`

STATE BAR OF WISCONSIN PINNACLE
Your Practice. Our Purpose.

AMC 2025

Session 6

Demystifying Reverse Mortgages

Presented by:

Mark T. Johnson, Johnson Teigen, LLC, Fitchburg
Noe J. Rincon, Krekeler Law S.C., Madison

About the Presenters

Mark T. Johnson is a partner with Johnson Teigen, LLC in Fitchburg, Wisconsin, where he practices in the areas of estate planning, estate and trust administration, elder law, special needs planning, and real estate. Mr. Johnson is a Certified Elder Law Attorney (CELA), as designated by the National Elder Law Foundation and recognized by the American Bar Association for specialty certification. He graduated with honors from the University of Wisconsin Law School, and he has a bachelor of music degree from St. Olaf College and a master of arts degree from the University of Notre Dame. He is a member of the Special Needs Alliance, the National Academy of Elder Law Attorneys (NAELA), the American Bar Association, the State Bar of Wisconsin (including its Elder Law and Special Needs section and Real Property, Probate and Trust Law section), and the Dane County Bar Association. He serves on the board of directors for NAELA and is a past president of the Wisconsin Chapter. He is a Fellow of the Wisconsin Law Foundation and a member of the Wisconsin Association of Charitable Gift Planners. Mr. Johnson has published articles in the *Wisconsin Law Review*, *Wisconsin Lawyer*, *Elder Law and Special Needs Journal of Wisconsin*, *NAELA News*, *Journal of Legal Nurse Consulting*, and has contributed to various publications of the State Bar of Wisconsin.

Noe J. Rincon, Krekeler Law Office S.C., Madison.

Reverse Mortgages: Legal and Financial Considerations for Older Homeowners

May 2025

In recent years, reverse mortgages have gained increasing attention as a retirement planning tool, especially as America's population continues to age. High-profile endorsements from figures like Henry "Fonzie" Winkler and the late Senator Fred Thompson have brought national attention to this financial option, but with greater awareness comes the need for greater understanding—particularly among legal and financial professionals advising seniors.

According to U.S. Census Bureau projections, the number of Americans aged 62 and older is expected to more than double, reaching over 98 million by 2060. While more people are working into older age, longevity is also increasing, and many seniors are faced with the challenge of making their retirement savings last. Approximately 78% of Americans aged 62 or older own their homes, and nearly all of them live independently, rather than in assisted or group housing. However, 97% of older homeowners spend more than 30% of their monthly income on housing costs, qualifying them as financially burdened under federal guidelines.

Understanding Reverse Mortgages

A reverse mortgage, formally known as a Home Equity Conversion Mortgage (HECM), is a government-insured loan available to homeowners aged 62 and older. Administered by the Federal Housing Administration (FHA), this financial product allows seniors to access a portion of their home equity without selling their home or taking on monthly mortgage payments.

Borrowers continue to hold title and ownership of their homes and may remain in the property so long as they comply with loan conditions, such as maintaining the home, paying property taxes, and maintaining adequate homeowner's insurance. Heirs may inherit any remaining equity after repaying the HECM loan, often by selling the home.

Eligible properties include single-family homes, two-to-four-unit residences (if the borrower occupies one unit), certain condominiums, townhomes, and HUD-approved manufactured homes. Borrowers must meet specific financial eligibility criteria, which include demonstrating the ability to cover ongoing housing costs and maintaining the home.

Key Features and Options

HECM loans come in two primary forms: fixed-rate and adjustable-rate.

- Fixed-rate HECMs generally disburse a one-time lump sum and maintain a consistent interest rate over the life of the loan.
- Adjustable-rate HECMs offer greater flexibility, with the option to receive funds such as:

- Equal monthly payments for life (*tenure*),
- Equal payments for a fixed period (*term*),
- A revolving line of credit,
- A combination of the above.

Borrowers may switch among disbursement options. However, due to federal regulations, borrowers are typically limited to withdrawing no more than 60% of their principal limit during the first 12 months following loan closing, with the potential to access an additional 10% under certain conditions.

There is also an HECM for Purchase option, which allows borrowers to use the proceeds from selling a previous residence to buy a new primary home in one transaction—again, with no required monthly mortgage payments. This feature can be appealing for retirees relocating or downsizing.

Common Misconceptions

Despite growing usage, reverse mortgages remain widely misunderstood. Several myths persist:

- Myth #1: The lender owns the home.
  In reality, the borrower retains ownership and can sell the home at any time. The loan becomes due only when loan conditions are not met (e.g., moving out, failing to pay taxes or insurance).
- Myth #2: The home must be mortgage-free.
  Not so—many borrowers use a reverse mortgage specifically to pay off an existing mortgage, thus eliminating monthly payments.
- Myth #3: Reverse mortgage funds are taxable.
  Proceeds from an HECM are not taxable income, making them a valuable tax-free source of retirement funding.
- Myth #4: Loan proceeds must be used in specific ways.
  On the contrary, funds can be used for anything from medical expenses to home improvements, debt reduction, or supplementing retirement income.
- Myth #5: Only low-income seniors use reverse mortgages.
  Increasingly, wealthier retirees are incorporating reverse mortgages into estate and tax planning as a means of managing longevity and market risk.

Legal Structure and Protections

HECM loans are non-recourse loans, meaning that the borrower—or their estate—can never owe more than the home's market value at the time of repayment. FHA insurance covers any remaining shortfall, provided the home is sold. This protects the borrower's other assets and income from creditor claims (24 C.F.R. § 206.27(b)(8)).

In many cases, reverse mortgages are also compatible with revocable trusts and life estate arrangements, making them a potentially useful tool in comprehensive estate planning.

Who Can Benefit?

HECMs may be beneficial for seniors who:

- Want to eliminate current mortgage payments and free up cash flow
- Require funds for long-term care, in-home care, or home modifications
- Seek to remain in their homes and age in place
- Are "house rich and cash poor"
- Need a hedge against market downturns or sequencing risks in retirement
- Require foreclosure relief or wish to access liquidity without selling

Because there is no minimum income or credit score requirement, and no obligation to repay the loan until maturity events occur, HECMs may offer a financial lifeline to homeowners otherwise unable to qualify for traditional loans.

Eligibility Requirements

To qualify for an HECM, borrowers must:

- Be at least 62 years old (the amount available depends on the age of the youngest borrower or spouse)
- Own the home outright or have a small remaining mortgage balance that can be paid off at closing
- Live in the home as their primary residence
- Stay current on property taxes, insurance, and homeowner's dues
- Demonstrate the ability to maintain the home

- Attend a HUD-approved counseling session, which explains the loan's terms, risks, and options (12 U.S.C. § 1715z-20)

Costs and Considerations

While reverse mortgages can be valuable, they also carry significant upfront costs:

- Origination fees ($2,000 to $6,000)
- Initial mortgage insurance premium (typically 2% of the home's appraised value)
- Appraisal, title, legal, and recording fees

While most of these fees can be paid from loan proceeds, they reduce the net funds available to the borrower.

Other considerations include:

- Rising loan balance: Since no monthly payments are made, interest accrues, increasing the balance over time.
- Reduced inheritance: If the loan balance exceeds the home's value, heirs may receive no equity.
- Potential interference with benefits: While proceeds are not taxable, they may affect means-tested benefits like Medicaid.

The Lawyer's Role

Attorneys advising clients on reverse mortgages should:

- Evaluate client goals and alternatives before loan origination
- Help clients understand and anticipate future risks
- Integrate the loan into estate planning, preparing heirs for the loan's implications
- Review loan documents thoroughly to clarify borrower and non-borrower rights—especially in light of case law like *Bennett v. Donovan*, *Santos v. RMS Inc.*, and *Chandler v. Wells Fargo*

Legal professionals should also be prepared to assist clients with bankruptcy planning, asset protection strategies, and ensuring compliance with HECM conditions.

Bankruptcy Considerations for Borrowers and Heirs

It may seem counterintuitive that borrowers could default on a reverse mortgage, which requires no monthly payments of principal or interest. However, defaults still occur—most often because borrowers fail to meet obligations such as paying property taxes, maintaining homeowner's insurance, or keeping the home in good repair. For seniors living on minimal fixed incomes, these non-loan expenses can become unmanageable.

Bankruptcy, particularly under Chapter 13, can offer a structured path to cure such defaults. Under 11 U.S.C. § 1322(b)(5), borrowers may repay missed property tax or insurance obligations over a period of up to 60 months. In *In re Clark*, 738 F.2d 869 (7th Cir. 1984), the court affirmed that Chapter 13 could be used to reinstate a reverse mortgage in default.

That said, filing bankruptcy does carry risks for reverse mortgage borrowers. Monthly disbursements under a tenure or term plan may be suspended during bankruptcy, as all of the debtor's assets—including any remaining home equity—become property of the bankruptcy estate under 11 U.S.C. § 541(a). This can disrupt access to needed funds during the pendency of the case.

Heirs may also find bankruptcy to be a useful tool. In certain circumstances, heirs can file their own Chapter 13 petitions to preserve the home, even if the reverse mortgage has matured and is in default. They may be allowed to pay only the fair market value of the property to retain it.

Normally, Chapter 13 prohibits modification of a mortgage secured solely by a debtor's principal residence (11 U.S.C. § 1322(b)(2)). This rule blocks attempts to "cram down" the loan balance to the property's current value. However, an exception exists under § 1322(c)(2) when the final payment on the mortgage was due before the end of the Chapter 13 plan. Because reverse mortgages often mature upon the borrower's death, courts have ruled that the debt can, in fact, be modified.

In *In re Sandoval*, 640 B.R. 165 (Bankr. E.D. Wis. 2022), the court allowed the borrower's heir to repay only $45,000 of a $154,000 matured reverse mortgage over the life of a 60-month Chapter 13 plan. The decision turned on the finding that the loan matured upon the borrower's death, qualifying it under the § 1322(c)(2) exception.

Conclusion

Reverse mortgages can be powerful financial tools for older homeowners—but they are not one-size-fits-all. In the right circumstances, they offer a flexible, tax-free source of income, the ability to age in place, and protection against market and longevity risk. However, they also come with complex legal, financial, and personal considerations. Attorneys practicing bankruptcy, estate planning, and elder law should be well-versed in reverse mortgage structure and implications to guide clients toward informed and sustainable decisions.

Demystifying Reverse Mortgages

Elder Law and Estate Planning Perspective

State Bar of Wisconsin Annual Meeting and Conference 2025

June 20, 2025

Attorney Mark T. Johnson
Johnson Teigen, LLC, Attorneys at Law

Summary of Reverse Mortgage Requirements

To qualify, a borrower must:

- Be age 62 or older
- Own the home outright (or with a small mortgage paid off at closing)
- Reside in the home
- Be responsible for expenses of maintenance, property taxes, and homeowner's insurance
- Participate in counseling session and pay fees for loan

A. Avoiding and Addressing Schemes, Scams, and Financial Exploitation

1. Poorly-advised financial products

An unscrupulous advisor may propose purchasing a financial product, such as an annuity, with a reverse mortgage as the source of funds.

2. Scams

A scammer may request funds from an individual, proposing a reverse mortgage as the source of funds. This applies to all types of scams—romance, investment, construction, etc.

3. Financial Exploitation

A bad actor, often known to the individual, may request funds from the individual, proposing a reverse mortgage as the source of funds. Thieves seek to access a victim's wealth, even if it involves liquidating home equity.

4. Interventions

A borrower is well-advised to involve other trusted parties, such as family members, attorneys, or financial advisors in assessing proposed transactions. Sometimes this involves legal documents and transactions too, such as trusts or powers of attorney. Furthermore, quick action may help rescue a wayward transaction if the borrower can exercise their right of rescission (within 3 days) for the reverse mortgage.

B. Estate Planning Issues

A Reverse Mortgage Reduces Equity and May Affect Transfer of Real Estate

a. If transferring home property to beneficiaries is important, the reverse mortgage will need to be paid off at the borrower's death (if not earlier). Therefore, the estate or the beneficiaries will need to have enough cash to pay off the mortgage in order to keep the property.

b. Others who live in the home may be displaced, even if they do not intend to live in the home long term after the borrower leaves the home or dies. If a spouse is a non-borrower, she or he will need to qualify as a "eligible non-borrower spouse" to remain in the home.

c. A reverse mortgage with a large balance due may leave an estate insolvent, with little or no liquidity and with little or no incentive for someone to serve as personal representative to settle the estate.

C. Long-Term Care Considerations and Issues

1. Reverse Mortgage Helps the Owner Stay in Their Home

a. If continuing to reside in the home is feasible, then accessing equity to pay for expenses may be a good idea.

b. A budget will help determine whether the available equity will be sufficient to cover expenses. A multi-year projection is essential, plus including various contingencies, such as higher costs of additional paid in-home assistance.

c. Understand the downsides:
   - origination fees are high
   - the reverse mortgage comes due if the owner moves out
   - the reverse mortgage comes due at the owner's death, affecting the borrower's estate plan

2. Reverse Mortgage and Medicaid

a. Long-term care Medicaid and home property in 4 short points:
   - Assets are classified as either countable or exempt.
   - Home real estate is exempt (up to $750,000 in equity for an unmarried person; unlimited equity for a married person).
   - Funds from a reverse mortgage or HELOC are not counted when the funds are merely available (treated as equity in home), but amounts paid to the borrower are countable assets in the month after the month received (i.e., if accumulated after the month distributed to the borrower). [MEH 16.7.2.1]
   - Medicaid Estate Recovery Program can seek reimbursement for Medicaid benefits paid from home equity or any other assets remaining at the recipient's death (or second to die in spousal cases).

b. Downsides of using a reverse mortgage with contemporaneous or eventual Medicaid benefits

- liquidates an exempt asset
- high expense of establishing the reverse mortgage
- requires owner to live in the home, which may not be feasible long term
- may be a strain for a spouse who is not a borrower (must qualify as "eligible non-borrower spouse")

c. Benefits of using a reverse mortgage in Medicaid situations
   - can provide cash to the "community spouse", i.e., the spouse at home who is not receiving Medicaid benefits
   - can provide cash to cure divestments
   - can provide cash for non-care expenses

3. Other Options for Accessing Home Equity

a. Home equity loan or line of credit
   - home equity can be borrowed for any purpose
   - borrower may not qualify because income may be too low
   - repayment begins right away
   - probably lower origination fees and greater flexibility than a reverse mortgage

b. Personal/family loan and mortgage
   - a family member could pay for expenses of the older person, taking back a note and securing the note with a mortgage
   - this arrangement is usually an open-ended demand note, so no repayment schedule is needed
   - it can be ahead of a Medicaid estate recovery lien
   - Downsides include there may not be anyone willing or able to lend the funds, and both parties should have separate counsel.

c. Refinance an existing mortgage
   - may draw out equity or reduce monthly payments
   - current rates may not be lower than existing mortgage
   - borrower may not qualify because income may be too low
   - repayment begins right away
   - probably lower fees for loan and closing

d. Downsize to less-expensive dwelling
   - frees up equity in a lump sum
   - requires move, which may be less desirable or feasible
   - may realize capital gains that may be taxable if in excess of exempt amount for primary residence

D. Comparisons of Options for Accessing Home Equity

	Medicaid (i.e., Estate Recovery after death)	Reverse Mortgage	Home Equity Loan/Line of Credit	Private/Family Loan
Interest Rate	None	Commercial rate, often adjustable, and accrues over life of loan	Commercial rate, often adjustable, and accrues over life of loan	Flexible, but often applicable federal rate
Repayment Requirements	Paid after death of Medicaid recipient (or second to die in spousal cases)	Paid after borrower leaves home or dies	Paid over the term of the loan, usually monthly payments	Paid pursuant to terms of note
Principal growth or calculation	Accrues at rate of Medicaid reimbursement to facility	Accrues as equity is borrowed	Accrues as equity is borrowed	Accrues as equity is borrowed, i.e., funds are advanced by note holder
Maximum payment to lender	Capped at equity of home	Capped at equity of home (non-recourse)	Per terms of loan, usually within equity of home, but subject to market forces	Per terms of loan; may exceed equity of home
Use of funds	Nursing home care or equivalent. Equity is not liquidated to cash, so no flexibility for use of funds	No restrictions for use of funds	No restrictions for use of funds	No restrictions for use of funds

E. Select Resources

1. Consumer Financial Protection Bureau: “Reverse mortgage loans”, and related questions and topics: https://www.consumerfinance.gov/consumer-tools/reverse-mortgages/

2. U.S. Department of Housing and Urban Development: Home Equity Conversion Mortgages for Seniors: https://www.hud.gov/hud-partners/single-family-hecmhome

3. Federal Trade Commission: Reverse Mortgages: https://consumer.ftc.gov/articles/reverse-mortgages

4. National Council on Aging: Get the Facts on Reverse Mortgages: https://www.ncoa.org/article/get-the-facts-on-reverse-mortgages/