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Reverse mortgages 101

by C. Robert Vernon

Ed note: *Because only one reverse mortgage lender is currently active in Canada – Canadian Home Income Plan, (CHIP) – this article refers to the provider by name. Naming the service provider should not be viewed as an endorsement of CHIP by either the author or LAWPRO.*

Retired clients, particularly those who are property rich but cash poor and rely on relatively fixed pension or investment income, frequently consult their solicitors about reverse mortgages.

Very simply, a reverse mortgage loan is a transaction in which a mortgage lender agrees to advance a fixed sum to an older home owner on the express understanding that, although neither principal nor interest need be repaid until the property is sold or the owner dies, interest accrues and is compounded regularly throughout the term.

For many home-owning seniors, a reverse mortgage is worth serious consideration. Lawyers advising clients who are interested in these transactions need to fully understand both the legal and financial issues associated with reverse mortgages.

Reverse mortgages offer seniors several benefits:

- A sum of money, limited by the value of the property and the owner's age, is generally advanced in a single payment,
- No repayment of principal or interest is required while the mortgagor continues to own and occupy the house,
- No recourse can be had against the owner or the owner's estate in the event that the aggregate amount of principal and interest eventually exceeds the value of the house when the mortgage comes due or is paid off, and

- Title to the property remains in the homeowner's name and the owner retains the right to decide when to move or sell the house.

Lawyers advising clients about reverse mortgages need to also consider these features:

- CHIP does not advance principal monthly, like an annuity, but rather advances most, if not all, of the principal amount of the mortgage at the outset, and leaves the homeowner with responsibility for investing any amount that may not be immediately required.
- The CHIP mortgage must be registered as a first charge on the property and secondary financing is not permitted.
- Interest rates are adjusted every six months, annually or every three years, depending on the option selected by the homeowner, and CHIP's interest rates seem high – generally 4.75 per cent above Government of Canada Treasury Bills and Bonds with similar terms; and
- Significant interest rate differential and prepayment penalties apply in cases other than the death of the last surviving mortgagor who has signed the reverse mortgage.

When advising clients about reverse mortgages, lawyers should ensure seniors fully understand all aspects of these types of transactions:

- Thoroughly discuss with clients not only the terms and conditions of the proposed reverse mortgage but also its advisability, to ensure that clients clearly understand the nature and consequences of the transaction.
- Since the principal amount of the reverse mortgage is paid to the homeowner in a lump sum, rather than in regular periodic payments, investment decisions must be made and budgeting issues addressed.
- Identify the impact of accumulated semi-annual compounding of interest in the estate planning process, as well as the cost of early termination of the reverse mortgage contract.
- Appropriate alternatives, such as secured lines of credit and mortgage-financed life annuities, should also be considered in the context of the individual client's needs and resources.
- Confirm your advice in writing, since surviving family members and heirs who were not consulted may be surprised to learn about the existence of the reverse mortgage.

Advising seniors on life lease housing

by C. Robert Vernon

Scan virtually any weekend real estate section these days and you'll find ads, and sometimes feature articles, on a major new development often aimed at seniors: life lease housing.

Although life lease housing has been marketed primarily to seniors, it is not necessarily limited to that group. In the spectrum of available housing tenures, life lease falls somewhere between traditional short-term rental accommodation and ownership.

The two essential ingredients of life lease are:

- A sole and exclusive right to occupy a designated housing unit, fee simple title to which is owned by a third party, and to enjoy shared use of common areas, and
- An entitlement to realize, in whole or in part, the equity in the unit when the period of occupancy ends, subject to any restrictions in the life lease.

The "market value" model is most commonly used for life lease projects in Ontario. When the resident dies or leaves, the unit is either redeemed by the sponsor, for resale, or sold by the resident/estate at market value, with the sponsor generally retaining up to 10 per cent of the selling price.

The age of the resident and the length of occupancy do not affect the amount received by the resident. Accordingly, this model offers the possibility of capital appreciation. On the other hand, the purchase price is often close to, and occasionally higher than, comparable condominium units, even though the purchaser does not acquire registered title and the ability to freely sell, lease or mortgage the unit.

Life lease housing in this province is not a creature of statute, although it is governed by numerous statutes of general application. In particular, the subdivision and part lot control provisions of Section 50 of the *Planning Act* must be part of any consideration of the enforceability of a life lease agreement. If the agreement limits the length of the interest granted by it, thereby creating a term of years – a leasehold interest – and if it is for a housing unit that is part of a building, it will be saved by the exemption contained in Section 50(9) of the *Act*.

If the project sponsor or developer has only a leasehold interest in the property, other serious issues arise. The life lease interest cannot extend beyond the term of the underlying ground lease and the ground lease must be kept in good standing by payment of rent and fulfillment of the lessee's covenants; failure to do so would put the subsequently created life lease interests in serious jeopardy.

However, the most important factor to be taken into account is the risk element. Unlike the purchase of a new condominium unit, where the purchaser's deposits must be held in trust or deposit insurance effected, there is no similar protection for purchasers of new life lease units.

Most life lease agreements require deposits of at least 25 per cent of the purchase price. Except when the sponsor decides not to proceed with construction, the deposits are non-refundable and may be applied to the costs of construction. The entitlement of the sponsor to use purchasers' deposits in this fashion is generally non-negotiable.

What makes life leases work financially is the fact that the deposits, in addition to the building site which the sponsor generally provides, constitute the equity that the construction lender requires be injected into the project before any mortgage funds are advanced. The expectation is that the balance of the purchase monies, paid after the building has been finished, will discharge the construction mortgage, after which the project will be debt free. The only effective way to substantially reduce this risk is to ensure that the life lease agreement permits its registration, or notice thereof, on title, and obliges the sponsor to obtain from all mortgagees written postponement agreements in favour of individual purchasers.

Although Ontario has no legislation expressly governing the marketing, construction and management of life lease housing, the regulations under two Ontario statutes now specifically recognize and extend significant benefits to life lease housing. In 2000, the regulations under the *Assessment Act* were amended to provide that life lease housing units are to be assessed in the same way as condominiums, equity co-operatives and other residential properties having less than seven self-contained units. In 2004, most life lease transactions were exempted from the *Land Transfer Tax*.

The documentation for each individual life lease project should be carefully reviewed and considered by the purchaser's solicitor. Title insurance protection is generally available for life lease transactions, provided that the life lease agreement, or notice of it, is registered on title.

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