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By Tom Kelly

In a recent column, we addressed the possibility of using an Individual Retirement Account to purchase investment real estate.

We pointed out that one of the challenges was that an IRA-leveraged loan is made to the IRA or plan, not to an individual, and that rules preclude an owner from using his or her personal credit to influence the loan. These IRA loans are known as “nonrecourse” loans, wherein the lender can only seek relief from the secured property in the event of default and foreclosure. The owner’s other assets, such as stocks, bonds and insurance policies, cannot be claimed.

Reverse mortgages also contain a “nonrecourse” component. The U.S. Department of Housing and Urban Development’s Home Equity Conversion Mortgage (HECM) program, the nation’s most popular reverse mortgage with a market share of at least 85 percent to 90 percent, often is marketed with the statement, “the senior can never owe more on her HECM loan than her house is worth at the time the loan is paid back.”

FHA recently announced the nonrecourse description in all its reverse mortgages may not be fully accurate in all circumstances. For example, this remote circumstance can occur when the children of the senior want to keep the home after the parent has died or moved out and the debt on the home has exceeded the home’s value.

According to HUD, nonrecourse means that although a borrower will always owe the entire loan balance, if the borrower (or estate) does not pay the balance when due, the mortgagee’s remedy is limited to foreclosure. The borrower will not be personally liable for any deficiency resulting from the foreclosure. While the home must be sold or foreclosed to satisfy the debt, no assets, other than the home, will be used to repay the debt.

At any time the borrower (or estate) may sell the property for the lesser of the full debt or the appraised value. If the loan is due and payable, the borrower (or estate) may sell the property for at least the lesser of the full debt or 95 percent of appraised value. However, the borrower (or estate) may not retain the home without paying the entire loan balance — which could mean putting you out of pocket to keep Mom’s home.

“HUD felt it was a good time for the clarity because of the popularity of the program and because some homes were dipping in value,” said Sarah Hulbert, president of Senior Financial Corp., a reverse mortgage lender. “The number of times this situation could happen are probably relatively few, but it’s best for all parties involved to have a clear understanding of the process.”

The move is timely for another reason. In a separate study, HUD revealed that 2008 will be viewed as a turning point in the history of the HECM program because annual

origination volume exceeded 100,000 loans for the first time. The decade-long rise in home prices, coupled with relatively low interest rates since 2000, have increased consumer demand for the product. In addition, lender interest in supplying reverse mortgages has increased since 2006, the year in which HECM loans were first packaged into mortgage-backed securities, the report found.

Questions on HUD's efforts to clarify the nonrecourse definition will undoubtedly come from adult children wondering why Mom paid mortgage insurance so her debt would not surpass the value of her property.

"The mortgage insurance was put in place to insure the value of the home at the time of the payoff," Hulbert said. "That payoff occurs when the senior leaves the home. If the family wants to keep the property and more is owed on it than its value at the time, it's up to the family to work that out with the lender."

That workout process might involve the lender accepting a sum less than the remaining debt on the home. This is known as a short sale. According to HUD, if a borrower (or estate) elects to follow the short-sale procedures, such sale of the property by the borrower (or the borrower's estate) must be an arm's-length transaction. HUD defines an arm's length transaction as being between two unrelated parties and must be characterized by a selling price and other conditions that would prevail in an open market environment.

Launched in 1989 as a limited pilot program, HECM volume has now exceeded 390,000 loans. More than 50 percent occurred in the 24 months preceding March 2008.

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