Using a Reverse Mortgage as a Retirement Investment Tool

My Comments: Retirement for most people has a time frame of many years. It's a period where health issues become more frequent and one's ability to generate new income is increasingly difficult. For some that's important since too many people these days retire without enough money to last the 25-30 years they're likely to live.

My reason for sharing this article is that today, reverse mortgages do not present the perceived threat they did 25 years ago. They are a highly regulated, safe way to help people pay their bills in retirement.

Though I'm semi-retired, I am also a licensed professional when it comes to talking about reverse mortgages. I simply want you to understand it's another viable tool when it comes to making sure you can pay your bills in the years ahead.

by Alina Tugend \ March 7, 2022 \ https://tinyurl.com/yapvrd93

Pulling the equity out of your house through a reverse mortgage seems to fly in the face of the American dream of proudly living in a fully paid-up home. That, combined with the sketchy reputation reverse mortgages have sometimes had, is why most people are wary of pursuing these loans.

But over the past decade, the U.S. Department of Housing and Urban Development strengthened regulations to protect consumers. HUD backs and oversees about 95% of reverse mortgages, and increasingly, **some retirement experts believe these loans can be part of an overall investment strategy** that lets people stay in their homes as they age. "Like any financial product, reverse mortgages can be a great tool," says Jennifer Fraser, director of stakeholder engagement at GreenPath Financial Wellness, a nonprofit financial counseling service. "They work well for some people and are not a great fit for others."

Reverse mortgages have been around for about 60 years, but in 1989, the law changed to allow the Federal Housing Authority to back reverse mortgages through an FHA-approved lender, and the Home Equity Conversion Mortgage was created. HECMs are the only federally insured reverse mortgages.

The following decades, however, proved a bumpy road for these loans. **Stories abounded of people taking the loans out without fully understanding -- or being told -- the specifics.** A minority of borrowers lost their homes because they didn't have enough money to cover property taxes, homeowners insurance and home maintenance. Once they defaulted, they faced foreclosure. "A combination of updated regulations and research means reverse mortgages are now safer for consumers," says Wade Pfau, a professor of retirement income at the American College of Financial Services.

Reforms, Pitfalls and Misunderstandings

First, the basics. **A reverse mortgage is a loan, with the interest on it compounding, but unlike a traditional mortgage, you or your estate repays the principal and interest at the end of the loan.**

Federally insured HECMs have strict requirements. You must be age 62 or older, and as of 2022, the loan can't be based on a home value greater than $970,800, even if the house is worth more. Typically, you must have at least 50% equity in the home, which must be your principal residence. In 2021, the average age of an HECM borrower was 73 years old, with the average home value $415,000, according to Steve Irwin, president of the National Reverse Mortgage Lenders Association. Besides HECMs, a small number of private reverse mortgages are available in some states through specific lenders. Typically, private reverse mortgages are more appropriate for someone younger than 62 who has a high-dollar-value house or lives in a condominium. Condos aren't always eligible for HECMs.

The lender takes over a house when the borrower dies or moves out for more than a year, but heirs are entitled to any leftover home equity and can even use it to pay off the reverse mortgage and reclaim the house. Because a reverse mortgage is considered a nonrecourse loan, you or your heirs can't owe more than the home's fair-market value. Mortgage insurance, which FHA requires borrowers to have, protects the lender if the home's value falls.

But other pitfalls exist, some of which HUD has addressed. The agency now requires that borrowers receive counseling at HUD-approved sites before closing on an HECM and limits how much a borrower can draw at closing or in the loan's first year. HUD also mandates a financial assessment of the borrower's sources of income, including Social Security, pensions and investments. **The amount you**

can borrow depends on your age (with older homeowners typically receiving more) and your house value, the amount of equity in it and interest rates. Although other debts are considered, there is no debt-to-income ratio requirement.

One important provision that HUD addressed pertains to spouses who aren't named on the reverse mortgage. Before 2014, the nonborrowing spouse could be evicted from the home or required to repay the reverse mortgage loan if the borrowing spouse died or moved into assisted living. **HUD made it easier for an eligible nonborrowing spouse to stay in the house**, although the reverse mortgage payments cease. The reverse mortgage is paid off when the nonborrowing spouse dies or moves out of the home.

HUD's changes have helped. The number of reverse mortgage defaults have fallen to about 1.5% in 2019, compared with between 3.6% and 5% before 2014, says Irwin. According to HUD, **49,207 HECMs were taken out in 2021**. Nevertheless, some people still don't know what a reverse mortgage is, says Cora Hume, a lawyer in the Office for Older Americans in the Consumer Financial Protection Bureau. "If people are taking out a product and don't understand it, that's a problem."

Irwin notes that **about 40% of potential applicants who go through counseling to take out the loans decide not to proceed**. Expense is a factor. Reverse mortgage fees, which are usually rolled into the loan, can be high. For example, fees and the required mortgage insurance are about $25,000 for an $800,000 house, according to Pfau.

The reverse mortgages themselves can be paid out in four different ways: a lump sum when the loan is taken out; tenure, which is equal monthly payments as long as at least one borrower lives and continues to use the home as a main residence; term, which consists of equal monthly payments over a fixed period; or a line of credit, also known as a standby mortgage, that can be used until the money is gone. **Only the lump sum option qualifies for a fixed interest rate.** Everything else has a variable rate.

A Built-In Portfolio Neutralizer

Although most people think of reverse mortgages as a standalone loan, it's time to consider them differently, says Jack Guttentag, a professor emeritus of finance at the University of Pennsylvania's Wharton School. "The way their full power can be realized is within the structure of a retirement plan." For example, he says, typically as people age, they are told to reduce portfolio risk by holding fewer stocks. If you have **an HECM line of credit, he says, it acts "as a builtin neutralizer" for a more stock-heavy portfolio**, letting you remain invested in equities longer.

That's why Ken Hillenburg, 72, from Temecula, Calif., decided to take out a reverse mortgage on the house he and his family have lived in for 34 years. A career in medical sales left him with a nice portfolio, but after retiring, he started thinking about how he could leave the most to his three adult children. Hillenburg had seen the commercials on television touting reverse mortgages and had a rudimentary understanding of them. Although his house is currently valued at about $850,000, real estate prices in his area have fluctuated dramatically over the years.

After much research, he decided to take out a reverse mortgage, using some of the money to pay the home's existing mortgage, which was approximately $1,500 monthly, and living off the rest. "We can now spend money out of the portfolio by choice, not necessity, and we protected the house," he says. "There will still be a fair amount of equity in it depending on how long we live," he says. "And if we go in the middle of a severe housing downturn, the kids won't be responsible for anything."

Pfau says if people plan to stay in their home for the foreseeable future and are interested in using a reverse mortgage as part of their retirement strategy, "it makes sense to incorporate it as early as possible rather than leaving it as a last resort." A line of credit through a reverse mortgage is like an insurance premium, he says. If you never need the insurance, "that's great, and if you do, then you have it." Hillenburg used government and independent third-party websites to do his research, rather than lenders' sites, to get information that was as objective as possible. The Consumer Financial Protection Bureau, reversemortgage.org, which is run by the National Reverse Mortgage Lenders Association, and AARP offer a variety of information, including reverse mortgage calculators.

Reverse mortgages certainly aren't for every older homeowner, Irwin says, and people should never feel pressured into taking one out, "but **for the right person under the right circumstances, this is a safe and good option to consider for effectively aging in place**."

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