FAQ: TEXAS' NEW AND IMPROVED REVERSE MORTGAGE[1]

by J. Alton Alsup[2]

Proposition 7, which Texas voters approved on November 8th, 2005, amended the Texas Constitution to authorize line of credit advances under a reverse mortgage that will empower senior homeowners to better control the amount and costs of their home equity borrowings by requesting advances only when needed and in amounts needed. This article in Q&A format is intended to familiarize clients of Texas attorneys with this powerful financial planning tool.

1. What is a reverse mortgage?

A reverse mortgage is a type of home equity loan authorized by the Texas Constitution (Sec. 50(a)(7), Art. XVI, Tex. Const.) that allows senior Texas homeowners, age 62 or older, to borrow against the equity in their homes without having to repay any of the mortgage debt during their life times so long as they continue to live in their homes and keep their property tax and insurance payments current. It is meant to provide "house rich but cash poor" seniors the resources needed to remain in their homes for the rest of their lives, if they so desire, by converting their home equity into annuity-like periodic payments, or advances, to the homeowners over their remaining lives or, if preferred, a term of years that may be used to pay for housing costs, medical care, and other costs of living.

2. Why is it called a "reverse" mortgage?

It is called a "reverse mortgage" because payments on the mortgage are said to flow in reverse – from the lender to the homeowner. Unlike a Texas home equity loan in which the homeowner must immediately begin repaying the principal loan amount in substantially equal monthly payments that amortize and fully repay the loan by the maturity date, disbursements made to the homeowner under a reverse mortgage simply accrue interest, including interest on interest, until maturity when the full loan balance of principal and interest is repaid to the lender in one final lump sum payment. A common misconception about reverse mortgages is that the transaction involves the transfer of title of the home to the mortgage lender in exchange for monthly payments. But a reverse mortgage is merely a loan secured by a lien of the homestead — just like the lien of a conventional, or "forward," mortgage.

3. What advantage does a reverse mortgage have over a home equity loan?

A reverse mortgage is tailored to the financial needs of senior homeowners who most often live on a limited or fixed income and may not otherwise qualify to repay a home equity or conventional mortgage loan. Before reverse mortgages first became widely available to Texas homeowners in

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[2] J. Alton ("Al") Alsup is a founding shareholder of Houston-based Brown, Fowler & Alsup P.C. and practices residential mortgage banking and real estate law exclusively. He is a graduate of The University of Texas School of Law and is Board Certified in Residential Real Estate Law by the Texas Board of Legal Specialization. He is the author of numerous articles on the subject of Texas homestead lending law, including "The New and Improved Texas Reverse Mortgage." (55 Consumer Fin. L. Q. Rep. 189, Spring, 2002)

2001, seniors too often were forced to sell and move from their homes in order to reach the cash equity in their homes needed to defray living costs. But there are no income or credit history requirements for eligibility for a reverse mortgage. Senior homeowners are not required to demonstrate general creditworthiness or to have a source of income or assets with which to repay the loan. And homeowners are eligible regardless of their advanced age or condition of their health.

4. How is eligibility for a reverse mortgage determined?

Any Texas resident age 62, or older, who owns and occupies as a principal dwelling a single family home, a qualified condominium unit or townhouse, or a permanently attached and qualified manufactured home, in which there is sufficient appraised home equity (i.e., appraised market value minus the current balance of all mortgages and liens secured on homestead property = equity) should qualify for a reverse mortgage. If the homeowner is married, both spouses in title must be age 62, or older, to qualify for an FHA-insured Home Equity Conversion Mortgage (HECM), the most popular currently available reverse mortgage program, and all loan applicants must first have completed mandatory counseling by an approved non-profit counseling agency on the risks and benefits of a reverse mortgage and alternative financing options.

5. Is the use of reverse mortgage loan proceeds restricted?

Proceeds from a reverse mortgage may be used by senior homeowners for any purpose, although most often loan proceeds are regarded as a supplement to Social Security benefits and pension payments and used by homeowners to maintain their homes in a good state of repair, pay property taxes and insurance when due, and defray medical and other ordinary costs of living during their Golden Years. Significantly, advances under a reverse mortgage are not taxable as income and do not affect senior homeowners' eligibility for Social Security or Medicare benefits. (However, senior homeowners electing a lump-sum advance of proceeds should seek counseling regarding their continued eligibility for Medicaid benefits if retaining the advance as a liquid asset.)

6. How is the maximum loan amount determined and disbursed?

The maximum loan amount under a reverse mortgage is calculated according to underwriting guidelines based upon a number of variable factors, including the age of the homeowner (or, if married, the age of the younger of the spouses), the method of optional advances the homeowner chooses (i.e., lump-sum, line of credit, term, or tenure), the appraised value of the home and home equity, and current interest rates. Assuming all other factors are equal, for example, a 62-year old homeowner choosing to receive monthly payments for the rest of his life (based on actuarial life expectancy) will receive less per month than an 82-year old choosing to receive monthly payments over a stated term of eight years. As calculated, the approved maximum principal limit that may be advanced under a reverse mortgage, when added to projected accrued interest and other borrowing costs over the loan term, should not exceed the projected fair market value of the home securing the loan at the time of maturity. Maximum advances under a reverse mortgage, therefore, generally will be less than available under a Texas home equity loan and most often will not exceed 50% of appraised home equity value as of the date of closing.

7. What are the closing and other costs of borrowing under a reverse mortgage?

Closing costs are similar but comparatively higher than imposed for a conventional mortgage. FHA-insured HECM program reverse mortgages, for example, which account for 90% of all reverse mortgages currently made nationwide, provide for a 2% loan origination fee payable to the mortgage lender, an up-front 2% FHA mortgage insurance premium (MIP) and a continuing annual .50% MIP premium factored into the monthly interest rate, and servicing fees of $35 per month set aside for payment to the loan servicer over the term of the loan. Other fees and charges for property appraisal and survey, credit report, flood certification, pest inspection, title insurance, document preparation, escrow, courier and recording fees are comparable to other mortgage loans.

8. What liability do Texas homeowners and their heirs have for repayment of reverse mortgages?

A reverse mortgage is a non-recourse loan and homeowners have no personal liability for repaying the loan. Homeowners are not required to make any repayments during the term of the loan, and the full loan amount owed, including all amounts advanced and accrued interest (including interest on interest), is typically repaid from sales proceeds when the homestead property is sold by the borrower or by the borrower's estate after the borrower, or the last of the borrowers, dies. When a reverse mortgage becomes due, the lender or note holder must look solely to recovery against the homestead property under its mortgage as its exclusive remedy. The homeowners will never owe more than the loan balance or the value of the homestead property, whichever is less, and no assets of borrowers other than the homestead property may be used to repay the debt. And neither the borrower's estate nor the heirs of the estate have any liability for any deficiency that may result from the sale of the homestead property.

9. What protections do Texas homeowners have against loss of their homes through foreclosure of a reverse mortgage?

Under Texas law, the loan balance of a reverse mortgage generally cannot be called due and payable until and unless the homeowner (i) sells or transfers the homestead property, (ii) permanently abandons the property for 12 consecutive months without obtaining the lender's prior approval, or (iii) dies (or, if married, the last of the homeowners dies). However, the lender in some cases may call the loan due if discovering the homeowner has committed actual fraud in connection with the loan or has defaulted on contractual obligations in the deed of trust to repair and maintain, pay taxes and assessments on, or insure the homestead property, or has failed to maintain the lender's first-lien priority on the homestead property. These conditions must be included in the written loan agreement and the lender additionally must provide the homeowner a separate written consumer notice of these conditions at closing. These conditions also are covered in financial counseling that is required of all homeowners before they are eligible to even make application for a reverse mortgage. If intending to foreclose for any reason, a lender must first give written notice to the homeowner that a ground for foreclosure exists and give the homeowner an opportunity to cure the ground for foreclosure. Finally, if the ground for foreclosure is other than the sale of the property or the death of the homeowner, the foreclosure may only be obtained by court order under applicable rules of civil procedure.

10. What is the future of reverse mortgages in Texas?

With the new Proposition 7 amendment to the constitution now authorizing line of credit terms, reverse mortgages in Texas are expected to triple in volume over the next several years. With the "graying" of America, the number of Americans age 65 or older is expected to double to 70 million

by the year 2030 and Texas's older population should then have burgeoned to over 4.4 million! Moreover, life expectancy for all Americans who were age 65 in 2000 is another 18 years on average, and the combination of such a large population growth and longer life spans of older Americans undoubtedly will place a strain on their personal financial resources and society's ability to provide adequate health and elder care services for them. Because home equity is the most significant asset in the estates of most older Americans, the reverse mortgage with its ability to convert that frozen asset into a stream of annuity-like payments to help cover on-going housing and health costs over their remaining lifetimes should prove to be an increasingly important option for many senior Texas homeowners.

11. Where can I learn more about reverse mortgages?

More about FHA's Home Equity Conversion Mortgage (HECM) and Fannie Mae's Home Keeper^{sm} reverse mortgage products offered in Texas by Financial Freedom Senior Funding Corporation, Wells Fargo Home Mortgage, and other reverse mortgage lenders can be found on the Website of the National Reverse Mortgage Lenders Association (NRMLA) at www.reversemortgage.org.