OLD DOMINION
CAPITAL MANAGEMENT, INC.

Your last resort? Maybe not!
Home Equity Conversion Mortgages

by Michael Ginty, CFP®

For over a year now, the advisors at Old Dominion have been thinking a lot about Home Equity Conversion Mortgages (HECMs, commonly referred to as Reverse Mortgages). My own personal opinion on these loans has always been that it should be utilized as a last resort. That was until I attended a Financial Planning Association conference session that opened my mind. After listening to the arguments about some ways these loans can improve retirement income strategies as well as some of the changes in the rules applying to these loans, I was intrigued enough to look deeper.

First of all, I understand the initial reaction clients have when I bring up this strategy. It took me a while to turn the corner too, but I am not doing my clients any favors by ignoring these tools and how they may fit into their financial plans. For most retirees, their home is one of their most valuable assets. Unfortunately, it is also illiquid. Without a way to access that equity, your house is like a big pile of money you live in.

We are only considering Federal Housing Authority (FHA) approved HECM Loans. The application process for these loans is designed to make sure homeowners are well informed and understand what they are getting into. They are also expensive to establish since they have high closing costs compared to traditional mortgages and Home Equity Lines of Credit. However, the high closing cost is what makes these loans safe. The cost is mostly due to the mortgage insurance premium tied to the loan. You must be at least 62 years old to apply for a HECM. Given the high closing costs of these loans, it does not make sense to pursue one unless you are reasonably sure this is the home you want to stay in potentially for the rest of your life.

Why would we consider a loan that has a very high upfront cost for our clients on the asset they worked so hard to pay off? Unlike a conventional mortgage, you never need to make a payment on this one as long as you live in the house as your primary residence and you or your heirs will never owe more than the sale price of the house when you no longer live there.

There are three ways that you can access the equity in your home through this type of loan (four if you do a combination of them) as follows:

First, this can be the only debt associated with this property. If you have any other lien against this property, it must be settled either before the loan is set up or with the proceeds from the HECM. The loan can pay a *lump sum*, commonly used to pay off your existing mortgage or to get into that retirement house you want mortgage-free.

The second option is to take *monthly tax free income* for a fixed period of time or over your lifetimes.

The third option is to set up *a line of credit* that you can access as you need or want, and this available line of credit will grow at the interest rate that is associated with the loan.

This last option – *a combination of the above* - is the most interesting and often the most challenging to comprehend.

Given the multiple lending options available, there are a number of ways we can see these tools improving our clients' financial situations. If you are 62 or older, don't be surprised if, during a meeting in the future, your advisor asks you if this is the house in which you want to spend the remainder of your life in. If you answer yes, a HECM discussion is sure to follow. In the meantime, if you have any questions about HECMs – or anything else for that matter – please do not hesitate to call.