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Revving Up for Reverse Mortgages

What boards need to know about the new financial tool for senior shareholders

By Paula Chin

Reverse mortgages — a type of loan that allows seniors to convert their home equity into cash — have long been available to owners of homes and condominiums in New York. But thanks to a recent change in state law, co-op shareholders 62 and older will soon become eligible to take out reverse mortgages on their apartments. It's a valuable financial tool for seniors . . . in need of money to cover their living expenses — and welcome news for co-op boards concerned about older residents being able to age in place amid rising maintenance fees and assessments. With the new law, which goes into effect May 30, co-ops will be traversing new territory. Here's what you need to know.

How It Works

As the name suggests, a reverse mortgage flips the script on the conventional mortgage arrangement by allowing borrowers 62 and older to tap into the increased value of their homes and borrow against it. (Note that co-op loans are not mortgages in the traditional sense, but this product is nevertheless referred to as a mortgage.) Unlike a conventional co-op loan where monthly payments are made, the reverse mortgage pays the borrower. It does so in one of four ways: a lump-sum payment; a line of credit; equal monthly payments for a fixed number of months; or monthly payments until the full loan is paid out. The loan's interest, which may be a fixed or variable rate, accrues and is added to the balance of the loan. As in the traditional financing world, a borrower can't have two mortgages. So if a senior still has an existing co-op loan but lots of equity in his apartment, the reverse mortgage will replace the existing loan.

A traditional co-op loan comes due when the apartment it financed is sold, or when an old loan is replaced by a newer one. But a reverse mortgage comes due when the senior borrower dies, no longer uses the apartment as his or her primary home, doesn't occupy the residence for longer than 12 consecutive months due to physical or mental illness, or sells the apartment. When one of these events happens, the borrower or the borrower's heirs must sell or refinance the residence to pay off the loan amount and interest that was paid out. If the residence is sold for more than is required to satisfy the obligation, the remaining equity goes

to the borrower or heirs. If the residence's market value falls below the loan amount, the lender takes the loss, since reverse mortgages are "non-recourse" loans, which means the lender cannot look to the borrower's other assets to satisfy the outstanding balance.

Board Concerns

With any co-op loan, a recognition agreement must be signed by the loan holder and the board. So, too, with reverse mortgages. Recognition agreements protect co-op corporations in a couple of ways. If, for instance, a shareholder falls behind in maintenance payments and the board deems the situation to be extremely serious, it can inform the lender of the situation. Because of the recognition agreement, the lender is obligated to make the maintenance payments. In turn, a co-op agrees to notify the lender if a shareholder attempts to take out any additional loans requiring board approval. The agreement gives the bank first lien against the shares and the proprietary lease, but if there's a foreclosure and the apartment is sold, the bank will receive the net proceeds after all sums owed to the co-op are satisfied.

While it may take a while before reverse mortgages for seniors actually become available in the New York market, lenders will almost certainly require an identical recognition agreement to the one currently in use.

"We're not going to proceed with any loan without one," says Philip Parziale, the chief operating officer and general counsel at Nationwide Equities, a mortgage lender that offers reverse mortgages. Adds Ken Jacobs, a partner at the law firm Smith Buss & Jacobs: "As long as a co-op has that lien on the unpaid maintenance and the lender must cure the default, boards are in a very good position."

Financing Limits

Most co-ops have financing limits in place, and the new law gives the board approval power over reverse mortgages to ensure that the coop's limits are not exceeded. Nationwide Equities will be offering reverse mortgages ranging from 35% to 62% of a co-op apartment's appraised value, depending on the age of the shareholder. "For a \$1 million apartment, that means the lowest loan would be \$350,000 and the highest we'd go is \$620,000," Parziale says. "The older the borrower, the more money they can access, because as life expectancy goes down, the loan is not going to be held as long."

Nationwide anticipates that it will have to be flexible. "If a co-op isn't comfortable with allowing people to finance more than 50% of the value of their apartment, we would only offer the shareholder 50%," Parziale says. "There's a common interest between us and the board in that we're both interested in making sure the borrower has enough equity in their home so that the loan and the accrued interest aren't worth more than the property when the

loan becomes due, even if real estate values go down, which isn't likely. The co-op would still be protected, but nobody wants to see that happen to a shareholder."

Because reverse mortgages are only for seniors, boards may be concerned about age discrimination charges if a senior is denied the loan. The new law takes this into account, Parziale says, and deems a reverse mortgage "a special benefit." Nevertheless, boards will have to be consistent with their financing requirements. "You can't discriminate by permitting one shareholder to get a reverse mortgage and not allowing someone else to get one," says Mark Hankin, a partner at the law firm Hankin & Mazel.

And boards can't have different requirements for reverse mortgages than for conventional ones. "If a co-op allows for financing, it has to allow reverse mortgages, because you have to impose the same rules on everyone, regardless of age," Hankin explains. "There should be no need to amend your governing documents, but there can't be any exceptions."

The New York State Department of Financial Services is now working out the final regulations on co-op reverse-mortgage lending, which are expected to come out in midyear. "One of the problems with reverse mortgages is that some lenders have historically been very predatory, taking advantage of older people by hitting them with high closing costs and other fees," says Peter Massa, a partner at the law firm Armstrong Teasdale.

The application process to obtain a reverse mortgage currently includes a required meeting with an approved Department of Housing and Urban Development counselor. But, says Bonny Gilbert, a New York loan officer with Fairway Independent Mortgage Corporation, a nationwide mortgage lender, "the state is going to decide if there should be additional consumer protections put in place."

In the long run, those protections can also help guard a co-op corporation's financial health. "Since reverse mortgages will allow people to stay in their apartments, you're going to have more continuity of ownership in your building," Parziale says. "You won't have forced sales where people have to dump their apartments at a reduced price, which will keep overall apartment values up."

For co-ops facing unavoidable maintenance increases and assessments, reverse mortgages could offer long-term shareholders on fixed incomes the ability to stay in their homes. "There's a real humanitarian benefit for boards," Massa says, "because you see a lot of cases where seniors on limited incomes have apartments that are worth a lot of money but don't have enough money to keep living in them. Reverse mortgages can let them do that — and still be able to have enough money to live their lives."