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THE 5 THINGS ADVISORS NEED TO KNOW ABOUT HECM STRATEGIES

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INTRODUCTION

The financial benefits of a well-structured retirement plan are clear, but the path to funding that plan is not always easy. If you are like many advisors, you probably have clients who are managing retirement by making taxable withdrawals from qualified accounts, or spending down portfolio assets you've both worked hard to build. You may also find yourself working with clients that have underestimated the length of their retirement, or who have goals that are more aggressive than the resources available. And while people may expect to fund their plan or boost their retirement cash flow by paying off their mortgage, the reality is that many who intended to be mortgage payment-free in retirement are not. These challenges make it tougher than ever for advisors to solve for today's retirement needs, and many are turning to an often-overlooked asset – home equity – to help.

Today's Home Equity Conversion Mortgage, or HECM (heck´•um), commonly known as a Reverse Mortgage, is a safe and effective option that can open the door to many retirement strategies. While a reverse mortgage can be a valuable tool in retirement planning, it is often excluded because most people's perceptions are based on outdated, inaccurate information.

The HECM program is safer, less expensive and better for your clients than the pre-financial assessment HECM programs. That's because FHA has overhauled the HECM reverse mortgage program, adding strong protections for homeowners.

The HECM program requires pre-counseling by an independent, certified expert to make sure your clients are a good fit for the loan, and vice versa. And FHA insurance guarantees that no matter what happens in the housing market, repayment is capped at the home's final value, protecting heirs and the estate. The FHA insurance also ensures that the loan can continue indefinitely as long as clients want it to and continue to meet loan terms*-regardless of loan balance. And make no mistake – your clients will continue to own their home – in fact, <u>they are required to be on the title.</u>

As more and more experts spread the word about the merits of home equity in retirement planning, this loan product will be increasingly important for current and future retirees as advisors seek new, creative strategies to give their clients more liquidity, improve the efficiency of asset spend down and make the most of assets that have typically remained dormant.

This white paper will address **5 key things that advisors, and their clients, should know about a HECM** to determine if it might be a strategy worth considering.

* Borrowers are obligated to continue to pay real estate taxes, homeowners insurance, occupy and adequately maintain the property

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1. TODAY'S HECM IS NO LONGER A LAST RESORT OPTION- IT IS A TOOL THAT CAN HELP MANY AMERICAN HOMEOWNERS NAVIGATE WHAT COULD BE A LONGER THAN EXPECTED RETIREMENT.

Despite perceptions to the contrary, today's reverse mortgages are not for clients with few financial options. Quite the opposite – new rules require credit and income underwriting, similar to other mortgages. And recent research studies have shown that the least effective way to use a reverse mortgage is as the "last resort" retirement option. The best use for a reverse mortgage is when used as part of a proactive, holistic financial plan. *

How did conventional wisdom get it so wrong? Years ago, the only requirements to get a reverse mortgage were reaching age 62 and having an eligible home with some equity. There were no financial requirements to identify clients who may have less ability to afford their home and lifestyle for the long term. This created issues as clients with insufficient income, assets, or financial responsibility were allowed to draw large sums of money at closing. There were few safety mechanisms to ensure that those clients were suitable or understood the program and the loan's requirements. Additionally, high costs throughout the life of the loan often made the reverse mortgage an option that was only appealing to those with few alternatives. This created problems as borrowers spent down their equity too quickly, with few checks and balances. Fortunately, all that has changed.

Contrast yesterday's scenario with the current HECM program. Today there are assessments made to ensure that borrowers can afford both the long-term costs of home ownership and the lifestyle they maintain. FHA Counseling is required of every borrower to ensure that the terms of the loan are clearly understood by all parties. Origination fees are limited by the Department of Housing and Urban Development. Borrowers rarely draw their full funds in cash at closing, and ongoing loan costs are reduced to slow the growth of the loan balance. Today's HECM is a responsible option that frees up cash and affords clients the right to additional financial flexibility in their retirement years.

* Journal of Financial Planning, Incorporating Home Equity into a Retirement Income Strategy by Wade D. Pfau, Ph.D., CFA

> "Using a reverse mortgage to tap home equity is one of the most powerful options available to retirees today."
>
> —Alicia Munnell, Director
>
> Center for Retirement Research at Boston College

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2. ACADEMIC RESEARCH SUPPORTS HECM STRATEGIES FOR LENGTHENING LIFESPAN OF A RETIREMENT PORTFOLIO AND INCREASING THE VALUE OF A LEGACY

A reverse mortgage can be a strategic way to increase the efficiency of asset dissipation, as demonstrated with research published in the Journal of Financial Planning since 2012. This research comes from a diverse array of resources including attorneys, wealth managers and professors of finance, economics, retirement income and personal financial planning at esteemed institutions, such as The American College, Texas Tech, University of Connecticut and Edinboro University of Pennsylvania. Among their key findings:

- Using a HECM can provide alternative sources of income, allowing a portfolio to remain invested longer for potentially higher returns, a stronger likelihood of portfolio survival, increased net legacy and lower taxable income.

- Using a HECM can also increase the sustainable withdrawal rate for a retirement portfolio.

- Using a HECM can provide a resource to draw in down markets, lessening the chance that clients will liquidate assets at the worst possible time. The HECM funds can be repaid as markets recover with no prepayment penalties.

- A HECM credit line increases in value over time, regardless of changes to the property value. It is guaranteed to be available as an income tax-free source of funds that can be tapped, or left alone to grow until needed. It is ideal to establish a HECM credit line is as early in retirement as possible.

As an advocate for your clients, check out the studies behind these findings and additional resources on our website at:

www.longbridge-financial.com/advisors/resources-for-advisors/

3. THERE ARE MANY WAYS A REVERSE MORTGAGE CAN IMPROVE RETIREMENT INCOME PLANNING

The HECM program can help advisors solve a variety of financial puzzles, while allowing the client to retain full control and ownership of their home. Potential uses are more ubiquitous than most realize—advisors are limited only by their creativity. Here are some of the more common ways we see borrowers using a reverse mortgage to shore up their retirement strategies:

Use a HECM for incremental cash flow. The ability to generate income tax-free cash flow can benefit homeowners in a wide range of tax brackets, making it a logical option for many clients over age 62 who plan to stay in their home for the long-term. The funds can be spent in any way, and there are several distribution options the borrower can choose from to best meet needs, from consistent monthly withdrawals to periodic access via a credit line.

Use a HECM to eliminate monthly mortgage payments. Many retirees today are still making mortgage payments. How big are the numbers? As shown by recent US Census data, 45% of US homeowners age 60 to 64, and almost a third of those age 65-74 are still constrained by monthly mortgage payments. Providing a solution that could free up more cash flow for retirement could be a life-changing recommendation. Replacing their existing mortgage with a HECM can stop the outflow, allowing clients to repurpose their former mortgage payment for more effective uses. And if they choose to make payments, they can—it is completely optional.

Use a HECM to reduce taxable income. Clients that are drawing down IRA assets beyond a required minimum distribution can reduce their taxable IRA withdrawal and instead draw from a HECM LOC on an income tax-free basis. This income can be received through a line of credit, lump sum, monthly payments, or a combination of all these options. The terms of the loan require that the borrower continue to live in and maintain the property while paying applicable property taxes and insurances.

Use a HECM to replace a HELOC. Loan payments on a HECM can be deferred indefinitely, whereas a HELOC is typically due after 10 years. Interest rates can also be more favorable on a HECM. Funds available from a HELOC are set at inception, but funds available via the HECM LOC will continue to grow over time. But the biggest benefit the HECM can offer your clients may be peace of mind, knowing the unused portion of the funds in a HECM LOC are guaranteed to be available throughout the life of the loan. Unlike the HELOC, a HECM LOC can never be reduced by the lender if market conditions change.

Use a HECM to establish a reserve for potential health care expenses. A recent study by the JP Morgan Chase Research Institute found that on average, 46% of older families encountered at least one major medical payment over a three-year study period. Tapping into home equity is an effective strategy to proactively combat the likelihood of medical expenses. Funds left in a HECM line of credit will grow over time, leaving more available for future use to cover unexpected health care or longevity expenses. For clients that either cannot or will not consider long-term care insurance, a HECM LOC can be a great option to cover those potential costs without putting portfolio assets at risk.

Use a HECM to avoid taking capital gains on other appreciated assets. Since selling appreciated assets can generate significant gains, clients may benefit by drawing from a HECM as an alternative source of funds. This strategy allows appreciated assets to remain in the estate, potentially passing to heirs with a larger net worth than previously achievable without a HECM. Clients with annuities can also leave their funds to accumulate longer, using a short-term withdrawal from their HECM instead of annuitizing at an earlier date.

"Home equity is key to Americans' retirement security, so it's crucial to responsibly offer reverse mortgages. That's why at Longbridge Financial, we are committed to changing and improving the reverse mortgage business through unparalleled service, expertise and transparency."

-Christopher Mayer, Longbridge Financial CEO

Paul Milstein Professor of Real Estate at Columbia Business School

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4. ALL LENDERS ARE NOT CREATED EQUAL

A number of lenders offer the HECM loans today, but there can be significant differences depending on who your clients choose to work with. We recommend the following best practices when evaluating lenders:

- **While some lenders specialize in reverse mortgage products, some are traditional lenders that do the occasional HECM**. A specialist will be able to better guide your client through the process than a lender that dabbles in reverse mortgages. Longbridge Financial, LLC is a specialist—mortgages are all we do.

- **A lender that both sells and services reverse mortgages can give your client a more comprehensive experience than one that only sells the mortgages**. The servicer is an important part of the transaction, as they will be your clients' main point of contact from closing to the end of the loan. The servicer will also work with heirs if all borrowers pass. Servicing is an often-overlooked piece of the process, but can be very important. Lenders that service their own loans are with your client through the life of the loan. Longbridge Financial, LLC serves as both the originator (seller) and servicer for our loans.

- **Costs and service levels can vary much more than often expected**, even though the HECM loan itself is standardized. Working with the right lender can ensure your clients have a much more positive experience. Advisors that are part of the Longbridge HECM Advisor Network ensure that their clients will be able to get special discounts that would not be otherwise available.

- **Any lender your clients work with should be a member of the National Reverse Mortgage Lenders Association (NRMLA)**, and fully subscribe to its Code of Ethics and Professional Responsibility. Not all lenders will meet this guideline – we do.

- **Know the types of costs involved with a HECM** and work with a lender that will build the best program for your client's unique needs. "Low cost" loans may have higher rates or additional fees that can significantly impact your client's loan balance over time. Be sure to ask about rates and service fees when your clients compare programs. Longbridge Financial, LLC is committed to working with each unique client to provide the best options for their needs, while providing excellent service and pricing transparency, with no hidden fees.

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5. WHEN IS A HECM STRATEGY NOT RIGHT?

Advisors often ask us how to know if a Home Equity Conversion Mortgage is right for their clients. Because it is such a flexible loan program, it is often easier to answer the opposite question – who should NOT consider a HECM strategy.

- Clients that do not intend to remain in their home for at least 3-5 years.
- Clients that may not be able to afford the home expenses and lifestyle costs even with a HECM.
- Clients who want to use their funds to purchase investments or annuities.
- Clients that live in a home that isn't suitable for aging in place (multiple staircases/inaccessible entries)
- Clients with someone (such as a special need child) who will want or need to live in the home after the loan ends, unless there are funds set aside to pay off the loan balance.
- Clients that may not have the financial responsibility to appropriately use their equity over time.

CONCLUSION

If you have clients that could, or should, consider HECM strategies, we can work with you side by side. Our licensed loan officers are available to start the process. You can be as involved as your client chooses as we lay out the options. Our HECM Advisor Network offers advisor support lines, a quote request site and resources to provide you with additional information. We will work hard to provide you and your clients with the tools to make informed decisions about their options.

If you have questions or ideas to discuss, feel free to contact us at **855-246-1765**. Let us walk you through the "nuts and bolts" of how a reverse mortgage works. You can also go to our website to find links to educational webinars that cover the details:

www.longbridge-financial.com/advisors/attend-a-webinar/

Can't attend a live session? Email us for a link to a recorded webinar at advisors@longbridge-financial.com.

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