Is there a role for Reverse Mortgages in financial planning?

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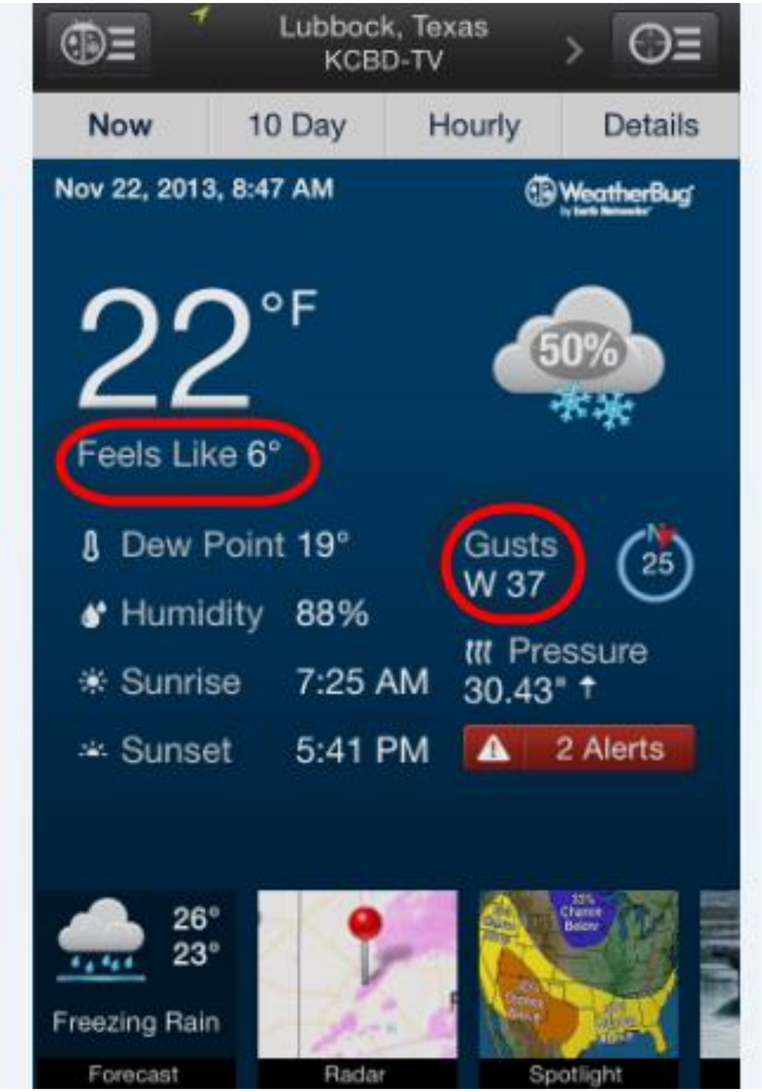
First, thanks for having us!



A reverse mortgage?

- Way to convert home equity to a useable resource – a mortgage in reverse.
- Home Equity Conversion Mortgage (HECM)
- Insured by FHA

Reverse Mortgages

- What is your initial thought? Expensive? Last resort only?

- Was ours too…

- Until we were educated.

Borrower Requirements

- Must be age 62 or over.
- Pay taxes and insurance.
- Maintain home.
- Current mortgage must be paid off or rolled into HECM.

Borrower Requirements

- Must be primary home and currently lived in, can be out 365 consecutive days.
- Single family property, HUD-approved condo, or up to 4-unit home.
- Borrower must complete counseling prior to closing.

Changes as of October

- Prior, there was no credit or asset check.
- Due to this, near 10% of reverse mortgages were in tax and insurance default.
- Most likely will be more formal credit check and test for assets related to paying taxes and insurance.
- No longer a “last resort?”

Principal Limit Factor (PLF)

- The amount of home equity available based on certain factors up to the home value limit $625,500.

- Think loan to value ratio, but home value in ratio capped at limit.

Benefit Level – The PLF

Calculated using following factors

- Age of the youngest borrower
  - Older yields higher benefit
- Interest rates
  - Lower expected rates (expected) yields higher benefit
  - Currently based on 10-year LIBOR swap rate

Types of Benefit

- **Tenure**- equal monthly payments for life as long as in home
- **Term**- equal monthly payments for a fixed period of time
- **Line of Credit**- unscheduled payments or in installments

Up Front Cost

- Mortgage closing costs
  - Title insurance, appraisal, attorney fees, etc, etc…
- Mortgage Insurance Premium (FHA) = 0.5%
    - Exception if > 60% PLF is used in first year, then 2.5%
- Origination fee

Borrowing/Growth Rate

- Combination of
  - FHA Mortgage Insurance Premium = 1.25%
  - Lender Margin = up to 3%
  - LIBOR rate = variable, geometric average = 2.8%
  - Today, would equal ~ 4.45%

Reverse Mortgages - Benefits

- No monthly principal or interest payment required
- Proceeds are tax-free
- Interest deductible when paid (and itemizing), interest payback is front loaded
  (Please consult a tax advisor)
- Benefit type can be changed

Reverse Mortgages - Benefits

- HECM (FHA insured) is non-recourse, the borrower or their estate will never owe more than the value of the home upon sale or death.
- The loan can not be called/cancelled as long as requirements are met.
- Unused line of credit grows over time.
- Can refinance if terms become better (upfront fees apply just as refinancing a traditional mortgage)

Reverse Mortgages - Issues

- They aren't free
- Misuse or ill advised use – bad press
- Stigma of using the home value; debt
- Misconceptions – I'll lose my home, bank owns home
- Mobility risk

Reverse Mortgage – FP Issues

- Cost sensitivity.
- Misunderstanding the product.
- FINRA over-compliance has been a big issue.
  - Complete disregard due to compliance issues – document use of proceeds.

(Possible) Uses

- The flexibility and attributes of this product has yielded many ideas of possible uses, here are a few.

Replace HELOC

	HELOC	Reverse Mortgage
Line growth?	No	Yes
Cancelable?	Yes	No
Requires repayment?	Yes	No
Age restriction?	None	62

The Standby Reverse Mortgage
A Three Bucket Strategy

- Goal – to avoid selling assets in bear markets

Investment Portfolio (Bucket)

Refill when rebalancing, making changes

or when CFR account is depleted, portfolio acceptable

Cash Flow Reserve Account (Bucket)

Borrow in bear market and cash depleted

Payback when portfolio back to acceptable

Standby RM (Bucket)

Retirement Living Expenses

Last resort reversed

- Set up line of credit today, let grow to be used in the future.
- Grows at rate of 4.25% + LIBOR, can grow to more than home value.
- Use proceeds when portfolio is exhausted.

Creating income

- Annuitizing home equity through tenure payment option rather than, or in addition to, the portfolio.
- Mortality issue intriguing.
- Currently researching this example.
- Results suggesting a good alternative, best when utilizing IA and standby methodology.

Refinance existing mortgage

- Use HECM to refinance existing mortgage, either pay off or not.
- Currently researching this example, seems to be optimal for few scenarios ran.
- Yielded maximum wealth as well as probability of meting goals.
- Unused LOC can grow for future use.

Deferring Social Security

- An issue of many people retiring early, not by choice.

- May be optimal to defer Social Security, can use term payment feature to supplement income during the deferral years.

- This is a “possible” idea!

Longevity insurance

- Initiate LOC today, convert to tenure payment later.
- Simulating idea of longevity insurance – deferred SPIA.
- Asset control is never given up to insurance company.

Conclusions

- Once I was educated, the ideas opened up.
- There is nothing wrong with the product, only past use and behavioral issues.
- Home equity can and will be an important for *everyone*.

Questions?