Save Your Retirement with a Reverse Mortgage

My Comments: Many of you may have negative thoughts when you hear the term 'reverse mortgage'. At one time that reaction was reasonable, but not any longer.

They are now a legitimate financial planning tool that advisors like me employ when the circumstances are appropriate. As you will read below, they can be a life saver when cash flow is limited or we're in the middle of a market crisis and you don't want to sell your stocks and bonds and lose a ton of money.

They can also be a critical element in your efforts to find financial freedom.

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Reverse mortgages have been around for a long time. It's a method that an individual can use to convert the equity built up in their home to a credit line or an income for as long as they remain in the home as their primary residence, without the burden of monthly mortgage payments. But up until recently the fees to establish one were very high. As a result, financial planners (including myself) did not recommend them to clients. In many cases our broker/dealer firms prohibited us from even talking about them.

But recently I met with Bob Tranchell, a senior VP at the Federal Savings Bank. Bob is a specialist in reverse mortgages. He explained to me all the changes that have occurred with reverse mortgages in the last few years. In 2010 and 2013 the federal govt. revised the Home Equity Conversion program (HECM) reduced its costs and made it more secure**.** Bob showed me how the reverse mortgage could become a very effective tool for aging baby boomers to give them security during their retirement years.

It is estimated that 87 percent of baby boomers will own a home in retirement, but 68 percent of them will still carry a mortgage. Research shows that the foreclosure rate for individuals between ages 65-74 increases by 920 percent. Often seniors who have a reduced income after retirement cannot maintain the payments they made while they were working.

In addition, boomers may face the dangers of being in the sandwich generation. They might have to help their aging parents financially at the same time they have to support their children with student loans and no job. A Merrill Lynch survey indicated that more than 60 percent of boomers are considered the family bank, handing out funds to their parents or adult children.

Let's look at an example of how a reverse mortgage can help a retired boomer. If he or she is at least 62 years old, he can take out a reverse mortgage on the value of his home up to $625,000. The percentage available is based on his age, the appraised home value, the lender's margin and the 10-year LIBOR rate (an interest rate index established by the Fed. Govt.). The 62-year-old will have access to 52.4 percent of the home value or $327,500.

He can take these funds as a lump sum, a fixed income for the rest of his life (Tenure), a term payment (fixed payment for a fixed period) or a credit line**.** The cost of the reverse mortgage is a 0.5 percent mortgage insurance premium, the loan origination fees and any closing costs. For the $327,500 amount the total costs would be between $6000-$14000 dollars. This can be wrapped into the mortgage. No loan payments are due as long as the individual keeps the home.

Payments that come from the reverse mortgage are received income tax free. If the individual does not tap into the mortgage the credit line increases each year based upon the lender's margin, a 1.25 percent mortgage insurance premium and the value of the 1-year LIBOR rate. Currently it increases at more than 5 percent a year! Eventually the credit line can exceed the actual value of the home, but the heirs of the borrower are only responsible for the value equal to 95 percent of the appraised value of the home. The rest is forgiven! They can choose to sell the home or take out a new mortgage and pay back the reverse mortgage.

Let's assume the 62-year-old took out a reverse mortgage for $320,000 and didn't touch it for 20 years. Based on current rates his credit line will have grown to $1,200,000 regardless of the value of the home. Assuming he wants to convert the loan into an income at age 82, he'd receive $10,103 per month for ten years and could still keep $300,000 in reserve as a line of credit (which will grow to $569,391 in another 10 years).

The reverse mortgage can also be used to pay off an existing mortgage and eliminate mortgage payments, pay for long term care or a long-term care policy or assist children or parents with financial needs. It cannot be used to purchase an annuity or buy stock. If the borrower is concerned about leaving a legacy to his or her children, he and his spouse can buy a second-to-die life insurance policy and pay the premium with some of the proceeds from the reverse mortgage. When the second spouse dies the kids will receive a tax-free death benefit which they can use to pay off the reverse mortgage and own the home debt free.

The possibilities are endless. I have only touched on a few. **Key to the program is that payments are received tax free, the loan is unsecured, and the heirs are only responsible to pay back a maximum of 95 percent of the home's value regardless of how much was taken out**. It's a win-win.