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HECM LINE OF CREDIT

Research Review: Reverse Mortgages in Retirement Planning: Dec 9 2014 Update

BY TOM DAVISON ON APRIL 18, 2014 · (LEAVE A COMMENT)

The research on reverse mortgages in financial planning has grown quickly in the last three years. Much of it focuses on sustainable withdrawals, consistently showing improvements to retirement spending. This post provides highlights of existing work. If you know of other work, please let me know!

Strategies Supplementing Investment Portfolio Withdrawals with Reverse Mortgages

Three research teams demonstrated substantial improvement in sustainable withdrawals when augmenting portfolio withdrawals many ways with reverse mortgage draws. This is due to several factors, including:

- Portfolio returns are higher than housing returns: leverage works
- More assets are available when housing wealth is included in spending
- Reverse mortgage Lines of Credit are guaranteed to grow, perhaps dramatically, over a homeowner's lifetime
- Sequence risk in early years is controlled when reverse mortgage funds are available early
- Reverse mortgage draws are tax-free loan proceeds

Research from Gerald Wagner and Barry and Stephen Sacks

A variety of strategies can be used to fund spending when combining reverse mortgage and portfolio draws. Wagner examines 5 strategies, such as a using the reverse mortgage line of credit first before any portfolio withdrawals, fixed monthly draws for 30 years, or monthly tenure advance guaranteed to continue as long as the homeowner stays in the house. All strategies improved sustainable retirement withdrawals. Benefits of each strategy are examined.

Wagner, Gerald C. 2013. "The 6.0 Percent Rule." Journal of Financial Planning, 26(12): 46 - 54.

- With only the portfolio to fund spending, sustainable withdrawals were 3.75%. In contrast, "With a 30-year spending horizon and first-year withdrawal of 6.0 percent, reverse mortgage scheduled advances as a portfolio supplement give

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"spending success" levels of 88 to 92 percent. Even with a first-year withdrawal of 6.5 percent, success levels are still 83 to 86 percent."

- "This paper provides financial planners with a review of the relative merits of using a reverse mortgage as a retirement spending supplement."
- After 15 years, the client's estate value is 10 to 30% higher using the reverse mortgage plus portfolio than relying on the portfolio alone, combining current portfolio, home value and deducting the reverse mortgage loan balance.
- http://www.onefpa.org/journal/Pages/December-2013-The-6-0-Percent-Rule.aspx

Sacks, Barry H., and Stephen R. Sacks. 2012. "Reversing the Conventional Wisdom: Using Home Equity to Supplement Retirement Income." Journal of Financial Planning 25(2): 43-52.

- "This paper examines three strategies for using home equity, in the form of a reverse mortgage credit line, to increase the safe maximum initial rate of retirement income withdrawals."
- http://www.onefpa.org/journal/Pages/Reversing%20the%20Conventional%20Wisdom%20Using%20Home%20Equity%20to%20Supplement%20Retirement%20Income.aspx

Standby Reverse Mortgages: Improve Investment Portfolio Withdrawals by Borrowing From and Repaying HECM Line of Credit

A Standby Reverse Mortgage is a strategy of borrowing from the HECM Line of Credit when the portfolio has suffered a significant downturn, and repaying it after the portfolio recovers so it is available to help future spending in the future. The team of Salter, Pfeiffer and Evensky introduced this concept.

Pfeiffer, Shaun, C. Angus Schaal, and John Salter. 2014. "HECM Reverse Mortgages: Now or Last Resort?" Journal of Financial Planning 27(5) 44-51.

- "This study outlines recent changes in the reverse mortgage market and investigates plan survival rates for distribution strategies that establish a Home Equity Conversion Mortgage (HECM) reverse mortgage line of credit at the beginning of retirement and as a last resort.
- "Early establishment of an HECM line of credit in the current low interest rate environment is shown to consistently provide higher 30-year survival rates than those shown for the last resort strategies. The early establishment survival advantage for real withdrawal rates at or above 5 percent is estimated to begin between 15 and 20 years after loan origination and is shown to be as high as 31 percentage points, or 85 percent, greater than the last resort survival rates."
- http://www.onefpa.org/journal/Pages/MAY14-HECM-Reverse-Mortgages-Now-or-Last-Resort.aspx

Pfeiffer, Shaun, John Salter, and Harold Evensky. 2013 "Increasing the Sustainable Withdrawal Rate Using the Standby Reverse Mortgage." Journal of Financial Planning 26(12): 55-62.

- Sustainable withdrawal rates jumped from 3.15% to 5 and 6% with a standby HECM Line of Credit. The real key, not directly addressed in the article, is the size of the line of credit in relation to the portfolio. Clients had an important boost in sustainable spending with a line of credit as small as 8% - 10% of the portfolio. The authors note "The findings from this research suggest that the adage of using a reverse mortgage as a last resort could be a huge mistake in a rising interest rate environment where a retiree waits to set up a line of credit in the future."
- http://www.onefpa.org/journal/Pages/December-2013-Increasing-the-Sustainable-Withdrawal-Rate-Using-the-Standby-Reverse-Mortgage.aspx
- Michael Kitces notes: "this latest version looks specifically at the maximum safe withdrawal rate that can be sustained by the strategy, and is updated for the latest reverse mortgage rules that took effect this fall. Using reduced

market expectations (relative to historical standards), the results show a significant improvement in safe withdrawal rates (in the neighborhood of 5% even with lower return assumptions) under the standby reverse mortgage scenario, driven in part by the favorable liquidation effects and in part simply because the strategy taps home equity and introduces additional assets to the retirement balance sheet." "clients who wish to implement the strategy should look at establishing the line of credit sooner rather than later (while interest rates are still low), even if there is no intention to borrow until an extended period into the future (to reduce the risk that rates will be higher and borrowing limits will be lower if the client waits until funds actually need to be used)."

- http://www.kitces.com/blog/weekend-reading-for-financial-planners-dec-7-8/

Salter, John, Shaun Pfeiffer, and Harold Evensky. 2012. "Standby Reverse Mortgages: A Risk Management Tool for Retirement Distributions." Journal of Financial Planning 25 (8): 40–48.

- "The authors propose using an HECM Saver reverse mortgage as a risk management tool in conjunction with a two-bucket investment strategy to increase the probability a client will be able to meet predetermined retirement goals."
- http://www.onefpa.org/journal/Pages/Standby%20Reverse%20Mortgages%20A%20Risk%20Management%20Tool%20for%20Retirement%20Distributions.aspx

Salter, John, Shaun Pfeiffer, and Harold Evensky. 2012. "Standby Reverse Mortgages: A Risk Management Tool for Retirement Distributions." Presentation sponsored by Genworth. Document created August 17, 2012.

- Talk based on Journal of Financial Planning 2012 article. Additional charts of interest, including details of HECM balance usage. For example: Less than 25% of plans had a HECM loan balance in any year, and about 5% of months had a plan with 100% of line of credit used
- http://bit.ly/1hgk0I2

Evensky, Harold. June 2013 "10 Questions. Harold Evensky on ETFs, Reverse Mortgages, and the Most Important Investment in the Coming Decade." Journal of Financial Planning 26(6): 16-20.

- Short discussion described in detail in other papers. "our conclusion was, anyone who qualified for it should consider doing it. And there's a high probability, based on our simulations, that most investors would never have occasion to draw on it, but as I said, we see it as an insurance policy."
- http://www.fpanet.org/docs/assets/CD39A280-E3A4-36A0-74A2636662D9880E/10Q.pdf

Reverse Mortgages in Financial Planning - General

Guttentag, Jack posts as "The Mortgage Professor"

- Guttentag discusses reverse mortgages and other types of mortgages on his website. Posts on a variety of aspects of reverse mortgages. Calculators provided.
- http://www.mtgprofessor.com/ArticleCategories/Reverse_Mortgages.htm

Kitces, Michael. 2014. "Taking a Fresh Look at Reverse Mortgages in Retirement." AICPA Advanced Personal Financial Planning Conference. January 21.

- An updated version of earlier talks.

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Kitces, Michael. 2013. "HECM Reverse Mortgages – Current Borrowing Limits May Not Last Much Longer." Nerd's Eye View. December 4.

- http://www.kitces.com/blog/hecm-reverse-mortgages-current-borrowing-limits-may-not-last-much-longer/

Kitces, Michael. 2013. "Is a Reverse Mortgage Better Than Keeping a Traditional Amortizing Mortgage in Retirement?" Nerd's Eye View. September 18.

- "the fact remains that all else being equal, traditional amortizing mortgages introduce additional sequence risks to the household leverage scenario (above and beyond just the risk that the portfolio fails to outperform the loan) that reverse mortgages alleviate, which should make reverse mortgages especially appealing for retirees who believe it's worth the risk of maintaining a mortgage and a portfolio side by side in retirement."
- http://www.kitces.com/blog/is-a-reverse-mortgage-better-than-keeping-a-traditional-amortizing-mortgage-in-retirement/

Kitces, Michael. 2013. "Will New Reverse Mortgage Changes Make Them a Better Financial Planning Tool?" Nerd's Eye View. September 11.

- http://www.kitces.com/blog/will-new-reverse-mortgage-changes-make-them-a-better-financial-planning-tool/

Kitces, Michael. 2013. "HUD Eliminating Fixed-Rate HECM Standard Reverse Mortgages, But HECM Saver Option Remains." Nerd's Eye View. February 27.

- http://www.kitces.com/blog/hud-eliminating-fixed-rate-hecm-standard-reverse-mortgages-but-hecm-saver-option-remains/

Kitces, Michael. 2011. "Evaluating Reverse Mortgage Strategies." The Kitces Report. November.

- Broad review of how reverse mortgages can fit in client's retirement plans.

Kitces, Michael. 2011. "A Fresh Look at the Reverse Mortgage." The Kitces Report. October.

- Summarizes the internal workings of reverse mortgages.

Lynch, Nicholas C. and Charles R Pryor. 2012. "Know the costs, benefits and alternatives for this retirement funding tool." Journal of Accountancy. July.

- Includes section on family-funded alternatives to reverse mortgages
- http://www.journalofaccountancy.com/issues/2012/jul/20103561

Munnell, Alicia H. and Steven A. Sass. 2014. "The Government's Redesigned Reverse Mortgage Program." Center for Retirement Research at Boston College. January, Number 14-1.

- Reverse mortgages, which allow retirees to tap their home equity, are insured by the government.
- The financial crisis hurt both the government's insurance fund and the borrowers: Declining home prices led to losses when homes were sold; More borrowers defaulted.
- In response, the government has redesigned the program by: creating a single loan option with a lower limit and fees; limiting initial withdrawals; and requiring financial assessments of borrowers.
- These changes should help reduce pressure on the insurance fund and make defaults less likely

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- Conclusion: "All these changes should be viewed as positive. A better customer experience combined with lower fees will also make reverse mortgages a more attractive option for retirees."
- http://crr.bc.edu/briefs/the-government%E2%80%99s-redesigned-reverse-mortgage-program

Pfau, Wade. 2014. "The Hidden Value of a Reverse Mortgage Standby Line of Credit." http://www.advisorperspectives.com Dec 9.

- "In this article, I show that the benefits of opening a home-equity conversion mortgage (HECM) line of credit extend beyond meeting spending needs. With the current HECM rules, those living in their homes long enough could reap a large windfall when the line of credit exceeds the home's value. This potential windfall is amplified by today's low interest rates. Even if the value of the home declines, the line of credit will continue to grow without regard for the home's subsequent value. Combining this with the fact that a HECM is a non-recourse loan means that the HECM provides a very valuable hedging property for home prices."
- The analysis suggests "suggest that the average 62-year old client will live long enough to have a 90% chance that the line of credit is worth more than their home. Any excess is the payoff from this strategy, and it also serves as a good protection from housing price declines."
- "The HECM program provides a way to create liquidity for the home, which is otherwise an illiquid asset. Removing the constraint about how home equity can be used affords a more efficient retirement-income strategy.
  Even if that line of credit does not end up being used to meet income needs, its growth could provide a way to leave a larger legacy at death. The HECM is non-recourse, and mortgage insurance premiums are paid so that the lender does not lose after having paid more to the borrower than the home is worth. In this sense, the mortgage insurance premiums can be viewed as insurance against a fall in home prices if one lives sufficiently long."

- http://www.advisorperspectives.com/newsletters14/Hidden_Value_of_Reverse_Mortgage_Standby_Line_of_Credit.php

Sass, Steven, Alicia H. Munnell, and Andrew Eschtruth. 2014. A Retirement Planning Guide. Using Your House for Income in Retirement. Center for Retirement Research at Boston College. September.

- *"Using Your House* reviews the two most common ways to use your house to boost your income in retirement - downsizing and a reverse mortgage - with clear examples, a discussion of the pros and cons of each approach, and links to tools on the web where you can get estimates of what downsizing or a reverse mortgage can do for you."
- http://crr.bc.edu/special-projects/books/using-your-house-for-income-in-retirement/

Quinn, Jane Bryant. 2013. "A great reverse mortgage idea: Take a credit line now." August 15.

- "But there's a valuable new opportunity at hand, for borrowers who don't need extra money now. You borrow as early as age 62 and take the mortgage in the form of a credit line instead of all-cash. You can borrow against the credit line at any time, but you don't have to take the money now. More important, this credit line grows every year - greatly increasing your borrowing power in the future."
- http://janebryantquinn.com/2013/08/a-great-reverse-mortgage-idea-take-a-credit-line-now

Technical Details for Reverse Mortgage Nerds

HUD handbook for Home Equity Conversion Mortgages (4235.1)

- http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh/4235.1

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HUD's site for lenders: Home Equity Conversion Mortgages for Lenders (HECMs)

- "The purpose of this page is to help FHA approved lenders by providing links to policy, guidance and tools that help in the origination and servicing of HECM loans."
- http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmhomelenders

Help Finding References

Send a note to tcbdavison@gmail.com (mailto:tcbdavison@gmail.com) if you need help finding a reference.

Categories: HECM Line of Credit (http://toolsforretirementplanning.com/category/hecm-line-of-credit/), Retirement Spending (http://toolsforretirementplanning.com/category/retirement-spending/), Reverse Mortgage (http://toolsforretirementplanning.com/category/reverse-mortgage/), Standby Reverse Mortgage (http://toolsforretirementplanning.com/category/standby-reverse-mortgage/), Sustainable Withdrawals (http://toolsforretirementplanning.com/category/sustainable-withdrawals/)