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Seniors may find reverse mortgage a good option as other investments decline

Reverse Mortgages - the "Investment" that Grows, says industry leader

Editor's Note: The following was requested from the author, a long-time contributor of information about the reverse mortgage program.

by Michael Branson, CEO All Reverse Mortgage

Feb. 2, 2016 - Are you losing money in your portfolio as the stock market is plunging right now? So many people are. Just yesterday I received a call from a borrower for whom I closed a reverse mortgage a little less than a year ago who wanted to thank me again and let me know that the reverse mortgage saved her.

Not only does she not have to make the monthly payment that she had before on a mortgage, but after speaking with a money manager to whom she turned for help with her dwindling portfolio, she is extremely happy that she chose a financial tool, the reverse mortgage, where the funds available to her are growing on an annual basis at a time when her portfolio is shrinking.

Let me explain.

The line of credit reverse mortgage has a feature whereby the unused portion of the line grows at a rate equal to the interest of the loan plus the annual Mortgage Insurance renewal rate. For most loans being originated now, this equals anywhere from 4.5% to 5.4% annually.

I want to be clear on this because there are a lot of people who either misstate how this line of credit grows or misunderstand the growth of the line. This is not interest that a borrower "earns" on the reverse mortgage funds that they have not used from their line. It is not as though you have placed money into a bank account and the bank pays you interest while the funds are in the account.

Source: https://reverse.mortgage/reverse-mortgage-credit-line-growth

The line of credit reverse mortgage is like any other loan in that you accrue interest on the funds as you borrow them. Just like a traditional Home Equity Line of Credit (HELOC), as long as you are not borrowing the funds, they remain available to you, but you do not accrue interest on the funds until you actually borrow them.

Unlike the HELOC, on a reverse mortgage there are no required monthly payments. And, the bank cannot arbitrarily decide to close the line

- if you haven't used it for a while,

- if the values in the neighborhood have changed,
- if they have made the decision to stop HELOC lending or
- your financial ability to qualify for the loan has changed at a later date.

There is also no maturity date of say, 10 or 15 years.

Once you have your reverse mortgage, you have it for as long as you live in the home and meet the other provisions of the lending agreements (pay your taxes and insurance and reasonably maintain the home).

And, unlike the standard HELOC, the reverse mortgage has a feature that allows the loan proceeds available to the borrower to grow as stated above.

Getting back to the issue of the growing line of credit, borrowers who use their entire loan proceeds would accrue interest and mortgage insurance renewal premiums on the outstanding balance causing the outstanding balance owed on the loan to grow at a rate that is acceptable to HUD based on their calculations. This is why borrowers are not given access to 100% of their equity.

So those borrowers who do borrow the maximum amount available to them do not accrue this interest and mortgage insurance as would a borrower who did.

To make the opportunity equal for all borrowers, HUD allows the amount available to the borrower who did not draw all his funds in the next year to grow by the amount of the interest and mortgage insurance premium that the borrower did not accrue on the loan.

For example, a 63-year-old borrower in Southern California with a $500,000 home with no mortgage to pay off, might start with a loan balance of about $8,828, if they take no initial funds with a line of credit from All Reverse Mortgage which pays for the initial costs and the Up-Front Mortgage Insurance Premium (maybe a bit more if you go with a lender who charges full fees).

The initial net Principal Limit (the loan amount available to the borrower after all costs) would be about $256,172. However, at the end of the first year with a 3% margin, that line of credit available to the borrower would now be $270,342...a healthy increase.

If rates did not go up and the borrower did not touch the line for 5 years, the amount available to the borrower would grow to $335,306.

In 10 years when the borrower was 73, the amount available would be $438,886.

In 15 years at 78 years old, the amount available to the borrower is $574,463.

That's assuming that the rates don't go up. If interest rates rise a moderate half percent per year in the first 4 years and stop at 2% increase hovering just above 6%, in that same 15year period, the line would grow to a little over $700,000!

		Annual Totals					End of Year Projections			
Yr	Age	SVC Fee	Cash Payment	MIP	Rate	Interest	Loan Balance	Line Of Credit	Property Value	Equity
1	63	$0	$0	$113	4.146%	$375	$9,316	$270,342	$520,000	$510,009
2	64	$0	$0	$119	4.146%	$396	$9,832	$285,296	$540,800	$530,293
3	65	$0	$0	$126	4.146%	$418	$10,375	$301,077	$562,432	$551,382
4	66	$0	$0	$133	4.146%	$441	$10,949	$317,731	$584,929	$573,305
5	67	$0	$0	$140	4.146%	$465	$11,555	$335,306	$608,326	$596,096
6	68	$0	$0	$148	4.146%	$491	$12,194	$353,854	$632,660	$619,790
7	69	$0	$0	$156	4.146%	$518	$12,869	$373,427	$657,966	$644,422
8	70	$0	$0	$165	4.146%	$547	$13,581	$394,083	$684,285	$670,029
9	71	$0	$0	$174	4.146%	$577	$14,332	$415,882	$711,656	$696,649
10	72	$0	$0	$184	4.146%	$609	$15,124	$438,886	$740,122	$724,323
11	73	$0	$0	$194	4.146%	$643	$15,961	$463,163	$769,727	$753,091
12	74	$0	$0	$205	4.146%	$678	$16,844	$488,783	$800,516	$782,997
13	75	$0	$0	$216	4.146%	$716	$17,776	$515,819	$832,537	$814,086
14	76	$0	$0	$228	4.146%	$755	$18,759	$544,352	$865,838	$846,404
15	77	$0	$0	$240	4.146%	$797	$19,797	$574,463	$900,472	$880,000
16	78	$0	$0	$254	4.146%	$841	$20,892	$606,239	$936,491	$914,924
17	79	$0	$0	$268	4.146%	$888	$22,047	$639,773	$973,950	$951,228
18	80	$0	$0	$283	4.146%	$937	$23,267	$675,162	$1,012,908	$988,966
19	81	$0	$0	$298	4.146%	$989	$24,554	$712,508	$1,053,425	$1,028,196
20	82	$0	$0	$315	4.146%	$1,044	$25,912	$751,920	$1,095,562	$1,068,975

Now remember, this is not interest anyone paid to you and you didn't earn any money on this at all. But you have a line of credit available to you for this amount, so your borrowing power has increased tremendously (with no additional qualification or fees).

But you also don't accrue interest on money you don't borrow and if you never borrow it, you or your heirs never have to pay that back and the equity in the home always belongs to you or your heirs.

You would have a loan insured by the federal government that could not be closed on the whim of the lender and those funds would be available to you if you ever had the need for as long as you lived in the home. Can you say the same thing for your stock portfolio right now?

I've heard some people say that reverse mortgages are the loan of last resort. I think that there have been some great articles out of late that dispel this myth. We did a reverse mortgage for a Congressional Economist who has written a testimonial on our site who claims this is the only loan that gives borrowers an even break.

"Could not be more satisfied. Product is one of the few structured financial instruments that may be fair to consumers under appropriate circumstances. (That's why Wells Fargo and Bank of America are leaving the market.) All Reverse got my paper because of superior service, including pointing out a better deal than I had been ready to sign." - Dr. W. Jackson, Ph.D., banking advisor to the U.S. Congress for 27 years

Is the loan more expensive? It can be, and we encourage you to shop around. But now that HUD charges a smaller premium on the Initial Mortgage Insurance for borrowers who need to use less than 60% of their proceeds in the first 12 months, those initial premiums are just 1/5th of those who utilize larger draws.

And, for those of you who will utilize larger draws, the pricing has been very favorable with investors seeking safe havens and buying bonds so there are many times when your costs can be drastically reduced as well.

And I would like to leave you with one more thought. There is never a prepayment penalty with a reverse mortgage. The loan that we have been discussing is the adjustable rate line of credit program. The fixed rate loan requires you to take a full draw of the funds available to you at initial closing and then there are no further draws available to you.

The adjustable rate line of credit program allows you to take any amount up to the maximum available under the program or no draws, saving the funds for later and experiencing the growth outlined above. So for those of you who were thinking that you didn't want to accrue interest even on the small balance to set up the loan, in the example above, the first year's annual interest would have been $488 including the MIP accrual - if you waited until the end of the year to pay it.

So while there is never a payment required on a reverse mortgage, because there is no prepayment penalty, you can pay any portion at any time up to and including payment in full without penalty.

One caution for all reverse mortgage holders though, unlike a HELOC, once the loan reaches a 0 balance, it is considered paid in full and would be closed. If you intend to keep your loan active, always keep at least a minimal balance owed on your loan and check with your servicer before you approach a 0 balance. You can re-borrow any funds you pay back under this scenario (and the growth begins again once the balance is paid down).

Finally, remember the mechanics of the reverse mortgage when considering when might be the best time to apply. The things that determine how much you can borrow are mostly out of your control - HUD program parameters, your age, the value of your home and interest rates at the time are the biggest contributing factors. You can control your age based on when you apply but that has the least effect on the final numbers.

For example, for our 63-year-old borrower above, one year older in age will increase his proceeds $3,000. Not a lot of money when you consider that just 1/2 of one percent rise in interest rates would net the borrower $32,000 less in proceeds. HUD may not make any changes but they have and there is no way for borrowers to plan for this eventuality. In our example, if the effective rate were to rise 1/2%, the value of the home would have to increase by $70,000 just for the borrower to break even with where he is today.

The bottom line is that the interest rates are still below the HUD floor of 5% even though the Federal Reserve raised them recently and no one knows when or how much they will rise next. The risk and return just isn't in the borrowers' favor in most instances.

Therefore, once you've made the decision that this is a viable retirement vehicle for you to protect yourself against future income or market losses the delay seldom brings rewards because only a HUD favorable change or a massive value increase will help but a HUD negative change or interest rate increase could reduce proceeds tremendously.

Take this last thought - our example borrower above could have waited another year to get his loan and would have received another $3,000 in available loan proceeds but the line of credit grew $14,170 so having the line for a year and not using it gained almost 5 times the additional proceeds of waiting (who knows how his stock portfolio will do).

Talk to your financial advisor and compare the line of credit and its future growth in your circumstances against future monetary needs and you may find that the reverse mortgage is the perfect "investment" for your portfolio.

Additional Resources:

- **Standby Reverse Mortgages: Risk Management Tool for Retirement Distributions**

  https:/www.onefpa.org/journal/Pages/Standby%20Reverse%20Mortgages%20A%20Risk%20Management%20Tool%20for%20Retirement%20Distributions.aspx

- **Incorporating Home Equity into a Retirement Income Strategy**

  http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685816

- Reverse Mortgage Calculator – Free tool to estimate your Reverse Mortgage Line of Credit and growth over time. https://reverse.mortgage/calculator

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http://www.allrmc.com/