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REVERSE MORTGAGES AND RISING INTEREST RATES

Low interest rates are no longer a foregone conclusion. Are these products a viable tool for older clients?

By Danielle Andrus

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Some planners may wonder about the merits of reverse mortgages as interest rates increase; the more that interest rates eat away at equity, the less appealing a product is that pays based on the value of that equity.

As of late May 2024, 30-year fixed rate mortgages were just under 7 percent, according to Freddie Mac, and 15-year FRMs were 6.24 percent.[1] That's up from under 3 percent in August 2021 and, of course, that follows 20 years of declining interest rates. The increase in interest rates has had a cooling effect on home purchases. Homeowners who bought or refinanced in the last couple of years are hesitant to sell, keeping existing homes off the market and sales down 3.7 percent compared to March 2023.[2] New-home sales are up nearly 9 percent over the same period, but overall mortgage activity is down over 10 percent since last year. Freddie Mac anticipates

higher mortgage rates will last through most of the remaining months of 2024.

While millennials and Gen X have the lowest mortgage rates and the highest balances, the agency found older generations are right behind them in years left to pay off a mortgage. The silent and boomer generations have an average of 18 years left on refinanced mortgages, paying $1,200 and $1,500 per month respectively.

“If we’re going to be comprehensive holistic planners holding the fiduciary standard, is it reasonable that we ignore housing wealth?”

Depending on how old your clients are, today’s rising interest rates could look like a troubling increase, but older clients remember when they were even higher. Don Graves, RICP, CLTC, president and founder of the Housing Wealth Institute and business development manager at Mutual of Omaha Mortgage, notes that interest rates are higher than they’ve been over the past 20 years but doesn’t call them “high.”

“When Jimmy Carter was president, 18 to 22 percent—that’s high. Interest rates today are higher, but they’re far from high,” Graves said in an interview.

He says the vast majority of reverse mortgage borrowers take a home equity line of credit instead of a lump sum, which gives them a powerful benefit in planning: choice.

“The reverse mortgage strategy increases the velocity at which the line of credit is growing,” he says. “Now, when emergencies come or expenses or enjoyment or just things in retirement, we have some optionality. Where do we draw from: income, investments, insurance, or your housing bucket?”

Graves believes that the value of a client’s home needs to be considered as an asset in retirement planning. Pew Research Center found in 2011 that home equity accounted for more than half of a household’s net worth.[3] As of 2021, housing is still a significant component of Americans’ wealth, accounting for 28.5 percent of aggregate household wealth, according to the Census Bureau. The largest component of wealth is retirement accounts, comprising over 34 percent of household wealth.[4]

“If we’re going to be comprehensive holistic planners holding the fiduciary standard, is it reasonable that we ignore housing wealth?” Graves asks.

Impact of Interest on Equity

The amount of equity that a borrower can access is determined by the principal limit factor, which is based on the borrower’s age, the home value, and the interest rate, explains Theresa Valinotti, president and owner of Truest Mortgage Lending, Inc.

“When interest rates are higher, then the amount that the borrower has access to is lower. That’s the immediate effect that we’re seeing,” she says of rising interest rates. “Also, because interest rates are higher, the balance on the loan is increasing at a faster pace.”

However, while higher interest rates clearly have some negative impacts on borrowers, there are some benefits to understand as well. “The unused portion on the line of credit grows at the same rate that is applied to the loan balance. What that means and how that benefits the borrower is that they have more access to equity,” Valinotti says.

“I would say 99 percent of what I do, in terms of the reverse mortgage, is based on an equity line,

and that's where it can be a powerful tool in financial planning," she says.

Using HELOC for Growth

Most reverse mortgages are home equity conversion mortgages and are federally insured and administered by the Federal Housing Administration (FHA). They're restricted to borrowers 62 or older. As of 2024, the maximum amount a borrower may be eligible for is $1,149,825, but the amount of the loan will be determined by the age of the youngest borrower, home value, and interest rate.

In fiscal year 2023, FHA issued nearly 33,000 HECMs, down 50 percent from the previous year. Borrowers who take a fixed-rate HECM may opt for funds to be disbursed as a lump sum, an option that garnered some interest between 2016 and 2022. However, approximately 93 percent of proceeds in 2023 were issued as a line of credit.

The agency notes that borrowers took smaller initial withdrawals in 2023 than the prior year: 60 percent compared to 72 percent in 2022. Borrowers who take large up-front withdrawals limit the resources they can tap to pay future taxes and insurance, FHA warns, as well as depleting equity faster as balances compound more quickly.

Applications in Planning

Although borrowers have to be at least 62 to be eligible for a HECM, there are some proprietary products that start at age 55, Valinotti says. These products aren't insured by the FHA, and eligibility requirements are set by the lenders that offer them.

Valinotti says a reverse mortgage isn't just a tool for a retired client. Some may want to take a reverse mortgage while they're still working and want to supplement their income before they begin claiming Social Security benefits, she says. Others are trying to mitigate the future cost of healthcare.

"That's a big reason to put a reverse mortgage in place as soon as possible so you have it sitting there, and that equity line's growing and you can tap into that for long-term care costs," she says.

Graves suggests reverse mortgages as a potential tool to address tax concerns on Roth conversions. "If I move my taxable dollars to non-tax, that's going to count as ordinary income tax and I've got to pay taxes. . . . Where do I get the money to pay the income taxes on the conversion? Do I get it from the asset itself or from another asset?" he posits.

Using a reverse mortgage to eliminate monthly payments on a traditional mortgage is another strategy planners can consider to free up monthly income for their clients in retirement, according to Graves. Clients can use the reverse mortgage to pay off the original loan, and any remaining balance on the line of credit will continue to grow.

Costs to Consider

A common objection to reverse mortgages is the cost. HECM borrowers will be charged a 2 percent initial mortgage insurance premium, plus 0.5 percent of the outstanding balance annually over the remaining term. Closing costs may include fees for a home appraisal, credit check, surveys and inspections, title search and insurance, and other taxes and fees.[5] Origination fees are capped at $6,000, and lenders can charge a monthly servicing fee of $30, or $35 if the loan has a monthly adjusting interest rate.

Borrowers are required to maintain homeowners' insurance and pay property taxes for as long as they have the reverse mortgage. Depending on where the home is, homeowners' insurance may be expensive or difficult to obtain. The Insurance Research Council reported in May that U.S. households spent an average $1,411 on homeowners' insurance in 2021, up 5 percent annually from $508 in 2001. In Florida, homeowners spend over 4 percent of their income on homeowners' insurance, more than twice the average of 1.99 percent, the IRC found. Meanwhile, State Farm announced in May 2023 that it stopped accepting new applications for California properties, six months after a similar announcement from Allstate.

Coastal states aren't the only ones at risk. A *New York Times* investigation found that insurers are pulling out of or raising rates in states like Iowa, Minnesota, Kentucky, Tennessee, and more.[6] Insurers reportedly lost money in 18 states last year, according to Christopher Flavelle and Mira Rojanasakul.

Inheriting HECM Homes

Valinotti says that some clients express concerns about not being able to pass their home to heirs if it's mortgaged with a reverse mortgage. She says that when a reverse mortgage borrower dies, heirs typically have three options regarding the property.

"They can refinance—secure other financing on the property, pay the reverse mortgage off, and keep the property—or they can sell the property and pay the reverse mortgage off and the net proceeds will go to the heirs. Or, because the reverse mortgage is a non-recourse loan, meaning that the lender can never come back to the borrowers or the heirs if the balance is more than what the value of the property is, they can simply turn the keys over to the lender and walk away from the property," she explains.

She cautions that planners who don't want to suggest a reverse mortgage to their clients because of this concern should make sure they understand the heirs' wishes in addition to their clients'.

"It's an old way of thinking," she says. Some generations in particular think, "'I have to pass my home down to my children,' when the funny thing is most of the adult children I talk to don't even

want the property if it means that their parents are able to pull equity from the home to give them a better lifestyle and keep their parents' portfolio intact. Bottom line is they're still able to pass down a legacy—it may not be the home, which again, most of the adult children don't even want to deal with."

More than a Last Resort

One pernicious myth about reverse mortgages, according to Graves, is that it's a tool for desperate consumers trying to wring the last dollar from their homes to cover their expenses. He attributes this thinking to a FINRA investor alert in 2010 that called reverse mortgages a "last resort way to secure additional monthly income in retirement."[7]

The profile of today's reverse mortgage borrower is what he calls the "cautious borrower. They have a workable retirement plan, but it needs some improvement or some contingency because retirement is longer, more expensive, and less predictable."

Conclusion

Valinotti is starting to see an increase in demand for reverse mortgages as financial planners learn more about them. "You cannot sell a reverse mortgage," explaining that her objective is instead to give financial planners the information they need for their clients to make an informed decision.

She encourages planners to keep an open mind about reverse mortgages. "Learn about them. Talk to a certified reverse mortgage specialist. Try to understand what they are and how they will benefit [clients]," she says.

Graves shares that sentiment and notes that a client's home is simply too valuable to be left out of the retirement portfolio. "It's too large an asset to be ignored. It's too important to be dismissed, it's too vital to be uneducated [about], and it creates outcomes. That's the final and most important—it creates outcomes that might not otherwise be achieved," he says. Strategic use of reverse mortgages gives planners "an opportunity to create optionality of outcomes and to solve problems, bridge gaps, and overcome concerns." ■

Endnotes

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