Home Made Money

A Consumer's Guide to Reverse Mortgages

AARP®

AARP does not endorse any reverse mortgage lender or product, but wants you to have the information you need to make an informed decision about these loans and other, less costly, alternatives.

AARP prohibits any company or individual from inserting a name or attaching any materials to this publication.

Home Made Money*

A Consumer's Guide to Reverse Mortgages

Part 1: Introducing Reverse Mortgages 1
- Reverse Mortgages 1
- Other Home Loans 1
- Forward Mortgages 2
- Common Features 3
- Loan Types and Costs 6

Part 2: The Home Equity Conversion Mortgage 8
- Versus Other Reverses 8
- HECM Eligibility 8
- HECM Benefits 9
- HECM Repayment 13
- HECM Costs 14
- Other Choices 19

Part 3: Other Choices 20
- Other Reverse Mortgages 20
- Alternatives to Reverse Mortgages 23

Part 4: Key Decisions 27
- Sharing the Decisions 27
- Selecting a Counselor 28
- Considering Alternatives 29
- Selecting a Time 30
- Selecting an Interest Rate 31
- Selecting a Lender 33
- Spending Your Equity 34

Glossary 38

Appendix: Rising Debt & Falling Equity 42

*An online version of this booklet is available at **www.aarp.org/revmort**. Free single copies are available by calling 1-800-209-8085.

Printing of this booklet was made possible, in part, with funding from the U. S. Department of Housing and Urban Development.

Some of the material in this guide was adapted with permission from publications previously developed by Ken Scholen and published by the National Center for Home Equity Conversion.

©1987, 1990, 1991, 1993, 1995, 1997, 2001, 2003, 2004, 2005, 2006 AARP.
Reprinting with permission only.

Part 1: Introducing Reverse Mortgages

Until recently, there were two main ways to get cash from your home: you could sell your home, but then you would have to move; or you could borrow against your home, but then you would have to make monthly loan repayments.

Now there is a third way of getting money from your home that does not require you to leave it or to make regular loan repayments.

"REVERSE" MORTGAGES

A "reverse" mortgage is a loan against your home that you do not have to pay back for as long as you live there. With a reverse mortgage, you can turn the value of your home into cash without having to move or to repay a loan each month.

The cash you get from a reverse mortgage can be paid to you in several ways:

- all at once, in a single lump sum of cash;
- as a regular monthly cash advance;
- as a "creditline" account that lets you decide when and how much of your available cash is paid to you; or
- as a combination of these payment methods.

No matter how this loan is paid out to you, you typically don't have to pay anything back until you die, sell your home, or permanently move out of your home. To be eligible for most reverse mortgages, you must own your home and be 62 years of age or older.

OTHER HOME LOANS

To qualify for most loans, the lender checks your income to see how much you can afford to pay back each month. But with a reverse mortgage, you don't have to make monthly repayments. So you don't need a minimum amount of income to qualify for a reverse mortgage. You could have no income, and still be able to get a reverse mortgage.

With most home loans, if you fail to make your monthly repayments, you could lose your home. But with a reverse mortgage, you don't have any monthly repayments to make. So you can't lose your home by failing to make them.

Reverse mortgages typically require no repayment for as long as you — or any co-owner(s) of yours — live in your home. So they differ from other home loans in these important ways:

- you don't need an income to qualify for a reverse mortgage; and
- you don't have to make monthly repayments on a reverse mortgage.

"FORWARD" MORTGAGES

You can see how a reverse mortgage works by comparing it to a "forward" mortgage — the kind you use to buy a home. Both types of mortgages create debt against your home. And both affect how much equity or ownership value you have in your home. But they do so in opposite ways.

"Debt" is the amount of money you owe a lender. It includes cash advances made to you or for your benefit, plus interest. "Home equity" means the value of your home (what it would sell for) minus any debt against it. For example, if your home is worth $150,000 and you still owe $30,000 on your mortgage, your home equity is $120,000.

Falling Debt, Rising Equity

When you purchased your home, you probably made a small down payment and borrowed the rest of the money you needed to buy it. Then you paid back your "forward" mortgage loan every month over many years. During that time:

- your debt decreased; and
- your home equity increased.

As you made each repayment, the amount you owed (your debt or "loan balance") grew smaller. But your ownership value (your "equity") grew larger.

If you eventually made a final mortgage payment, you then owed nothing, and your home equity equaled the value of your home. In short, your forward mortgage was a "falling debt, rising equity" type of deal.

Rising Debt, Falling Equity

Reverse mortgages have a different purpose than forward mortgages do. With a forward mortgage, you use your income to repay debt, and this

builds up equity in your home. But with a reverse mortgage, you are taking the equity out in cash. So with a reverse mortgage:

- your debt increases; and
- your home equity decreases.

It's just the opposite, or reverse, of a forward mortgage. During a reverse mortgage, the lender sends you cash, and you make no repayments. So the amount you owe (your debt) gets larger as you get more cash and more interest is added to your loan balance. As your debt grows, your equity shrinks, unless your home's value is growing at a high rate.

When a reverse mortgage becomes due and payable, you may owe a lot of money and your equity may be very small. If you have the loan for a long time, or if your home's value decreases, there may not be any equity left at the end of the loan.

In short, a reverse mortgage is a "rising debt, falling equity" type of deal. But that is exactly what informed reverse mortgage borrowers want: to "spend down" their home equity while they live in their homes, without having to make monthly loan repayments.

(To make certain you understand what "rising debt" and "falling equity" mean, read the **Appendix** at the end of this booklet.)

Exceptions

Reverse mortgages don't always have rising debt and falling equity. If a home's value grows rapidly, your equity could increase over time. Or, if you only get one loan advance and no interest is charged on it, your debt would never change. So your equity would grow as your home's value increases.

But most home values don't grow at consistently high rates, and interest is charged on most mortgages. So the majority of reverse mortgages end up being "rising debt, falling equity" loans.

COMMON FEATURES

Although there are different types of reverse mortgages, all of them are similar in certain ways. Here are the features that most have in common.

Homeownership

With a reverse mortgage, you remain the owner of your home just like when you had a forward mortgage. So you are still responsible for paying your property taxes and homeowner insurance, and for making property repairs.

When the loan is over, you or your heirs must repay all of your cash advances plus interest (see "Debt Limit" below for more on repayment). Reputable lenders don't want your house; they want repayment.

Financing Fees

You can use the money you get from a reverse mortgage to pay the various fees that are charged on the loan. This is called "financing" the loan costs. The costs are added to your loan balance, and you pay them back plus interest when the loan is over.

Loan Amounts

The amount of money you can get depends most on the specific reverse mortgage plan or program you select. It also depends on the kind of cash advances you choose. Some reverse mortgages cost a lot more than others, and this reduces the amount of cash you can get from them. Within each loan program, the cash amounts you can get generally depend on your age and your home's value:

- the older you are, the more cash you can get; and
- the more your home is worth, the more cash you can get.

The specific dollar amount available to you may also depend on interest rates and closing costs on home loans in your area.

Debt Payoff

Reverse mortgages generally must be "first" mortgages, that is, they must be the primary debt against your home. So if you now owe any money on your property, you generally must do one of two things:

- pay off the old debt before you get a reverse mortgage; or
- pay off the old debt with the money you get from a reverse mortgage.

Most reverse mortgage borrowers pay off any prior debt with an initial lump sum advance from their reverse mortgage.

In some cases, you may not have to pay off other debt against your home. This can occur if the prior lender agrees to be repaid after the reverse mortgage is repaid. Generally the only lenders willing to consider "subordinating" their loans in this way are state or local government agencies.

Debt Limit

The debt you owe on a reverse mortgage equals all the loan advances you receive (including any used to finance loan costs or pay off prior debt), plus all the interest that is added to your loan balance. If that amount is less than your home is worth when you pay back the loan, then you (or your estate) keep whatever amount is left over.

But if your rising loan balance ever grows to equal the value of your home, then your total debt is limited by the value of your home. Put another way, you can never owe more than what your home is worth at the time the loan is repaid.

This overall cap on your loan balance is called a "non-recourse" limit. It means that the lender, when seeking repayment of your loan, does not have legal recourse to anything other than your home's value. The lender may not seek repayment from your income, your other assets, or your heirs.

Repayment

All reverse mortgages become due and payable when the last surviving borrower dies, sells the home, or permanently moves out of the home. (Typically, a "permanent move" means that neither you nor any other co-borrower has lived in your home for one continuous year.)

Reverse mortgage lenders can also require repayment at any time if you:

- fail to pay your property taxes;
- fail to maintain and repair your home; or
- fail to keep your home insured.

These are fairly standard "conditions of default" on any mortgage. On a reverse mortgage, however, lenders generally have the option to pay for these expenses by reducing your loan advances, and using the difference to pay these obligations. This is only an option, however, if you have not already used up all of your available loan funds.

Other default conditions could include:

- your declaration of bankruptcy;
- your donation or abandonment of your home;
- your perpetration of fraud or misrepresentation; or
- eminent domain or condemnation proceedings involving your home.

A reverse mortgage may also include "acceleration" clauses that make it due and payable. Generally, these relate to changes that could affect the security of the loan for the lender. For example:

- renting out part or all of your home;
- adding a new owner to your home's title;
- changing your home's zoning classification; or
- taking out new debt against your home.

You must read the loan documents carefully to make certain you understand all the conditions that can cause your loan to become due and payable.

Canceling the Deal

After closing a reverse mortgage, you have three extra days to reconsider your decision. If for any reason you decide you do not want the loan, you can cancel it. But you must do this within three business days after closing. "Business day" includes Saturdays, but not Sundays or legal public holidays.

If you decide to use this "right of recission," you must do so in writing, using the form provided by the lender at closing, or by letter, fax, or telegram. It must be hand delivered, mailed, faxed, or filed with a telegraph company before midnight of the third business day. You cannot rescind orally by telephone or in person. It must be written.

LOAN TYPES & COSTS

The most well-known and widely available reverse mortgage is the HECM (Home Equity Conversion Mortgage). This loan is discussed in detail in **Part 2**. Other types of reverse mortgages and alternatives to these loans are discussed in **Part 3**.

Loan costs can vary by a lot from one type of reverse mortgage to another. Not all reverse mortgages include the same types of loan costs. As a result, the true, total cost of reverse mortgages can be difficult to understand and compare. That is why federal Truth-in-Lending law requires lenders to disclose a "Total Annual Loan Cost" for these loans.

Total Annual Loan Cost

The TALC (Total Annual Loan Cost) combines all of a reverse mortgage's costs into a single annual average rate.

TALC disclosures can be useful when comparing one type of reverse mortgage to another. But they also show that the true, total cost of an

individual reverse mortgage loan can vary by a lot, and can end up being much more — or less — expensive than you might imagine. TALC disclosures reveal that reverse mortgages generally are most costly when you live in your home only a few years after closing the loan. Short-term TALC rates are very high because the start-up costs are usually a very large part of the total amount that you owe in the early years of the loan.

But as your loan balance grows larger over time, the start-up costs become a smaller part of your debt. As these costs are spread out over more and more years, the TALC rate declines.

If the loan's growing balance catches up to the home's value, your debt is then limited by that value. This makes the true cost of the loan decrease at a faster rate. So the longer you live in your home, or the less its value grows, the less expensive your loan is likely to be.

An explanation of how TALC rates are calculated can be found on the internet at **www.reverse.org/talctuto.htm/**. Some shortcomings of the TALC disclosure and a more complete way to measure reverse mortgage costs and benefits are discussed in **Part 2**.

2

Part 2: The Home Equity Conversion Mortgage (HECM)

The HECM (Home Equity Conversion Mortgage) is the only reverse mortgage insured by the federal government. HECM loans are insured by the FHA (Federal Housing Administration), which is part of the U.S. HUD (Department of Housing and Urban Development).

The FHA tells HECM lenders how much they can lend you, based on your age and home value. The HECM program limits your loan costs, and the FHA guarantees that lenders will meet their obligations.

VERSUS OTHER REVERSES

HECM loans generally provide the largest loan advances of any available reverse mortgage. Often they provide substantially more cash than any other program. HECMs also provide the most flexibility in how the cash can be paid to you.

The money you get from a HECM can be used for any purpose you choose. Although they are not inexpensive, HECM loans can be much less costly than the other reverse mortgages that can be used for any purpose.

Generally, the only reverse mortgages that cost less than HECMs are the ones offered by state or local governments. These loans typically must be used for one specific purpose only, for example, to repair your home, or pay your property taxes. They also generally are available only to homeowners with low to moderate incomes.

Part 3 of this booklet discusses reverse mortgages other than HECMs. But the descriptions of the HECM program in this section introduce some concepts that will help you understand any reverse mortgage.

HECM ELIGIBILITY

HECM loans are available in all 50 states, the District of Columbia, and Puerto Rico. To be eligible for a HECM loan:

> you, and any other owners of your home, must be aged 62 or over, live in your home as a principal residence, and not be delinquent on any federal debt;

your home must be a single-family residence in a 1- to 4-unit dwelling, or part of a planned unit development (PUD) or a HUD-approved condominium; some manufactured housing is eligible, but cooperatives and most mobile homes are not;

your home must be at least one year old and meet HUD's minimum property standards, but you can use the HECM to pay for repairs that may be required; and

you must discuss the program with a counselor from a HUD-approved counseling agency; information on HECM counseling appears in **Part 4** of this booklet.

HECM BENEFITS

The HECM program provides the widest array of cash-advance choices. You can take all of your loan as:

a single lump sum of cash; or as

a "creditline" account of a specific dollar amount that you control, that is, you decide when to make a cash withdrawal from this account, and how much cash to withdraw; or as

a monthly cash advance for a specific period of time, or for as long as you live in your home.

In addition, you can choose any combination of these options, and change your cash advance choices at any future time.

Loan Amounts

The amount of cash you can get depends on your age, current interest rates, and your home's value. The older you are, the more cash you can get. But if there is more than one owner, the age of the youngest is the one that counts. The lower interest rates are when the loan closes, the greater your loan amount will be.

In general, the greater your home's appraised value, the more money you can get. But the value is subject to limits that vary by county, as defined in Section 203b of the National Housing Act. In 2006, these "203b" limits range from $200,160 in most non-metro areas to $362,790 in many urban areas. These limits are subject to change every January, and some may also change at other times.

If your home is worth more than the limit for your county, you are still eligible for a HECM loan. But the amount of money you can get is based on your county limit, not on your home's actual value. For example, if your home is

valued at $200,000 and your county limit is $175,000, then your cash advances are the same as they would be if your home were valued at $175,000.

The amount of money you can get from a HECM loan also depends on how you want it paid to you: lump sum, creditline, monthly advance, or some combination of these three types of cash advances.

Lump Sums & Creditlines

Table 1 shows how much you could get from a HECM if you take it all as a single lump sum of cash or as a creditline:

if the value of your home (or the 203-b limit in your county, whichever is less) is $150,000, $250,000, or $350,000;

if the expected interest rate on the loan is 6%, 7%, or 8%;

if the age of the youngest borrower at closing is 65, 70, 75, 80, 85, or 90; and

if the servicing fee is $35, closing costs are $2,500, and the origination fee is 2% of your home value or 203-b limit, whichever is less.

You can divide the amounts in Table 1 between a lump sum and a creditline. For example, a 75-year-old borrower living in a $250,000 home getting a HECM loan at 7% expected interest could select:

a lump sum or creditline of $134,984; or

any combination of lump sum and creditline that totals $134,984, for example, a lump sum of $30,000 and a creditline of $104,984.

For an estimate of HECM cash benefits based on your age, home value, 203-b limit, and current interest rates, go to the online calculator at **www.rmaarp.com**.

Creditline Growth

Perhaps the most attractive HECM feature is that its creditline grows larger over time. This means that the amount of cash available to you increases until you withdraw all of it.

For example, if the creditline equals $100,000 and you withdraw $20,000, you would have $80,000 left. But if your next withdrawal is one year later, you would then have more than $80,000 left — because the $80,000 grows larger by the same total rate being charged on your loan balance. If that rate were to equal 6% per year, for example, your available creditline one year later would be $84,800 (6% x $80,000 = $4,800).

Table 1: HECM Lump Sum or Creditline

Home Value	Age	Lump sum or creditline when expected rate is		
		6%	7%	8%
$150,000	65	$74,325	$59,626	$47,530
	70	81,782	68,513	56,965
	75	89,638	78,084	67,672
	80	97,930	88,228	79,088
	85	106,260	98,400	90,820
	90	114,250	108,233	102,207
$250,000	65	$129,425	$104,526	$84,030
	70	141,682	119,213	99,665
	75	154,538	134,984	117,372
	80	168,030	151,628	136,188
	85	181,460	168,200	155,420
	90	194,150	184,033	173,907
$350,000	65	$184,525	$149,426	$120,530
	70	201,582	169,913	142,365
	75	219,438	191,884	167,072
	80	238,130	215,028	193,288
	85	256,660	238,000	220,020
	90	274,050	259,833	245,607

So a growing HECM credit line can give you a lot more total cash than a creditline that does not grow. The HECM creditline keeps growing larger every month for as long as you have any credit left, that is, until you withdraw all your remaining cash. The calculator at **www.rmaarp.com** estimates how much cash would remain in a HECM versus a non-growing creditline.*

HECM creditline growth means you should not even think about taking a large lump sum of cash from a HECM and putting it into savings or most investments. If you did that, you would be charged interest on the full amount of the HECM lump sum.

But if you leave the money in the creditline, you would not only avoid substantial interest charges. You would also end up with more available cash, as your creditline grows larger at a greater rate than a savings account or safe investments are likely to grow.

* The rate at which your creditline grows each month equals the current interest rate being charged on your loan plus one-half of one percentage point, divided by twelve. So if the interest rate this month is 5.5%, your creditline would grow by 0.5% (5.5% + 0.5% = 6%/12 = 0.5%). If you had a creditline of $80,000 at the start of the month, it would equal $80,400 at the end (0.5% X $80,000 = $400).

Plus a Monthly Advance

The HECM program lets you combine a lump sum, a creditline, or both with a monthly advance. A monthly loan advance does not increase or decrease in dollar amount over time. So it will buy less in the future as prices increase with inflation.

You can choose to have monthly HECM advances paid to you:

for a specific number of years that you select (a "term" plan); or

for as long as you live in your home (a "tenure" plan).

A term plan gives you larger monthly advances than a tenure plan does. The shorter the term, the greater the advances can be. But the advances only run for a specific period of time. You do not have to repay the loan when the term ends, but you no longer receive monthly advances past the end of the term you select.

Table 2 shows some of the combinations that could be selected by a 75-year-old female borrower living in a $250,000 home with a loan at 7% expected interest and the same loan costs as assumed in Table 1.

For example, if this borrower selects a $20,000 lump sum and a $40,000 creditline, she also could get any one of the following: a monthly advance of

Table 2: HECM Monthly Advance Plus Lump Sums or Creditlines for a 75-Year-Old Borrower Living in a $250,000 Home*

Any combination of a lump sum and a creditline totaling...	plus a monthly advance for...			
	tenure	15 years	10 years	5 years
0	$991	$1,243	$1,592	$2,688
$20,000	844	1,059	1,356	2,289
$40,000	697	875	1,120	1,891
$60,000	550	690	884	1,493
$80,000	403	506	648	1,094
$100,000	256	322	412	696
$120,000	110	138	176	298
$134,984	0	0	0	0

*Based on a 7% expected interest rate and the loan costs used in Table 1.

$550 for as long as she lives in her home, $690 each month for 15 years, $884 each month for 10 years, or $1,493 monthly for 5 years. Table 2 makes two things clear:

- if you take more money as a lump sum or creditline, the monthly advances are smaller; and
- if you select a shorter term of monthly advances, the amount of each advance is greater.

Monthly Advances Only

Table 2 also shows that you get the largest possible monthly advance if you do not take a lump sum or a creditline. But putting all of your loan funds into a monthly advance reduces your financial flexibility, especially if you have little in savings. Remember, monthly advances are fixed. So their purchasing power decreases with inflation.

Adding a growing creditline to a monthly advance not only gives you a hedge against rising prices. It also provides readily available cash for unexpected expenses. If you are interested in a monthly advance, therefore, it's a good idea to consider adding a creditline as well.

On the other hand, for a $20 fee, you could change your payment plan at any time. For example, you could add a creditline to a monthly advance, although this would reduce the amount of the monthly advance. You could also convert part or all of a creditline into a monthly advance.

Another option is to get monthly cash advances for the rest of your life no matter where you live. You can accomplish this by using a HECM to purchase an annuity. But this option can be complicated and has some drawbacks. So before considering it, be sure to learn all that you need to know about this option at **www.aarp.org/revmort/**.

HECM REPAYMENT

As with most reverse mortgages, you must repay a HECM loan in full when the last surviving borrower dies or sells the home. It also may become due and payable if:

- you allow the property to deteriorate, except for reasonable wear and tear, and you fail to correct the problem; or
- all borrowers permanently move to a new principal residence; or
- due to physical or mental illness, the last surviving borrower fails to live in the home for 12 months in a row; or

you fail to pay property taxes or hazard insurance, or violate any other borrower obligation.

HECM COSTS

Almost all the costs of a Home Equity Conversion Mortgage can be "financed," that is, they can be paid from the proceeds of the loan. Financing the costs reduces the net loan amount available to you, but it also reduces your cash, out-of-pocket cost. The itemized costs of a HECM loan include an origination fee, third-party closing costs, a mortgage insurance premium, a servicing fee, and interest.

Origination Fee

An origination fee pays a lender for preparing your paperwork and processing your loan, also known as "originating" a loan. HECM regulations limit the origination fee to 2% of your home's value or 2% of your county's 203-b limit, whichever is less. If this amount is less than $2,000, a lender may charge up to $2,000.

On a $350,000 home, for example, the origination fee could be as high as $7,000. But the amount may vary from one lender to another, so it can pay to shop around. The amount of the origination fee may also be negotiable with some lenders.

3rd-Party Closing Costs

A "closing" is a meeting at which legal documents are signed to "close the deal" on setting up a mortgage. The date of closing is the day on which a mortgage begins.

Closing a mortgage requires a variety of services by third parties other than the originating lender. These services include an appraisal, title search and insurance, surveys, inspections, recording fees, mortgage taxes, credit checks, and others.

Third-party closing costs on a HECM loan vary somewhat with the value of the home. They also can vary a lot from one state or area to another. But all the HECM lenders in a given area are likely to charge about the same closing costs on any specific loan.

A lender may require a cash application fee to pay for an appraisal and minimal credit check. Some will refund this fee to you. Others will apply it to your origination fee or third-party closing costs.

Mortgage Insurance Premium (MIP)

HECM insurance is financed by a mortgage insurance premium charged on all HECM loans. The cost, which may be financed with the loan, is charged in two parts:

- 2% of your home's value (or 2% of the 203-b limit in your area, whichever is less) is charged "upfront" at closing; and
- 0.5% is added to the interest rate charged on your rising loan balance.

HECM insurance guarantees that you will receive your promised loan advances, and not have to repay the loan for as long as you live in your home, no matter:

- how long you live there;
- what happens to your home's value; and
- what happens to the lender from whom you got your loan.

The MIP also guarantees that your total debt can never be greater that the value of your home at the time the loan is repaid. It makes it possible for you to keep getting your monthly loan advances or growing creditline as promised even if:

- you live much longer than others your age;
- your home's value grows very little, not at all, or declines, or;
- your loan balance catches up to and then is limited by the value of your home.

As a government program, HECM insurance does not generate a profit. The premiums paid by all borrowers are used to continue making loan advances to and limit the amount owed by the borrowers who live the longest and whose home values grow the least or decline.

Servicing Fee

"Servicing" a loan means everything lenders or their agents do after closing it: making or changing loan advances at your request, transferring insurance premiums to FHA, sending account statements, paying property taxes and insurance from the loan at your request, and monitoring your compliance with your obligations under the loan agreement.

FHA limits the servicing fee to $30 per month if the loan has an annually adjustable interest rate, and to $35 if the rate is monthly adjustable (see below). But the amount of this fee can vary from lender to lender within these limits. So it can pay to shop around.

To finance this fee with the loan, a lender is required to "set aside" a prescribed dollar amount* and deduct it from your available loan funds. But this total amount is not added to your loan balance. Instead, the monthly fee is added to your loan balance each month.

On traditional "forward" mortgages, the cost of servicing is added to the interest rate. So you may not have seen this fee before — but you've paid it.

Interest Rates

Virtually all lenders charge adjustable interest rates on HECM loans. This means that the rate can increase or decrease over time. But lenders don't have any control over what the rate will be when the loan closes, or how it will change over time.

HECM program regulations require that lenders must offer an annually adjustable rate tied to the current one-year U.S. Treasury Security rate. This means that the rate charged on your loan can change once each year. But any change in this rate:

- must be the same change (increase or decrease) that occurred in the one-year Treasury rate;
- is subject to a limit or "cap" of 2 percentage points per year and 5 total points over the life of the loan.

A HECM lender may also offer a lower rate that is adjusted every month. Changes in this monthly adjustable rate also must be tied to the one-year Treasury rate. But the only limit is a 10 percentage point cap over the life of the loan.

During any given week, all HECM lenders are highly likely to charge the same interest rates on each adjustable rate option. Virtually all of them charge the current one-year Treasury rate plus the "margin" set by Fannie Mae.

The advantages of each interest rate option and more information on the Fannie Mae margin are discussed in **Part 4** of this booklet.

On January 3, 2006, the interest rate on a HECM with monthly adjustable interest was 5.87%. The rate on annually-adjustable HECMs was 7.47%. By contrast, Bankrate.com's benchmark for annually adjustable "forward" mortgages was 5.56%.

*The amount "set aside" for servicing is the "present value" of the monthly fee from closing until the borrower would reach age 100. Since few borrowers live to age 100, the total amount set aside overstates the actual amount likely to be charged on most loans over the life of the loan.

Total Cost Disclosures

As discussed in **Part 1**, the true, total cost of a reverse mortgage depends on factors other than its various costs. Knowing the specific costs that will be charged on a reverse mortgage, therefore, is only the first step in understanding its total cost. You also need to understand how that cost will vary based on the other factors that affect it.

As also discussed in Part 1, the TALC (Total Annual Loan Cost) of a reverse mortgage depends upon:

- how long you live in your home; and
- what happens to its value during that time.

In general, the TALC rate is greatest when the loan is repaid within a few years after closing when the upfront costs are still a large part of the total amount owed. On the other hand, TALC rates are lowest when you live longer than others your age, or when your home's value grows little, or declines.

TALC Shortcomings

When they went into effect in the mid-1990s, TALC disclosures were an important step in alerting consumers to the real costs of reverse mortgages. But since then, a number of problems with these disclosures have become clear.

The vast majority of reverse mortgage borrowers select a creditline. The true cost of these creditlines depends to a large degree on the size and timing of the cash advances requested by the borrower during the life of the loan.

But TALC regulations require lenders to assume that all borrowers will request one-half of their creditline at closing, and none thereafter. This simplifies the calculation and provides a way to compare different creditlines. But it does not reveal how different the true cost of these loans can be based on a borrower's pattern of creditline advances. And it does not reflect the value of a growing versus a non-growing creditline.

TALC regulations also require lenders to assume that the initial interest rate charged on a reverse mortgage will never change. This assumption simplifies the calculation and provides a single standard of comparison.

But after the past few years of low interest rates, future rates may be less likely to remain low. So this assumption may result in an underestimate of the true cost of current reverse mortgages.

TALC disclosures also do not address two key considerations for reverse mortgage borrowers:

- the total amount of cash you get from the loan; and
- the amount of equity you or your heirs get to keep at the end of the loan.

Model Specifications

In 2000, under a grant from the U. S. Department of Housing and Urban Development, the AARP Foundation's Reverse Mortgage Education Project invited reverse mortgage counselors and lenders to develop a more complete and individually customized approach to measuring reverse mortgage costs and benefits.

The result of this joint effort was a set of model specifications for analyzing and comparing reverse mortgages. The specifications are based on a simple way of looking at these loans.

All reverse mortgages turn your home equity into three things:

- loan advances paid to you;
- loan costs paid to the lender and others; and
- leftover equity, if any, paid to you or your heirs at the end of the loan.

Because reverse mortgages turn home equity into only these three things, you can analyze any reverse mortgage by asking three simple questions:

- How much would I get?
- How much would I pay?
- How much would be left at the end of the loan?

At the end of a reverse mortgage, all of your home's value will have been turned into one of these three things: loan advances, loan costs, or leftover equity.

AARP's model specifications provide a set of rules for estimating how much of your home's value will have been turned into each of these three things at various future times. They also estimate a total annual average loan cost for each of these future times.

The specifications permit all of these estimates to be based on the creditline advances and a future interest rate that you select. You can also choose the rate at which you expect your home's value will grow.

By varying these factors, you can see how much effect each can have on a loan's total cash advances, total cost, and leftover equity. You need to keep in

mind, however, that all of these figures are estimates. The actual figures will depend on:

- the actual creditline advances you select during the loan:
- the actual interest rates charged on the loan; and
- the actual changes in your home's value during the loan.

The model specifications were originally developed to help consumers compare different types of reverse mortgages. But the estimates they produce are also very helpful in understanding any individual loan. In particular, they show you the total picture of what would happen to all of your home equity under various assumptions that you can specify.

Information on obtaining loan analyses and comparisons produced by the model specifications is discussed in **Part 4** of this booklet. For a copy of the model specifications, go to **www.aarp.org/revmort**, click on "Basics," and then on "Total Costs and Model Specifications." Scroll down to "AARP Resources" for a link to the specifications.

OTHER CHOICES

TALC disclosures and other measures estimate the total cost of a HECM. But only you can determine how much it would be worth to you.

How important is it — how much would you pay — to remain in your present home? How do you rate a HECM's cost and benefits compared to what may appear to be your two main alternatives:

- selling and moving to a new home; or
- continuing to live in your present home with your current income and assets?

Do you have other options? What are your other possible alternatives?

Part 3 of this booklet discusses other reverse mortgages that may be available to you. It also explores various alternatives to reverse mortgages for you to explore and consider.

3

Part 3: Other Choices

A Home Equity Conversion Mortgage may be a reasonable choice for you — either now, or at some future time. But until you compare it to your other options, you cannot make an informed decision about it.

This section discusses other types of reverse mortgages, and alternatives to reverse mortgages. Seriously considering all your options will help you see more clearly why you prefer some to others. It is also likely to lead you to the decision that best serves your needs.

OTHER REVERSE MORTGAGES

Deferred Payment Loans (DPLs)

Many local and some state government agencies offer DPLs (deferred payment loans) for repairing or improving your home. This type of public sector reverse mortgage provides a one-time, lump sum advance. No repayment is required for as long as you live in your home.

DPLs aren't available everywhere, and they can be difficult to find, in part because they go by a variety of names and descriptions. Contact your city or county housing department, area agency or county office on aging, or the nearest community action or community development agency. Also contact your state housing finance agency. If these agencies don't offer DPLs, they may know where to find them, or they may offer other low-cost home repair loans with easily affordable monthly payments.

Eligibility criteria vary from program to program. Most are limited to homeowners with low or moderate incomes. Many place a limit on a home's value, or lend only in defined areas. Some have a minimum borrower age or a disability requirement.

DPLs can be used only for the specific types of repairs or improvements that each program allows. This may limit you to projects that replace or repair basic items such as your roof, wiring, heating, plumbing, floors, stairs, or porches. Many programs will cover improvements in accessibility or energy efficiency. Such modifications may include the installation of ramps, rails, grab bars, storm windows, insulation, or weather-stripping. (Search for "fixing homes" at www.aarp.org.)

You may be able to combine a DPL with a HECM loan. To do this, the DPL lender must agree to be repaid after the HECM is repaid. The best thing about DPLs is their very low cost. Generally they have no origination fee, no insurance premium, minimal (if any) closing costs, and very low (or no) interest.

If interest is charged, it is often done on a "fixed" basis, that is, the rate never changes. Many DPL programs also charge "simple" rather than "compound" interest. This means that interest is not charged on any of the interest that has been previously added to the loan balance.

Some DPL programs even forgive part or all of the loan if you live in your home for a certain period of time. In other words, you may end up paying nothing back ever. If you can find and qualify for a "forgivable" DPL, you would most likely have more equity left at the end of the loan than you had at the beginning. In any case, a DPL is one of the best bargains you will find.

Even so, you still must be careful dealing with home improvement contractors. Ask the DPL program for help in finding a reliable contractor and developing a sound contract.

Property Tax Deferral (PTD)

Some state and local government agencies offer "property tax deferral" (PTD) loans. This type of public sector reverse mortgage generally provides annual loan advances that can be used only to pay your property taxes. No repayment is required for as long as you live in your home.

According to an AARP study, some type of PTD program was available during 2002 in parts or all of the following states: Arizona, California, Colorado, Florida, Georgia, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Hampshire, North Dakota, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, Wyoming, and the District of Columbia.

In some states, PTD is available on a uniform, statewide basis. In many others, it is not available in all areas, or is not the same in all the areas where it is available. Eligibility criteria vary considerably. Most programs have a minimum age of 65 and are limited to homeowners with low or moderate incomes.

If you live in a state listed above, contact the local government agency to which you pay your property taxes. This agency can tell you if the program is available in your area, and what you must do to qualify. It also can give you details on how the program works.

The amount of the annual PTD loan advance is generally limited by the amount of your property tax bill for that year. Some programs limit the annual advance to some part of the tax bill, or to a specific amount.
In the most restrictive programs, the loan can only be used to pay for special assessments.

The total amount you can borrow over the life of a PTD loan is limited in most programs. In other words, you may become ineligible for additional annual loan advances at some point in the future.

PTD programs generally do not permit these loans to be "subordinate" to other loans. So you cannot have a PTD loan and another reverse mortgage at the same time.

Like deferred payment loans, PTD loans generally charge no origination fee, no insurance premium, and minimal, if any, closing costs. The interest rate is usually fixed, but it varies from program to program. In some cases, interest is charged on a simple basis, that is, no "interest on interest."

Other Public Loans

State housing finance agencies in Connecticut and Montana offer specialized reverse mortgage loans. The Connecticut plan is limited to persons who are no longer able to function on their own.

These plans provide limited lump sum advances, plus monthly advances that stop after a fixed period of time. But the loan does not have to be repaid for as long as you live in your home. The cost of these plans is very low, but the benefits are limited as well.

For more information on the Connecticut plan, call 1-860-571-3502. For information on the Montana program call 1-800-761-6264 or 1-406-841-2840.

Proprietary Reverse Mortgages

"Proprietary" reverse mortgages are almost always the most expensive type of reverse mortgage. But if your home is worth more than HUD's 203-b limit for your county, one of these loans might provide larger cash advances than a HECM.

These mortgages can be used for any purpose, and are open to homeowners aged 62 and over without regard to income. Only one program is now available (January 2006) in all states; another is currently being offered in 41 states. Other programs may become available at a future time. Proprietary

reverse mortgages are offered by banks, mortgage companies, and other private lenders. They are generally backed by the private companies that develop them.

These companies have proprietary or ownership rights to these products, and they decide which lenders may offer them. By contrast, federally insured HECM loans may be offered by any lender approved by the Federal Housing Administration.

If you live in a higher-valued home, you might be able to get more cash from a proprietary plan than from a HECM. But you need to be very careful when comparing the costs and benefits of these loans to a HECM.

For example, the most widely available proprietary plan offers a creditline that does not grow larger over time. So an initially smaller HECM creditline — which does grow larger over time — can provide more total cash than an initially larger creditline from this proprietary plan.

The online calculator at www.rmaarp.com estimates how much cash would remain in a growing HECM creditline versus the non-growing creditline provided by this proprietary plan.

The most complete way to compare a proprietary loan to a HECM is to obtain a side-by-side comparison produced by software that meets AARP's model specifications for analyzing and comparing reverse mortgages. Then be certain you understand these comparisons in detail before making any decisions.

Information on obtaining and using these revealing comparisons is presented in **Part** 4 of this booklet.

ALTERNATIVES TO REVERSE MORTGAGES

Selling and Moving

Many homeowners become interested in reverse mortgages as a way to remain living in their present homes. Selling the home and moving elsewhere are generally not very appealing to most reverse mortgage shoppers.

The single best way to evaluate a reverse mortgage, however, is to compare it to what may be your only other viable option: selling your home and using the proceeds to buy or rent a new home. Do you know:

How much cash you could get by selling your home?

What it would cost you to buy (and maintain) or rent a new home?

How much money you could safely earn on any money left over after you buy a new home?

Have you recently looked into buying a less costly home, renting an apartment, or moving into assisted living or other alternative housing?

Until you have seen and considered other housing options, how do you know that none could be preferable to your current home? Or preferable to a reverse mortgage? For your own peace of mind, you should seriously look into what else might be available. (Search for "housing options" at **www.aarp.org**.)

Most likely you will come to one of two conclusions:

you may find another housing option that is a lot more attractive than you thought; or

you may confirm what you were fairly certain of all along: that where you live now is the best place for you to be.

No matter what you conclude, you will have a much better idea of the overall costs and benefits of staying versus moving. That will give you a better sense of what is important to you. And it will then be easier for you to evaluate the comparative costs and benefits of a reverse mortgage.

Public Benefits

Your home is probably the most important investment you have ever made. You've probably spent much of your adult life making monthly payments on a traditional "forward" mortgage. So cashing in on that long-term investment while continuing to live in your home can be an appealing idea.

But most people have also made another kind of long-term investment. They've paid taxes all of their adult lives, and this has supported a variety of public programs. From time to time, most of us have benefited from some of these programs.

But you can't benefit from a program if you don't know it exists. That's why you should be aware of the major programs for which you may be eligible.

Supplemental Income

A substantial portion of all Americans aged 65 and over who are eligible for monthly cash benefits from SSI (Supplemental Security Income) are not getting them.

To qualify for this program in 2006, your liquid resources (cash and savings) must be less than $2,000 ($3,000 for a couple). Certain resources, such as a home, a small burial fund, or one car usually do not count. Your monthly unearned income cannot exceed $623 ($924 for a couple). But the income limits are greater if you have earned income from a job, or if you live in one of the states providing a supplement to SSI.

If you qualify for SSI, you may be automatically eligible for other public benefits as well. For the latest information, call 1-800-772-1213. On the Internet, go to **www.ssa.gov** and search for "SSI."

Health Care Costs

Public benefit programs can also help pay for medical expenses. For the latest information, search for "Medicaid" and "Medicare prescripton drug coverage" at **www.aarp.org**. You can also call the Medicare Hotline at 1-800-633-4227. When you call, say "Medicaid" or "drug coverage" to get information about these programs.

Property Tax Relief

Most states have one or more property tax relief programs. For information on property tax relief in your state, contact the local agency to which you pay your property taxes, your state department of revenue or taxation, or your nearest area agency on aging.

Agencies on Aging

Your single best source for a wide variety of public benefit programs is your AAA (area agency on aging). Find your AAA by calling 1-800-677-1116 or search online at **www.eldercare.gov**.

This agency can help you find programs such as

- energy assistance
- household chore services
- home health care
- prescription drugs
- meal programs
- housing
- transportation, and many others.

BenefitsCheckup.org

This one-stop online public benefits source sponsored by the National Council on the Aging helps you find programs that may pay for some of the costs of prescription drugs, health care, utilities, and other essential items or services. You fill out an online questionnaire to find programs for which you may be eligible. BenefitsCheckup.org also provides the contact information you need to learn more about — and apply for — these programs.

Postpone or Combine

Public benefits can make it possible for you to postpone getting a reverse mortgage until a future time. In many cases, that may allow you to get larger future loan advances because you will be older and your home's value is likely to be greater at that time. And the longer you wait, the less your equity will have been consumed by interest charges.

On the other hand, you can sign up for public benefits and take out a reverse mortgage. If you do, your need for loan advances will be less than if you were not receiving public benefits. By taking smaller loan advances, you will have smaller interest charges and preserve more equity for future use.

Cautions

Just make certain you don't jeopardize any public benefits by getting more cash than you need from a reverse mortgage.

For example, loan proceeds remaining in a checking or savings account at the end of a calendar month are counted as liquid assets by SSI and similar programs. If your total liquid assets exceed SSI limits (currently $2,000 for a single person, $3,000 for a couple), you can lose your eligibility. So limit your loan proceeds to what you expect to spend in a given month (Source: *Reverse Mortgages: A Lawyer's Guide*, American Bar Association, 1997, pp. 35-36).

Part 4: Key Decisions

Homeowners seriously considering a reverse mortgage should ask themselves these key questions:

Who else should I involve in considering this loan?

Which counselor should I choose?

Have I given due consideration to all my choices?

When would be the best time to take out a reverse mortgage?

What interest rate should I select?

Which lender should I choose?

How should I use this loan?

No one can answer these questions for you. Only you can decide what's right for you and your situation. But you need to consider these decisions carefully, because you will make them one way or another. And it's better to do so by thinking them through.

SHARING THE DECISIONS

Who else should you involve in making your decisions about a reverse mortgage? You may have a trusted friend or advisor who knows your circumstances — or someone who is generally good at figuring things out or discussing them with you. You may even want to invite such people to your discussion with a HUD-approved counseling agency.

On the other hand, you should be cautious of anyone who seems eager for you to get a reverse mortgage. Be especially alert if that person just happens to have ideas about what you might do with your loan proceeds. Watch out in particular for anyone trying to sell you something, or to get your signature on an agreement to pay them for any purpose.

Remember, we call such people "con men" because they are very good at gaining our confidence and trust. It's sad but true that the stranger being so nice to you may be more interested in your equity than your well-being.

Your Heirs

You also need to think about the impact of a reverse mortgage on your heirs. A loan with "rising debt and falling equity" means there will be less equity

left for your heirs. If you get a lot of cash over many years from the loan, there may be little if any left for them.

Many children of reverse mortgage borrowers are pleased that their parents are able to use their equity and remain living in their homes. Often it is a great relief to these children that their parents are able to take care of their own needs; many even encourage their parents to do so.

Whether or not you decide to discuss this matter with your children or other heirs depends on a variety of personal and family factors. You may value their advice or want to know what they think. Or you may think it best not to discuss it before making a decision, or not to tell them after you have closed a loan.

On the other hand, to avoid future misunderstanding, you may want to make a note of your decision in your will. Whatever you decide, the important thing is to give some thought to your heirs. A reverse mortgage can have a substantial impact on your estate. So you need to think through how you want this to become known to your heirs.

SELECTING A COUNSELOR

To be eligible for a federally insured HECM (Home Equity Conversion Mortgage), you must discuss the loan with a counselor employed by a nonprofit or public agency approved by HUD (the U. S. Department of Housing and Urban Development).

This counseling can be very helpful. So it can be a good idea even if you are thinking about applying for some other type of reverse mortgage.

To find the HUD-approved counseling agency nearest you call 1-800-569-4287, or search online at **www.hud.gov/offices/hsg/sfh/hecm/hecmlist.cfm/**.

National Network Counselors

You may also request HUD-approved HECM counseling through the AARP Foundation's Reverse Mortgage Education Project. The Project administers a national exam for HUD-approved HECM counselors, and the highest scorers are eligible to participate in a national HECM counseling network. These counselors are required to use loan analysis and comparison software that meets the model specifications discussed in **Part 2**.

Network counselors provide in-person counseling in their local areas, and counseling by telephone in other areas nationwide. For current information on requesting HECM counseling services from these counselors, go to

www.hecmresources.org/network.cfm or call 1-800-209-8085. This counseling generally takes at least one hour. When provided by telephone, it typically requires two or more calls.

Be Prepared

However you request counseling, prepare for it carefully. If you are interested in a HECM, make certain you are eligible by re-checking the eligibility criteria in **Part 2**. Use the calculator at www.rmaarp.com to see if you can get the amount of cash you need to pay off any current debt on your home, and for other purposes.

Before requesting counseling, thoroughly consider each of the decisions discussed in this section. Make a written list of your questions, concerns, and the additional information you need. Include questions about the alternatives discussed in **Part 3**. Ask your counselor to send you loan printouts in advance so you can review them before your counseling session.

CONSIDERING ALTERNATIVES

Have you carefully considered the main alternatives to a HECM? Have you seriously looked into the other options discussed in **Part 3**? If not, you should do so before applying for a HECM. Even if you end up getting a HECM, combining it with another option may make more sense than not.

If you plan to sell and move anytime soon, you should consider a home equity loan and, if you live in one of the few areas that still have them, an "uninsured" reverse mortgage.

Other Loans

HECMs and proprietary reverse mortgages are most expensive if the loan is repaid within a few years after closing. These loans typically have substantial start-up costs, and guarantee that you can stay in your home for as long as you want. But if you know you are going to sell and move within a few years, you would be paying for something you are neither expecting nor likely to need. And that's generally an expensive thing to do.

If you can qualify for a low-cost home equity loan and easily make the required monthly repayments, this option can be less costly than a HECM or a proprietary reverse mortgage. But before applying for a home equity loan, learn about the potential pitfalls in this market. Search for "home equity loans" and "predatory lenders" at www.aarp.org.

In some parts of Arizona and Massachusetts, you can still get an "uninsured" reverse mortgage. These loans typically provide monthly advances only, and they must be repaid in full on a specific date.

These are the only reverse mortgages that do not permit you to remain in your home for as long as you choose. But if you definitely plan to sell and move before they become due, these loans may make sense for you. To the extent that such loans are still available, HECM counselors in these states generally can help you find them.

Proprietary Reverse Mortgages

If you are considering a proprietary reverse mortgage, you must proceed with caution.

If your home is worth more than HUD's 203-b limit in your county, you might be able to get larger loan advances than you could get from a HECM. But you are also highly likely to pay more, and you need to understand how much more these loans can cost.

The best way to compare the costs and benefits of a proprietary plan versus a HECM is to get the side-by-side loan comparisons produced by software that meets AARP's model specifications as discussed in **Part 3**.

You can get these comparisons from counselors who belong to the national HECM counseling network described on page 28. The latest information on obtaining counseling from these counselors can be found at **www.hecmresources.org/requests.cfm**.

You can also get these comparisons from some lenders. For the latest information on lenders who can provide these comparisons, go to **www.aarp.org/revmort/list/** and click on "Selecting a Lender."

SELECTING A TIME

When would be the best time to take out a reverse mortgage: now or later? In the future, you may be eligible for larger cash advances because you will be older and your home is likely to be worth more. If your home's value is currently greater than your county's 203-b limit, that limit is likely to increase. On the other hand, if interest rates rise, you may not be able get greater loan advances in the future.

Look at Table 1 in **Part 2** or use the calculator at **www.aarp.org/revmort** to see how much difference an older age or greater home value could make. The table also shows you how much difference a higher interest rate could make.

If you decide against getting a reverse mortgage at this time, you can still consider that future possibility as your home equity nest egg. For example, if you or your surviving spouse lives longer than expected, or if you otherwise encounter unexpected cash needs, you could consider a reverse mortgage at that time.

That's what having a nest egg is all about. You don't use it till you need it. But until then, you know it's there.

SELECTING AN INTEREST RATE

If you are considering a HECM, should you select an interest rate that can change every year, or one that can change every month?

HECM lenders must offer an interest rate that is tied to the one-year U.S. T-rate (Treasury Security rate). Once a year, this rate can increase or decrease by the same amount as any increase or decrease in the T-rate. But this "annually adjustable" rate cannot change by more than 2 percentage points up or down per year, nor by more than 5 total points up or down over the life of the loan.

HECM lenders may also offer a lower "monthly adjustable" rate that can increase or decrease each month by the same amount as any increase or decrease in the T-rate each month. But the only limit on this rate is a 10 percentage point cap over the life of the loan.

At present (January 2006), the annually adjustable rate has is 3.1 percentage points greater than the T-rate. The monthly adjustable rate is 1.5 percentage points greater than the T-rate. These 3.1% and 1.5% "margins" are set by Fannie Mae, the company that supplies the money that is lent to you in the HECM program.

Since the one-year T-rate for January 3, 2006 is 4.37%, the annually adjustable rate charged on HECM loans is 7.47% and the monthly adjustable rate is 5.87%.

So the monthly adjustable rate is one and six-tenths of a percentage point (1.6%) lower than the annual rate.

Monthly versus Annual

The advantages of the monthly adjustable rate are:

- you get larger loan advances;
- when rates fall, your rate will drop sooner than an annually adjusting rate;

your rate will be lower than an annually adjusting rate for as long as increases in the T-rate are less than 3.6 percentage points per year or 6.6 points over the life of the loan; and

your rate can decrease by more than 2 points per year, and by more than 5 points over the life of the loan.

How much greater would the loan advances be when selecting a monthly versus an annually adjusting interest rate? On January 3, 2006, a 75-year-old single borrower living in a $250,000 home could have gotten a creditline of about $127,000 from an annually adjustable HECM versus about $157,500 from a monthly adjustable HECM.

The main advantage of the annually adjustable rate is that a lower interest rate will be charged on your loan balance whenever T-rate increases are greater than 3.6 points per year or 6.6 points over the life of the loan. Also, when rates increase, your rate will not rise as soon as a monthly adjusting rate will.

Which rate should you select? It depends on how much you value the extra cash you could get with the lower, monthly adjustable rate. It also depends on what you think may happen to interest rates. How likely do you think it is that future T-rate:

increases will be greater than 3.6 points in a given year, or 6.6 points over the life of the loan; or that

decreases will be greater than 2 points in a given year, or 5 points over the life of the loan?

During the 1990s, the difference between the lowest and highest one-year T-rate on a weekly basis was about 5.5 points. But for the previous decade, that difference was about 11.5 points.*

Most HECM borrowers select a monthly adjustable rate, no doubt because they prefer the greater cash advances and the lower initial rate. Some may also believe the T-rate is unlikely to exceed the annual rate's caps for any extended time. Others may prefer the larger advances even if they believe that rising interest rates may cost them more.

Borrowers selecting an annual rate are generally concerned that rising rates might exceed the annual rate's caps for extended periods. Without the protection of these caps, they fear, their loan balances will grow faster, so there may be a lot less equity left for them or their heirs when the loan is over.

*Source: Federal Reserve Bank of New York

SELECTING A LENDER

The most complete lists of HECM lenders can be found online at www.hud.gov/ll/code/llplcrit.html/. Enter your city or select your state, place a checkmark in the "HECM" box, and click the "SUBMIT" button.

But which lender should you use to get a HECM loan? You need to consider cost, origination services, loan servicing, and a lender's professional commitment to meeting consumer needs.

Cost

Generally the only HECM loan costs that lenders control are the origination fee and the servicing fee. So be sure to find out the dollar amount that each lender you are considering would charge you for these fees. Although third-party closing costs are not likely to vary much from lender to lender, you might want to check these as well.

At present, HECM interest rates do not vary from one lender to another (unlike traditional mortgages). The rates can change each week, but during any given week, every HECM lender charges the same rates. This could change in the future, however. So check out the latest information at www.aarp.org/revmort.

Origination Services

The level of service a lender provides may be more difficult to assess than cost is, but service can be important. You will want your loan officer to be knowledgeable, experienced, and respectful.

After reading this booklet, you will be better able to gauge how well a lender knows reverse mortgages. How long a lender has been offering HECMs and in how many places may be particularly important if your loan runs into any unexpected snags.

An experienced lender has already encountered most of the issues that can cause problems, and is most likely to have a good working relationship with the nearest HUD office.

You will also want a loan officer who respects your knowledge and preferences and helps you reach your own decisions. Pressure sales tactics are a sure sign that a lender is more concerned about selling you a loan than meeting your needs.

Loan Servicing

At loan closing, most originating lenders transfer their loans to another office or company specializing in servicing the loan from that point forward. Ask each lender: "Who will service my loan after it closes?"

Request a sample of the account statements the servicer would send you. Make certain you fully understand all the information on these statements. In particular, if you are considering a HECM creditline, find out how the servicer would keep you informed about the growing amount of credit a HECM provides (see **Part 2**).

Professional Commitment

A commitment to meeting consumer needs can be seen in a lender's professional relationships and consumer information.

For example, members of the NRMLA (National Reverse Mortgage Lenders Association) have developed "best practices" for their industry. For more information, go to **www.reversemortgage.org**.

If you don't want to be contacted by a NRMLA lender, however, be sure to state that preference if you request any NRMLA publications. Lenders committed to the highest standard of consumer information can provide loan analyses and comparisons that meet AARP's model specifications as discussed in **Part 2**.

For the latest information on lenders who can provide this type of consumer information, go to **www.aarp.org/revmort**. But please note that AARP does not endorse any reverse mortgage product or lender.

SPENDING YOUR EQUITY

How much of your available loan amount would you take as a lump sum, as a creditline, or as a monthly advance? For what reasons would you take withdrawals from a HECM creditline?

You need to consider these questions carefully, especially if your home equity is one of your few financial assets. Very simply, the more equity you use now, the less will be left in the future. If you spend all your equity too soon, it may become financially difficult for you to remain living in your home.

On the other hand, if you have to move due to disability or failing health, you would need to pay for the cost of moving, future living expenses, and possibly assisted living or other types of care. So the amount of equity remaining at the end of your loan could be vitally important to you.

Leftover Estimates

HECM counselors and lenders can estimate how much equity would be left at various future times based on assumptions about future interest rates, your loan advances, and about changes in your home's value.

These estimates generally assume that your home would be sold to repay the loan. So they deduct the estimated cost of selling your home from your remaining equity.

Then it's a simple calculation: If the estimated net sale proceeds are greater than your estimated debt, you (or your heirs) would get the difference in a lump sum of cash. If at any point your rising debt catches up to your home's value, then there would be no equity left.

Estimate Shortcomings

Unless your counselor or lender uses computer software based on AARP's model specifications, the leftover estimates they provide may have shortcomings similar to the ones discussed in **Part 2** about TALC rates.

Most reverse mortgage borrowers select a creditline. The amount of leftover equity at the end of a creditline loan depends primarily on the size and timing of the cash advances a borrower requests during the loan.

Computer software based on the model specifications lets you enter the creditline draws that you expect to make. This gives you a more accurate estimate of the equity that would remain if your loan were to end at various points in the future. Other loan software may not permit you to see how your expected creditline draws would affect your remaining equity.

Other loan software may also assume that the initial interest rate charged on your loan will never change. But that may be unlikely after a time of relatively low interest rates (January 2006). So this assumption may overestimate your future leftover equity.

Software based on the model specifications lets you select the interest rate used to estimate your leftover equity. So you can choose a higher rate than the one that is initially charged on your loan.

By varying these factors, you can see how much effect each can have on your leftover equity. You should remember, however, that all of these figures are estimates. The actual figures will depend on

- the actual creditline advances you select during the loan;
- the actual interest rates charged on the loan; and

the actual changes in your home's value during the loan.

Creditline Growth

Most HECM borrowers put all of their available cash into a creditline. So it's important to be able to see how creditline withdrawals affect the growing amount of credit available from a HECM.

The calculator at www.rmaarp.com can show you the effect of various creditline withdrawal patterns on a year-by-year basis. To see them, run the calculator and then on the "Loan Calculator Estimates" page click on the "Creditline" button toward the bottom of the page, and follow the instructions.

Computer software based on AARP's model specifications can also show the effect of different creditline withdrawals on your future loan balance, total amount owed, and total annual average loan cost.

If you take a HECM creditline, keep an eye on its growth. Being aware of how much cash remains in your creditline and the rate at which it is growing will help you make decisions about making cash withdrawals.

Remember, you can control the amount of credit that remains in your account. The less cash you take out now, the more will remain for later. It doesn't make much sense to set up a creditline and then not use it. But you should also avoid using too much too soon.

For example, if you spend all the cash in your creditline, will you still be able to pay your property taxes and homeowner's insurance? If you fail to make these payments, and there is no cash left in your creditline, a HECM lender can foreclose on your loan. Just like with a forward mortgage, if you do not pay your property taxes and insurance, you could lose your home.

So be certain to leave enough cash in your creditline to pay your taxes and insurance if you do not have other funds available for this purpose.

Investing

Investing the money you get from a reverse mortgage is a highly questionable practice. It is extremely unlikely that you could safely earn more from an investment than the loan would cost.

Careful Spending

Be wary of anyone who wants to sell you something, and suggests a reverse mortgage as a way to pay for it. Be especially wary if

- you do not fully understand what they are selling; or
- you are not certain that you need what they are selling.

Remember that the total cost to you equals the cost of what they are selling plus the cost of the reverse mortgage. If you conclude that you do need what they are selling, be sure to shop around before making a decision. You are under no obligation to buy goods or services from the party that suggested you borrow against your home to pay for them.

For example, if an insurance agent tries to sell you an annuity by way of reverse mortgage financing, be sure to check out all the information about these types of arrangements at **www.aarp.org/revmort**. Click on "Key Decisions" under "Reverse Mortgages" on the left, and then on "Spending Your Equity."

Refinancing

After you get a reverse mortage, sometime in the future you may be able to increase the loan funds available to you by refinancing the loan. Large increases in your home's value, increases in HUD's 203-b limits, or lower interest rates could make this possible.

When you refinance a HECM, lenders are required to show you the total cost of refinancing, and compare it to the increase in available loan funds that a refinance would provide.

This comparison makes it easy for you to see the total costs that would be added to the amount you owe versus the additional loan funds that would become available to you. If you need help understanding the comparison, HECM counselors can explain it to you.

Glossary

203-b limit
in the federally insured HECM program, the dollar amount for each county that limits how much of a home's value can be used to determine a borrower's loan advances, as established in Section 203-b of the National Housing Act

acceleration clause
the part of a contract that defines when a loan may be declared due and payable

adjustable rate
an interest rate that changes, based on changes in a published market-rate index

annuity
a monthly cash advance for life from an insurance company

appraisal
an estimate of a home's market value

appreciation
an increase in a home's value

Area Agency on Aging (AAA)
a local or regional nonprofit organization providing information on services and programs for older adults

cap
a limitation on the amount by which an adjustable interest rate may change during a specified time period

closing
a meeting at which legal documents are signed to "close the deal" on a mortgage; the time at which a mortgage begins

condemnation
a court action adjudging a property to be unfit for use, or converting a private property to public use under the right of eminent domain

creditline
a credit account that permits a borrower to control the timing and amount of the loan advances; also known as a "line-of-credit"

current interest rate
in the HECM program, the interest rate currently being charged on a loan, which equals the one-year rate for U.S. Treasury Securities, plus a margin

deferred payment loans (DPLs)
reverse mortgages providing lump sums for repairing or improving homes, usually offered by state or local governments

depreciation
a decrease in the value of a home

eminent domain
the right of a government to take private property for public use, for example, to build a highway

expected interest rate
in the HECM program, the interest rate used to determine a borrower's loan advances, which equals the 10-year rate for U.S. Treasury Securities, plus a margin

Fannie Mae
a private company that buys and sells mortgages; a government-sponsored entity that operates under the general oversight of the federal government

Federal Housing Administration (FHA)
the part of HUD (the U.S. Department of Housing and Urban Development) that insures HECM loans

federally insured reverse mortgage
a Home Equity Conversion Mortgage (HECM) (see below)

home equity
the value of a home, minus any debt against it

home equity conversion
turning home equity into cash without having to leave your home or make regular loan repayments

Home Equity Conversion Mortgage (HECM)
the only reverse mortgage program insured by the Federal Housing Administration (see Part 2)

initial interest rate
in the HECM program, the interest rate that is first charged on the loan beginning at closing, which equals the one-year rate for U.S. Treasury Securities, plus a margin

leftover equity
the net proceeds from selling a home, minus the total amount of debt owed against it

loan advances
payments made to a borrower, or to another party on behalf of a borrower

loan balance
the amount owed, including principal and interest; capped (limited) in a reverse mortgage by a non-recourse limit

lump sum
a single loan advance at closing

margin
in the HECM program, the amount added to the one-year Treasury rate to determine the initial and current interest rates, and to the 10-year Treasury rate to determine the expected interest rate

maturity
when a loan becomes due and payable

model specifications
a detailed set of rules for analyzing and comparing reverse mortgages (see Part 2)

mortgage
a legal document making a home available to a lender to satisfy a debt

non-recourse mortgage
a home loan in which a lender may look only to the value of the home for repayment; a home loan in which the borrower can never owe more than the home's value at the time the loan is repaid

origination
the overall administrative process of setting up a mortgage, including the preparation of documents

property tax deferral (PTD)
reverse mortgages providing annual loan advances for paying property taxes, usually offered by state or local governments

proprietary reverse mortgage
a reverse mortgage product owned by a private company

reverse annuity mortgage
a reverse mortgage in which a lump sum is used to purchase an annuity

reverse mortgage
a non-recourse loan against home equity providing cash advances to a borrower and requiring no repayment until a future time

right of recission
a borrower's right to cancel a home loan within three business days of closing

servicing
performing administrative functions on a loan after closing

shared equity
an itemized loan cost based on a percent of a home's value at loan maturity; for example, a 5% shared equity fee on a home worth $200,000 at maturity would be $10,000

Supplemental Security Income (SSI)
a federal program providing monthly cash benefits to low-income persons aged 65+, blind, or disabled

tenure advances
fixed monthly loan advances for as long as a borrower lives in a home

term advances
fixed monthly loan advances for a specific period of time

Total Annual Loan Cost (TALC) rate
the projected annual average cost of a reverse mortgage including all itemized costs

T-rate
the rate for U.S. Treasury Securities; used to determine the initial, expected, and current interest rates for the HECM program

uninsured reverse mortgage
a reverse mortgage that becomes due and payable on a specific date

MORE INFORMATION ONLINE
To get the latest information on reverse mortgages, visit AARP's website at www.aarp.org/revmort. There you will find more details and more up-to-date coverage of the topics presented in this booklet.

Appendix: Rising Debt and Falling Equity

The purpose and operation of a reverse mortgage are different from those of a standard “forward” mortgage. The purpose of a forward mortgage is to purchase a home; the purpose of a reverse mortgage is to generate cash.

In a forward mortgage, your home equity increases over time. Your loan balance (the amount you owe) decreases as you make monthly repayments to the lender. Meanwhile the value of your home is usually increasing. Forward mortgages are “falling debt, rising equity” transactions (see Table A-1).

In a reverse mortgage, your home equity generally decreases over time. Your loan balance rises as loan advances are made to you by the lender, interest is added to the outstanding loan balance, and you make no repayments to the lender. Unless the home appreciates (grows in value) at more than a moderate rate, the loan balance starts “catching up” to the home. Reverse mortgages are typically “rising debt, falling equity” transactions (see Table A-1).

A simplified example of a reverse mortgage is presented in Table A-2. The purpose of this table is to show the “rising debt, falling equity” characteristics of reverse mortgages in general. To simplify the example, the table does not include all the closing costs and fees that are generally charged by a mortgage company or bank. It also does not include the costs of selling a home, which typically reduce the amount of equity remaining at the end of the loan.

In the example, you can see that the $1,000 monthly loan advances in column A are added to the monthly interest at 0.5% in column B to equal the loan balance (amount owed) in column C. Over time, the loan balance grows larger. You can also see that the loan balance is subtracted from the home's value (assumed to be growing at 4% per year) in column D to produce the amount of remaining home equity in column D-C.

Figure A-1 shows how the loan balance on a forward mortgage declines over time while the home’s value is rising. Since home equity equals home value minus debt (the top line minus the bottom line in the figure), home equity is everything between the two lines, which increases over time.

Figure A-2 shows how the loan balance on a reverse mortgage rises over time (the figure assumes a monthly loan advance). Since home equity equals home value minus debt (the top line minus the bottom line in the figure), home equity is everything between the two lines, which decreases over time.

Table A-1: Comparison of Typical "Forward" and Reverse Mortgages

Item	"Forward" Mortgage	Reverse Mortgage
Purpose of loan	to purchase a home	to generate income
Before closing, borrower has…	no equity in the home	a lot of equity in the home
At closing, borrower	owes a lot, and has little equity	owes very little, and has a lot of equity
During the loan, borrower...	makes monthly payments to the lender	receives payments from the lender
	loan balance goes down	loan balance rises
	equity grows	equity declines
At end of loan, borrower...	owes nothing	owes substantial amount
	has substantial equity equity	has much less, little, or no equity
Type of Transaction	**Falling Debt-Rising Equity**	**Rising Debt-Falling Equity**

TABLE A-2: Simplified* Reverse Mortgage Example

Assumptions:

Monthly Loan Advance	$1,000
Monthly Interest Rate	0.5%
Original Home Value	$200,000
Appreciation Rate	4% per year

	A	B	C	D	(D-C)
End of Year	**Principal Advances**	**Interest@ 0.5%/mo.**	**Loan Balance**	**Home Value**	**Home Equity**
1	$12,000	$397	$12,397	$208,000	$195,602
2	24,000	1,559	25,559	216,320	190,760
3	36,000	3,532	39,532	224,872	185,339
4	48,000	6,368	54,368	233,971	179,602
5	60,000	10,118	70,118	243,330	173,211
6	72,000	14,840	86,840	253,063	166,222
7	84,000	20,594	104,594	263,186	158,591
8	96,000	27,442	123,442	273,713	150,270
9	108,000	35,453	143,453	284,662	141,208
10	120,000	44,698	164,698	296,048	131,349

*Illustrative example only; does not include loan closing costs and fees, or home selling costs.

Figure A-1: Forward Mortgage

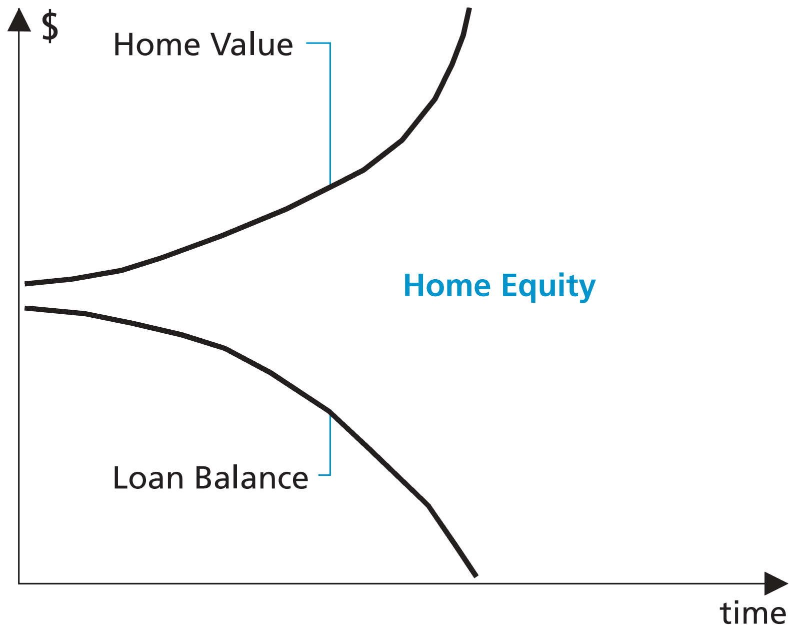
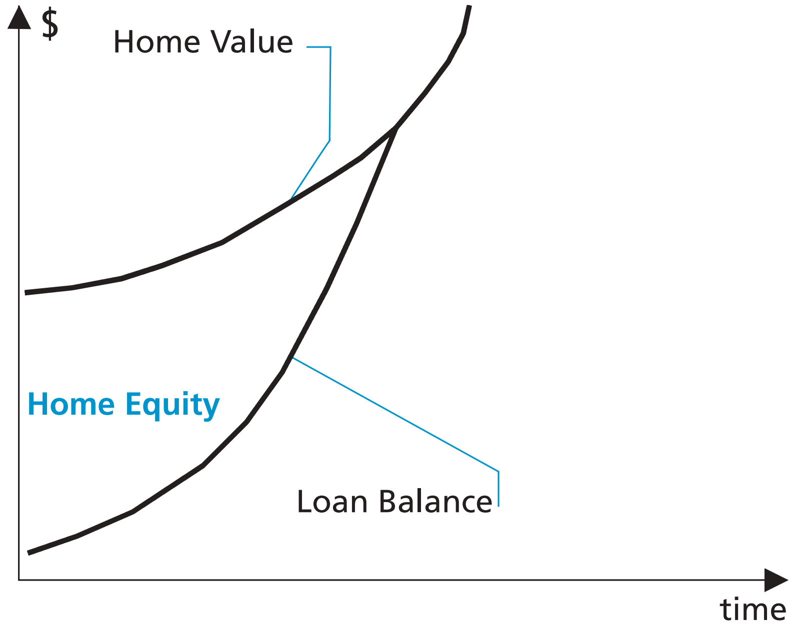


Figure A-2: Reverse Mortgage



The Loan Balance line does not cross over and continue past the Home Value line because of the non-recourse limit, as discussed on page 5.

The AARP Foundation is AARP's affiliated charity. Foundation programs provide security, protection and empowerment for older persons in need. Low-income older workers receive the job training and placement they need to re-join the workforce. Free tax preparation is provided for low- and moderate-income individuals, with special attention to those 60 and older. The Foundation's litigation staff protects the legal rights of older Americans in critical health, long-term care, consumer and employment situations. Additional programs provide information, education and services to ensure that people over 50 lead lives of independence, dignity and purpose. Foundation programs are funded by grants, tax-deductible contributions and AARP.

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. We produce *AARP The Magazine*, published bimonthly; *AARP Bulletin*, our monthly newspaper; *AARP Segunda Juventud*, our bimonthly magazine in Spanish and English; *NRTA Live & Learn*, our quarterly newsletter for 50+ educators; and our website, www.aarp.org. AARP Foundation is our affiliated charity that provides security, protection, and empowerment to older persons in need with support from thousands of volunteers, donors, and sponsors. We have staffed offices in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

601 E Street, NW
Washington, DC 20049
www.aarp.org

D12894(106)