

## **What's a Reverse Mortgage?**

A reverse mortgage is a loan for older homeowners (usually 62+) that allows them to borrow against their home equity, receiving money as a lump sum, monthly payments, or a line of credit, with no payments due as long as they live in the home and meet loan terms.

### **Potential pros and cons**

#### **Pros:**

- Eliminates monthly mortgage payments.
- Provides tax-free cash.
- Allows you to stay in your home.
- Includes non-recourse protection, meaning you won't owe more than your home is worth.

#### **Cons:**

- Can involve high fees and costs.
- Reduces home equity over time.
- Requires you to continue paying property taxes, insurance, and maintenance.
- May impact eligibility for government benefits.

### **Here are the top 10 common uses for HECM proceeds:**

1. **Supplementing Retirement Income:** Many retirees use HECM proceeds to boost their monthly income, helping to cover living expenses.
2. **Paying Off Existing Mortgages:** HECM funds can be used to pay off a traditional mortgage, eliminating monthly payments and reducing financial stress.
3. **Home Renovations:** Some homeowners use the funds for home improvements or modifications, enhancing their living space or increasing property value.
4. **Healthcare Expenses:** HECM proceeds can help cover healthcare costs, including long-term care, medical bills, or insurance premiums.
5. **Debt Consolidation:** Retirees may use the funds to consolidate debts, reducing interest rates and simplifying payments.
6. **Travel and Leisure:** Many Baby Boomers choose to use HECM proceeds to fund travel and leisure activities, enjoying their retirement years.
7. **Supporting Family Members:** Some retirees provide financial assistance to adult children or grandchildren for education, home purchases, or emergencies.

8. **Emergency Expenses:** HECM funds can serve as a financial safety net for unexpected expenses, such as car repairs or home maintenance.

9. **Investing:** Some homeowners may use the proceeds to invest in financial products or opportunities, aiming for potential returns.

10. **Establishing a Line of Credit:** Retirees might set up a line of credit with HECM proceeds, providing a flexible funding source for future needs.

### **How a reverse mortgage line of credit works:**

A line of credit attached to a home equity conversion mortgage (HECM) has some unique features that distinguish it from the more widely understood home equity line of credit (HELOC). Both allow homeowners to tap equity, but they aren't identical. Using a HELOC as a jumping-off point, let's look at the unique advantages of a reverse mortgage line of credit with a HECM can offer.

### **HELOC vs. HECM line of credit**

A home equity line of credit is a short-term loan with a fixed draw period, usually 5-10 years. Homeowners approved for a HELOC can access the funds at any time, in the same way they might use a credit card. Available funds decrease as credit use increases. Also, like a credit card, the lender who extends the HELOC can cancel or revoke it for various reasons. A line of credit in a home equity conversion mortgage ([HECM](#)), works a bit differently.

### **How a line of credit works with a HECM**

A line of credit option is not available with all reverse mortgages, but it is an option for all HECMs. Like a HELOC the HECM LOC allows borrowers to pull funds from a reserve of equity. Also, similar to HELOC borrowers, reverse mortgage borrowers are not required to use their line of credit and interest only accrues on funds they withdraw.

### **How a HECM line of credit differs from a HELOC**

There are several important features that distinguish HECM LOCs from regular HELOCs.

Because the U.S. Department of Housing and Urban Development (HUD) guarantees HECMs, lenders cannot freeze a HECM line of credit if the home drops in value. This feature may not be available with proprietary reverse mortgages.

The payout flexibility that HECMs offer borrowers also extends to the line of credit. HECM borrowers may elect to take equity out as cash or keep it in reserve as a line of credit. They may also choose a combination of the two. The amount available through the line of credit depends on the amount of available equity and how much the borrower chooses to take as cash payments.

For instance, take a HECM borrower eligible to take \$100,000 (after fees) of equity out of their home. Say this borrower elects to take a payout of \$50,000 cash and reserve \$50,000 as a line of credit. That borrower will have access to an available line of credit of \$50,000 on day one of the loan.

## **A HECM line of credit grows over time**

A unique feature of a HECM line of credit is that it grows over time. This growth occurs at the same rate as the interest plus the annual mortgage insurance premium (MIP) charged to the loan (0.50% of the principal). Even if the borrower's home depreciates, the mortgage line of credit will continue to grow at the same rate.

Using the example above, on day one of the loan, that borrower will have a \$50,000 line of credit. However, that available \$50,000 will immediately increase at the interest rate applied to the principal plus the ongoing mortgage insurance premium rate. The borrower will start the next month with an increased loan balance and a higher line of credit.

## **What is the mortgage insurance premium (MIP)?**

Homeowners with federally insured HECM loans pay mortgage insurance premiums or MIPs that allow the Federal Housing Authority to insure these loans. HECM borrowers pay an upfront MIP of 2% of the home value, and an annual MIP which is 0.50% of the loan amount. This fee is added to the balance of the loan.

## **Are borrowers required to get a line of credit?**

There is no requirement that HECM borrowers choose the line of credit option. However, with a unique growth structure and the fact that they cannot be canceled due to a decrease in home value, these lines of credit can offer a safety net that borrowers may or may not ever need to access. They also allow older homeowners to leverage home equity while protecting other investment sources.

## **What about lines of credit in proprietary reverse mortgage**

While still subject to regulations, proprietary reverse mortgages can be structured differently than HECMs. As long as they meet the regulatory guidelines, loan structure and terms for proprietary reverse mortgages are up to the lender providing them. Which means, the line of credit option will be dependent on the terms of the individual loan.

If you have a question about a particular loan, be sure to ask the loan officer representing it. And, as always, when embarking on a major financial decision, be sure to enlist the guidance of a qualified financial advisor.

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