Tax Letter

July 2006, Vol 10 - Reverse Mortgage

Dear clients and friends:

In general, reverse mortgage (RM) is a **"retirement" income source**. RM borrowers do not make monthly or periodical payments on the loan borrowed. Most important of all, RM borrowers can stay in their own home which secured the mortgage. It can be arranged for life or for a term certain. Excess value of home will be returned to the borrowers or their heirs, whichever the case may be. Currently, there are two "government" programs and a number of private programs.

I . Reverse Mortgage Programs (RM Programs)

(A) Home Equity Conversion Mortgage (HECM) by Federal Housing Administration (FHA)

This is the grandfather of all Reverse Mortgage.
Nearly 90% of the RM market.
Insured by FHA.
Counseling required.
62 years or older, home must be occupied as principle residence with substantial equity.
Adjustable rate only, no fixed rate program. Index = 1 year T-Bill.
Choice of monthly or annual adjustment.
Mortgage Insurance required, 2% up front and 0.5% annually.
Monthly mortgage servicing fee required. Monthly fee will not exceed $35.
Points and closing costs/expenses required
Maximum loan limited set by FHA. For 2006, maximum amount = $ 362,790.
Payment choices, Tenure, Term or Credit line (non revolving, with growth factor).

(B) Home Keeper Mortgage (HKM) by Fannie Mae

This is the second best known and available RM program.
Guaranteed by Fannie Mae
Counseling required.
62 years or older, home must be occupied as principle residence with substantial equity
Adjustable rate only, no fixed rate program. Index = weekly average of 1 month market CD
Monthly adjustment only. No annual adjustment available.
Mortgage Insurance not required.
Monthly mortgage servicing fee required. Monthly fee will not exceed $35.
Points and closing costs/expenses required.

Maximum loan limited set by Fannie Mae. For 2006, maximum amount = $417,000.
Payment choices, Tenure or Credit line (revolving but no growth).

(C) Commercial Programs

Out of many private programs, two captured our attention. They are the "Cash Account" program and the "Simple Zero Cash Account" program. They are commercially developed and are NOT guaranteed by either the FHA or the Fannie Mae. The "Cash Account" program has monthly or periodically payment methods, while the "Simple Zero Cash" program pay the senior borrower one lump sum payment at closing. Other details are the same.

Total amount can be higher than both the FHA and Fannie Mae maximum.
62 years or older and No counseling requirement
Adjustable rate only, equal to 6% plus 6 month LIBOR.
Monthly adjustment, no adjustment cap, life time interest cap at 6% above initial annual rate.
Non resource loan, no prepayment penalty, no up-front costs or fees.

II Tax Implication:

(A) Deductibility – Interest accrued on all above Reverse Mortgage programs are Not currently deductible. They will be deductible for the year when they are paid.

(B) Life time pay-out – Upon death of senior borrower, the loan plus interest will be paid by the Estate. Estate may accelerate IRA and/or other IRD (income with respect to the Decedent) to take advantage of the interest deduction for the Estate income tax return. If the loan plus interest will be paid by an heir, then, the heir may be able to deduct the amount of interest paid.

(C) From a theoretical point, the interest may not be allowed to deduct at all. IRC SS.163(h)(3) define deductible home mortgage as acquisition indebtedness and/or home improvement indebtedness. If these amounts of indebtedness are refinanced, only the interest attributable to the refinanced amount is deductible. We believed that the meaning of this section prohibit deduction of mortgage interest in excess of the balance remaining from the original indebtedness.

Any question, please give us a call at 415-381-0681, or visit our website at www.chochan.com.

Sincerely,

Cho F. Chan, CPA, Inc.