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Reverse Mortgages in Bankruptcy

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The reverse mortgage is a loan available to homeowners 62 and older with significant equity in their homes. It has grown to be an attractive option for the elderly population as a means to supplement retirement income. Home Equity Conversion Mortgages (HECMS) are reverse mortgages that are insured by the U.S. Federal Government and is only available through an FHA approved lender as opposed to a proprietary reverse mortgage through a private lender. In both, loan proceeds are usually paid out in the form of monthly payments made to the borrower, a line of credit, a lump sum payment or some combination. There is no set date for maturity. The borrower may become in default for not maintaining the property or failure to pay property taxes and insurance but generally, unless the home is no longer occupied by the mortgagor, is sold or until the last surviving mortgagor dies, the loan will not come due for repayment. So, what happens when someone with a reverse mortgage files for bankruptcy?

Typically, terms in the loan documents dictate how filing bankruptcy will affect the loan. For instance, under the terms of some private reverse mortgages the filing of the bankruptcy is a default, giving the creditor the right to accelerate the mortgage, though some creditors choose not to do so. Relief from the automatic stay will need to be obtained to proceed with foreclosure. It is not a default, however, under the HECMS program for a mortgagor to file bankruptcy though the mortgagor will need to petition the court for access to additional funds. The loan documents may also call for, or the creditor may elect to close the line of credit and cease making monthly disbursements under the premise that the bankruptcy filer should not incur new debt. In this circumstance, the mortgagor may seek a reaffirmation agreement.

There are a couple of scenarios for lenders and servicers to be aware. First, the same significant amounts of equity that made the borrower an attractive candidate for a reverse mortgage also make the property vulnerable to a Chapter 7 trustee to seize, and then sell for the benefit of the unsecured creditors. In this case, the reverse mortgage lender should file a secured claim to protect their lien. Secondly, if the loan matures for any reason prior to or while the borrower is in a Chapter 13 bankruptcy, the borrower, or an heir to the estate, depending on the circumstance may be allowed to cram down the interest rate and the loan amount to the current value. The lender would also be forced to allow the Debtor to pay off the loan throughout the life of the Chapter 13 plan.

The good news for lenders is in most instances a reverse mortgage is treated just like any other secured debt in bankruptcy. If you have any doubt on how a bankruptcy filing affects your reverse mortgage consult with your attorney.