Bringing Retirement Dreams Within Reach

Downsizing or relocating in retirement is easier with the Home Equity Conversion Mortgage (HECM) for Purchase

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Executive Summary

As Baby Boomers enter retirement in record numbers, many are contemplating how to attain their dream retirement home — whether that means downsizing to a smaller house or maintenance-free condo, moving closer to family or relocating to the beach — in the face of diminished investment portfolios, longer expected lifespans and skyrocketing healthcare costs. The HUD-insured home-equity conversion mortgage (HECM), a mortgage product created by Congress specifically to serve older borrowers, may be the best tool for enabling retirement-age homeowners to both purchase their dream home and create an additional nest egg of retirement savings.

This paper provides a brief overview of the HECM program, including a special type of reverse mortgage called "HECM for Purchase" that allows older borrowers to buy their new principal residence and obtain a reverse mortgage within a single transaction. Examples illustrate how using a HECM for Purchase allows older borrowers to buy a new home without depleting their liquid assets, enabling greater financial security in retirement.

As Baby Boomers enter retirement in record numbers, many are contemplating how to attain their dream retirement home in the face of diminished investment portfolios, longer expected lifespans and skyrocketing healthcare costs. Whether "dream home" means downsizing to a smaller house or maintenance-free condo, moving closer to family or relocating to the beach, 70% of Boomers believe the house they own in retirement will be their best one yet, according to a 2014 survey by Better Homes and Gardens Real Estate.

Yet four out of five financial planners say running out of money is their clients' top concern, according to a 2015 survey by the American Institute of Certified Public Accountants (AICPA). This retirement apprehension among Baby Boomers is more than justified. As expected lifespans in the U.S. approach eight decades, many Baby Boomers face the daunting task of stretching their retirement assets over 20- or 30-year horizons — yet a 2016 survey by GOBankingRates found that 34% of US households approaching retirement have no retirement savings of any kind.

How can retirement-age homeowners both purchase their dream home and create an additional nest egg of retirement savings? The HUD-insured home-equity conversion mortgage (HECM), a mortgage product created by Congress specifically to serve older borrowers, may be the best tool for reconciling these seemingly incongruous consumer sentiments.

What is a HECM?

As Americans plan for retirement, we typically expect Social Security and personal savings, such as 401(k) and IRA accounts, to serve as the primary sources of retirement income. But there's another potential source of income many of us forget about — even though, like Social Security, we pay our own money into it for much of our lives. That income source is our home equity.

A HECM, also called a reverse mortgage, is a type of loan made against the equity in a home. It was created by Congress in 1988 to allow homeowners age 62 or older to tap into their home equity and receive fixed cash payments over time or an available line of credit.

Like a typical mortgage, the HUD-insured HECM can be structured with a fixed rate or an adjustable rate. Fixed-rate HECM loans are disbursed to the borrower as a single lump-sum payment. For adjustable-rate HECMs, borrowers can choose to receive a monthly payment or a line of credit.

Unlike a typical mortgage, a HECM requires no monthly mortgage payment from the borrower. As long as borrowers maintain the home as their primary residence and keep their property taxes, homeowner's insurance and any homeowner association fees current, the HECM does not have to be repaid until the borrowers die or move out of the home.

The HECM is a non-recourse loan, which is one benefit of the HUD insurance. This means that in no case can the borrower, or their estate, ever owe more than the value of the home.

How can a HECM be used to purchase a home?

The HECM for Purchase program was added in 2008 to make it easier for older homeowners to downsize or relocate. This special type of HECM allows older borrowers to buy their new principal residence and obtain a reverse mortgage within a single transaction, eliminating the need for a second closing. HECM for Purchase can be used to help fund the purchase of an existing or new construction home (as long as a certificate of occupancy or equivalent has been issued).

While traditional HECMs are used to access a percentage of the home's value, the HECM for Purchase allows a lender to contribute that same percentage toward the purchase price of the home. For example, for a 62-year-old homebuyer, the HECM may contribute up to 52.4% of the sales price, assuming the sales price is less than $625,500. For a homebuyer age 90 or above, the HECM may contribute up to 75%. Borrowers must complete a Financial Assessment and meet additional credit guidelines required by the HECM for Purchase program.

Like a standard HECM, the HECM for Purchase is intended for the homeowner's principal residence, so occupancy must be established within 60 days of purchasing the new home. Borrowers who do not sell their previous home must demonstrate the financial capacity to maintain two homes.

See **page 4** for examples of how HECM for Purchase works in downsizing and upsizing scenarios.

A Line of Credit That Grows Over Time

An adjustable-rate HECM line of credit may also be the ideal choice for older homeowners who want to extend the life of their investment portfolios. A 2012 study by Salter, Pfeiffer and Evensky found that homeowners entering retirement with both home equity and a retirement savings nest egg could improve the "survival rate" of their savings over a 30-year horizon by as much as 85% using a HECM line of credit as an alternate source of income in times of poor stock market performance.

With a HECM line of credit, borrowers can withdraw HECM funds and pay them back as often as they want with no prepayment penalties or tax repercussions. By drawing on the HECM line of credit instead of 401(k) savings whenever financial markets are down, borrowers can significantly improve their retirement income and estate value at end of life.

Best of all, a HECM credit line grows over time, automatically making more funds available to the borrower as an additional source of retirement income. For a typical borrower today, the growth rate of a HECM line of credit averages between 5% and 6% per year This feature makes the HECM line-of-credit loan behave more like an additional investment than a traditional loan.

Peace of Mind for the Family

When a HECM borrower dies, an eligible non-borrowing spouse can continue living in the home as long as they wish, so long as property taxes, homeowner's insurance and other property charges are paid and the home is maintained. If both spouses are borrowers, the reverse mortgage comes due only after both spouses die or no longer use the home as their primary residence.

At that time, any equity remaining in the home goes to the heirs or to the estate. The heirs can pay off or refinance the mortgage balance to keep the home, sell the home themselves to settle up the loan. Any remaining equity is theirs to keep.

Remember that HECMs are non-recourse loans, and therefore only the value of the home itself stands as collateral for the debt. If for any reason there's not enough value left in the home to settle up the entire loan balance, the heirs or estate are not held responsible for the difference. The lender would instead look to the FHA mortgage insurance to cover the difference.

Timing Makes a Difference

The percentage of home equity value borrowers receive as their initial line of credit depends on the age of the youngest borrower or eligible non-borrowing spouse. While older borrowers generally get a larger initial line of credit, the ideal time to get a reverse mortgage is as young as possible (age 62), before borrowers have unnecessarily depleted their investments and other retirement savings. More importantly, waiting another year to get a HECM line of credit only gives borrowers a 0.5%-1% higher principal limit factor, whereas the available line of credit grows at a much faster rate (around 5-6% per year) Getting the loan in place early provides the best protection for the retirement investment portfolio and the longest possible period for line of credit growth to occur.

Example

James and Mary Wilson, ages 65 and 62, are contemplating near-term retirement. They decide to sell their current home, worth $200,000, which is larger than they need and may soon require costly upkeep. After realtor commissions, escrow and closing costs, the Wilsons net $186,000 from the sale of their home. That's a useful chunk of funds, but they still need a place to live. Their CPA suggests renting, but this option holds limited appeal for the Wilsons, who have been lifelong homeowners.

Option 1: Downsize to an Efficient, New Condo

First, the Wilsons consider downsizing into an energy-efficient condo that meets their needs and lifestyle changes. The new property has a $150,000 purchase price. The Wilsons could use the $186,000 proceeds from the sale of their former home to buy the more modest property outright. But there's a smarter approach.

Instead of depleting most of their liquid assets to buy the new home outright, the Wilsons could take out a HECM for Purchase against the new home. Because Mary is on the younger side, the Wilsons would qualify to receive 52.4% of the $150,000 home value, less $7,100 in financing and closing costs — a total of $71,500 in reverse mortgage funds.

The Wilsons could apply the $71,500 in reverse mortgage funds to the purchase of the $150,000 house. They could cover the remaining $78,500, considered a down payment, with some of the proceeds from the sale of their former home. Then the Wilsons would have a new home with zero monthly mortgage payment, and instead of depleting all the funds from their previous home sale, they would still have $107,500 to help fund their retirement.

Option 2: Upgrade to Destination Dream Home

Then again, the Wilsons have always wanted to live lakeside in their golden years. What happens if they upgrade to a desirable lake cabin that costs $275,000? Again, the Wilsons could apply all the proceeds from the sale of their former home to the new house and take out a traditional mortgage to cover the remaining $89,000 — but they're nervous about the idea of 30 years of mortgage payments. In fact, the Wilsons aren't even sure they'll qualify for a traditional 30-year mortgage, since James' main source of income is Social Security and Mary only works part-time.

Instead of depleting all their liquid assets and taking on a monthly mortgage payment, the Wilsons could take out a HECM for Purchase against the new home. Because Mary is only 62, the Wilsons would qualify to receive 52.4% of the $275,000 home value, less $13,650 in financing and closing costs — a total of $130,450 in reverse mortgage funds.

The Wilsons could apply the $130,450 in reverse mortgage funds to the purchase of the $275,000 house, then cover the remaining $144,550 with some of the proceeds from the sale of their former home. Then the Wilsons would have their dream house — worth 38% more than their former residence — with zero monthly mortgage payment. And instead of depleting all the funds from their previous home sale, the Wilsons would have a nest egg of $41,450 to invest in a savings fund.

In both scenarios, as long as the Wilsons maintained the new home as their primary residence and kept their property tax, homeowner's insurance and any homeowner association fees current, they'd never have to make a monthly principal and interest mortgage payment.

EXAMPLE 1

Cash Purchase		HECM for Purchase	
$186,000	Proceeds from sale of home	$186,000	Proceeds from sale of home
–$150,000	New home purchase	–$78,500	New home purchase *(HECM for Purchase funds cover the remaining $71,500)*
$36,000	**Remaining liquid assets**	**$107,500**	**Remaining liquid assets**

EXAMPLE 2

Cash Purchase		HECM for Purchase	
$186,000	Proceeds from sale of home	$186,000	Proceeds from sale of home
–$275,000	New home purchase	–$144,550	New home purchase *(HECM for Purchase funds cover the remaining $130,450)*
–$89,000	**Remaining debt** (about a $400/month mortgage payment over 30 years)	**$41,450**	**Remaining liquid assets**

About ReverseVision

Recognized as a Deloitte's 2015 Technology Fast 500™ Company, ReverseVision is the leading software and technology provider for the reverse mortgage industry, offering products and services focused exclusively on reverse mortgages. More reverse mortgages are originated monthly using ReverseVision technology than all other reverse mortgage LOS combined. ReverseVision has partnered with some of the finest and fastest-growing lending organizations in the U.S. to provide the leading reverse mortgage technology to brokers, correspondents, lenders and investors.

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