KEEN ON
RETIREMENT

Could a Reverse Mortgage Flip Your Retirement Plans Upside-Down—In a Good Way?

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski:	Hey everybody. Welcome back to another episode of Keen On Retirement. I'm your Cohost, Steve Sanduski. And joining me in the studio today, Bill Keen, Matt Wilson. Guys, how are things going?
Bill Keen:	We're doing great here, Steve. How are you doing today?
Steve Sanduski:	Doing fantastic. Looking forward to another great conversation. And I know, Matt, I think you've got another one of your … you're becoming I think famous for this now. This day in history kind of thing.
Matt Wilson:	You know I am a fan of history. Back in March of 2007, so about 12 years ago, the Chairman of the Federal Reserve which was a gentleman named Ben Bernanke, he came out in a shared congress that the U.S. housing crisis is likely to be contained.
Bill Keen:	Contained? 2007. That seems a little early, Matt, for that statement.
Matt Wilson:	Well, it is early and I think he was wrong with that. He did not have the housing crisis contained. We know that housing prices really took a big tumble from basically the top and Q1 of '07 really didn't bottom out until 2011. So the housing crisis had quite a ways to go since he made that statement.
Speaker 4:	Fail.
Steve Sanduski:	Well, I guess you failed there.
Matt Wilson:	You did fail.
Bill Keen:	Do we have a fourth party on the line today?

Steve Sanduski: I think we have some gremlins in the studio.

Matt Wilson: Yes.

Bill Keen: Okay. Very good. Well you know as they say with a lot of these financial prognosticators, he wasn't wrong, he was just early.

Matt Wilson: He was just early.

Bill Keen: That's right.

Matt Wilson: Yeah. So I thought that was an interesting comment though and an interesting fact going back 12 years because housing has rebounded significantly since then. Housing prices have performed very well and housing market is really strong. It still does have a lot of ways to go from where it was back at the high but housing is an important topic because it does represent a very large portion of most people's net worth. Considering what houses prices have done, there's a lot of equity in there and we do get questions from time to time around how do we tap the equity in our home?

Bill Keen: And it would make a sense to plan that that equity is there at some point for folks down the road. And to your point, how do we access that and how do we account for it in a financial plan?

Matt Wilson: It is definitely an asset that doesn't need to be accounted for in a financial plan. And in fact, I think we just got a question from a listener on this very topic.

Bill Keen: We did and I'd like to bring that to the show today if that's all right with you Steve?

Steve Sanduski: Yeah, absolutely.

Bill Keen: We have a question here from loyal listener Chuck in California. I wanted to thank Chuck for listening. I get notes from Chuck every so often on various episodes and I love to answer back and forth. So Chuck, we appreciate your engagement and your interest and we appreciate you posting this question to us. So Chuck says, "I look through your podcast and I think I have them all in search of one dealing with reverse mortgages but with no luck. From what I have seen in the L.A. Times, this can be an important subject for retirees. I was hoping you would consider doing a podcast on this. Apparently, a reverse mortgage can make or break a person's financial situation and/or that of a survivor depending on any of the several options connected with them."

So that is a great question and it leads us to dedicating an entire episode here to that topic, Steve.

Steve Sanduski: Yeah. Well, it is a good topic. So why don't we start with just a definition? So what is a reverse mortgage and how does it differ from a traditional mortgage?

Matt Wilson: A reverse mortgage is a mortgage where you don't necessarily have to pay it back which-

Steve Sanduski: Well, I want one of those.

Matt Wilson: At least you don't have to pay it back.

Steve Sanduski: Okay.

Matt Wilson: Because it's secured against the equity in your house. The forward mortgage, most people are familiar with, what we're going to call traditional mortgage is yes, you take a loan and you have to make payments based on the schedule. And there's different types especially when we consider what option someone has when it comes to tapping the equity in their house. You could do a cash-out refi so you could just take some cash out of that, or you can set up what's considered a line of credit. So you just use it as needed but there's downsides to those, one being you now have a payment that you have to make.

Bill Keen: I can think of another one as well, Matt.

Matt Wilson: Well that, and when it comes to the line of credit, it may not be the one you needed because they can close them.

Bill Keen: One of the things about this retirement planning endeavor is making sure that folks have the cash flow that they need when they need it in retirement throughout the course of their retirement and part of that is not having to spin down your assets when the market is not doing as well or through difficult times. So Steve, a lot of people had home equity lines of credit simply as a backup.

Maybe they hadn't drawn on those lines, they're just there as a backup for potentially a difficult time or an emergency. Well for example, we had a pretty difficult time. We've talked about this now on several of our recent podcast episodes back in '08, '09 where the financial markets basically froze and a good majority of those lines or credit were closed to Matt's point by the banks. So right when someone may have needed it during a difficult time, those were not available for them.

Matt Wilson: So that leads us to our topic today. A reverse mortgage. And what is the difference between those? You maybe have seen some late-night commercials featuring some celebrities talking about reverse mortgages.

Bill Keen: Magnum P.I.

Matt Wilson: Yes. Mr. Tom Selleck was featured in one of them and I think Fred Pryor was another.

Steve Sanduski: What is Tom Selleck's most famous movie?

Bill Keen: Steve, we watch a lot of financial research and we're doing a lot of studies. We don't spend a lot of time watching TV, right Matt?

Matt Wilson: We can Google it.

Steve Sanduski: I'm going to throw out one, and maybe your listeners can chime in too. How about Three Men and a Baby?

Bill Keen: Okay.

Matt Wilson: I remember that one.

Steve Sanduski: That was a good one. That was a good one.

Matt Wilson: Yeah.

Bill Keen: Yes, it was.

Matt Wilson: Yeah.

Steve Sanduski: And then what's the famous line from that show?

Bill Keen: All right. We're getting diverted here.

Matt Wilson: That, I do not know.

Steve Sanduski: "I'll give you $1,000 to change that diaper." I think it was Tom Selleck that said that.

Matt Wilson: Okay. Well, when that movie came out, $1,000 was quite a sum of money.

Steve Sanduski: Well, it's still a sum of money to me. What are you talking about?

Bill Keen: And we tie that back into reverse mortgages.

Matt Wilson: Yes.

Steve Sanduski: That was a good segue, Bill.

Bill Keen: Can you take one to pay that?

Matt Wilson: Well, he's now being more famous I think for selling reverse mortgages nowadays.

Bill Keen: Right.

Matt Wilson: But unlike a traditional mortgage, a reverse mortgage is repaid when the borrowers no longer live in the home. So you won't make monthly mortgage payments but you'll need to continue to pay property taxes and homeowner's insurance in addition to keeping the house up in good condition. So essentially what the bank is doing is giving you either a lump sum of money or they're setting up a line of credit and you can tap that whatever you want in this reverse mortgage but you don't actually make any payments.

Now you might say, "Well, that sounds pretty good." Well, there are downsides. There is interest and it's what we would call negative amortization, meaning, if you take out one of these reverse mortgages, the balance that you owe is going up every month.

Bill Keen: Right.

Matt Wilson: Similar to a traditional mortgage in the sense that there's an interest rate and there's a loan balance but instead of you making payments, they're just adding the payment back into the … what you owe and then either when you move out of the house or you pass away, they're just clawing back that loan balance out of the equity of the house.

Bill Keen: We have so many clients that are just really wanting to have their homes paid forth free and clear. So the concept on the surface seems pretty unnerving, right, to now all of a sudden, have a mortgage, an interest building up against you. But to your point, you're just capturing your own equity out of your home.

Steve Sanduski: And what do you have to do to qualify? Can anybody take out a reverse mortgage? Do you have to be a certain age or how does that work?

Matt Wilson: To be eligible, you have to at least be 62 years old. And they're going to pull credit and determine the risk level so to speak which would be how much are they going to lend you and the interest rate that they're going to charge.

Steve Sanduski: And then if I still have a existing mortgage on my house, so let's say I still owe some money on my house, can I still get a reverse mortgage too?

Bill Keen: Well see, many people that are interested in a reverse mortgage, they do still owe money on their home through a traditional mortgage. So if that is your situation, you will essentially be trading one loan for another, usually, a larger one. And some of the money that you borrow with the reverse mortgage will be used to pay off your current traditional mortgage. So if you owe a lot on current mortgage, you may not have much from the reverse mortgage left over over and above to spend on other things.

However, a reverse mortgage would free up money you have been using to make monthly mortgage payments even in that case. But if you still owe a lot of money on your existing mortgage, you might not have enough equity to pay off your current mortgage with the reverse mortgage which means essentially, you might not be able to get a reverse mortgage. So to your point, yes, you have to be over 62 but there does have to be a sufficient amount of equity in the home to even be able to qualify in the first place.

Steve Sanduski: Okay. So then what happens if I decide, well, I need or I want to sell my house when I have a reverse mortgage outstanding?

Bill Keen: The money you borrow and the interest and fees added to the loan balance will shrink your equity. So if your home prices rises, you might gain back some of that equity. It's hard to predict how much over that course of time but if you do decide to move or downsize, you simply sell your home and hopefully you have equity and you pay that reverse mortgage off and away you go. So you never actually give up title to your property. You have title of the property the entire time.

Steve Sanduski: And then what happens if I actually pass away? Will I have this reverse mortgage in place? Am I setting up my heirs for failure here because I've saddled them with this or how does that work?

Bill Keen: Well, it's kind of the same thing. If there's equity in the home and you pass away, your heirs have a couple of choices. If there is equity, it would make sense that they would sell the home, capture the equity, pay off the reverse mortgage and go on down the road. It's also possible that your home could be worth less than the reverse mortgage has added up to. And we haven't talked about the different types of reverse mortgages today but there's three kinds.

And the ones that we're really talking about today are the federally insured reverse mortgages and they're called the HECMs. The HECMs or home equity conversion mortgages. These are nonrecourse loans which means that from the mortgage interest that you've been paying on this loan, the government would pick up the difference between what your house was worth if it was worth less than the actual loan has accumulated to over the course of your life.

So there is some protection there on the consumer side in getting involved in one of these. And I know that might make someone feel a little squirmy thinking, my goodness. We've taken all the equity plus out of our home, but if they needed the resources to live, then it is what it is. Now, you also mentioned your heirs in your question. And in that case, yeah, the heirs wouldn't get any of that equity. You needed the equity.

So sometimes, there's an order to importance and in that specific case, it might have been that the person with the reverse mortgage needed the capital.

Matt Wilson: Yeah. And there's an interesting factor that you just said about if you did owe more than what your home was worth, you don't have to make up the difference or your state doesn't or your heirs don't. And you might think, well, that sounds too good to be true. Well, part of the cost you paid to maintain this loan is mortgage insurance. So what these reverse mortgage companies are doing is they are building in part of the annual cost to the loan in an insurance cost so that if you did end up owing more than what it's worth, they're made whole so that's why they do that.

Bill Keen: Right. And I think it's important also to talk about a surviving spouse because we talked about having to be over 62 and typically, there's a couple in a home. So if the person that was on the loan passes away, in most cases, it can be structured especially under these HECMs so that the surviving spouse is not forced to leave the home. Now, if they weren't a signor on this loan, then they would not be able to receive any more resources or any more cash flow from it but they wouldn't be forced out of a home.

So it might make sense upfront to have both parties, both spouses become seniors. That's an important thing. And to Chuck's question, he did make mention of that. It can make or break a person's financial situation and/or that of a survivor. So it's important to really think that through upfront.

Steve Sanduski: So let's say I'm listening to this and I'm thinking, this sounds interesting. I can get some money out of my house, I can get a big check and I don't have to pay it back and when I pass away, the … hopefully, the equity that's remaining in my home gets sold and everybody is happy. So I'm thinking, not bad. So who would you say is a good candidate for a reverse mortgage? What is the situation of a person that would be … it might be a potentially good idea for them to get a reverse mortgage?

Matt Wilson: The candidates that would be considered good for a reverse mortgage is individuals or married couples that own their home and don't have much savings, or in addition to that, need an infusion of cash. And that's where the reverse mortgage can come in and help them out because many Americans.

May not have much saved for retirement, they might have a lot of equity in a home and this is how a product like a reverse mortgage can help supplement their income.

Steve Sanduski: Okay. So then what about people who would not be a good candidate? Would it just be the opposite of that?

Matt Wilson: Ones who definitely don't have a lot of equity in their home if you don't have enough income to, already to make your bills, you might be better off just selling your house and completely downsizing then looking to take reverse mortgage because you have to make sure that you continue to make the property tax payments, the insurance … homeowner's insurance payments and continue to keep the house in good order. So if you think that's going to be difficult to do, you definitely don't want to take out a reverse mortgage.

That would then potentially put you in default if you don't do those things.

Bill Keen: Right.

Matt Wilson: And if you get in default, they're going to foreclose on your house.

Bill Keen: So downsizing actually … It is in some cases the preferential move which would be … sounds simplistic but it truly would in a lot of the cases, simply downsizing your situation and capturing the equity that way. We had a situation in Kansas City about five or six years ago and I won't say names but it was someone who was well-known in the political arena here in Kansas City, well-respected and got into a reverse mortgage and of course it hit the newspapers when the house was being foreclosed on because there was what, $40,000 or $50,000 I think approximately of property taxes that were in arrears and because of an illness of one of the spouses and they were up in age, up in their 80s.

Couldn't make the property tax payments and a local, very credible reverse mortgage company, a mortgage company that does reverse mortgages had to foreclose on that property. So that's a perfect example to Matt's point. You have to keep the taxes up. You have to keep the insurance up and you have to keep the property up and in good standing.

And I don't know exactly how they know if you're keeping your property up. That would be one thing I would like to learn.

Matt Wilson: Yeah.

Bill Keen: Do they send examiner out to look at the status of your property or not? The other factor too is you have to be living in your house. It needs to be your primary residence, and I've seen various numbers thrown around if you're going to be gone from your home for more than two months, you should let your lender know that you're going to be maybe at a summer home or a winter home, something to that nature and if you're ill and you had to be away from your home, you can be away from your home in a long-term treatment facility or a retirement community or an assisted living type of community for up to a year.

But after that year, that's the time where they could now say, "Okay. We're going to foreclose on this property."

Steve Sanduski: Now, what kind of reputation does this industry have? And I know you guys are all over the idea of transparency, consumer protection and fraud prevention. So as we think about the reverse mortgage industry, is there anything that our listeners should be thinking about?

Matt Wilson: We always recommend folks get several quotes or go see a few different people when they do consider something like this because there are proprietary reverse mortgages in addition to the ones that we're really focusing on today which are ones that are backed by the government. The ones that are backed by the government have very defined rules and very specific ways of how they operate and what has to be disclosed to you. You actually have to go through a counseling session.

So they take it very seriously. They want to make sure that this makes the most sense for you and that you're prepared and understand all the risks around them because yeah, the industry, especially on the proprietary side I think didn't necessarily tell people about all the risks.

Bill Keen: I think some examples, Steve, of abuses of this have been in times where maybe a salesperson for the product is promoting this as if it's a solution to all your problems and pushes you to rush through and take out the loan or maybe even has idea on how you could spend the money. For example, some of these salespeople might try to sell you things like home improvement services. So there's a company that maybe focuses on home improvement but then suggests to you that the reverse mortgage could be an easy way to pay for them.

You never want to be approached by somebody that's soliciting an ancillary product and then brining you the idea of a reverse mortgage. There was also some abuses reported and sanctioned with financial people pressuring you to do a reverse mortgage but then having to buy other financial products like annuities or long-term care insurance. So resist the pressure the products might not work out, you might not … they might not be appropriate for you, there might be a number of reasons why you shouldn't be taking a reverse mortgage just to buy other investments.

And to Matt's point as well, a counselor from an independent government-approved housing counseling agency has to meet with you. You have to meet with them and have a session that could cost about $125 to do that. But you have to go through that and they will lay out to you all of the advantages and disadvantages that you can take your materials and compare all the prices because there's a lot of embedded cost and expenses to setting one of these things up.

And it does bear repeating. Shop around and compare the cost. The mortgage insurance premium is usually the same from lender to lender on most loans but most other costs including origination fees, interest rates, closing costs and service ADPs can vary widely among these lenders. So it's not just a one-size-fits-all type scenario. And we help people look at these as well.

So we will sit down with someone and really walk through one, do you need it in the first place? And two, which one makes sense and how would we evaluate those things?

Steve Sanduski: Did we touch on the tax aspect here? Is there any tax ramification to the receipt of the money from the reverse mortgage?

Bill Keen: We hadn't yet, but it typically in most cases, the money received would be tax-free and that's one of the selling points that a lot of these folks that are promoting these things talk to folks about like … from a cursory level to just say, "Hey, it's tax-free income. It won't affect your social security taxation or penalization. It won't affect your Medicare premiums." And that's in most cases true. But if you think about it, you're just receiving your own equity back.

So I would hope it wouldn't be taxable.

Steve Sanduski: I would so.

Bill Keen: It's your after-tax money that you had made equity in your home. So that's not hard to understand. A lot of people do ask about whether or not the interest that is accruing against you as you are drawing this down and time continues to go on and on, is that a tax deduction just like it would be on a normal mortgage? And the answer to that is it is but it's not until the loan closes out. You don't get a statement each year and get to write off that mortgage interest each year like you would've on a traditional mortgage.

So a couple of tax angles there on this.

Steve Sanduski: And then overall, do you have any sense for how popular or not popular reverse mortgages are?

Matt Wilson: There's about a million reverse mortgages out there now. So they're definitely growing in popularity and I can see why. And I believe it has helped that the government has stepped in and really help put some parameters around how these work. It's interesting too because you think about, okay, well how does this work and how much can we get? You can expect to receive anywhere between 40% and 60% of the value of your home if you go through the HECM route, the home equity conversion mortgage. The younger you are or the closer to 62, the lower the amount and the older you are, the higher the amount that you can receive, up to about 60%. And there's three different ways that you can receive the money.

Bill Keen: Yes.

Matt Wilson: So there's a line of credit option, and this is interesting. There's actually been some academic research done around this specific option and basically, it's a line of credit that you have access to that is an adjustable interest rate. So it just varies based on prevailing interest rates. What happens over time is that line of credit grows.

Bill Keen: Okay. Let me just clarify. You haven't drawn any credit but the accessible line is growing, is that what you're saying?

Matt Wilson: That's right.

Bill Keen: Because the house is going up in value and you're getting older? That formula, is that right?

Matt Wilson: That's right. They're basing it on future appreciation of the home but it's growing at prevailing interest rates too. So if the rate they're charging you is 4% on anything you borrow, your line of credit is also going to grow at 4%. Now, there's a maximum stated in the loan, so it's not like it's just going to compound indefinitely. They're going to say, "This is the maximum that we're going to give you but we're going to start at, call it 50% and then it's going to grow to this maximum amount."

So any untapped equity in that line of credit is going to grow over time. You might think, okay, well how … Why wouldn't people just do that? Again, to Bill's point, there's some cost to set these up. They're not free and it is based on the home value and it's a percentage based on the home value. Now, the HUD caps, the origination cost up to $6,000 but then there's additional cost with the title and insurance and other closing fees.

So to set these up, you could be looking at in the tens of thousands of dollars, depending on the home value that you have.

Bill Keen: Just to have a line open in case of emergency. In this case, the way we're describing this type of situation.

Matt Wilson: Yeah. Because when I first heard that, I said, "Well gosh, why would more people set those up? If you had a growing line of credit, that couldn't ever be closed. Why wouldn't you do it especially if you're planning to stay in this house for a very long time? There is a cost to that so that is part of it. The second payment option is a monthly payment which again is based on an adjustable interest rate. They will set up just monthly payments to supplement your income and you can pick a specific term. So there are fixed monthly payments for a set number of years or you can set up a tenure which is fixed monthly payments as long as you don't exceed the maximum mortgage amount. So they will just continue to pay you until you actually hit that maximum amount or you sell the house or you pass away.

That also has the credit line growth feature too. So again, you can actually be drawing money out but actually still have an increase in the amount that you can take out over time which is … that's why these academic studies are looking at these growth features saying, "Well now, you've got a line of credit. You have access to equity that might be growing over time, not just locking it in", which maybe there are some planning scenarios where that can make sense.

Now lastly, I think where people probably think about this the most is a lump sum feature. So where they just give you a chunk of money and it's all upfront at once and again, it doesn't grow, so it just … here's the chunk of money. And then every single month that goes by, they're applying the interest cost to the total of balance against the equity in your house which then will be repaid either when you pass away or when you sell the home.

Bill Keen: Of course, you have the whole balance drawn so if you didn't necessarily need all of it right then, you're paying interest sooner than you needed. But again, everyone is different so they have given us several different ways to customize these things for each person's situation.

Steve Sanduski: All right. Well guys, as we wrap up here, anything else that you want to share about this?

Bill Keen: Steve, I think we've done in the limited time that we had today a pretty good overview of the different angles to what to be considering with respect to these. A lot of people have not done the research or looked into these, they just have steered clear of them one, because of some of the bad reputation they had I think from years ago. And two, just because the idea of going backwards in that is scary to folks. But I would end by saying before you look into a reverse mortgage, and of course looking into one is way different than signing paperwork.

So look into them all you want but before you enter into one, look at the other options. One of the options would be waiting. If you take out a reverse mortgage when you're too young, you may get into something that you didn't necessarily need so just waiting is one. Sometimes, doing nothing is the action. There's other home equity options like we've mentioned whether it's traditional home equity line of credit could make sense in some cases. Also, for cash flow purposes, you could refinance a mortgage.

Maybe you take your mortgage out a little longer to reduce the payment schedule knowing that you wouldn't have it paid off by the time you pass, but heck, we're talking here today about going never having to pay it off. In fact, going backwards. So refinancing and changing your payment schedule could be an option and we've mentioned earlier, downsizing in good portion of the cases could be the right situation as well. And of course, we always talk about spending in all of our episodes, figuring out ways to lower your expenses to take some of the pressure off as well. These could be options to signing on the dotted line for reverse mortgage.

Matt Wilson: Yeah.

Bill Keen: But if you're considering a reverse mortgage though, it's shop around, decide which type of reverse mortgage might be right and it could depend on what you're going to do with the money, compare the options, terms, fees, all those things like we mentioned, get the counseling session and take it to a fiduciary adviser and have them help you think through these things and figure out if it's the right thing for you or one of your loved ones.

Steve Sanduski: Excellent. Well, that's a great way to wrap it up here. And for those of you listening, if you want to get all the details, if you want to read the notes that we've written about what we talked about today, if you actually want to read the transcripts of what we've talked about today, you can get all of that at keenonretirement.com. That's K-E-E-N onretirement.com. You can listen to all the previous episodes as well. And if you have a question, you can certainly ask that question on the website there, keenonretirement.com and maybe you will end up on a future episode as well.

So guys, as always, thank you and we'll look forward to the next show.

Bill Keen: All right. Thanks Steve and thank you Matt.

Matt Wilson: All right. Thank you.