Timing Is Everything

Building a better retirement with a

Home Equity Conversion Mortgage (HECM)

CONNECTING THE REVERSE MORTGAGE INDUSTRY SINCE 2007

Executive Summary

The ability of Americans to realize their ideal retirement can be greatly affected by economic uncertainty. Once individuals retire and begin withdrawing money from their investment portfolios, the sequence of returns — the timing of when the financial market has good years and when it has bad ones — can have a major impact on wealth. While individuals may feel like they are subject to the whims of a fickle financial market, financial tools are available to help retirees limit their sequence-of-returns risk. One of the most under-utilized, yet effective, tools is the home-equity conversion mortgage (HECM).

This paper defines the concept of sequence-of-returns risk, provides an overview of the HECM program and demonstrates how retirees can use HECM funds to buffer against sequence-of-returns losses and significantly increase the value of their investment portfolios, allowing more financial freedom in retirement and greater estate value at end of life. Lender strategies such as using technology to model HECM loans for clients and partnering with financial planners to generate referral business are discussed. Examples illustrating sequence-of-returns risk (both historically and prospectively) along with the advantages of using HECM as a financial tool are provided.

Taking Retirement from "Good" to "Great"

A growing number of Americans are approaching retirement with significant investment portfolios; in fact, one in five have over half a million dollars in assets, according to a 2015 Gallup article.

On paper, these individuals may appear "funded" or even "well-funded" for retirement — barring any major losses or unforeseen expenses — but there's still a lot of room for improvement. If asked to describe their goals for a better retirement, a typical Baby Boomer's answers might include:

- **Protecting current assets.** Like all investments, retirement accounts can enjoy positive returns and be stressed by negative returns. Over the course of a 10-, 20- or 30-year retirement, assets are exposed to a lot of downside risk that can derail even a rock-solid retirement plan.
- **Living longer.** A long and enjoyable retirement should be a cause for celebration, yet even "well-funded" retirees understandably worry they'll outlive their retirement savings — and perhaps rightly so. Wealthier Americans can expect to outlive the average US lifespan by a decade.
- **Spending more money.** Whether they dream of traveling the world or buying a home in a life-long desired setting, many retirees would love to afford a higher standard of living.
- **Leaving a legacy.** Often, retirees wish to preserve some net worth as a legacy for their heirs.

The good news is that all these objectives are achievable. But first, we need to understand what's getting in our way. Simply put, one of the biggest obstacles preventing Americans from realizing our ideal retirement is economic uncertainty.

Sequence of Returns: The Wild Card in Retirement Success

It doesn't take a degree in economics to know that financial markets have good years and bad years, and that these ups and downs can have a significant impact on investment portfolios. In fact, most Baby Boomers have experienced first-hand the effects of market volatility on their savings.

Because 401(k)s and IRAs — the most common retirement accounts — are long-term savings vehicles, most people take a long view as they save for retirement. Instead of fixating on a year or two of lousy (or stellar) financial market performance, we focus on the "average rate of return" earned by our investment portfolio over time — an appropriate view during the contribution years.

Yet once retirees begin withdrawing money from their investment portfolios, the **sequence of returns** — the timing of when the financial market has good years and when it has bad ones — can have a major impact on wealth. Two people who begin retirement with the same amount of savings can have different financial outcomes depending on the sequence of returns they experience — even if they earn the same average return over the course of retirement.

Example 1 on page 5 shows how it's not just *average* returns that impact financial wealth, but the *timing* of those returns.

Overcoming Sequence-of-Returns Risk

Though many of us feel like we are at the mercy of the whims of a fickle financial market, the reality is that there are financial tools available to help retirees limit their sequence-of-returns risk. One of the most effective tools is the home-equity conversion mortgage (HECM).

Introducing the HECM

As Americans plan for retirement, we typically expect Social Security and personal savings, such as 401(k) and IRA accounts, to serve as our 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 home-equity conversion mortgage (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 receive a percentage of their home equity as 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.

A Line of Credit That Grows Over Time

An adjustable-rate HECM line of credit may be the ideal choice for senior 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 to reduce sequence-of-returns risk.

With a HECM line of credit, borrowers can withdraw HECM funds and pay them back as often as they want with no financial 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 can be as much as 4% or more per year. This feature makes the HECM line-of-credit loan behave more like an additional investment than a traditional loan.

Example 2 on page 6 shows how HECM can be used to mitigate sequence-of-returns risk and extend retirement savings.

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, therefore only the value of the home itself can be used to repay the loan. 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.

Time Is of the Essence

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 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. 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.

Technology Is Your Friend

Millions of Baby Boomers who don't yet qualify for a HECM will become eligible over the next 11 years. To forge relationships with these borrowers of tomorrow, lenders need to start speaking their language today. That means not just understanding how HECMs fit into holistic financial planning, but sharing that knowledge through a "hands-on" experience complete with graphs, calculations and simulations. It means making the latest technologies our standard sales practices.

The most impactful way to educate borrowers and advisors is by using tools that visually present the benefits of a HECM using the borrower's own home and investment portfolio data. The best tools keep it simple and incorporate charts and other visuals to facilitate understanding.

For example, in early 2016, ReverseVision piloted a simulation tool that demonstrated the benefits of using a HECM as a financial tool in managing estate value, liquidity and sequence-of-returns strategy. After running more than 4,000 simulations, the tool demonstrated that getting a HECM early in retirement improves portfolio value over a 30-year horizon in more than 75% of cases.

Educating Financial Planners

Successful reverse mortgage loan officers rely on established referral partners to generate qualified leads. HECM referral partners include the usual suspects, like real estate agents and homebuilders, but loan officers also have unique referral channels — like Certified Financial Planners, wealth managers, senior advisors, tax advisors and retirement planners. Teaming up with an advisor who has earned his clients' trust can be a foot in the door to developing long-term borrower relationships.

In April 2016, the Department of Labor issued a new rule expanding its definition of "fiduciary" to include financial advisors who provide investment advice and retirement planning services. By law, fiduciaries must offer advice that serves their clients' "best interests" and disclose any conflicts of interest. Industry experts speculate that the rule will compel financial advisors to present clients with a wider array of financial products, including HECM, instead of steering them toward only investment products that generate commission for the advisors.

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.

For more information, visit **http://www.reversevision.com**.

Example 1: How Sequence of Returns Affects Portfolio Balance

Let's look at an example that illustrates the concept of sequence-of-returns risk and demonstrates how it can affect a retirement portfolio balance.

In this scenario, Sally and Betty each began retirement 20 years ago with an investment portfolio worth $300,000. Both withdrew 4% of their starting balance ($12,000) per year to pay for living and other retirement expenses. The only difference between Sally and Betty is that they invested in different assets and, consequently, experienced different returns on the stock market.

Sally experienced what we'll call a "bad to good" scenario. Her portfolio's performance was down for the first five years of Sally's retirement, but then it recovered and her portfolio experienced steady growth for the remainder of her retirement.

Betty, on the other hand, experienced a "good to bad" scenario in which she enjoyed several years of steady investment gains early in retirement followed by five years of losses.

After 20 years of retirement, Sally and Betty are left with dramatically different balances in their investment accounts:

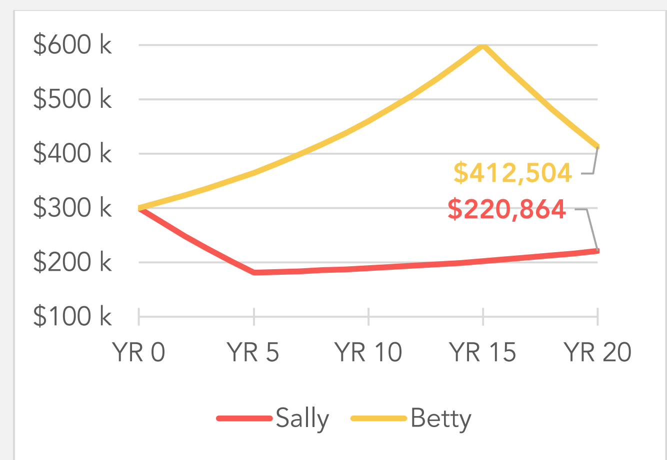
Sally's Balance: $220,864
Betty's Balance: $412,504

Even though both women started with the same balance ($300,000), withdrew funds at the same rate ($12,000 per year) and experienced the same average rate of returns (5%), the sequence of returns made all the difference.

Sequence of Returns Over 20-Year Retirement

	Sally	Betty
Year	**Rate of Return**	
1996	-5%	8%
1997	-5%	8%
1998	-5%	8%
1999	-5%	8%
2000	-5%	8%
2001	8%	8%
2002	8%	8%
2003	8%	8%
2004	8%	8%
2005	8%	8%
2006	8%	8%
2007	8%	8%
2008	8%	8%
2009	8%	8%
2010	8%	8%
2011	8%	-5%
2012	8%	-5%
2013	8%	-5%
2014	8%	-5%
2015	8%	-5%
20-Yr Avg.	**5%**	**5%**

Portfolio Balance Over 20-Year Retirement



Example 2: How HECM Mitigates Sequence-of-Returns Risk

Now let's see how a HECM line of credit can help hedge against sequence-of-returns risk — this time using historical S&P stock market performance data.

As in the previous scenario, Sally began retirement 20 years ago with an investment portfolio worth $300,000. Most years, the stock market yielded a positive annual return, and Sally withdrew 4% of the initial balance or $12,000 from her investment account to pay for living and other retirement expenses the following year. **But, after each of the four years when the stock market was down, in the subsequent year, Sally used $12,000 from her HECM line of credit instead of from the investment portfolio.**

This strategy may seem complicated, but it was actually easy for Sally, because there was no "guessing" required. Sally simply waited to see how her stock portfolio performed each year and chose the appropriate source of funding — her investment account or HECM line of credit — the next year.

Since the S&P was down in 2000, 2001, 2002 and 2008, Sally relied on her HECM line of credit each of the following years (2001, 2002, 2003 and 2009), withdrawing a total of $48,000 in HECM funds.

But that's okay, because using HECM funds to buffer against sequence-of-returns losses gave Sally more than $120,000 extra dollars in her investment account at the end of 20 years:

Balance without HECM: $888,279
Balance with HECM: $1,008,347

Now Sally can choose to use a portion of her investment portfolio to repay the funds she withdrew from her HECM line of credit — or not. It's up to Sally.

Sequence of Returns Over 20-Year Retirement

Year	Rate of Return	Income Source
1996	23%	Portfolio
1997	33%	Portfolio
1998	28%	Portfolio
1999	21%	Portfolio
2000	-9%	Portfolio
2001	-12%	HECM
2002	-22%	HECM
2003	28%	HECM
2004	11%	Portfolio
2005	5%	Portfolio
2006	16%	Portfolio
2007	5%	Portfolio
2008	-37%	Portfolio
2009	26%	HECM
2010	15%	Portfolio
2011	2%	Portfolio
2012	16%	Portfolio
2013	32%	Portfolio
2014	14%	Portfolio
2015	1%	Portfolio

Portfolio Balance Over 20-Year Retirement