REVERSE MORTGAGES: AN INNOVATIVE TOOL FOR ELDER LAW ATTORNEYS

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On April 5, 1996, Kathleen Beargie, a seventy-two-year-old widow living in California, became the first person in the United States to close a reverse mortgage under a new national lending program.1 This was not the first time she earned the distinction of being first. In the 1940s, Ms. Beargie placed first in a national chemistry competition and, as a result, was awarded an academic scholarship to Oberlin College in Ohio.2 Since that time Ms. Beargie has received academic degrees in French, chemistry, paleontology, and a doctorate in comparative vertebrate anatomy and embryology.3 Recently, Ms. Beargie has put her study skills to work on researching a new type of mortgage commonly known as a “reverse mortgage.”

Upon completion of her research, Ms. Beargie took advantage of this new mortgage by raising capital against the equity in her home to pay medical and dental bills.5 Ms. Beargie then established a line of credit and purchased some vehicles with the funds remaining from the reverse mortgage.6 Unlike a traditional mortgage, she has no obligation to make loan payments as long as she owns the home used as collateral for the reverse mortgage. However, upon the subsequent sale of the home, the proceeds raised will go directly to the lending institution.7 Since there are no monthly loan payments,

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2. See id.
3. See id.
4. See id.
5. See id.
6. See id.
7. In reverse mortgage situations, the sale of the home usually occurs upon the mortgagor's death. The basic principle behind the mortgage is that an elderly individual
Ms. Beargie did not have to qualify for the reverse mortgage loan as would normally be required with a home equity loan. The reverse mortgage loan is designed for individuals, like Ms. Beargie, who are cash-poor but equity-rich as a result of their debt-free home ownership. Through a reverse mortgage, elderly individuals can alleviate financial burdens and enjoy their golden years.

The central purpose of this Article is to demonstrate to elder law attorneys the important role a reverse mortgage can play in the financial future of elderly clients. This Article uses the Home Equity Conversion Mortgage (HECM) insured by the Federal Housing Administration (FHA) as the base model for its reverse mortgage discussion. This Article will explain the concept and practical application of the reverse mortgage in planning an elderly client's financial future. Furthermore, this Article will demonstrate the potential value of state-sponsored consumer education programs (which instruct the elderly about using a reverse mortgage) encourage and expediate the use of private resources to delay and reduce the demand for nursing home care at public expense.

I. THE IMPORTANCE OF THE REVERSE MORTGAGE TO THE ELDER LAW ATTORNEY

The average elder law attorney must be knowledgeable in several different fields of law to serve elderly clients properly. She must often do financial planning, tax work, probate, and in some cases, set up living wills. The reverse mortgage, although complex, is an important tool for planning an elder person's estate for several reasons. First, home equity is an untapped financial resource for the elderly. Second, consumer interest in using reverse mortgages for financial security has significantly increased. Third, new versions of reverse mortgages have been introduced into the market offering...
greater access and flexibility for consumers.

A. Scale of Potential Use

Home equity is the single largest untapped financial resource for the elderly. Based on 1996 U.S. Census data, more than 6.7 million households are included in the market for reverse mortgages. These homes are mortgage-debt free with clear titles held by individuals over the age of sixty-nine, and are valued at over $30,000.11 In Florida, that corresponds to 636,281 households.12 Nationally, another 4.4 million similarly situated homeowners between the ages of sixty-two and sixty-nine will swell the market potential to over eleven million dwellings by the end of this decade.13 In Florida, the potential market will include 958,993 homeowners by 2000. Home equity is an untapped resource which may provide financial comfort to individuals not currently taking advantage of their long-term build-up of home equity.

The critical importance of home equity as a financial resource for the low-income elderly is reflected in a recent study. The 1991 American Housing Survey estimated that there were 3.5 million elderly homeowners with incomes below $15,000 and with homes valued at more than $50,000.14 These elderly homeowners are “house rich, but cash poor.”15 Accessibility to these untapped financial resources makes a reverse mortgage an attractive option to elderly clients who lack the immediate financial liquidity needed for medical expenses and living costs.

Recently, enormous consumer interest in reverse mortgages has developed. Inquiries concerning reverse mortgages have been the top mail-generator at the American Association of Retired Persons (AARP) for several years.16 Given the scope and importance of oth
er issues the AARP addresses (such as social security, taxes, Medicare), pensions, health, housing, disability, crime, and bereavement, this reflects an amazing level of consumer grassroots interest.  

Furthermore, new types of mortgage arrangements are being offered to provide borrowers with more choices. In late 1995, Fannie Mae introduced its latest version of the reverse mortgage, “The Home Keeper Mortgage.” Prior to that, Transamerica HomeFirst announced a new “line of credit” product in 1994 and increased the program options in 1995. With the increasing demand for reverse mortgages and the growing corporate response to satisfy these demands, elder law attorneys must learn about reverse mortgages to meet the inevitable needs of their clients.

B. Designed for the Elderly

The reverse mortgage is tailored to fit the financial profile of an elderly client. Individuals who have fixed incomes need access to additional funds when their expenses increase due to an emergency situation or an increase in the cost of living expenses. However, an elderly person, unable to pay the additional debt out of a fixed monthly income, cannot access sources such as common home equity loans and lines of credit. In contrast, a borrower obtains a reverse mortgage with no income requirement and very little out-of-pocket expense.

A reverse mortgage also satisfies elderly clients' desire to remain in their own homes for the rest of their lives. First, no restric-
tions exist on using the funds. The reverse mortgagor can use the cash disbursements to pay taxes, or to repair and renovate the property allowing her to live in a more comfortable home. Second, since no repayment of the mortgage is due until the house is sold following the death of the mortgagee, there is no creditor pressure to sell or alter the status quo.

C. Reverse Mortgage: Not a New Concept

The first reverse mortgage was issued in Portland, Maine in 1961. Much later, in 1989, the federal government created the common form of the reverse mortgage: the Home Equity Conversion Mortgage (HECM), insured by the FHA. As of November 1995, approximately 13,000 reverse mortgages closed in the United States. However, in Florida, as of July 1994, there had been only 319 reverse mortgages closed since the inception of the reverse mortgage concept. Given the potential value to the elderly and the large population who could be helped by a reverse mortgage, these statistics reflect an obvious but serious lack of appreciation for the utility of the reverse mortgage. Professional advisors, who strive to help the elderly and their families meet financial needs, must overcome the obstacles which restrict access to this vital resource.

D. Underutilization of Reverse Mortgages

Several historical barriers explain why reverse mortgages have not been accepted by borrowers and lenders. The main factors include the novelty and complexity of these mortgages; the lack of professional lending expertise in the field; the complexity of the calculation of costs; the psychological intimidation of borrowing

28. See id.
29. See id.
31. See Preliminary Evaluation, supra note 21, at 5-10. From January to September of 1995, a total of only 370 reverse mortgages have been issued by lending institutions. See H. Jane Lehman, FHA Reverse Mortgage Program May Take a Breather, Orlando Sentinel, Sept. 17, 1995, at J1.
32. See Lehman, supra note 31, at J1.
33. See Rasmussen et al., supra note 11, at 1.
against one's home; and the reticence of institutional lenders to
draft these relatively new mortgage instruments.

Understanding how reverse mortgages work and evaluating
other options can even challenge well-versed professionals.35 A trou-
bling lack of professional expertise exists on this subject.36 For in-
stance, systematic evaluation of consumer support for reverse mort-
gages by AARP and the National Center for Home Equity Conver-
sion has revealed a substantial need for training programs.37 Train-
ing is needed for attorneys, estate planners, accountants, financial
planners, public benefit specialists, elder law attorneys, and geriat-
ric care managers in the basic reverse mortgage applications.38 If at-
torneys advising elderly clients understand the advantages of re-
verse mortgages and the release of home equity, the elderly will be
more receptive to such devices in their financial planning.39

The pricing structure does not accurately reflect the real cost of
a reverse mortgage to the borrower, and can sometimes hinder con-
sumer acceptance.40 In fact, this structure makes reverse mortgages
appear more expensive than they actually are.41 In addition to ex-
plaining how reverse mortgages are calculated, an educated elder
law attorney should put the cost into its proper perspective depend-
ing on the client’s needs.

Another barrier to consumer acceptance is that borrowing
against an elderly person’s most significant asset (the home) can
offend deeply held values relating to debt and intergenerational
obligations.42 If the reverse mortgage could be recharacterized as an
appropriate cashing-in of a well-earned nest egg, but without the
possibility of losing the home, this might help the elderly client be-
come more receptive to the concept.43

The final and most common barrier is that lenders have been
slow to enter the market, especially before the HECM reverse mort-
gage.44 Furthermore, there were certain state law barriers to reverse

36. See id. at 4, 22.
37. See id. at 22.
38. See id.
39. See id.
41. See id.
42. See id. at 4. See also Hammond, supra note 15, at 107.
43. See Scholen, supra note 7, at 316.
44. See Hammond, supra note 15, at 88.
mortgages. Marketing at the community level was sparse because of the relatively low profitability to lenders and the large effort necessary to educate consumers. In particular, the lack of a secondary market for reverse mortgages was detrimental. However, Fannie Mae now provides that secondary market.

II. BASIC STRUCTURE OF REVERSE MORTGAGES

A reverse mortgage is a rising debt, non-recourse loan secured by the principle residence of the borrower. The mortgage attaches as a first lien to the borrower’s home and the borrower retains title. Funds are distributed to the borrower on one of several disbursement schedules, including, but not limited to: a lump sum payment, monthly payments, or a line of credit with the lending institution or bank. The repayment of the debt, plus interest and costs, is deferred until the sale of the residence.

A. A Mixture of Traditional Mortgage Features

A reverse mortgage is beneficial because of the method of determining available funds, the open-ended nature of the note, the variety of cash disbursement options, and the fact that it is a non-recourse loan. Structurally, a reverse mortgage is an amalgamation of an open-ended mortgage, a negative amortization mortgage, and a balloon mortgage.

1. Determination of Available Loan Proceeds Amount and Schedule

The amount of funds available to a borrower in a traditional forward mortgage is primarily based on the value of the home, the interest rate, and the ability of the borrower to make monthly payments. Funds are disbursed on a one-time transaction. In contrast,
in a reverse mortgage, the funds are calculated using algorithms accounting for the borrower's age, the schedule of distributions, equity in the home, and the current interest rate. The borrower's income is not considered in approving the loan. Generally, the older the borrower, the greater the amount available. See id. at 18. In other words, the higher the equity value of the home, the greater the amount available. The amount of funds available is also subject to varying interest rates. The higher the current interest rate, the lower the amount of funds available. The underlying principle is that the amount loaned must not generate a debt (including principal, interest, and loan charges) that will exceed the residence's value based on life expectancy and other factors.

2. Payment Schedules

In a reverse mortgage, full payment of the accrued debt is due at the end of the term. The end of the term primarily occurs when the owner sells or permanently vacates the house, or, in a declining number of cases, on a fixed repayment date. Until that time, there are no payments due to the lending institution. Given the desire of many elderly individuals to remain in their homes as long as possible, payment deferral is of paramount importance to the elderly borrower, and can be the most appealing feature of a reverse mortgage.

3. Non-Recourse Nature of the Reverse Mortgage

Because no set date exists when complete repayment of the debt must occur, the debt may grow larger than the value of the residence. Since this is a non-recourse mortgage, the lending institution may not recover the deficiency from the other assets of the

53. See id. at 18.
54. See id. All programs now existing place caps on the amount of recognized equity; however these programs vary concerning the size of the equity cap. See id.
55. See Edelstein, supra note 34, at 3.
56. See Scholen, supra note 7, at 6.
57. See Hammond, supra note 15, at 78 (citing a survey conducted by AARP indicating that 86% of the respondents stated that they wished to live in their homes for the rest of their lives).
58. See Scholen, supra note 7, at 6.
In contrast, however, if the value of the house at sale exceeds the debt payoff, the excess proceeds do not remain with the lending institution. Instead, these revert to the borrower's estate.

4. Tax Implications and Effects on Public Benefits

A common concern of potential borrowers is how the Internal Revenue Service (IRS) categorizes reverse mortgages. Generally, concerns about an increase in federal income tax liability may be put to rest, because the IRS does not consider loan advances to be gross income. In addition, if the purchase of an annuity is part of the reverse mortgage plan, cash advances on that annuity may be partially deductible.

Another area of concern is whether the interest paid on the loan is deductible. IRS Revenue Ruling 80-248 states that interest accrued during the term of a reverse mortgage is not deductible until the expiration of the loan term. Furthermore, there are no capital gains taxes if the home is sold upon the death of the borrower.

In reference to the impact on government benefits, the proceeds gained from a reverse mortgage are not to be defined as income. However, loan proceeds retained by the borrower beyond the month in which they are received may adversely affect Supplemental Security Income (SSI) and Medicaid eligibility. Moreover, a reverse mortgage plan involving annuity advances might be considered unearned income, and therefore might possibly reduce government benefits for the borrower.

III. THE HOME EQUITY CONVERSION MORTGAGE: HECM

59. See id. at 19.
60. See id. at 69–75 (offering a more in-depth discussion about the use of proceeds after the sale).
61. See id.
62. See Edelstein, supra note 34, at 16.
63. See Scholen, supra note 7, at 249.
64. See Edelstein, supra note 34, at 16.
65. See Scholen, supra note 7, at 251.
66. See id. at 252.
67. See id.
68. See Scholen, supra note 7, at 252. For more information concerning the effect of reverse mortgages on SSI programs, see Edelstein, supra note 34, at 18–20.
A. History

The Home Equity Conversion Mortgage Insurance Demonstration was first created by Congress through § 255(k) of the National Housing Act, as amended by § 417 of the Housing and Community Development Act of 1987.\(^69\) The purpose of this new form of reverse mortgage was threefold: (1) to meet the needs of elderly homeowners by governmentally insuring reverse mortgages; (2) to encourage the involvement of lending institutions in making and servicing reverse mortgages; and (3) to help evaluate the need and demand among the elderly for reverse mortgages.\(^70\)

Initially, only 2500 reverse mortgages insured by the FHA were authorized to be issued by the U.S. Department of Housing and Urban Development (HUD) through approved lending institutions. The institutions were chosen via lottery from different regions around the country.\(^71\) Several amendments since then will cause the number of HECM reverse mortgages to exceed 50,000 projected by the year 2000.\(^72\) Recently, HUD Secretary Henry Cisneros asked Congress to revoke this cap and extend the program indefinitely to more than twelve million Americans over the age of sixty-two who have fully paid off their home mortgages.\(^73\)

B. Eligibility

Generally before acceptance, an application for a HECM mortgage must meet four requirements. First, the homeowner, or the youngest of the owners of the home, must be at least sixty-two when

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70. See id.
71. See Edelstein, supra note 34, at 5.
72. The program was initially set to expire in 1991 but Congress extended it in 1990 to make FHA insurance available for 25,000 loans through all 10,000 FHA approved lending institutions. See Pub. L. No. 101-508 § 2106 (a) (substituting September 30, 1995 in place of September 30, 1991); Pub. L. No. 101-508, § 2106(b) (substituting “may not exceed 2,500” for “may not exceed 25,000”). Afterwards, Pub. L. No. 104-99, § 406 substituted “1996” for “1995” and “30,000” for “25,000”. See id. Finally, Pub. L. No. 104-120, § 6(a) extended expiration of authority under this section from September 30, 1996 to September 30, 2000. See id. In addition, Pub. L. No. 104-120, § 6(b) increased the maximum number of mortgages which may be insured under this section from 30,000 to 50,000. See id.
submitting the application for FHA insurance. Second, the property must be a dwelling designed as a family home. Mobile homes, duplexes, triplexes, and cooperative units are not eligible under this criteria. A condominium unit designed for single family occupancy is considered an eligible property. If the dwelling unit is in a condominium, the condominium project must have been committed to condominium ownership plan by deed, or another recorded instrument acceptable to HUD. Third, any outstanding liens or mortgages on the home must be small enough to be paid with the initial HECM advance. Fourth, the home must meet HUD's minimum property standards. However, repairs needed to bring the home up to this standard may be financed from mortgage proceeds before or after the closing, in accordance with the reverse mortgage rules. Given these eligibility requirements, interestingly, the typical HECM borrower has the following profile:

- Female Living Alone: 59.5%
- Median Age: seventy-six
- Median Property Value: $102,000
- Median Income: less than $10,368 per year

In general, qualified HECM borrowers have lower incomes and higher home values than the general population of elderly homeowners. In cases where the potential borrower is deemed legally incompetent, the borrower may still be eligible for an HECM, if a valid durable power of attorney exists which can be used for the closing documents. Moreover, property held in trust is also eligi
ble for an HECM, if the trust and the borrowers meet specified requirements.85

C. Calculation of Funds Available

Under the HECM program, the maximum amount available to the borrower at the time of closing is called the net principal limit.86 To calculate the net principal limit, the following information is needed:87 (1) the amount of equity in the home (fair market value less mortgages/liens); (2) HUD's maximum single family mortgage insurance limit for the applicable geographic area;88 (3) the age of the youngest borrower(s); (4) the current interest rate. Although the calculation of payment amounts can be quickly determined using software provided by the FHA,89 the calculation itself can easily be broken down into a three-step process. Appendix A provides the details of this process.

D. Types of Advances Available

Although the net principal amount is immediately available to the borrower at closing, an HECM borrower may choose to take cash advances over a period of time. Three basic methods or plans of cash advancements exists: (1) a line-of-credit payment plan; (2) a term payment plan; and (3) a tenure payment plan.90 The borrower may also chose to combine the term or tenure payment plans with a line of credit payment plan for an increase in the flexibility of payments.91 These combinations of hybrid plans are called: "modified term payment plans," and "modified tenure payment plans."92 Fur-
thermore, a borrower has the option of beginning with one payment plan and later changing to another for a nominal fee.93

The line-of-credit plan is one of the most popular payment plans chosen. Here, the borrower receives a line of credit from the lending institution with the right to withdraw amounts of the borrower's choosing, so long as these amounts do not exceed the principal limit for the given month.94 Note, however, that the principal limit will increase each month by one-twelfth of the expected average mortgage interest rate, plus the monthly mortgage interest payment.95 Alternatively, all of the funds in a line of credit may be withdrawn at once.96 This is often described as “the lump sum” option.97 These features render this plan the most popular form. This is evidenced by the fact that as of mid-July, 1994, over 56% of borrowers under the HECM reverse mortgage had chosen the line of credit plan.98

The second most popular plan, the term payment plan, provides for equal monthly payments at a fixed rate and for a given number of months according to the borrower's predetermination.99 This payment plan offers the borrower greater cash flow because the date for payoff is certain and secure.100 If the reverse mortgage were prepaid in full, or became due and payable earlier for other reasons, the borrower would still be allowed to remain in his home.101 As of mid-July, 1994, about 11.1% of all HECM borrowers had chosen the term payment plan.102

The third plan, the monthly tenure payment plan, also known as the modified tenure plan, provides the borrower with equal monthly payments as long as the property is the primary residence, or unless the mortgage is prepaid in full or becomes payable for other reasons.103 As of mid-July, 1994, 8.2% of all HECM borrowers chose this plan.104
The two combination plans possess certain advantages. The modified tenure payment plan enables a borrower to divide her cash advancements between an amount used for cash advances and another amount kept in reserve as a credit line. As of mid-July 1994, 7.9% of HECM borrowers chose this option. In a modified term payment plan, a borrower might request monthly payments for a fixed term of months using a portion of the net principal limit received at closing, with the balance reserved for a credit line to meet future needs. As of mid-July, 1994, about 16.2% of HECM borrowers chose this option.

A reverse mortgage borrower's power to restructure the payment plan on request is limited. Only 14% of HECM borrowers made changes in their payment plan options through July of 1994. It may be too early in the HECM Demonstration to evaluate the long-term utilization of this option.

E. Components of Loan Costs

Four basic charges are associated with a HECM reverse mortgage in addition to basic interest: origination fees, mortgage insurance premiums, basic closing costs, and monthly service charges. An origination fee is charged to cover the lending institutions initial costs in preparing and processing the loan application. No stated limits exist on the amount charged as an origination fee; however, a limit exists on how much the fee can be financed. Currently, that limit is $1800.

A mortgage insurance premium (MIP) consists of two parts: (1) a one-time charge at closing consisting of 2% of the maximum claim amount and (2) an annual premium charge of 1½% per

105. See HUD Handbook, supra note 80, at 1-3.
107. See id.
110. See id. at 2-23.
111. See Scholen, supra note 7, at 108–13. Closing costs are estimated at $1000 to $1800, although in some states they may be over $3000. See id. at 109.
113. See Scholen, supra note 7, at 108.
year. The annual premium accrued is paid in monthly installments. The one-time premium charge can either be paid by the borrower in full at the closing, or it can be added to the principal limit.116

Basic closing costs will usually vary from one location to another, but primarily include the expenses for property appraisal, recording fees, title insurance, and a credit report.117 The lending institution may require the borrower to pay some of these costs before the closing.118

Finally, a monthly service charge exists not exceeding thirty dollars in the case of an annually adjusted interest rate.119 At closing, a sum that is sufficient to cover the total sum of monthly service charges over the life of the loan is “set aside” and deducted from the principle limit. Interest will be charged only as the monthly amounts are due.120

F. Counseling Requirements with the HECM

The HECM Demonstration requires homeowners to receive counseling from HUD-approved agencies prior to their commitment to the HECM program.121 The counseling, performed by either non-profit or public agencies,122 usually involves a single session of one to three hours and is very client-specific. The session must cover what the statute mandates: borrowers must be informed about other housing and social services, and financial resources which may be available; other home equity conversion models besides HECM; financial implications associated with the HECM; potential impacts of a reverse mortgage on their tax status; eligibility for public benefits; and their estate as a whole.123

To prove that the potential borrower has completed the required

115. See id. § 206.105(a)–(b); see also §§ 206.25(a), 206.111.
116. See id. § 206.31(a)(1).
118. See id. § 206.31(a) (1996).
119. See HUD HANDBOOK, supra note 80, at 1–7.
120. See Evaluation, supra note 14, at 6-5 to -6.
121. See 12 U.S.C. § 1715z-20(f) (1994); see also 24 C.F.R. § 206.41. The HUD requirements are set forth in HUD HANDBOOK NO. 7610.1 REV-2. See generally HUD HANDBOOK, supra note 80, at ch. 2.
122. See Edelstein, supra note 34, at 14.
counseling program, the counseling agency must issue to the potential borrower a certificate of completion of the required session(s).\textsuperscript{124} For individuals who are legally incapacitated, the counseling sessions may be held with a person holding a power of attorney, with a court-appointed conservator, or with a guardian representing the incapacitated borrower.\textsuperscript{125} The AARP is the only group with a Department of Housing and Urban Development (HUD) contract for providing training to HECM counsellors. As of August 1994, AARP offered over sixty-four training sessions to approximately 3000 people.\textsuperscript{126}

G. Truth in Lending Act (TILA) Disclosure Requirements

Because HECM borrowers may switch to a credit line at any-time during the duration of the reverse mortgage, and may also prepay the outstanding balance in whole or in part and refinance, the Federal Reserve Board (FRB) has determined that HUD's HECM reverse mortgage is open-ended credit falling within the bounds of the Truth in Lending Act (TILA)\textsuperscript{127} and its implementing regulation, Regulation Z.\textsuperscript{128} The Home Ownership and Equity Protection Act of 1994 (HOEPA) amended TILA in September 1994; this standard applies to all reverse mortgage transactions consummated after October 1, 1995.\textsuperscript{129}

The disclosure requirement mandated by these statutes applies to all reverse mortgages, not just the HECM.\textsuperscript{130} The disclosed information must be furnished at least three business days prior to the consummation of the reverse mortgage.\textsuperscript{131} Furthermore, the “total annual loan cost” must be calculated by a formula found in Appendix K of TILA,\textsuperscript{132} which includes all of the mortgage costs. The for

\textsuperscript{124} See HUD HANDBOOK, supra note 80, app. at 16.
\textsuperscript{125} See id. at 2-2. No master list of counseling agencies exists, but one can be found in any given area by calling the local HUD office. Counselors are guided by the HUD HANDBOOK NO. 7610.1 REV-2 and the HUD HANDBOOK NO. 4235.1 REV-1.
\textsuperscript{126} See EVALUATION, supra note 14, at 4-5.
\textsuperscript{130} See id. app. at K.
\textsuperscript{132} See 12 C.F.R. § 226.33(b) (1996). The result is the annual average interest rate that would generate the total amount owed at any point during the loan, if the rate had
mula is complicated, however, the calculation can be easily done by using the software available from the FHA. The results can vary enormously depending on the time when the loan comes due and the way the cash advances were taken.

Finally, to give the potential borrower a better perspective on the loan, total loan cost may be calculated for three different loan periods: (1) a two-year loan period; (2) life expectancy in years; and (3) life expectancy in years multiplied by 1.4 and rounded to the nearest full year. This helps the borrower understand the impact of time on costs. Reverse mortgages are generally more costly in the short-term, less costly over a given period of time, and least costly when the borrower lives longer than the average elderly person and when his or her home appreciates at either a low or moderate rate.

H. The Pay-Off Date

For the HECM, the homeowner's obligation to pay off the loan is deferred until one of the following occurs: (1) the borrower dies and the property is not the primary residence of at least one surviving borrower; (2) the borrower conveys all of his or her title in the property and no other mortgagor retains a fee simple or leasehold title to the property as set forth in 24 C.F.R. § 206.45(a); (3) the borrower fails to occupy the property because of physical or mental illness, and the property is not the principle place of residence of the other borrower; or (4) the borrower fails to perform an obligation under...
the mortgage, for example (maintain hazard insurance coverage, pay taxes, or maintain the residence in good condition as set forth in 24 C.F.R. § 226.27(2), (3), (5), (6). When the house does finally sell, any excess remaining after satisfaction of the debt is the property of the departing homeowner or the homeowner's probated estate.

I. Skepticism: Too Good to be True?

The skepticism most borrowers and professionals express about reverse mortgages is that borrowers who outlive the value of their deflating homes will receive more money than can be recovered on sale at the time of their death. The skeptics question why any lending institution would finance a reverse mortgage, defer payment until some uncertain future date, and most importantly, take the risk of losing money if the proceeds from the sale of the home are less than the debt owed.

Potential borrowers must understand that the amount loaned, including projected interest earned, is calculated actuarially so that the debt will not, on the average, exceed the value of the home. This means that the borrower can borrow only a percentage of the home's equity, a percentage based on the borrower's age and the interest rate assumed. This percentage may be found in a table commonly referred to as the FHA Principal Limit Factor. The principle limit factor can also be calculated with the FHA software. These limitations are a cap on the amount paid to borrowers based on various risk factors. They reduce the risk of loan losses to the lending institutions.

Lending institutions may also protect themselves through an assignment option created from the FHA insuring process. Under an assignment option, lending institutions obtain FHA mortgage insurance for recovery of any money advanced, up-front charges, and the interest earned. Furthermore, any time the loan balance becomes

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138. See Scholen, supra note 7, at 71.
139. See id. at 20. One way to address this is to explain how the FHA-insured HECM protects the lender through a mortgage insurance premium that the borrower pays. See infra notes 142–50 and accompanying text for a more in-depth discussion of how the FHA-insured HECM protects the lender.
140. See Evaluation, supra note 14, at ES-3.
141. See Scholen, supra note 7, at 20.
greater than or equal to 98% of the maximum claim amount (appraised value or 203(B) limit, whichever is less), the lending institution can assign the mortgage to HUD. HUD will in turn pay the lender institution its amount due, and continue to pay the borrower (on a monthly payment plan or from any unused credit line) until the borrower dies or sells the home.

A further protection to the lending institution is connected to the cost of the FHA insurance. The borrower pays for the FHA insurance through a mortgage insurance premium (MIP). The MIP fees are charged against the borrower at the closing and an annual premium charge is also calculated into the reverse mortgage. At the inception of the insurance program, an immediate charge of 2% of the maximum claim amount is credited to HUD. There is also a monthly premium of one-twelfth of the annual rate of ½% of the outstanding principal balance accruing on the outstanding balance. Since both parts of the MIP can be financed, HUD collects these sums when the home is sold. An added benefit from the FHA insurance option is that it protects the borrower in case the lending institution defaults on the reverse mortgage.

The HECM Demonstration reverse mortgage was not designed to be a subsidy program, but rather a program that breaks even financially. Since its inception, HUD has not lost money for two reasons: (1) HUD receives the 2% mortgage insurance premium and the annual ½% premium; and (2) the majority of borrowers’ homes are worth more than the 203(b) maximum. In fact, as of June 30, 1994, calculations showed that the present value of mortgage insurance premiums (collected and due in the future) exceeded, by six million dollars, (or about eight hundred dollars per loan) the present value of the ultimate insurance claim losses. HUD estimates that if none of the insured cases applied to properties whose value exceeded the 203(b) limit, the net worth of the HECM book value would fall to fifty dollars per loan — essentially the break-even

144. See id.
145. The HUD HANDBOOK outlines procedures for the borrower to follow if the lender defaults. See HUD HANDBOOK, supra note 80, app. at 14.
146. See EVALUATION, supra note 14, at 6-2.
147. See id. at ES-3.
J. Potential Abuses

A recognizable potential downside exists within the HECM Demonstration reverse mortgage. Because the average elderly borrower is vulnerable and these mortgages are complex, abuses may occur. Overly aggressive lenders, self-interested children of the elderly, and those who do business with the elderly may have an incentive to inappropriately push the elderly into financing a reverse mortgage.149

A recent example is a class action filed in California against Providian Corporation (formerly “Capital Holding Corporation”) and one of its subsidiaries for misrepresenting the costs and fees of its reverse mortgage plans.150 The plaintiffs claim that the defendants did not inform them of the plan’s potential negative implications upon the plaintiffs’ Medi-Cal eligibility.151 In a few cases, these misrepresentations left borrowers without a home.152

Although the implementation of any plan will never be problem-free, an elder law attorney, well-trained in reverse mortgages, could have explained all of the potential consequences. To stop potential abuses from becoming common-place situations, the legal and financial communities must work together.

IV. THE POTENTIAL FOR THE REVERSE MORTGAGE TO HELP MEET FLORIDA’S LONG-TERM CARE NEEDS

A. Recommendations of the Commission of Long-Term Care

After a year of intensive evaluation of Florida’s long-term care system, the members of the Long-Term Care Commission recommended that the state redesign its long-term care service delivery system to adequately deal with the growing elderly population.153
Two major steps toward this goal included the integration of acute and long-term care, and the adoption of a managed-care approach to the delivery of this service. The committee also made the following specific recommendations:

(1) Florida should plan for long-term care in a unified, cooperative process to ensure that the state's long-term care dollars are spent in the most appropriate and cost effective way incorporating institutional, residential, and community services.

(2) The long-term care system should provide service to people in the least restrictive environment, encouraging aging in place with appropriate incentives, and reimbursement to providers of care, to ensure quality of life, dignity, personal rights and protection from physical, emotional, and financial exploitation.

(3) The long-term care system should encourage self-determination, ensuring that people make informed decisions about their care, and should provide a variety of choices of quality care.

(4) The long-term care system should insure that people are allowed to make choices that reflect personal needs and wishes and should provide services in a safe and healthy environment.

(5) The long-term care system should encourage support of the family and informal caregivers, including volunteers, to enable them to continue providing care.

(6) The long-term care system should build upon existing local informal and formal support systems; be financed through public/private partnerships; maximize the use of private resources including private insurance; and be structured to reduce administrative and regulatory burdens.

The reverse mortgage can play an important role in helping to meet some of the above-mentioned needs, because it allows elderly individuals the personal freedom and opportunity to stay in her home through financial self-determination. The individual is not prematurely placed into a nursing home due to financial insolvency. The potential strains upon the state's coffers are passed onto the
private sector by offering a viable way of turning home equity into liquid cash.

Financing of long-term care by the purchase of insurance is another positive feature. Unfortunately, private long-term care insurance has evolved at a snail-like pace.\textsuperscript{161} Very high premium costs place these policies beyond the financial grasp of the majority of older Americans.\textsuperscript{162} Through the application of reverse mortgages, individuals who are healthy enough to qualify for long-term insurance, and who have the financial means or sufficient monthly income to meet their daily living expenses, may now have the ability to afford the premium payments of insurance plans. If a reverse mortgage borrower were to choose the credit line of payment, that plan could suffice for many years to cover the cost of the long-term care insurance premiums.\textsuperscript{163}

A major advantage of this model for financing long-term care insurance is that it is based on personal determination and control, which has been shown to contribute positively to an individual's long-term physical and emotional well-being.\textsuperscript{164} Moreover, the fact that the elderly individual makes use of mortgage-generated tax-free dollars to purchase the insurance mitigates the personal cost.\textsuperscript{165} The ability of a reverse mortgage to help finance long-term care insurance is consistent with the Long-Term Care Commission's recommendation of privatizing some of the cost of elderly care to allevi-
B. Proposals for State Action Supporting Reverse Mortgage Utilization

1. Development of a Sound Legal Basis

Generally, the charter-granting agency must give lending institutions specific authority to make non-amortized loans secured by residential real estate. However, in 1982, Congress authorized state-chartered lenders to make alternative real estate loans despite state law prohibitions. This was accomplished without preemption through the flexibility of the note, tailored to state requirements. Naturally, the validity and enforceability of the mortgage and the promissory note turn upon their compliance with state law. Obviously, removing any existing barriers will increase the confidence level of potential borrowers, and equally important, that of the lending institutions. Since reverse mortgages were not envisioned when state mortgage precedents evolved, conflicts should be expected. These conflicts are most commonly lien priorities, recordation taxes, maximum terms, restrictions on variable rates, and usury. Only one state in the country explicitly prohibits reverse mortgages.

One way to ensure that these mortgages are legally grounded is for states to adopt the model statute developed by a national panel convened by the AARP. This model statute provides a clear statutory mechanism within which most of the problematic issues concerning reverse mortgages are addressed. Its adoption by state legislatures would provide security for both lenders and borrowers.

169. See HUD Handbook, supra note 80, at 6-3.
171. See Edelstein, supra note 34, at 20.
172. See id.; see also Hammond, supra note 15, at 92–106.
173. See Edelstein, supra note 34, at 20. Texas specifically outlaws reverse mortgages in its constitution. See id.
175. See Edelstein, supra note 34, at 21.
2. Development of an Intensive Consumer Education Program

The most important goal recommended by the Long-Term Care Commission directed Florida to take an active role in educating its citizens in understanding reverse mortgages and assessing their value to their individual situations. Organizing and funding programs through existing organizations that provide educational programs may be one of the most prudent ways of accomplishing this goal. The AARP and the National Center for Home Equity Conversion have already developed the materials for training counselors, and could be a source of assistance in implementing an intensive state-wide system.176 This program could also include education about long-term care insurance.177

V. CONCLUSION

The reverse mortgage represents a recently developed, effective mechanism to meet the needs of the elderly. As our country is faced with a growing elderly population, the nation needs to find a mechanism that helps shift the burden of long-term elder care from the public to the private sector. Although the types of reverse mortgages are increasing, the underlying design principles of converting home equity into cash, allowing the borrower to remain in his home, and deferring final payback until the sale of the home, remain the same. As a source of much needed liquidity while retaining the home, the reverse mortgage represents a major opportunity for improving the quality of life for the elderly while easing the public burden of long-term care costs. Furthermore, restructuring Florida's long-term care system to include reverse mortgages could be very beneficial.

177. Florida’s Long-Term Care Commission has already recommended that the state investigate the manner in which the state promotes public education regarding the need for cost and pertinent features of long-term care insurance. See Future, supra note 153, at 40.
APPENDIX A

Calculation of Funds Available

As previously stated in the text, in order to calculate the net principle limit, the following information is needed: (1) the amount of equity in the home (fair market value less mortgages and liens); (2) HUD's maximum single-family mortgage insurance limit for the applicable geographic area; (3) the age of the youngest borrower(s); (4) the current interest rate.

The first step is to use factors one and two as alternatives to determine the maximum equity amount for the reverse mortgage. The amount of equity available for the reverse mortgage is the lesser of either the appraised value of the property or HUD's maximum single-family mortgage insurance limit, which varies from county to county and is updated several times a year in the Federal Register. This is sometimes referred to as the adjusted property value. The medium appraised property value for all HECM borrowers, as of June 1994, was $102,000.

The second step is to determine the principal factor. The principle factor can be determined based on the age of the youngest borrower and the expected interest rate, either by using a table or the software referred to above. The principle limit increases each month by one-twelfth of the sum of the expected rate, and the annual mortgage insurance premium (MIP) rate of 5%. Next, the principal limit for the youngest borrower is determined at the time of application by finding the product of the principal limit factor and the adjusted property value.

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178. See Edelstein, supra note 34, at 10.
180. See id. at 2-13.
181. See HUD Handbook, supra note 80, app. at 20, 5-1. The handbook states that the software is available free of charge from local HUD offices, or from HUD itself at (301) 921-7171. See id.
182. See id. at 5-2. What makes this reasonable is that the borrower is growing older and the projected interest accrual is decreasing, so that the amount available is increasing. See id.
183. See id. at 5-3.
In the final step, the net principal limit is calculated by subtracting any initial disbursements to the borrower, costs which can be financed, and set-asides from the principal limit.\textsuperscript{184} One possible set-aside may be for repairs to the home, calculated to equal 150\% of the cost of repairs necessary to bring the home up to FHA standards.\textsuperscript{185} After completion of repairs, unused amounts become available to the borrower. Another set-aside added to this calculation is the amount calculated to cover future loan servicing fees over the life of the reverse mortgage loan.\textsuperscript{186} This three-step process is quickly and easily calculated by using software provided by the F.H.A.

\textsuperscript{184} See id.
\textsuperscript{185} See HUD Handbook, supra note 80, at 3-7.
\textsuperscript{186} See id. at 5-5 through 5-7; see also 24 C.F.R. § 206.201 (1996). To date, lenders perform most of the HECM servicing activity. See Evaluation, supra note 14, at 3-11.
APPENDIX B

OTHER TYPES OF REVERSE MORTGAGES

A. Fannie Mae: Homekeeper Mortgage

Fannie Mae's new "HomeKeeper Mortgage" is expected to be attractive to many lenders. This long-awaited reverse mortgage was unveiled Nov. 9, 1995. This plan provides greater cash advances than the HECM plan for homes with average or above-average values.

Fannie Mae does not make mortgage loans directly, but rather purchases loans from some 2000 mortgage lenders around the country. As the largest United States private asset-based corporation, Fannie Mae provides a high level of security because it will continue payments to the borrower if the lender defaults. The minimum age requirement is sixty-two for the youngest borrower. All borrowers must occupy the property as their primary residence and there can be no more than three co-borrowers. The home must be a single-family or one-unit dwelling. Condominiums and cooperatives are not eligible. Multifamily dwellings, such as two to four family buildings, are not eligible. The borrower must attend a consumer education session, but the session can be conducted either by a non-profit or public agency, or by the lender if no third-party agency is available.

188. See Scholen, supra note 7, at 167.
189. Customer Educ. Group, Fannie Mae, Money From Home: A Consumer's Guide to Reverse Mortgage Options 4 (1996) [hereinafter Money]. This free 106 page booklet is available from Fannie Mae, Customer Education Group, 3900 Wisconsin Avenue NW, Washington, DC 20016-2899. Interested borrowers are advised to contact Fannie Mae's Office of Public Information at 1-800-732-6643. This booklet includes a discussion of the HECM and a comparison of the two products, worksheets useful to help clients evaluate the suitability of these products for their situations.
190. See Money, supra note 189, at 4.
191. See id.
192. See id. at 5.
193. See id.
194. See id.
The amount available for borrowing is termed the “principal limit” and is calculated using the following four factors: (1) the age and number of borrowers, (2) the value of the property, (3) the adjusted property value, and (4) the optional Equity Share feature. The uniform nationwide limit on the home’s value is $207,000. The Equity Share feature allows the borrower to receive higher cash payments throughout the life of the loan in exchange for payment of a fee equal to 10% of the property value at the time the loan is due and payable.

Three payment plans are offered: monthly tenure, line-of-credit and a combination of the two, known as a modified tenure plan. The basic charges on this mortgage include interest and four types of fees: (1) a one-time origination fee, (2) points charged at origination, (3) other closing costs, and (4) monthly servicing fees.

B. Household Senior Services — “Ever Yours”

The Ever Yours mortgage is available to applicants sixty-two or older. No repayment will occur until the borrower sells or transfers his interest in the home, or dies, so long as property taxes, home condition, and insurance are maintained, and no new liens are incurred which threaten the lender’s security interest. This reverse

195. See Money, supra note 191, at 5. Sample calculations provide the following: a 75-year-old homeowner with a home value of $200,000 would be eligible to borrow $73,201, while a 95-year-old homeowner could borrow $120,573. A couple, both aged 75-years-old, could borrow $40,141; if both were aged 95, they could borrow $119,452. See id. at 6.

196. See id. at 190. Fannie Mae does not currently purchase loans on single-family loans within the continental United States.

197. See id. at 6–7. The total amount due is still capped at an amount equal to the value of the property. See id. at 7. Also, note that the calculation is slightly different in cases where the borrower’s property value was higher than the maximum loan amount at the time of origination.

198. See Money, supra note 191, at 10.

199. See id. at 15. The interest rate is based on the most current weekly average of the one-month secondary market CD index as published in the Federal Reserve’s H-15 Bulletin. The interest rate can change monthly but cannot increase by more than 12% over the life of the loan. See id.

200. See id. Examples of typical average closing costs of three regional lenders vary from $12,580 to $1887. See id. at 16.

201. See id. at 17. This flat fee covers the monthly costs of processing payments and record-keeping. The lender determines these fees which can be no greater than $30 per month and no less than $15 per month.

202. See Scholen, supra note 7, at 122.
mortgage can provide a lump sum, a credit line, or both.\textsuperscript{203} The borrower receives a checkbook which, as each check is used, causes a subtraction from the available credit line and an addition to the loan balance.\textsuperscript{204} The maximum amount available to the borrower cannot exceed $250,000.\textsuperscript{205} The plan applies a variable interest rate on the loan balance. The rate equals the “prime rate” plus 3\%, changeable monthly.\textsuperscript{206} Over the life of the loan, the minimum rate is 8% and the maximum rate is 21\%, or a rate dictated by law.\textsuperscript{207} There is no risk-pooling fee, no servicing fee, nor any cost based on appreciation.\textsuperscript{208} Upfront costs include an origination fee of 2\% of the home's value (maximum of $5000), appraisal, title search, title insurance, required inspections, and possible recording fees or mortgage taxes.\textsuperscript{209}

C. Transamerica HomeFirst — “House Money”

This product is available to borrowers no younger than sixty-five. The maximum loan origination home value is $750,000.\textsuperscript{210} The minimum home equity must be $75,000. There is a lifetime plan (HouseMoney Lifetime plan) with regular monthly payments, a cash account creditline (HouseMoney Cash Account), and even a term plan (HouseMoney Term plan) for homeowners ninety years or older. One interest rate quoted in one of Transamerica’s HomeFirst's consumer brochures floats at 5\% above the one-year Treasury rate.\textsuperscript{211}

D. Private Reverse Mortgages

\textsuperscript{203} See Scholen, supra note 7, at 122.  
\textsuperscript{204} See id. at 123.  
\textsuperscript{205} See id.  
\textsuperscript{206} See id. at 128.  
\textsuperscript{207} See id.  
\textsuperscript{208} See Scholen, supra note 7, at 129.  
\textsuperscript{209} See id. at 128. Advertising material lists a toll-free number 1-800-414-EVER for further information.  
\textsuperscript{210} See id. at 139.  
\textsuperscript{211} The toll-free number for this product is 1-800-538-5569. A free video is also available. A new free handbook for professionals has just been published and is available by faxing the Marketing Communications Department at 415-983-7905 or by writing: Professional Handbook, Transamerica HomeFirst, 505 Sansome St., 11th Floor, San Francisco, CA 94111
A private reverse mortgage can be created from resources entirely within the family. The adult children can place a mortgage on the elderly patient's home to secure cash disbursements made on some agreed-upon schedule. When the parent(s) enter a nursing home or pass away, the home can be sold and the mortgage repaid.

In this situation, the parents would receive the income tax-free because it would be a loan secured by the home.212 Second, the adult children would be earning tax-deferred income with no taxes due until the parents died and the home was sold.213 Third, the parents' estate would receive a tax deduction on the interest paid at the time the house was sold and the loan repaid.214 Last, the parents may feel an additional sense of security because of a reduced risk of foreclosure.

212. See Edelstein, supra note 34, at 16.
213. See id.
214. See id.