years from the date borrowing can begin (age 62) presents a potentially long time period for prediction of income needs and creates particular risk where the only way out requires sale of the client's home.

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§14.25 2. For Debt Consolidation or Refinancing Existing Mortgage

Reverse mortgages are often recommended by brokers to consolidate debt or for debt relief. This use of a reverse mortgage might be appropriate, for example, when paying traditional mortgage liabilities is a burden on family income. However, care must be taken to assure that the burdens relieved are not replaced with new debt. Advisors should be wary of brokers trying to churn mortgages by promising relief from prior bad loans.

In addition to consolidating nonmortgage debt, HECM loans can be used to replace existing mortgages. The advantage to the borrower might include a reduction in interest rates from the existing mortgage rates (depending on the mortgage terms), consolidation of existing consumer debt, and elimination of the need to make monthly payments on outstanding debt. However, borrowers must be advised that it is rarely ever a good idea to replace unsecured debt with secured debt because, if for no other reason, secured debt is not discharged in bankruptcy.

Further, HUD Mortgagee Letter 2009–49 (Nov. 18, 2009) clarifies that in order to use a reverse mortgage to consolidate existing mortgage debt, no outstanding liability (subordinated liability) may remain on the property being financed. The Letter presents the following example:

[A] homeowner has an existing forward mortgage and seeks HECM financing to pay off that mortgage and some other debts. The HECM proceeds, however, will be insufficient to cover a payoff of the forward mortgage, HECM closing costs and other debts. In such a case, if the borrower, in order to close the HECM transaction, obtains subordinate financing which then gives rise to a third or other subordinate lien against the property, the subordinate financing would violate [24 CFR] §206.32(a), because it is made in connection with the HECM transaction. Therefore, any excess balance due on an existing lien must be paid in full, forgiven, or otherwise extinguished prior to or at closing of the HECM loan transaction.

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§14.26 3. As Source of Funds for Investment

It is generally considered extremely unwise to risk the family home as a method of obtaining funds for investment. The fees and interest charges of a reverse mortgage and the difficulty of refinancing (*e.g.*, due to compounding on the loan) make it highly unlikely that a borrower would receive any positive leverage from this type of transaction. For a period of time, brokers were coupling reverse mortgages with the purchase of annuities from the proceeds. This is no longer permitted in California. CC §1923.2(i).

PRACTICE TIP: The use of reverse mortgage proceeds for investment purposes is an area of much potential abuse, and it should receive the highest level of scrutiny or be avoided altogether without the most sophisticated investment and tax advice. It is extremely rare that an investment will guarantee sufficient returns to justify using a reverse mortgage as a source of investment funds.

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§14.26A 4. To Purchase Home While Retaining Income

With the passage of the Housing and Economic Recovery Act of 2008 (HERA) (Pub L 110–289, 122 Stat 2654), a home equity conversion mortgage (HECM) can now be used to directly fund the purchase of a new residence. 12 USC §1715z–20(m). See §14.11A. Previously, these loans were limited to equity conversions on property already owned. Purchase of a home with a HECM before passage of the Act would have required that the home first be purchased with conventional financing and then refinanced with a HECM. Now there is no need for intermediate financing. This not only eliminates the complication and cost of a more layered transaction but also may allow to take place what would have been an otherwise impossible transaction (because of the difficulty of obtaining short-term financing or the lack of adequate cash resources). See HUD Mortgagee Letters 2008–33 (Oct. 20, 2008), 2009–11 (Mar. 27, 2009).

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§14.27 5. To Fund Long-Term Home Care

In certain situations, a reverse mortgage may be a legitimate method of obtaining funds to finance a nonrecurring special need. A reverse mortgage may also be used to allow an individual to continue to live

independently and in the family home when few, if any, other options exist. It may also allow an ill or disabled individual to afford to remain in his or her home.

However, as the risk increases that at-home care will be inadequate and the potential need for institutionalized care increases, a reverse mortgage may be a poor choice because reverse mortgages are called when no borrowers remain in the home. 24 CFR §206.27(c)(2)(i). Though current products allow for temporary absence from the home, loans can be called if the home is not occupied by a borrower for more than 12 consecutive months. 24 CFR §206.27(c)(2)(ii); CC §1923.2(g)(2). This makes these loans quite risky if used to fund care for someone who is at an elevated risk for needing institutionalized care. Additionally, the forced sale of the principal residence will result in an otherwise uncountable asset becoming a countable asset for Medi-Cal eligibility purposes. See 22 Cal Code Regs §50425(f). But even if public benefits are not initially desired and forced liquidation of the property does not interfere with the client's objectives, the consequences can be surprisingly negative.

In addition, much of the housing stock is simply unsuited to seniors, particularly those with disabilities, and this may include the client's current residence. Clients interested in using reverse mortgages to fund in-home care must determine the need for alterations and retrofitting to make the home livable, and accommodate any future decline in the client's physical and mental condition.

PRACTICE TIP: Because reverse mortgages load fees on the front end of the contract (*e.g.*, origination and insurance), these loans are most expensive if held for short periods of time. There are examples of reverse mortgages held for less than 2 years and then canceled, resulting in effective interest and fees as high as 49 percent. If institutionalized care is likely to be needed, the homeowner may be better off using more traditional forms of borrowing, even if some of the loan proceeds might need to be used to service the debt for a short period of time.

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a. Reverse Mortgages and LTC Medi-Cal

§14.28 (1) Not Useful to Reduce Assets to Create Eligibility

Many individuals rely on benefits from the state and federally funded Medi-Cal program to help pay for the costs of long-term care (LTC). A few marketers have suggested using reverse mortgages in coordination with Medi-Cal benefits. However, extreme caution is in order.

Because the value of real property is reduced (for Medi-Cal purposes) by any encumbrances against it (22 Cal Code Regs §§50415(b), 50419), the loan balance of a reverse mortgage would lower the value of the property that secures it. However, assuming statutory requirements are met (*e.g.*, an expressed intent to return home; see 22 Cal Code Regs §50425(c)(3)), the value of the principal residence is inconsequential because the principal residence is an exempt asset (see 42 USC §1382b(a); Welf & I C §14006(b)) and thus uncountable regardless of value. 22 Cal Code Regs §50425; 20 CFR §416.1212(b) (SSI rule applicable to Medi-Cal in determining eligibility for Medi-Cal benefits; see Welf & I C §§14006(c), 14006.1(b)).

However, with the passage of the Deficit Reduction Act of 2005 (DRA) (Pub L 109–171, 120 Stat 4) and the move toward implementation of new housing limits for unmarried Medi-Cal applicants and beneficiaries through Stats 2008, ch 379 (discussed in chap 10), focus has once again been placed on the use of reverse mortgages in a Medi-Cal planning context. DRA itself inserted language into 42 USC §1396p that appears to endorse the use of reverse mortgages to reduce home equity for Medi-Cal purposes. Specifically, DRA inserted the following language at 42 USC §1396p(f)(3): "Nothing in this subsection shall be construed as preventing an individual from using a reverse mortgage or home equity loan to reduce the individual's total equity interest in the home."

However, one of the few reasons a reverse mortgage will be called is if the homeowner no longer resides in the property (after 12 months). See 24 CFR §206.27(c)(2)(ii). So, if an institutionalized Medi-Cal beneficiary owns a home with a reverse mortgage, the loan is likely to be called after 1 year of institutionalization. This would most likely necessitate liquidation of the home to satisfy loan repayment, resulting in the loss of the home to which the institutionalized person may want to return. In addition, if any value remained after repayment of the outstanding loan balance, it would become a countable asset, resulting in the loss of Medi-Cal benefits. Clearly, a reverse mortgage is a very limited tool for reducing the Medi-Cal value of a principal residence when there is excess value.

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§14.29 (2) May Be Useful to Provide Additional Cash Flow for Well Spouse of Institutionalized Medi-Cal Beneficiary

On the other hand, a reverse mortgage may be a useful tool for producing additional cash flow for the well spouse of an institutionalized individual on Medi-Cal. Here the advantage is not in the reduction of the equity value of the home (which does not apply when a community spouse still occupies the principal residence) but in the generation of cash flow. Because payments are loan proceeds and not income, they are not included in the calculation of share of cost. CC §1923.9. (However, beware of Reverse Annuity Mortgages or annuities funded with a reverse mortgage (see §14.30), in which share of cost can be increased as a result of a transaction; see ACWD Letter No. 08–17 (Apr. 25, 2008)).

Of course, any funds received before determination of Medi-Cal eligibility and still retained by the applicant or spouse will be considered available assets and thus included in the determination of eligibility. See §9.14. So any mortgage providing for a lump-sum payout should not be executed before eligibility is determined. Likewise, funds from a reverse line of credit would be countable to the extent they are not expended in the month of receipt. See §9.15.

NOTE: There may be an unintended and potentially costly negative impact of selling one's home as the result of passage of the Deficit Reduction Act of 2005 (DRA) (Pub L 109–171, 120 Stat 4). Before DRA, principal residences, regardless of value, that met one of four standards (occupied by the applicant or spouse; by a minor, blind, or disabled child (of any age); or by a sibling or son or daughter who lived in the home continuously for at least 1 year before the applicant entered a nursing home; or when the owner intended to return home) were fully exempt from consideration as an asset in determining eligibility for Medi-Cal. DRA now prohibits Medi-Cal eligibility in the case of a single individual when the value of the principal residence exceeds a specific value (\$750,000 in California), although Welf & I C §14006.15(f)–(g) clearly states that the new home equity limit will not be effective until implementing regulations are adopted, and it will not be applied retroactively.

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§14.30 b. Risks of RAM Loans and Using Reverse Mortgages to Fund Certain Annuities

A reverse mortgage providing a stream of income for life does so by providing a payment to the borrower and increasing the loaned amount on a monthly basis.

Early forms of reverse mortgages called Reverse Annuity Mortgages (RAMs) provided lifetime income by combining a lump-sum reverse mortgage with a life-based annuity contract. For example, a borrower could take out a reverse mortgage providing an immediate payment of \$200,000, which would then be used to fund an annuity providing monthly payments for life. The result was that even though the borrower had yet to receive any net funds from the mortgage, he or she already owed a mortgage amount of \$200,000 (plus fees). If the annuity provided no guarantee rights (*i.e.*, a life-only annuity), a premature death resulted in a huge loss to the estate with little or no benefit to the homeowner.

Such forms of RAMs have generally been replaced by today's reverse mortgages. However, some organizations or individual salespersons may still advise that a reverse lump-sum mortgage be established and then be used to

purchase an immediate annuity. The homeowner pays fees to establish the loan, pays fees (though usually hidden) to purchase the annuity, and may even pay fees to the agent for referring the borrower to the lending firm. In some cases, a reverse mortgage has been used to fund an annuity that is not even scheduled to make payments to the homeowner for a number of years. During this time, of course, interest and other charges continue to accrue against the equity in the home. This is seldom a good idea. See [§14.26](#).

In addition, unlike reverse mortgages making periodic payments, the monthly proceeds produced by these products are proceeds from an annuity and as such would be countable as income for purposes of calculating Medi-Cal share of cost. See [chap 9](#). Many consider the threat of financial elder abuse high when dealing with reverse mortgage annuity products. There are rare circumstances, if any, in which using a RAM would be an effective financial decision.

NOTE: In California, the initiator of the reverse mortgage is prohibited from representing any other insurance or financial product or referring the borrower to someone who represents any other insurance or financial product. [CC §1923.2](#). See [§14.26](#). See also [CC §1923.5](#), discussed in [§14.31](#).

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E. Consumer Protections

§14.31 1. Mandatory Counseling

The first source a client is likely to turn to for information about reverse mortgages is the lender or broker who is offering the product. As a protection for consumers, potential reverse mortgage borrowers are required to receive free counseling through HUD before obtaining a reverse mortgage. 12 USC §1715z-20(d)(2)(B), (f); 24 CFR §206.41.

Counseling need not occur in person; it can be conducted over the phone at the request of the borrower. HUD Mortgagee Letter 2007-08 (Apr. 27, 2007). Counselors can be found on the HUD website at https://entp.hud.gov/idapp/html/hecm_agency_look.cfm.

NOTE: Significant doubt exists about whether the complex nature of this type of counseling can be accomplished without a face-to-face meeting. In 2011, the California Senior Legislature identified this issue as a priority and asserted that 90 percent of counseling occurs on the phone. Senior Assembly Proposal (AP) No. 32, available at <https://www.4csl.org/Proposals/Session2011/2011AP32.htm>. The requirement that phone counseling be conducted only at the borrower's request is a result of Stats 2012, ch 641, §1 (AB 2010), which amended [CC §1923.2](#) on September 27, 2012.

In 2014, AB 1700 (Stats 2014, ch 854) was signed into law. Its changes to the Civil Code were, in part, due to the finding that many seniors did not understand the reverse mortgage product even after counseling. Now, before counseling, the lender must give the applicant a mandatory, plain-language disclosure statement in conspicuous 16-point or larger type, as specified in [CC §1923.5\(a\)](#). The statement must include, *e.g.*, a warning that senior citizen advocacy groups advise against using the proceeds of a reverse mortgage to purchase an annuity or similar financial product. Further, the lender or the agency counselor must give the client a written worksheet guide that advises the prospective borrower, in 14-point or larger type, to review and answer five questions when considering whether to apply for a reverse mortgage. [CC §1923.5\(b\)\(1\)](#). The lender may not approve the application until the prospective borrower returns the worksheet guide signed by both the borrower and the agency counselor. [CC §1923.5\(b\)\(2\)](#).

NOTE: These sections of the Civil Code are unfortunately devoid of statutory remedies. Claims might be presented as unfair business practices under [Bus & P C §§17200-17210](#).

The quality of HUD-approved counseling varies. Perhaps the biggest concern is that even if counselors know the difference between different loan options or products, they are unlikely to be prepared to counsel clients on

alternatives to a reverse mortgage, or to have sophisticated financial training. Further, HUD counselors are not trained to provide advice about Medi-Cal or other public benefit programs or the interaction between these programs and reverse mortgages.

PRACTICE TIP: The use of mandatory counseling is a two-edged sword for other reasons. If challenging the origination of the reverse mortgage on fraud grounds, for example, the plaintiff must address the existence of a supposedly disinterested HUD counselor advising the borrower, particularly as the borrower acknowledges the receipt of the counseling by signing Housing and Urban Development form HUD-92902. Because challenging a reverse mortgage frequently occurs after the borrower's death or incapacity, the borrower is generally unavailable to testify as to the nature, content, and extent of the counseling.

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§14.32 2. Three-Day Right of Rescission

Homeowners who enter into a reverse mortgage have a 3-day right of rescission of the reverse mortgage contract, which begins on closing of the loan. 12 CFR §226.15(a). For purposes of the 3-day right of rescission, the term "business days" excludes Sundays but includes Saturdays. 12 CFR §226.2(a)(6). Homeowners may rescind without incurring any cost or penalty. 12 CFR §226.15(d)(1). Care must be taken to rescind in the manner described in the loan documents; otherwise, the lender may argue that the borrower did not follow the proper procedure.

PRACTICE TIP: If rescinding, the homeowners should ensure that (1) they use all methods of rescission described in the loan documents and (2) proof of delivery results from the methods used to notify the lender of the reverse mortgage's rescission. In addition, reverse mortgages are, like other loans, subject to the Truth in Lending Act (TILA) (15 USC §§1601–1667f) and the Real Estate Settlement Procedures Act of 1974 (RESPA) (12 USC §§2601–2617), with some minor variations due to the nature of the loans. On TILA, see the FDIC's Compliance Examination Manual at <https://www.fdic.gov/regulations/compliance/manual/>. On RESPA, see <https://www.hud.gov/hudprograms/respa>.

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§14.33 3. California Statutory Protections

California's reverse mortgage protections are primarily found in CC §§1923–1923.10. California, unlike many states that have laws excluding reverse mortgages from their predatory lending statutes entirely, protects consumers from certain abusive practices, most importantly by doing the following:

- Prohibiting prepayment penalties on early repayment of reverse mortgages. CC §1923.2(a).
- Prohibiting lenders from requiring a borrower to purchase an annuity as a condition of obtaining a reverse mortgage loan. CC §1923.2(i).
- Mandating that the prospective borrower be advised about counseling before obtaining the reverse mortgage loan checklist and alerted about issues that he or she should discuss with the agency counselor. CC §1923.5. See §14.31.
- Mandating that potential borrowers receive financial counseling from an approved HUD counselor; the lender must provide the prospective borrower with a list of not fewer than ten approved nonprofit counseling agencies in the state. CC §1923.2(j)–(k).
- Requiring that loan documents be presented in the language (Spanish, Chinese, Tagalog, Vietnamese, or Korean) in which the contract was negotiated. CC §1632(b).
- Mandating that the lender not accept an application until 7 days have passed since the date the prospective borrower received counseling, as evidenced by a signed and dated counseling certification. CC §1923.2(k).