Reverse Mortgages with Wade Pfau
Feb. 12, 2020

Hosted by Tom Dickson
Financial Experts Network
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To Get a CE Credit for Today’s Session

Today’s program is eligible for 1 CE credit for professionals with: CFP, CLU, RICP, and ChFC.

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A Financial Experts Membership is Best if you….

• Value **live webinars** from best-in-class experts
  • 86% of our attendees rate our webinars EXCELLENT

• Education on a **range of topics** such as: college planning, investments, retirement income, tax planning, Social Security, Medicare, LTCi, HSAs, divorce planning, annuities and MORE.

• Will use tools like webinar transcript and small case study groups
The EXPERT in Specialized Area

National Figures and Undiscovered EXPERTS

The “Dean” of Financial Planning

Wade Pfau
Annuity Expert

Kurt Czarnowski
Mr. Social Security

Aaron Zolbrod
Medicare Specialist
The #1 Reason our webinars have a following:

90% of advisors learned something that will help them better serve their client
Dear Tom:
Today’s Fafsa webinar plus all the prior ones you have run that I have attended have been excellent. I’ve been a fee-only NAPFA member for more than 20 years, and yours have been the most useful ones I have ever attended.

Thank you for all that you are doing for your members!

Dorothy Cole
Merrimack NH

Tom:
Great value. Absolutely unbelievable!
Paul Riskus
CFP®, CTFA®, CLU®, RICP®
San Antonio, Texas

Tom:
Your offer a lot of value for $9 a month. Your speakers are of the highest quality.
Kevin H.
Ohio
# Member Benefits

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[March 19 Sept. 9]
Learn more about Member’s program and 2020 Webinars

Info Session: Friday, Feb. 21 11:00 ET

Register Here
BIG Thanks to...

Joe Damo, Reverse Mortgage Specialist, AAG
Cell: 513-939-6034
Email: jdamo@aag.com

Caitlin Taylor, Account Manager, MoneyGuidePro
Wade Pfau’s New Book: See Amazon.com

Dr. Wade Pfau brings a level of honesty, intellectual rigor and impartiality seldom witnessed in financial product analysis.

WADE A. DOKKEN, President, WealthVest
How to use Reverse Mortgages to Secure Your Retirement

Presented by:
Wade Pfau, Ph.D., CFA, RICP
RICP Curriculum Director
The American College for Financial Services & RetirementResearcher.com
Key Retirement Risks

- Longevity Risk
  - Unknown Planning Horizon

- Macro/Market
  - Investment Volatility
  - Interest Rate Volatility
  - Public Policy & Taxation
  - Sequence of Returns

- Inflation
  - Rising Costs of Living

- Personal Spending
  - Health & Long-term Care
  - Help Other Family Members
  - Divorce
  - Fraud/Theft
Retirement Optimization Plan

GOALS
- Longevity
- Lifestyle
- Legacy
- Liquidity

ASSETS
- Reliable Income
  - Social Security
  - Pensions
  - Income Annuities
  - Bond Ladder
- Diversified Portfolio
  - Life Insurance
- Reserves
  - Cash
  - Insurance
  - Home Equity
  - Family & Safety Net

LIABILITIES
- Essential Expenses
- Discretionary Expenses
- Legacy
- Contingencies
Managing Volatility in Retirement

• **Spend Conservatively**
  (tenure payment, refinance mortgage, Social Security delay bridge)

• **Spending Flexibility**

• **Reduce Volatility**

• **Buffer Assets – Avoid Selling at Losses**
  (coordinated spending strategies)
**Spend Conservatively**

**Sequence Risk and the Portfolio Impact of Spending Levels**

*Inflation-Adjusted Spending Defined as a Percentage of Retirement Date Assets, No Fees Using SBBI Data, 1966-1995, S&P 500*
Buffer Asset Concept

Sequence Risk and the Portfolio Impact of Skipping a Year of Distributions

End of Year


Remaining Wealth

$2 mil $1.8 mil $1.6 mil $1.4 mil $1.2 mil $1 mil $800k $600k $400k $200k $0

All Distributions
Skip 1967
Skip 1970
Skip 1974
Skip 1975
Sequence Risk and the Portfolio Impact of Skipping a Year of Distributions
Uses for Reverse Mortgages
# The Spectrum of Potential Reverse Mortgage Uses

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<th>Portfolio/Debt Coordination for Housing</th>
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<td>Portfolio Coordination for Retirement Spending</td>
<td>Spend Home Equity First to Leverage Portfolio Upside Potential</td>
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<td>Coordinate HECM Spending to Mitigate Sequence Risk</td>
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<td>Use Tenure Payments to Reduce Portfolio Withdrawals</td>
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<td>Tax Bracket Management &amp; Taxes for Roth Conversions</td>
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<td>Premiums for Existing Long-Term Care Insurance Policies</td>
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<td>Preserve Credit as Insurance Policy</td>
<td>Support Retirement Spending After Portfolio Depletion</td>
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<td>Protective Hedge for Home Value</td>
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<td>Provides Contingency Fund for Spending Shocks (In home care, health expenses, divorce settlement)</td>
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Understanding How Reverse Mortgages Work
# Addressing the Negative Image

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<th>Misconceptions</th>
<th>Now Addressed</th>
<th>Remaining Issues</th>
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<td>Non-borrowing Spouses</td>
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<td>Taxpayer Risk</td>
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<td>Quickly Deplete Home Equity for Questionable Reasons</td>
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Eligibility Requirements for HECMs

• Borrowers: 62 and older
• Equity in the home
• Financial resources to cover property taxes, homeowner’s insurance, and home maintenance
• Counseling session with FHA-approved counselor
• FHA Home Appraisal
• Primary residency
• FHA Lending limit: $765,600
Essential Jargon

1. Principal Limit / Principal Limit Factor (PLF)

2. Expected Rate

3. Effective Rate
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<th>Type</th>
<th>Components</th>
<th>Applies to:</th>
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<td>Expected Rate</td>
<td>10-year LIBOR Swap Rate + Lender’s Margin</td>
<td>Initial Principal Limit Factor</td>
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<td>Set-Asides for Servicing Costs in Old Mortgages</td>
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<td>Effective Rate</td>
<td>1-month LIBOR Rate + Lender's Margin + Mortgage Insurance Premium (0.5%)</td>
<td>Ongoing Principal Limit Growth Rate</td>
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<td>Loan Balance Growth Rate</td>
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<td>Line of Credit Growth Rate</td>
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<td>Post-2014 Set Asides for Financially Strained</td>
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Expected and Effective Rates: Example

One-month LIBOR rate: 1.25%
10-year LIBOR swap rate: 2.25%

Lenders margin: 2.75%

Expected Rate = 2.25% + 2.75% = 5%
Effective Rate: = 1.25% + 2.75% + 0.5% = 4.5%
Initial Principal Limit (Principal Limit Factor)

Expected rate = 10-year Libor Swap Rate + Lender’s Margin
Understanding Line of Credit Growth

Principal Limit = Loan Balance + Available Line of Credit + Set-Asides
Understanding Line of Credit Growth
Comparing Principal Limits Based on When the Reverse Mortgage Opens

10-Year LIBOR Swap Rate: 2.25%
Lender’s Margin: 2.75%
One-month LIBOR rate: 1.25%
Understanding Line of Credit Growth
Comparing Principal Limits Based on When the Reverse Mortgage Opens

Impact of 1% interest rate increase later in the first year
HECMs and the Interest Rate Environment

Low interest rates *favor* HECMs:

- Lower expected rate = larger initial principal limit
- Subsequent principal limit growth is lower, unless interest rates subsequently rise and accelerate growth
HECM Spending Options

1. Lump-sum payment
2. Tenure payment
3. Term payment
4. Line of Credit

5. Modified tenure or modified term payment
Traditional Mortgage

Reverse Mortgage
Example for Carrying Mortgage into Retirement

• 65-year old couple enters retirement
• Twenty years ago, purchased a $300,000 home with a 20% down payment, using a 7.5% fixed 30-year mortgage for the rest
• Five years ago, refinanced into a 3.5% fixed 15-year mortgage
• Annual mortgage payments = $15,574
• 10 years left on mortgage; Remaining mortgage balance = $129,526.
• Home value grew at 3% for past 20 years. It is worth $541,833 today.
• The principal limit is 45.9% of $541,833, or $248,701
• Upfront costs: $6,000 + $10,837 + $2,500 = $19,337 financed in loan
• Remaining Line of Credit: $99,839
Probability of Success for a 4% Post-Tax & Mortgage Initial Withdrawal Rate, $1 million portfolio, $541,833 home value, 25% Marginal Tax Rate
Probability of Success for a 4% Post-Tax Initial Withdrawal Rate
$1 million portfolio, $541,833 home value, 25% Marginal Tax Rate
Median Legacy Wealth for a 4% Post-Tax Initial Withdrawal Rate
$1 million portfolio, $541,833 home value, 25% Marginal Tax Rate
Shifting from Traditional Mortgage to Reverse Mortgage:

- Reduced withdrawal rate -> reduced sequence risk -> increased probability of success

- Mortgage leverages the portfolio – legacy will be larger if portfolio growth rate exceeds loan growth rate

- High initial HECM borrowing reduces the overall percentage of the initial home value that can be accessed through reverse mortgage (voluntary repayment helps against this advantage for Line of Credit uses)
HECM for Purchase
Example for HECM for Purchase

• 65-year old couple enters retirement with $1.4 million in IRA
• Seeking to purchase a $300,000 home
• Traditional mortgage:
  • A 3.5% fixed 15-year mortgage with a 20% down payment
  • Annual mortgage payments = $20,838
• HECM for Purchase:
  • The principal limit is 45.9% of $300,000, or $137,700; Portfolio to finance the rest
  • Upfront costs: $5,000 + $6,000 + $2,500 = $13,500 paid from portfolio
  • No Remaining Line of Credit
Probability of Success for a 4% Post-Tax Initial Withdrawal Rate
$1 million portfolio, $541,833 home value, 25% Marginal Tax Rate
HECM for Purchase:

• Reduced withdrawal rate -> reduced sequence risk -> increased probability of success

• HECM for Purchase leverages the portfolio – legacy will be larger if portfolio growth exceeds loan growth

• High initial HECM borrowing reduces the overall percentage of the initial home value that can be accessed through reverse mortgage (voluntary repayment helps)
Portfolio Coordination for Retirement Spending
An idea whose time had come?

“Reversing the Conventional Wisdom: Using Home Equity to Supplement Retirement Income”
Barry Sacks and Steven Sacks
Journal of Financial Planning, February 2012

“Standby Reverse Mortgages a Risk Management Tool for Retirement Distributions”
John Salter, Shaun Pfeiffer, and Harold Evensky
Journal of Financial Planning, August 2012

**Thesis:** Strategic use of a reverse mortgage standby line of credit can create retirement income efficiencies through its contribution to managing sequence of returns risk in retirement
HECM Strategies for Portfolio Coordination

• Ignore Home Equity

• Home Equity as Last Resort ("Conventional Wisdom")
• Use Home Equity First
• Sacks and Sacks Coordination Strategy
• Texas Tech Coordination Strategy
• Use Home Equity Last
• Use Tenure Payment
Probability of Success for a 4% Post-Tax Initial Withdrawal Rate
$1 million portfolio, $500,000 home value, 25% Marginal Tax Rate
Median Real Legacy Value for a 4% Post-Tax Initial Withdrawal Rate $1 million portfolio, $500,000 home value, 25% Marginal Tax Rate
Conclusions

• Conventional wisdom hurts retirement sustainability: HECM shouldn’t be last resort

• Strategic HECM use: improved retirement sustainability, larger legacy

• WHY IT WORKS: Buffer to Mitigate Sequence Risk; Growing Line of Credit

• Low interest rates favor HECM (unlike everything else)

• HECM helps middle class: more benefits when home value is large relative to portfolio size (and when home value is under $765,600)

• Responsible use of HECM can improve retirement income efficiency
THANK YOU!
ANY QUESTIONS?

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