Reverse mortgages:
From stigma to smart strategy

By Mike Mooney

According to a number of recent articles and retirement researchers, the reverse mortgage is a valuable tool for older Americans who are facing financial uncertainty in retirement.

Let’s face it, of all the strategies available to seniors and their advisors who are planning for a secure and financially stable retirement, the reverse mortgage has historically been seen as a last resort. But spurred on by a number of positive reverse mortgage product and program changes that have been implemented in the last few years, a recent wave of support from wealth management experts and academics has not only helped to sway public opinion, but also provided educated insight into the essential strategic uses of a reverse mortgage.

In an April 2016 ThinkAdvisor.com article, Dr. Wade Pfau, professor of retirement income at The American College and founder of RetirementResearcher.com, discussed the often-overlooked benefits of Home Equity Conversion Mortgages (HECMs)—more popularly known as reverse mortgages—and identified specific situations in which a HECM could be deployed as part of a comprehensive retirement plan to serve the needs of clients in different life stages.

Pfau noted that clients age 62 and older can use a HECM to help finance their preferred living situation in retirement: whether it’s paying off their existing mortgage and/or funding renovations to remain in their current home, or using a HECM to “rightsize” and purchase a new home that is more suitable to their changing needs.

Aside from providing housing options, Pfau identified that a HECM can also be used to supplement retirement income while a client’s portfolios grow, or as a safety net for long-term healthcare, reduced or delayed Social Security benefits, or taxes on investments. Furthermore, the HECM line of credit option can be especially advantageous for clients who wait until they have exhausted their portfolio to access their available funds—because the unused line of credit grows, independent of home value.

In any case, one important benefit of a reverse mortgage is its flexible repayment feature: The loan does not have to be repaid until the last surviving borrower (or qualified non-borrowing spouse) passes away, sells the home or moves out. No required monthly principal and interest payments are required. However, borrowers can choose to pay down their principal and interest if and when they choose, and no pre-payment penalties apply. This flexible payment feature gives clients greater financial freedom and control compared to a traditional home equity-based loan or line of credit. As with any home-secured loan, the borrower must of course keep current with property taxes and insurance for the loan to remain in good standing.

In addition to these tactical uses that Pfau discussed, when examining the efficacy of reverse mortgages it is imperative that financial professionals, especially bankers, also recognize the increased consumer protections, new underwriting standards, and the significantly lower closing costs that now accompany HECMs.

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Recent federal legislation and the implementation of stricter underwriting standards have led to a number of positive advancements that better protect consumers as well as the sustainability of the program as a whole. And banking institutions are starting to take notice, as are national media. The New York Times reported on reverse mortgages in June 2016, citing that “some community bankers are quietly offering the loans, too, bringing a kind of Main Street respectability to a product that has long lacked it.”

Why this new respectability? What has changed?

- New limitations have been placed on the amount of money that can be drawn at closing and in the first 12 months of the loan, helping to extend the life of the borrower’s home equity.
- Lenders are now required to perform a financial assessment on each application, to determine a prospective borrower’s ability and willingness to meet their ongoing loan obligations, reduce default rates and ensure the loans are a sustainable solution.
- An adjusted Mortgage Insurance Premium (MIP) has also been added to more accurately price for risk involved with reverse mortgages.
- Protections for non-borrowing spouses have also been included into the foundation of the program. These provisions have been made to allow a non-borrowing spouse meeting certain criteria to remain in the home in the event that the borrower passes away or no longer lives in the property.

Also garnering renewed interest in the reverse mortgage program is the considerably lower closing costs associated with the product—a feature that was highlighted in a recent Chicago Tribune business article in July 2016. Reverse Mortgage Funding LLC (RMF), the only reverse mortgage lender endorsed by the American Bankers Association through its subsidiary, the Corporation for American Banking, is one of the few lenders that currently offers a low-cost pricing option that reduces up-front costs to only about $125. With this option, the borrower receives a lender credit at closing, covering all closing costs except for the fee for mandatory reverse mortgage counseling, which the borrower pays directly to an independent counseling agency.

In light of these vast regulatory improvements, additional consumer protections, competitive pricing and the growing realization that a reverse mortgage offers many advantages over a traditional home equity loan or line of credit, many community banks have recently begun to embrace the full potential of reverse mortgage products, banks are able to retain clients who are in need of more efficient retirement income strategies.

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4With this pricing option, borrower receives a lender credit covering nearly all closing costs. Up-front cost shown is for a non-refundable independent counseling fee of approximately $125 on average, which the borrower pays directly to the counseling agency. Not available in all states. Certain conditions and fees apply.