PART XX: REVERSE MORTGAGES

8021. What is a reverse mortgage?

A reverse mortgage is a loan where the lender pays a homeowner (in a lump sum, a monthly advance, a line of credit, or a combination of all three) while he or she continues to live in the home. With a reverse mortgage, the homeowner retains title to the home. Depending on the plan, a reverse mortgage becomes due with interest when the homeowner moves, sells the home, reaches the end of a pre-selected loan period, or dies. Because reverse mortgages are considered loan advances and not income, the amount received is not taxable. Any interest (including original issue discount) accrued on a reverse mortgage is not deductible until the loan is paid in full. The deduction may be limited because a reverse mortgage loan generally is subject to the limit on home equity debt.[1] A lender commits itself to a principal amount, not to exceed 80 percent of the property's appraised value.

Planning Point: Although available through the private sector the vast majority of reverse mortgage borrowers choose to use a Home Equity Conversion Mortgage (HECM), which are regulated by the Department of Housing and Urban Development (HUD) and only available through an approved Federal House Administration (FHA) lender.

8022. How is eligibility for a reverse mortgage determined?

Eligibility for a reverse mortgage is dependent upon:

1. The titleholder for the property must be at least 62 years old, and if title is held jointly, the youngest of the two titleholders must be at least 62.

2. The property must be a single family home, an FHA approved condo, or a multiple family dwelling consisting of at least two, but no more than four, units.

3. The home must be occupied by and be the primary residence of the borrower(s).

4. There must be enough equity in the home to cover the payoff of all existing mortgages, liens, or legal obligations tied to the home.

The above listed requirements for eligibility are based on those that have been set by HUD for their Home Equity Conversion Mortgage Program (HECM) which covers over 90 percent of all reverse mortgages presently being written.

Planning Point: However, it is important to recognize that there is a private market that many borrowers turn to for reverse mortgages. Those who choose this private marketplace may find that these individual or corporate lenders have their own criteria that differ from HECM's.

---

1. IRS Publication 17.

8023. How much money can a person expect to receive from a reverse mortgage?

Generally speaking, the higher the property value, the older the borrower(s), and the lower the current interest rates – the larger the loan. Although it is possible to find slight differences from lender to lender, most adhere to the four variables considered when calculating the maximum amount of a HECM Standard or HECM SAVER loan. These variables often include:

1. The age of the borrower, or the youngest age of joint borrowers.
2. The prevailing interest rates in the marketplace in which the loan is being written.
3. The lesser of the appraised value or the maximum loan limit (presently set by HECM/FHA at $625,500) or the sales price of the home being purchased.
4. The initial Mortgage Insurance Premium.

Unlike traditional mortgages where the loan to value (LTV) ratio is a significant feature, in a reverse mortgage there is no stated maximum. Unfortunately there is a general misunderstanding that the LTV ratio for a reverse mortgage is linked to the age of the borrower, leading many borrowers to believe that a 67-year-old would have an LTV ratio of 67 percent, a 70-year-old 70 percent, etc. In reality, the range for most LTV ratios is 50 to 65 percent of the home's appraised value.

Planning Point: Another option available on reverse mortgages issued through the HECM/FHA for homeowners with appraised home values in excess of $625,500 is the private sector.

Those who choose this route should keep in mind the private lenders are not required to follow the strict letter of the law as set by HUD and administered by the FHA. They should however insist that the general outlines of the HECM be followed as closely as possible.

The number of lenders willing to issue reverse mortgage loans has dwindled over the past few years primarily as a result of the extended historically low interest rates. As rates rise, the number of mortgage companies entering or reentering this market should increase.

8024. How are the funds generated from a reverse mortgage distributed to the borrower?

Although some private lenders may offer different plans, generally there are five ways that a borrower can receive money:

1. **Lifetime or Tenure:** This plan offers equal monthly payments which will be paid as long as the borrower(s) are alive and continue to occupy the property as a principal residence.
2. **Period Certain or Term:** This plan offers the borrower(s) equal monthly payments that will be paid over a predetermined fixed period of months. The time period and payment amount is set prior to the first payment and cannot be changed.

If the borrower(s) die before the end of the period, the payments will continue for the remaining period to their identified beneficiary or beneficiaries.

3. **Line of Credit**: This plan provides for the establishment of an account that makes a predetermined amount of money accessible to the borrower at any time up until such time as the line of credit is exhausted.

4. **Combo or Modified Tenure:** This is a combination of line of credit and scheduled monthly, or a single lump sum payment with the remainder of the funds being distributed in predetermined payments or as a line of credit.

5. **Combo Modified Term**: This plan is a combination of a line of credit plus monthly payments for a fixed period of months selected by the borrower.

The availability of these options may vary depending on the lender.

Planning Point: In their September 21, 2010, Mortgagee Letter 2010-34 HUD introduced the HECM Saver and established the MIP rates for both the HECM Saver and HECM Standard. The initial MIP for the HECM Saver was set at 0.01 percent and for HECM Standard at 2 percent of the maximum claim amount; the amount of MIP will continue to be 2 percent. Both are calculated on the maximum claim amount, and must be paid at the time of loan closing.

On both the Saver and the Standard, the MIP is charged monthly on the outstanding balance at an annual rate of 1.25 percent.

MIP Rates	HECM Saver	HECM Standard
Initial MIP	.01 Percent	2.0 Percent
Annual MIP	1.25 Percent	1.25 Percent

8025. Are the proceeds received from a reverse mortgage taxable?

The IRS considers a reverse mortgage a loan, and because funds received by way of a loan are not considered income, the amount(s) the borrower(s) receive at any given time are not taxable.

8026. Is the interest accrued on the reverse mortgage deductible by the borrower?

According to Code Section 451, and Treasury Regulation Section 1.451-2, the answer is no.

Interest on a reverse mortgage added monthly to the outstanding loan balance as it accrues, is neither includible in a cash method lender's gross income, nor deductible by a cash method borrower at the time it is added.

8027. Is it possible for an estate or heirs of the borrower(s) to receive funds after the final settlement of a reverse mortgage?

Assuming that the reverse mortgage is not called due to the failure of the borrower(s) to comply with the terms and conditions of the loan, the final settlement of the loan will come due when the borrower(s) sell the home, die, or no longer use the home as the primary residence.

At that time, the heirs or estate have six months (this can be extended for a second six months) to repay the lender the principal plus accrued interest, and any other legitimate charges associated with the loan. Should the amount generated from the sale of the home be greater than the amount owed to the lender, all proceeds remaining belong to the borrower(s), heirs, or estate. However this is a "nonrecourse" loan which means that the borrower can never owe more than the value of the home regardless of loan balance; as such, no debt can ever be passed along to the heirs or estate.

8028. Do the heirs have to sell the property to repay the loan?

No, repayment can be accomplished in a number of different ways. If the heirs – or any one heir – want to buy the house, they can pay off the loan and take title. This can be accomplished by putting up the cash required to pay off the loan, by using a conventional mortgage, or using a home equity loan on another property. In reality, the financing options available are limited only by the imagination and credit worthiness of the buyer. If someone wants to buy the property, the only obstacle that they are likely to encounter will be how to come up with entire amount of the existing mortgage balance regardless of the home's appraised value.

There is also nothing stopping a would-be buyer from negotiating the price for which the lender is willing to sell the house; this is particularly true in cases where the market value of the house won't cover the loan.

8029. Will proceeds received from a reverse mortgage affect Social Security, Medicare, other government benefits, or pension benefits?

It is often suggested that funds received from a reverse mortgage do not affect either government or private retirement benefits; however, there have been cases where the government considered those funds as assets which resulted in the disqualification for Medicaid.

The following are three examples when funds from a reverse mortgage can affect government benefits:

1. If a borrower is on Medicaid, any reverse mortgage proceeds he or she receives must be used immediately to stay within state and/or federal government guidelines for Medicaid recipients.

2. Any funds that are retained by a borrower count as an asset and must be included when calculating Medicaid eligibility.

3. Any income that is generated from the investment of funds received from a reverse mortgage – depending on the tax status of the investment vehicle being used – may be required to be included in the amount of Social Security benefits that are taxable, and at the level those benefits are taxed.

Planning Point: According to the National Reverse Mortgage Lenders Association, a taxpayer can prevent losing Medicaid coverage by spending all reverse mortgage proceeds in the same calendar month. Only the amount that remains the following month counts as an asset.

8030. Can a reverse mortgage be put into a trust?

No other question generates such a diverse array of answers. When it comes to whether a reverse mortgage can be put into a trust, it take less than ten minutes to find the answer you want (right or wrong) on the Internet. However, the overriding authority as to whether a reverse mortgage can be put into a specific trust that meets HUD requirements is set out in HUD – Directive Number: 4235.1 Home Equity Conversion Mortgages.

4-5 HOME EQUITY CONVERSION MORTGAGES FOR PROPERTY HELD INTRUST.

HUD will insure HECMs on property in the name of an inter vivos trust, also known as a living trust. In general, a living trust is created during the lifetime of a person; (*as opposed to a testimonial trust which is created by the person's will after his/her death)*. A living trust is created when the owner of the property conveys his/her property to a trust for his or her own benefit or that of a third party (the beneficiaries). The trust holds legal title, and the beneficiary holds equitable title. A person may name him/herself as the beneficiary. The trustee is under a fiduciary responsibility to hold and manage the trust assets for the beneficiary. The trustee's responsibilities are set out in the trust agreement.

Property held in a land trust is eligible for a HECM if the requirements for a living trust are met. Property held in a living trust is eligible for a HECM if the trusts, and borrowers, meet the following requirements:

HUD - Directive Number: 4235.1 Home Equity Conversion Mortgages

A. Conditions for Origination in the Name of a Living Trust.

1) All beneficiaries of the trust must be eligible HECM borrowers at the time of origination and until the mortgage is released [i.e. borrower/beneficiary must occupy the property as a principal residence and new beneficiaries may not be added to the trust]. Contingent beneficiaries, that receive no benefit from the trust nor have any control over the trust assets until the beneficiary is deceased, need not be eligible HECM borrowers.

2) The trustee must sign the mortgage, and the mortgage must be signed by each borrower/beneficiary if necessary to create a valid first mortgage. The borrower/beneficiary must sign the Note and Loan Agreement. The lender may require the signature of the trustee on the Note or the signature of the borrower/beneficiary on the mortgage.

3) The trust shall not be a party to the Loan Agreement. The borrower/beneficiary may issue instructions to the lender to permit the trustee to exercise one or more rights stated in the Loan Agreement on behalf of the beneficiary; i.e. the right to receive loan advances or to request changes in the payment plan.

4) The lender must be satisfied that the trust is valid and enforceable, that it provides the lender with a reasonable means to assure that it is notified of any subsequent

change of occupancy or transfer of beneficial interest, and ensures that each borrower/beneficiary has the legal right to occupy the property for the remainder of his or her life.

B. Transfer of the Property Into or From a Trust.

1) The borrower under an insured HECM may transfer the property to a living trust without causing the mortgage to become due and payable if the lender finds that the trust meets all requirements that would have applied if the trust owned the property at closing. The lender may require the trust to formally assume the borrower's obligation to repay the debt as stated in the Note if considered advisable to avoid difficulty in enforcement of the Note and mortgage.

2) If the trust is terminated, or the property is otherwise transferred from an eligible trust holding the property, the mortgage will not become due and payable, provided that one or more of the original borrowers who signed the Note and Loan Agreement continue to occupy the property as a principal residence and continue to retain title to the property in fee simple or on a leasehold interest as set forth in 24 CFR Section 206.45(a).

8031. Is a Reverse Mortgage borrower required to purchase Mortgage Insurance Premium (MIP)?

Yes. Mortgage insurance has always been required on HECM loans. In order to reduce the high initial upfront cost that was keeping many people over 62 from obtaining a reverse mortgage, in 2010 the Federal Housing Administration introduced the HECM SAVER. The goal was to make reverse mortgages more affordable for more seniors by reducing the initial MIP and other upfront fees. In order to do this, these cost reductions are offset by lowering the amount available to the borrower.

(MIP) Mortgage Insurance Premium	HECM SAVER	HECM STANDARD
Amount of initial premium	0.01 percent of maximum claim amount (lesser of sales price, appraised value or FHA mortgage limit.)	2 percent of the FHA maximum claim amount.
Upfront fees	Lower	Higher
Amount of money available to borrower	Lower	Higher

As to the deductibility of Mortgage Insurance Premiums; according to IRS Publication 936, you can treat amounts paid during 2013 for qualified mortgage insurance as home mortgage interest. The insurance must be in connection with home acquisition debt, and the insurance contract must have been issued after 2006.

BK-SBM-15TFInvest-140469-Part 20.indd 6 10/1/2014 2:10:20 PM

Qualified mortgage insurance. Qualified mortgage insurance is mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (as defined in section 2 of the Homeowners Protection Act of 1998 as in effect on December 20, 2006).

In their September 21, 2010, Mortgagee Letter 2010-34 HUD introduced the HECM Saver and established the MIP rates for both the HECM Saver and HECM Standard. The initial MIP for the HECM Saver was set at 0.01 percent and for HECM Standard at 2 percent of the maximum claim amount; the amount of MIP will continue to be 2 percent. Both are calculated on the maximum claim amount, and must be paid at the time of loan closing.

On both the Saver and the Standard the MIP is charged monthly on the outstanding balance at an annual rate of 1.25 percent.

MIP Rates	HECM Saver	HECM Standard
Initial MIP	.01 Percent	2.0 Percent
Annual MIP	1.25 Percent	1.25 Percent

8032. Can a HECM be used to purchase a new home?

Yes. Known as the HECM for Purchase, this program was designed to allow seniors to purchase a new principal residence and obtain a reverse mortgage within a single transaction.

This program has been available since it was originally introduced as part of the Housing and Economic Recovery Act of 2008, yet has only recently started gaining popularity.

The Federal Housing Administration (FHA) defines "HECM for Purchase" as a real estate purchase where title to the property is transferred to the HECM mortgagor, whom the mortgagor will occupy as a principal residence, and, at the time of closing, the HECM first and second liens will be the only liens against the property. HECM mortgagors must occupy the property within 60 days from the date of closing. Lenders are required to ensure all outstanding or unpaid obligations incurred by the prospective mortgagor in connection with the HECM transaction are satisfied at closing.

Only properties where construction is completed are eligible for a HECM-for-Purchase as described in HUD's *ML*-2007-06.

The funding of a HECM for Purchase is an area that has generated an unexpected amount of confusion and debate among borrowers and some advisors. In order to help clarify this, the following text has been taken from the Mortgagee Letter 2009-11 dated March 27, 2009, addressed to All FHA-Approved Mortgagees and All HUD-Approved Housing Counseling Agencies:

FUNDING SOURCES: HECM mortgagors must use cash on hand or cash from the sale or liquidation of the mortgagor's assets for the required monetary investment. The monetary investment requirement can also be met by the use of approved funding sources as defined in

HUD Handbook 4155.1 REV-5, section 2-10, with the exception of the following funding sources which **may not** be used:

- Sweat Equity
- Trade Equity
- Rent Credit
- Cash or its equivalent, in whole or in part, from the following parties, before, during or after loan closing:
  - The seller or any other person or entity that financially benefits from the transactions, or
  - Any third party or entity that is reimbursed, directly or indirectly, by any of the parties described in the previous bullet.

FHA prohibits seller contributions (also known as "seller concessions"), the use of loan discount points, interest rate buy downs, closing cost down payment assistance, builder incentives, gifts or personal property given by the seller or any other party involved in the transaction. This includes customary charges that are normally paid on behalf of the borrower by the seller.

GAP FINANCING: Consistent with existing regulatory requirements in 24 CFR 206.32(a), HECM mortgagors may not obtain a bridge loan (also known as "gap financing") or engage in other interim financing methods to meet the monetary investment requirement or payment of closing costs needed to complete the purchase transaction. This restriction includes subordinate liens, personal loans, cash withdrawals from credit cards, seller financing and any other lending commitment that cannot be satisfied at closing.

8033. Is the flexible rate option still available on the Hickam Standard?

In a January 30, 2013 Mortgage Letter 2013-01, the United States Department of Housing and Urban Development and the Federal Housing Administration (FHA) announced the elimination of the flexible rate option on the Hickam standard. As of April 1, 2013, the home equity conversion (HECM) program will consolidate the fixed rate Hickam standard and fixed-rate Hickam saver initial mortgage insurance premiums and principal limit factors under the Hickam saver fixed interest rate pricing option. Prospective mortgagors seeking the adjustable interest rate mortgages can continue to use the Hickam standard pricing option and principal limit factors.

The reason given by HUD as for this change was "[t]o help sustain the (HECM) program as a viable financial resource for aging homeowners and to strengthen the Mutual Mortgage Insurance Fund, the (HECM) Saver will be the only initial MIP option available to mortgagors who seek the predictability of a fixed rate mortgage and lower upfront closing cost."

Those who follow the reverse mortgage market take a slightly different view as to why HUD has made this change. Statistics show that the number of reverse mortgages being issued has increased in recent years and all indications are that they will continue to increase for the foreseeable future. However, somewhat unexpectedly, the number of defaults has also increased. Although it is generally accepted that, because no payments are required on a reverse mortgage until sometime in the future, there can be no default due to lack of payments, there is growing confusion as to the responsibilities of the borrower to pay both the property taxes and their homeowners insurance premiums in a timely manner.

Because these defaults have occurred at a significantly higher rate in the HECM Standard Fixed product than the variable products, many believe the defaults can be linked in large part to the HECM Standard Fixed requirement that the entire amount of the reverse mortgage be paid upfront a lump sum. As such, once those initial funds are gone, in many cases there are no other resources available to the borrower. This problem could potentially be eliminated if the payments were delayed for those choosing either the monthly-income or line-of-credit option.

Another suggested reason for the increasingly high level of defaults is that taxpayers delay using reverse mortgages until after they have spent down all of their other assets. Proponents of this rationale suggest that retirees should consider a reverse mortgage as a possible income supplement during their pre-retirement planning.

8034. Can a surviving spouse remain in a home that is subject to a reverse mortgage even though the surviving spouse is not the borrower under the mortgage?

Under a recently decided court ruling, a surviving spouse may remain in a home that is subject to a reverse mortgage even though the sole borrower on the mortgage is the deceased spouse.[1] Because eligibility for a reverse mortgage depends upon the borrower's reaching age 62 (see Q 8022), in some cases married taxpayers have been advised that the younger spouse can sell the home to the older spouse in a quitclaim sale. The older spouse would then qualify for a reverse mortgage, but would be listed as the sole borrower on the mortgage.

U.S. Department of Housing and Urban Development (HUD) regulations governing reverse mortgages, however, allowed the lender to demand that the loan be repaid immediately upon the death of the borrower.[2] A group of surviving spouses who were facing foreclosure on homes that were subject to reverse mortgages challenged this rule, arguing that the HUD regulation violated a federal law because it did not protect the surviving spouse. Federal regulations provide that HUD may not issue a reverse mortgage unless it provides that the homeowner's obligation to satisfy the loan is deferred until the homeowner's death, the sale of the home or certain other enumerated events.[3] Under those regulations, the term "homeowner" was defined to include the spouse of the homeowner.

The court agreed with the plaintiffs and ruled that since the regulations specifically referred to a spouse of a homeowner, rather than a co-mortgager or co-borrower, the law meant to protect

1. *Bennett v. Donovan*, 2013 U.S. Dist. LEXIS 140440.
2. 24 CFR 206.27.
3. 12 U.S.C. 1715z-20(j).

a surviving spouse of a borrower-homeowner regardless of whether that surviving spouse was also a borrower under the reverse mortgage. As a result of this case, HUD regulations now provide that reverse mortgages issued after August 4, 2014 must allow the surviving spouse to remain in the home that is subject to the reverse mortgage after the borrower dies, so long as the following are true:

(1) the non-borrowing spouse must be married to the borrowing spouse when the reverse mortgage is closed and must remain married to the borrowing spouse until the death of the surviving spouse,

(2) the marriage must be disclosed at the time of the mortgage origination,

(3) the non-borrowing spouse must be specifically named in the loan documents,

(4) the non-borrowing spouse must establish legal ownership of the home or legal right to remain in the home within 90 days of the borrowing spouse's death,

(5) the non-borrowing spouse must occupy the home securing the reverse mortgage as his or her principal residence, and

(6) the non-borrowing spouse must continue to satisfy all other loan obligations.[1]

If a surviving spouse fails to satisfy the criteria enumerated above, the lender may require immediate repayment of the reverse mortgage.

8035. Are there any financial assessments that are required in determining a taxpayer's eligibility for a reverse mortgage?

Yes. As a result of several instances in which taxpayers were approved for reverse mortgages where they did not have the financial ability to maintain the home, the Federal Housing Administration (FHA) has issued new financial assessment rules in order to determine whether a taxpayer will be eligible for a reverse mortgage.

For reverse mortgages issued after January 13, 2014, in order to approve a reverse mortgage, the lender must first complete a financial assessment of the taxpayer that includes the following steps:

(1) performing a credit history analysis,

(2) performing a cash flow/residual income analysis,

(3) documenting and verifying credit, income, assets and property charges,

(4) evaluating any extenuating circumstances and compensating factors that might otherwise impact a taxpayer's financial position,

1. HUD Mortgagee Letter 2014-07.

(5) evaluating the results of the financial assessment in order to determine eligibility,

(6) determining if funding sources for property charges from HECM proceeds will be required, and

(7) completing a HECM financial assessment worksheet.[1]

Further, in order to qualify for a HECM reverse mortgage, a taxpayer must now fully satisfy any federal judgments and delinquent debts to the federal government (or enter into an approved repayment plan prior to closing the HECM mortgage). The FHA does not similarly require that any state or local judgments be satisfied prior to closing a reverse mortgage.

8036. Are there any limits on the amount of reverse mortgage disbursements that a taxpayer is entitled to receive within the first 12 months of closing?

Yes. The U.S. Department of Housing and Urban Development (HUD) has conducted studies finding that borrowers under reverse mortgages who received all of the proceeds of the mortgage at the time of closing, or shortly after closing, had a substantially higher risk of default on the mortgage. As a result, new limitations have been introduced to ensure that taxpayer-borrowers are able to meet their financial obligations and remain in homes that are subject to reverse mortgages.

The maximum value that a taxpayer is entitled to receive from a reverse mortgage at the time the loan is closed, or within the first 12 months after closing, is now limited to 60 percent of the "principal limit" or the sum of "mandatory obligations" plus 10 percent of the principal limit.[2] After the first 12 months, the taxpayer is entitled to access the remainder of the loan.

A taxpayer's principal limit for a HECM reverse mortgage is essentially the maximum amount that the taxpayer is entitled to receive from the HECM before any disbursements are made. It is calculated using a formula that is based upon the age of the borrower, the expected average mortgage interest rate and the maximum claim amount that may be drawn under the loan (which factors in the value of the home and is subject to an overall cap of $625,500). See Q 8023 for a discussion of how the amount that will be available through a reverse mortgage is calculated.

Mandatory obligations include, but are not limited to, expenses such as origination and closing fees, any current mortgage debt, federal tax debt, certain repair expenses required as a condition of closing, the initial mortgage insurance premium (MIP, see Q 8031), and fees required for warranties and inspections.[3]

These new limitations are effective for reverse mortgages issued on or after September 30, 2013.

1. HUD Mortgagee Letter 2013-28. The Department of Housing and Urban Development (HUD) financial assessment guide provides detailed guidelines for the financial review, as well as the factors that must be considered in determining whether to issue the reverse mortgage. It is available at http://portal.hud.gov/hudportal/documents/huddoc?id=13-28mlatch.pdf (last accessed September 10, 2014).
2. HUD Mortgagee Letter 2013-27.
3. HUD Mortgagee Letter 2013-27 provides a detailed list of the types of expenses that are treated as mandatory obligations.

8037. What are the consequences if a taxpayer receives disbursements from a reverse mortgage that exceed the new limitations that apply for 2013 and beyond?

There are situations where taxpayer could potentially receive reverse mortgage disbursements within the first 12 months that exceed the limitations imposed for loans issued on or after September 30, 2013. While the maximum disbursement that a taxpayer is generally entitled to receive from a reverse mortgage at the time the loan is closed, or within the first 12 months after closing, is now limited to 60 percent of the principal limit, the taxpayer may also elect to receive the sum of his or her mandatory obligations plus 10 percent of the principal limit (see Q 8036).[1]

The borrower under a reverse mortgage may receive initial disbursements of more than 60 percent of the principal limit in several situations, including the following:

(1) the taxpayer's mandatory obligations initially exceed 60 percent of the principal limit, or

(2) the taxpayer's mandatory obligations exceed 50 percent of the principal limit and the taxpayer elects to receive the full additional 10 percent of his or her principal limit.

If the borrower's initial disbursement at the closing (or other disbursements within the first 12 month period) exceeds 60 percent of the principal limit, the cost of the reverse mortgage will increase. Rather than charging an initial mortgage insurance premium (MIP, see Q 8031) of 0.50 percent of the maximum claim amount, the borrower's initial MIP will increase to 2.50 percent.[2]

8038. Are borrowers under a reverse mortgage responsible for any costs relating to the property underlying the mortgage?

Yes. In connection with the financial assessment that is now mandated by the U.S. Department of Housing and Urban Development (HUD) (see Q 8035), a more stringent set of rules has now been implemented to ensure that borrowers under reverse mortgages are able to pay the property charges associated with maintaining the home subject to the mortgage.

If the results of the HUD financial assessment indicate that the borrower may be financially unable to pay the property charges associated with maintaining the home, the lender has two options:

(1) It may set aside a certain amount of the reverse mortgage proceeds to pay future property charges. The amount set aside is based on the life expectancy of the youngest borrower, and the current sum of the tax, hazard and flood insurance charges required to maintain the property, adjusted annually by 1.20 percent to reflect anticipated increases over the life of the mortgage;

1. HUD Mortgagee Letter 2013-27.
2. HUD Mortgagee Letter 2013-27.

(2) It may authorize the borrower to pay property charges as they become due via withholding from the reverse mortgage monthly disbursements or line of credit.[1]

Property charges are defined to include costs such as property taxes, hazard insurance premiums, applicable flood insurance premiums, ground rents, condominium fees, planned unit development fees, homeowner's association fees, and any special assessments that may be levied under municipal or state law.[2]

Despite this, if it is determined that a set-aside is required to fund the property charges, only property taxes, hazard insurance and flood insurance can be included, though the borrower remains liable for paying all other property charges that arise. Further, if the lifetime set-aside is insufficient to cover charges, the borrower remains liable for paying any property charges in excess of the set-aside.[3]

The borrower is also entitled to specifically elect to have a set-aside or automatic withholding apply in order to cover applicable property charges even if the results of the financial assessment do not indicate that either option is necessary. If the election is voluntary, the borrower can cancel at his or her request.[4]

1. HUD Mortgagee Letter 2013-27.
2. HUD Mortgagee Letter 2013-27.
3. HUD Mortgagee Letter 2013-27.
4. HUD Mortgagee Letter 2013-27.