TRUST ADVICE NEWS

Newsletter Focusing On Important Estate Planning Trends

Authored by Attorney Richard O. Barndt, J.D., LL.M. (Tax)
Serving Southern California's Estate Planning Needs Since 1995

February 2008

INSIDE THIS ISSUE

Trust Advice News
Newsletter

Richard O. Barndt
J.D., LL.M. (Tax)
Author

Office Locations

San Diego County

6265 Greenwich Drive
Suite 100C
San Diego, CA 92122
Tel: 858-554-1712
Fax: 858-455-6260

Orange County

1206 North Broadway
Santa Ana, CA 92701
Tel: 714-939-1810
Fax: 714-550-7234

RichardBarndt@TrustAdvice.com
www.trustadvice.com

To be added to or removed from our mailing list, or to receive Trust Advice News via email, please call or email us. Thank you.

NEED TAX HELP?

It is tax season once again and some of you may need some assistance with your taxes. Over the years, I and many of my clients have used the services of Ms. Sandy Lifgren, an enrolled agent. Ms. Lifgren has substantial experience in the financial planning industry, and for the past several years has worked preparing income tax returns in her own tax practice. She also works with Intuit, the company that writes tax software such as Quicken, Quickbooks and LaCerte.

Ms. Lifgren meets clients at either our office on Greenwich Drive or at her office. If you would like an appointment with her, please contact my office and ask for a "tax appointment."

REVERSE MORTGAGES

Over the last few years we have noticed an increase in questions related to reverse mortgages. Due to advertising on television, radio and in print, everyone seems know that reverse mortgages exist, but they are less clear on how they work. I will try to explain the basic parameters of these new loans.

In its simplest sense, a reverse mortgage is a secured loan on your primary residence which contains no obligation to repay or make any payments at all until: (1) your death; (2) you sell (or gift) the home; or (3) you permanently reside elsewhere.

You remain the owner of your home, and you are still responsible for paying your property taxes and home-owners insurance and for making property repairs. In fact, lenders could require repayment of the loan at any time for common conditions of default, such as: (1) failure to pay your property taxes; (2) failure to maintain and repair your home; or (3) failure to keep your home insured.

There is a requirement to pay off all pre-existing mortgages when obtaining a reverse mortgage, so you must borrow at least enough money to pay off all existing loans.

When the loan matures, you or your heirs must repay all of the cash advances plus interest within the time limits contained in your loan documents. Reverse mortgages are non-recourse loans, which means that you (or your heirs) can never owe more than your home's value, regardless of the loan balance.

You have three business days to reconsider your decision after the documents are signed on a reverse mortgage. You must cancel the mortgage *in writing* within three business days. You *cannot* cancel in person or by telephone.

Age Requirements. Applicants for reverse mortgages must be at least age sixty-two. If you are single and at least age sixty-two, you qualify. For married couples, BOTH OF YOU must be at least age sixty-two. For example, if both husband and wife are age sixty-two or over, then both husband and wife can be the borrowers on the reverse mortgage. This means that the loan does not have to be repaid until *both* spouses pass away (the surviving spouse can still live in the home), sell (or gift) the home, or permanently reside elsewhere.

If one spouse is under age sixty two, then that spouse's name must be removed from the deed to the home in order for the older spouse alone to apply for a reverse mortgage. This situation presents serious estate planning issues and will probably necessitate custom estate planning to secure the rights of the younger spouse.

continued on page 2 . . .

PENDING FEE SCHEDULE CHANGES

After more than 10 years without raising our fees, we will be increasing our fees effective June 1, 2008. Living Trust Estate Plans will be raised to $1,050 for single persons and $1,400 for married persons. Any clients or prospective clients who wish to take advantage of our existing fee rates, $900 for single persons **($150 savings)** and $1,200 for married persons **($200 savings)** should call our office to have any needed legal work *completed* before June 1, 2008.

Reverse Mortgages (continued)

One problem is that if the older spouse dies first, then the younger spouse will be obligated to repay the reverse mortgage. If there are insufficient liquid funds available for the repayment of the reverse mortgage, and the surviving spouse is unable to secure other financing, then the younger surviving spouse may be forced to sell the primary residence in order to repay the loan.

To reduce this risk, as long as the older spouse is still living, the reverse mortgage can be refinanced with both spouses as the borrower in later years after the younger spouse attains sixty two years of age. In that circumstance, both spouses will also be a few years older and the property may have appreciated in value, which could result in higher borrowing limits.

The money received through a reverse mortgage is usually received income tax free (both federal and state), because the money is a *loan*. It is not *earned* income. After paying off any existing loans on your home, you can use the remaining money for anything you want.

You do not even need to have good credit or even meet minimum income requirements to qualify for a reverse mortgage. With a traditional mortgage, the lender wants to know that you have the ability to make the payments to repay the loan. With a reverse mortgage, it is understood that you will not repay the loan during your lifetime. Therefore, the lender is only concerned that you meet the age and ownership requirements. Your credit score and income is irrelevant.

A reverse mortgage does not effect Social Security, Supplemental Security Income, Medicare and Medicaid Benefits. If you receive Supplemental Security Income payments, you must spend the proceeds from the reverse mortgage every month, and should not accumulate borrowed funds to the next month. It is advisable to check with your local area agency on aging.

3 Main Types of Reverse Mortgages. As of the printing of this newsletter, there are three main types of reverse mortgages available. The most popular type of reverse mortgage (allowing access to comparatively more cash at lower interest rates for homes valued at about $550,000 or less) is the Home Equity Conversion Mortgage (HECM) (pronounced "heck-um"). The HECM is insured by the Federal Housing Administration, an arm of the U.S. Department of Housing and Urban Development (HUD), and is subject to HUD/FHA lending limits.

The second type of reverse mortgage is the Fannie Mae HomeKeeper. This is a program offered by Fannie Mae, a government-sponsored entity. This program is subject to the Fannie Mae lending limits. Due to Fannie Mae HomeKeeper's lending limits and other factors, this type of reverse mortgage is not very popular.

The third type of reverse mortgage is the Proprietary Loan type, which are offered by private lending companies not affiliated with any government agencies. Generally they offer higher lending limits at higher interest rates. These types of reverse mortgages are sometimes useful in areas such as Southern California where home values are higher then in most other parts of the country, allowing the borrower to access more cash (greater than the HECM and/or Fannie Mae loans).

Calculating Your Maximum Loan. In choosing a particular type of reverse mortgage, the various lending limits will be a factor. For the first type of reverse mortgage (the HECM), HUD has a lending limit which varies by county, currently $362,790 for counties in southern California except for Imperial County. However, this is merely a theoretical maximum. In reality, this lending limit is rarely achieved. Fannie Mae's nationwide lending limit is $417,000, but again, this is a theoretical maximum. Proprietary reverse mortgage lending limits can often be the highest among the three types of reverse mortgages because they don't have a government imposed lending limit.

Any particular borrower's loan limit (the amount any particular borrower is eligible to borrow) is primarily determined by three factors: (1) the age of the borrower(s) (for married couples, sometimes the age of the youngest, sometimes the average age, depending on the type of reverse mortgage); (2) current interest rates (generally interest rates are variable, resulting in higher borrowing limits when interest rates are lower); and (3) appraised value of your primary residence.

When these three factors are factored into each of the three types of reverse mortgages, different loan limit figures are revealed. Then you choose the one best suited to your situation. You can run a simple example by using the "financial calculator" provided by a reverse mortgage company named Financial Freedom which is on their website located at "http://www.financialfreedom.com/ReverseMortgageCalculator/." It's easy, check it out.

Accessing the Money. Once a reverse mortgage is in place, there are three basic methods to access your money. You can receive the money in a lump-sum, in monthly payments, in a line of credit, or in a combination of these. With a lump sum, you can reinvest the borrowed money in other investments if you choose. This can partially offset the interest that is accruing on the reverse mortgage.

With monthly payments, you can elect to receive a particular amount automatically every month that will continue as long as you live in your home. It's kind of like annuitizing, but you can change the monthly amount that you receive if you want, and the entire amount of your payment is income tax free.

The line of credit option is used generally when you don't have an immediate need for the money, so you don't make any immediate withdrawals (other than any financed loan costs). As time goes by, the amount that you *could* borrow increases because your age continued to increase, which causes an increase in the amount that you can borrow (remember, age was one of the three main factors to determine your loan limit).

continued on page 3 . . .

Reverse Mortgages (continued)

Fluxuations in the other two factors, current interest rates and value of your home, will not cause the amount you *could* borrow to increase or decrease. Changes in these two factors could only effect the amount you could borrow if you refinance an existing reverse mortgage and establish a new reverse mortgage.

Reverse mortgage loan costs vary widely among the three various types of reverse mortgages. However, loan costs among different HECM reverse mortgage providers should be similar, and this should be the same with different Fannie Mae providers. However, proprietary reverse mortgage lenders offer more options than HECM and Fannie Mae, and the loan costs of their various choices also vary.

Beware of Reverse Mortgage Scams! Wherever there is money to be made, you will find scams. While reverse mortgages are viable financial products which are appropriate for those persons who need them, understand the costs, and borrow responsibly. You must always act prudently when seeking to obtaining a reverse mortgage. It is important to work with a person who candidly explains your options and provides various choices of available reverse mortgages, including interest rates, lending limits and other cost factors.

Some typical scams to avoid are: (1) people charging for information provided for free from HUD; (2) pushing reverse mortgages as a way to pay for large purchases (e.g., financial products such as annuities, or expensive motor homes); and (3) unethical reverse mortgage terms (e.g., extraneous fees, or *shared equity* or *shared appreciation* terms). With a *shared equity* loan, the borrower *owes* a percent of a home's value when the loan is repaid. With a *shared appreciation* loan, the borrower *owes* a percent of any increase in the home's value since the loan closed. Stay away from these loans.

ESTATE PLANNING ISSUES

Can I Still Bequest My Home To Whom I Want After My Death? Yes. Since you still own your home (it is merely subject to the reverse mortgage loan as secured by the deed of trust), you can leave your residence to anyone of your choosing at your death. That person merely takes your home subject to the reverse mortgage. When the recipient receives your home, the reverse mortgage must be repaid. However, you still need to have the usual estate planning documents in place, such as a revocable living trust, to avoid probate at your death.

For married couples with one spouse under age 62, additional estate planning may be required. For example, a separate property trust created by the older spouse for the purpose of guaranteeing the rights of the younger spouse in the home in the event of the death of the older spouse. For younger non-spouses, this could involve gift tax and/or property tax reassessment issues that you should discuss with your attorney or other tax professional.

Should You Update Your Estate Plan? Maybe. Reverse mortgages are very compatible with estate plans when properly integrated, including revocable living trust based estate plans. Holding title to your home in your *revocable* living trust is generally acceptable as long as you are the beneficiary of your trust while you are alive (which is usually the case).

Irrevocable trusts can be more problematic though. For example, a married couple with an AB Trust is required to divide their trust assets into two portions at the death of the first spouse, one portion to be funded into the *revocable* survivors trust ("A" Trust) and the other portion to be distributed into the *irrevocable* credit shelter trust ("B" Trust).

If the married couple obtains a reverse mortgage while they are both living (prior to the A-B division), then generally there is no problem because the AB Trust is revocable while both spouses are living. When the first spouse dies, then we must transfer the home into the A Trust (revocable), B Trust (irrevocable), or partly into each. Transferring the home (or part of the home) into the A Trust is not a problem because that trust is *revocable* by the surviving spouse.

Transferring the home (or part of the home) into the *irrevocable* B Trust *might* be a problem. Generally, if the surviving spouse if the beneficiary of the B Trust (which is usually the case), then there is no problem in transferring the home (or part of the home) into the B Trust. However, if the surviving spouse is not the beneficiary of the B Trust, then transferring the home (or part of the home) may force the repayment of the reverse mortgage.

Sometimes the surviving spouse applies for a reverse mortgage *after* the death of the first spouse, and has both an A Trust and B Trust which were established and funded at the death of the first spouse. If the home was funded completely into the *revocable* A trust, then the surviving spouse will qualify for a reverse mortgage. However, if the home was funded all or partially into the *irrevocable* B trust, then the survivor may have a problem. The most popular HECM loans through HUD do not allow homes owned by irrevocable trusts to qualify for a reverse mortgage. However, the companies which offer proprietary reverse mortgages often do offer reverse mortgages for homes owned by *irrevocable* trusts.

In summary, reverse mortgages are generally compatible with common estate planning techniques, including living trust planning. However, making sure that your existing living trust and overall estate planning will not cause a problem causing your ineligibility for a reverse mortgage may be money well spent.

In closing, ALWAYS READ THE LOAN DOCUMENTS and have them reviewed with you by a financial professional!! ■

IMPORTANT ESTATE PLANNING UPDATES

Warning for All Clients Married or Single (HIPAA Update Flyer) - 9/1/2004
AB Disclaimer Trust: Is It For You? - 9/1/2004
Current Status of Federal Estate Tax - 9/1/2004
Recommended Update of "ABC" Trusts - 9/1/2000
Recommended Update of Community Property Agreement ("Aggregate" Agreements) - 7/1/2000

Download flyers regarding above updates from Downloads on www.trustadvice.com

This issue of *Trust Advice News* focusing on Reverse Mortgages was co-authored by Liz Glenn, a mortgage broker with Southwestern Mortgage Company (Member of National Reverse Mortgage Lenders Association), a reverse mortgage lender who offers advice and reverse mortgages products offered from HUD, Fannie Mae as well as other proprietary reverse mortgage products. Liz Glenn can be contacted at 858-395-9140, or you can email her at lizglenn@san.rr.com.

Disclaimer: This is not a recommendation to use the services of Liz Glenn or Southwestern Mortgage Company. Whenever hiring professional services, you should always exercise due diligence.

Attorney Richard O. Barndt has been providing estate planning services in Southern California for over 12 years. He holds a Bachelors Degree in Electrical Engineering, a Juris Doctor, and a Masters Degree in Taxation. Attorney Barndt's practice includes Revocable Living Trusts, Irrevocable Trusts, Financial Durable Powers of Attorneys, Health Care Directives, Trust Administration, Gift and Estate Tax Panning, Gift and Estate Tax Return Preparation.

The Law Firm of

RICHARD O. BARNDT

6265 Greenwich Drive
Suite 100C
San Diego, CA 92122

1206 North Broadway
Santa Ana, CA 92701