Reverse Mortgages: Has Their Time Finally Arrived?

Reverse mortgage is the term commonly used for what is actually called a Home Equity Conversion Mortgage (HECM). HECMs used to be very poorly regulated. They were sold in apparently random situations, often by mortgage brokers without the training and experience to understand them fully. In many ways they'd become 'the flavor of the month'.

Over the past five years or so, things have improved on all fronts so we're beginning to consider them for several client situations. Here are some financial strategies utilizing HECMs.

- **Lowering mortgage payments** – When income remains constant but expenses rise, it may become difficult to maintain an existing mortgage payment. A HECM, which doesn't require a monthly payment, can be used to re-finance the original mortgage. A HECM may also be used to finance home renovations to allow for aging in place or even to purchase a new (perhaps smaller) home without requiring a monthly payment.

- **Avoiding investment account withdrawals** - No one wants to be forced to sell securities to cover living expenses when markets are down. A HECM draw can be used instead, providing time for portfolios to regain their value and mitigating what's known as *sequence of return* risks.

- **Annuity alternative** – Those considering an annuity to provide retirement income might find a HECM preferable since payments can be easily 'turned on and off' as needed. Annuities have significant internal and sales costs so up the front expenses associated with a HECM may be quite reasonable in comparison.

- **Delaying Social Security** – The longer Social Security is deferred, the higher the monthly payment. A HECM can help cover living expenses during the gap years from the beginning of retirement until maximum SS payments become available at age 70.

- **Tax bracket management** – HECM payments are not taxable income so using one might allow for a tax efficient Roth conversion by keeping other taxable income low.

- **Covering insurance premiums** – A HECM can be used to pay long-term care insurance premiums or to replace an LTC policy. Again, HECM income is not taxable so there are no tax considerations.

- **Financing retirement** – Even the best laid plans can sometimes be derailed. If investment accounts have been depleted, a HECM can be a way to fund retirement spending.

With all of these potential uses, why has WWA only recently begun suggesting HECMs to our clients? The most important reason is that much of the risk previously associated with HECMs has been mitigated. The borrowing process now includes mandatory insurance from the Department of Housing and Urban Development. A HUD insurance premium is paid by every borrower at closing and again yearly. It guarantees that the mortgage holder will never 'go in the hole' using a HECM. Even if the home's ultimate value should fall below the amount borrowed, the estate will not owe the difference.

Why might we recommend a relatively complex HECM over a much simpler second mortgage or Home Equity Line of Credit, especially since HELOCs usually have no closing costs and often a lower interest rate? The most important reason is that HELOCs can be cancelled at any time by the lending institution; HECMs can't. The last thing we want for a client is to have their line of credit disappear just when it's needed.

The other reason is flexibility. If money is needed to replace an existing mortgage, a HECM can be structured for the highest immediate borrowing amount. If the money is intended for later use 'as needed', a HECM can start with a lower initial limit which grows more quickly over time. For clients who don't want to tap their investments until things improve, a draw can be taken, then repaid if they wish, to maintain a high borrowing limit.

What are some HECM requirements? At least one of the borrowers must be 62 or older. The property must be owner-occupied and used as a principal residence. There is financial underwriting to confirm that property taxes and insurance payments can be kept current. Finally, borrowers must complete a one-hour HECM counseling course on the phone.

WWA has vetted several mortgage companies that offer HECMs and now has one to recommend (*not* the one pitched by actor Tom Selleck on late night TV). Of course, we have additional information and are constantly updating our knowledge. We're happy to share what we've learned if you're interested.