Making a Case for Reverse Mortgages in Retirement Income Conversations

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Social Security benefits represent the largest retirement income asset for most Americans, supplying roughly two-thirds of retirees with more than half of their retirement income, according the Employee Benefits Research Institute (EBRI). For many Americans, what they have saved for retirement will prove to be inadequate, especially if one of their most valuable assets is ignored. “Few people consider monetizing their housing wealth, yet home equity is often between 60 and 70 percent of their net worth according to the U.S. Census Bureau.

This asset is hiding in plain sight, an asset that retirees have been saving for via regular mortgage payments throughout their lives, but is virtually invisible when clients enter the decumulation phase. For much of middle America, it is like trying to retire on just 35 percent, or less, of their accumulated wealth,” stated Shelley Giordano, Chair of the Funding Longevity Task Force at the American College of Financial Services. Recent research led by the Task Force demonstrates that, despite playing a lesser role in the retirement income story, home equity can be a significant resource. Including a discussion of the housing asset is an appropriate component in careful retirement income planning.

The wellspring of interest in reverse mortgages is attributed, in part, to Robert C. Merton, Distinguished Professor of Finance, MIT Sloan School & Nobel Laureate – Economics 1997. He is traveling the world encouraging financial services professionals to reconsider housing wealth as an inevitable solution to funding the global longevity challenge. For Dr. Merton, the most compelling reason for using the house via a reverse mortgage is that the loan is non-recourse. He explained, “A reverse mortgage is both a stream of income as a hedge and an asset. It changes from the former to the latter when the people in the house no longer need it. The reverse mortgage recognizes it by saying, ‘As long as you’re in the house, you pay nothing, even if you live to be 120.’ When you’re not there, your heirs get the unspent cash from the reverse mortgage and they can sell the house, pay the amount due, keep the difference or let the bank take the house if the amount owed exceeds the value of the house**.** That’s a wonderful contract!”

Advisors should be aware that many of the abuses of reverse mortgages in the past have been addressed by The Reverse Mortgage Stabilization Act of 2013 and other regulatory improvements. The Federal Housing Authority (FHA) now requires that lenders validate that the Home Equity Conversion Mortgage (HECM) is a sustainable solution for any given homeowner.

In an interview with The American College of Financial Services, Donald Graves, RICP®, of the HECM Advisors Group and president of the HECM Institute, discussed several ways to support retirement income strategies with a reverse mortgage, specifically, a reverse mortgage line of credit.

“The typical retiree, from my understanding, is looking at four ‘Ls’— longevity, lifestyle, liquidity and legacy.” said Graves, and the type of reverse mortgage will depend on a client’s specific goals and concerns. Roughly 95 percent of reverse mortgages are The Home Equity Conversion Mortgage (HECM) and the only type that is insured by the federal Department of Housing and Urban Development. The FHA regulates the HECM industry closely and provides the backstop for consumers so that neither they, nor their heirs, are responsible for any debt beyond what the house provides at sale. No deficiency judgment may ever be taken against the borrower or his estate; the house is the loan’s sole collateral. In addition, the HECM is so flexible that the client does not have to commit to any particular way of using the loan and can easily move from one structure to another throughout the course of the loan.

The client can choose to access cash from a reverse mortgage as a lump sum, line of credit, tenure payment, term payment, or combination of these options. The client may elect to treat the loan as an interest-only home equity line of credit (HELOC), but also have the option to just as easily return to a mortgage with no payments if their circumstances change. The ultimate decision on how to use the HECM over time will depend on what the client and advisor want to accomplish.

Why Are Reverse Mortgages Becoming Popular Again?

In general, older consumers are carrying more debt into their retirements than in previous decades, with mortgage debt responsible for the lion’s share. According to the Consumer Financial Protection Bureau, 68 percent percent of retired boomers — roughly 4.4 million— have an existing mortgage and report that making mortgage payments in addition to other monthly expenses is a hardship, yet they wish to remain in their current homes throughout retirement.

By replacing a typical mortgage with the lump sum from a reverse mortgage, the client is no longer required to provide monthly principal and interest payments. Without the monthly debt obligation, clients achieve some breathing room and can dramatically slow the drain on fragile portfolios.

A client without a large existing mortgage to pay off may elect to establish a reverse mortgage line of credit. This line of credit provides a liquid emergency fund to meet unforeseen spending shocks in retirement. Clients may want to use the standby line to help mitigate losses from selling in down markets. “Mitigating sequence risk of returns in a portfolio simply involves setting up the reverse mortgage line of credit and drawing from that if the preceding year is flat or negative,” explained Graves. In addition to increasing longevity of a client’s retirement assets, removing the need to spend assets during a market downturn can increase satisfaction in retirement.

Annuitizing home equity can also help to lessen a retiree’s withdrawal rate. Research published by Gerald Wagner, PhD, CFA and Wade Pfau, PhD, CFA suggests that steady monthly tenure payments from the HECM contribute to cash flow survival for a wide range of clients. In other words, the probability of running out of money is less if home equity is factored into retirement income planning.

Creative Uses of Reverse Mortgage Lines of Credit

Aside from extending a retirement income plan's longevity and helping to mitigate portfolio risk, reverse mortgages can be used for Social Security optimization, providing individuals the option to defer claiming their Social Security benefits when they would otherwise be unable. Although no strategy is right for everyone, some clients will be helped if they can both delay Social Security *and* portfolio draws by using the HECM as an "income bridge" in the early years of retirement, especially if the early years are in bear markets.

Clients can use a reverse mortgage line of credit without drawing against their retirement portfolio to accomplish any number of retirement goals, needs or desires like:

- Self-insuring for long-term care
- Gifting to children and grandchildren
- Paying the taxes on a Roth Conversion

Another benefit to monetizing home equity with a reverse mortgage is the absence of income taxes. "For a client in the 33 percent overall tax bracket, every dollar taken out of a reverse mortgage equals a dollar and a half not taken out of retirement assets," said Shelley Giordano quoting Task Force member Dr. Thomas C.B. Davison, CFP®.

A Special Note on "Standby Lines of Credit"

Most advisors are unaware that when the reverse mortgage is used as a "standby line of credit," borrowing power grows month-over-month at the cost of the money actually borrowed. "The HECM line of credit, unlike a traditional HELOC, cannot be canceled, frozen or reduced and must grow in credit capacity regardless of the underlying home value," observed Giordano. Graves concurred, calling the standby line of credit "the Swiss army knife of retirement income planning." An advisor familiar with the literature will best be able to guide clients in the appropriate, and prudent use of home equity with an eye to conserving it just as they would any other client's other assets. "Had advisors been versed in the proactive but controlled use of reverse mortgages, many of the unfortunate situations that arose at the end of the housing bubble could have been avoided," noted Giordano.

A Better Way to Position Reverse Mortgages with Clients

First and foremost, Graves urged financial advisors to reframe their opinion of reverse mortgages and start viewing them as supplementary to a complete retirement income plan. As advisors work with clients, it's important they have a comprehensive understanding of how a reverse mortgage can meet their clients' goals, regardless of the retirement income strategy. "We're not saying it's the conclusion," Graves said of reverse mortgages, "We're saying it should be part of the conversation." Giordano agreed, stating that the best way for an advisor to learn the intricacies of a reverse mortgage is to pursue one for a specific client. "Pick one client who has a particular need and contact two or three lenders for proposals," said Giordano. "You will learn quickly about the various options, and how interest rates, life expectancies, home values, and existing mortgages interplay. Once you see how it works for one client, the rest will be easy."