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The Pros and Cons of Reverse Mortgages

by

Tom Dickson and Laurence Kotlikoff



Tom Dickson is a passionate personal financial educator with extensive knowledge of reverse mortgages. His [Financial Experts Network](#) platform offers outstanding webinars that feature Best-in-Field experts educating listeners on personal financial decisions such as credit scores, college planning, Medicare, HSAs, tax strategies, Paycheck Protection loans and much more. Throughout his 37 years in the financial services, he worked in the mutual fund, online brokerage, trust banking, mortgage, and fintech tool sectors.



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Professor Kotlikoff received his B.A. in Economics from the University of Pennsylvania in 1973 and his Ph.D. in Economics from Harvard University in 1977. Kotlikoff is the Director of the Fiscal Analysis Center and a regular contributor to Forbes.com. [@Kotlikoff](#)

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AGENDA

Reverse Mortgages, the Basics -- Tom

Baby Boomers' Retirement Crisis & Trapped Equity Dilemma

How Reverse Mortgages Work

Who's Eligible

Interest Rates and Fees

Using MaxiFi to Assess Reverse Mortgages -- Larry

Quick Review of MaxiFi

The Potential Lifetime Spending Increase from RMs

The Risk of Moving If You Use an RM

Illustrations

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Americans' Grave Retirement Financing Problem

- 10,000 Boomers are Retiring Daily
- Half Have Less than \$50,000 in Wealth
- Few have Pensions
- Most Face High Medicare Premiums and Out of Pocket Health Expenses
- Most Take Social Security Far Too Early
- Most Face Increasing Social Security Benefit Taxation via Inflation
- Social Security is Effectively Bankrupt with a \$53 Trillion Unfunded Liability
- Two in Five Retirees Over 60 Live Entirely on Social Security

The Trapped Equity Problem

- Almost Half of Seniors' Net Worth Constitute Home Equity
- Median Home Equity of those 65+ is Almost \$150K
- Home Equity Rises with Age as Mortgage Is Paid Off
- Problem – Tens of Millions of Elderly are House Poor
- House Poor isn't Just About High Carrying Costs
- House Poor Includes Inability to Spend Home Equity

The Upside of Reverse Mortgages

- Goal is Un-trapping Your Trapped Home Equity
- You Take Out a Special Mortgage on Your Home
- Why's It Special?
- Because You Don't Need to Pay a Penny Back Until You Move

The Downside of Reverse Mortgages

- You Can Move Voluntarily or Involuntarily (to the Cemetery)
- If You Set Things Up Right, It's the Last Spouse to Move that Matters
- When You Move, You Repay Everything Borrowed, Included Fees, Plus Accumulate Interest
- If What You Need to Repay Exceeds Your Home Value, You Don't Need to Make Up the Difference

Reverse Mortgages (RMs) – Eligibility

- Need to Be 62 Plus
- Existing Mortgage Needs to Be Low Enough to Be Paid Off with RM
- Younger Spouses Can Retain RM if Older Spouse Dies
- Need to Take an Approved Counseling Course

Max Amount You Can Borrow Via an RM

- Multiply the Principal Limit Factor Times the Maximum Claim Amount
- Principal Limit Factor (PLF) Rises from 52.4% at Age 62 to 73.0% at Age 90
- Maximum Claim Amount (MAC) is Lessor of Home Value and \$822,375
- Max You Can Borrow: $PLF \times MAC$ less Outstanding Mortgage Less Fees

Ways to Receive Monies Borrowed Under an RM

- Lump Sum Payment
- Monthly Payment for Fixed Number of Years or Rest of Your Life
- Line of Credit
- Combination of the Above

RM Interest Rate

- Fixed or Variable
- Fixed RM Rate Now Roughly 3.5 Percent
- Variable RM Rate Now Roughly 2.5 Percent
- 30-Year Standard Mortgage Rate is Now Roughly 2.8 Percent
- 30-Year Treasury Bond Yield is Now 1.94 Percent
- RM Rate is Fixed, Hence, Inflation Can Erode Its Real Value Dramatically

RM Repayment

- Neither Interest Nor Principal Payments Required
- Unpaid Interest and Principal Plus Unpaid Fees Compound
- Outstanding Balance Is Due When You Move or Sell

Fees

- Counseling Fee
- Appraisal Fee
- Origination Fee
- Third Party Servicing Fee
- Initial Mortgage Insurance Premium
- Annual Mortgage Insurance Premium
- Closing Costs -- Title Insurance, Survey Fee, Credit Report Fee, Escrow Fee, Doc Prep Fee, Recording Fee, Pest Inspection, Courier Fee, Flood Certification Fee

Total Fees Can Be Substantial

- Counseling Fee -- \$125
- Origination Fee – Greater of \$2,500 and 2% of First \$200K of Appraised Value Plus 1% of Appraised Value Over \$200,000. Max of \$6,000.
- Third Party Fee – Depends on Lender
- Initial Mortgage Insurance Premium – Max of 2% of Appraised Home Value and \$822,375.
- Annual Mortgage Insurance Premium -- .5% of Outstanding Balance, which Will Likely Grow through Time
- Closing Costs – Vary Considerably

RM Reduces Longevity Risk, But at the Price of Moving Risk

- If You Take Out an RM and Can Stay in Your Home Long Enough, You'll End Up Living Rent-Free In a House Owned by your RM Lender.
- Much or All of Your Home Equity Will Go to the RM Lender, Not to Your Children or Other Heirs
- If You Live in Your House Long Enough, You'll Un-trap Lots of your Trapped Equity.
- If You Have to Move, All Receipt and Unpaid Fees, Compounded at Interest, Come Due.
- You May Have Little Left Especially After Capital Gains Taxes to Buy/Rent a New Home or Buy into a Nice Nursing Home.
- Note Capital Gains Taxes Are Based on the Sale Price of Your Home, Not the Proceeds You Receive After the RM Balance Is Paid. This Can Be a Killer for those, Like Many, Long-Term Californians with Large Housing Cap Gains

MaxiFi – Quick Review

- Consumption Smoothing – Achieving a Stable Living Standard
- Maximizes your Lifetime Discretionary Spending
- Incorporates Fed/State Taxes, Soc Sec Benefits, Medicare Premiums
- Calculates Lifetime Spending Impact of Any and All Financial Moves
- Unlimited What If Scenarios
- Can Easily Model Reverse Mortgages

MaxiFi and Reverse Mortgages

- Can Measure Lifetime Spending Gain from Reverse Mortgages
- Can Measure Moving Risk Arising with Reverse Mortgages
- Can Evaluate Alternative Ways to Free Trapped Equity
- Incorporates All Tax Issues Arising with Reverse Mortgages
- Properly Deals with Inflation

Three Simple Steps

1. Enter Proceeds, Lump Sum or Annual as Non-Taxable Special Receipt
2. Enter a Non-Tax Related Special Expense at your Max Age.
3. Set Expense at Larger of Terminal House Value Less RM Balance and 0.

Modeling an RM in MaxiFi Assuming You Move

- Set Up an Alternative Profile
- Enter Proceeds, Lump Sum or Annual, as Non-Taxable Special Receipt
- Specify Moving Date, If You Want to Model Moving
- Enter Repayment at Moving Date as Non-Tax Related Special Expense

Modeling a Reverse Mortgage in MaxiFi Assuming You Move

- Set Up an Alternative Profile
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Meet Jim and Sharon

- Age 63
- Live in Massachusetts
- Have a Combined \$500K in 401(k)
- Own a \$350K House, no Mortgage
- Each Collects \$2,000 Per Month from Social Security
- Couple Receives \$8,350 Per Year from a RM

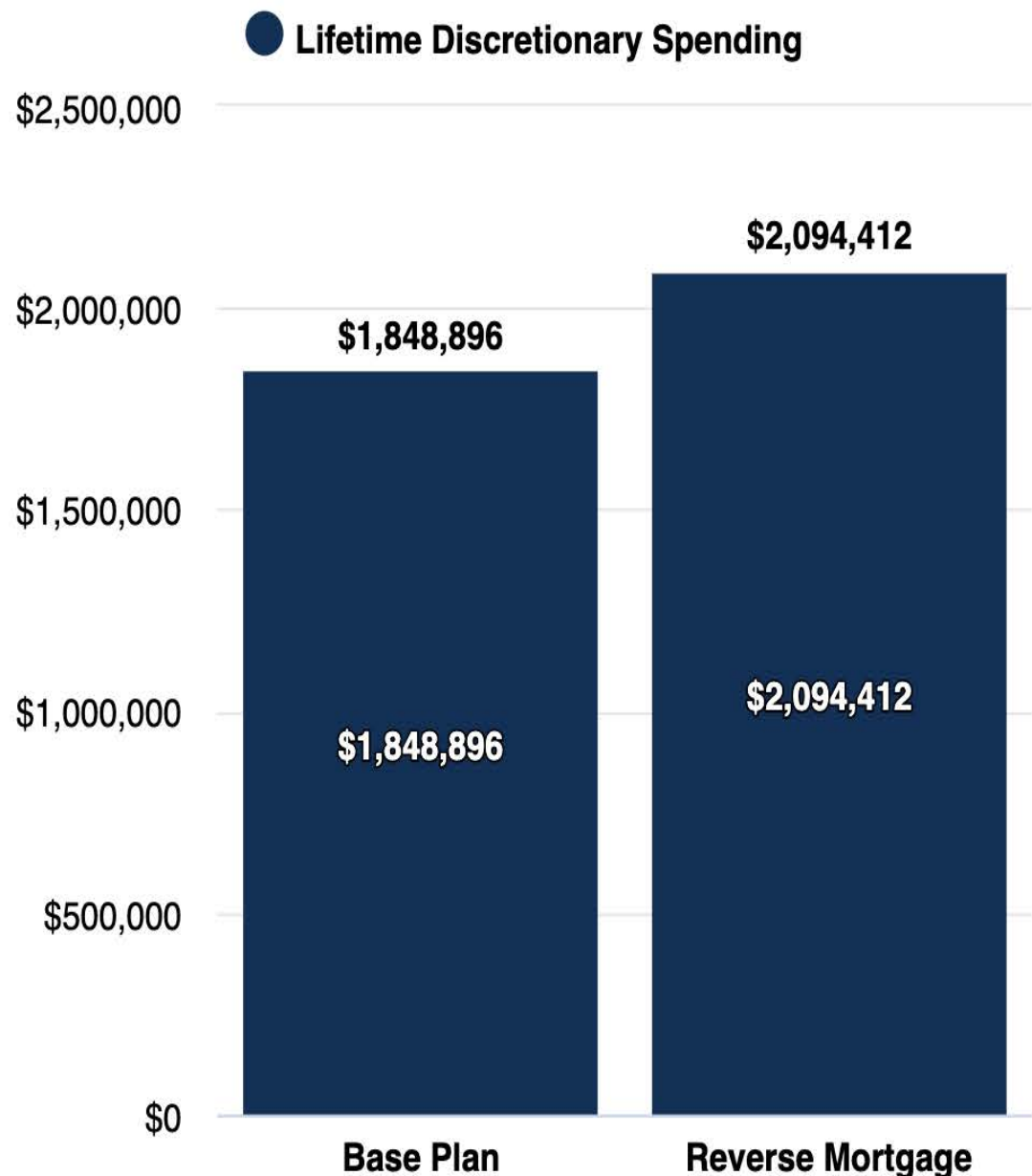
RM Available to Jim and Sharon at 62

Scenario: Age 62	Age 62		Age 72		Age 82		Age 100
Home Value	\$ 350,000		\$ 406,189		\$ 471,399		\$ 616,279
Loan Balance	\$ 12,118		\$ 118,570		\$ 272,290		\$ 740,946
Net Home Equity	\$ 337,882		\$ 287,619		\$ 199,109		\$ (124,667)
Total Tax-Free Cash Draws			\$ 83,509		\$ 167,018		\$ 317,335
Monthly Tax-Free Payment Through Age 100	\$ 714.64						
Appreciation	1.5%						

Lifetime Discretionary Spending

The chart below shows the difference in Lifetime Discretionary Spending between the Base Plan and Reverse Mortgage.

 **\$245,516**
Increase in Lifetime Discretionary Spending
Under the Reverse Mortgage



Why Is the Gain from the RM \$239,224, not \$350,000?

- The RM Living Standard Gain, Under the Best-Case Scenario, is 13%
- Reverse Mortgages Limit How Much Home Equity Can Be Withdrawn
- The Reverse Mortgage Proceeds Total \$308,950, Not \$350,000
- Investment of RM Proceeds Are Subject to Fed & State Income Tax
- The RM Interest Rate and Fees Are High.

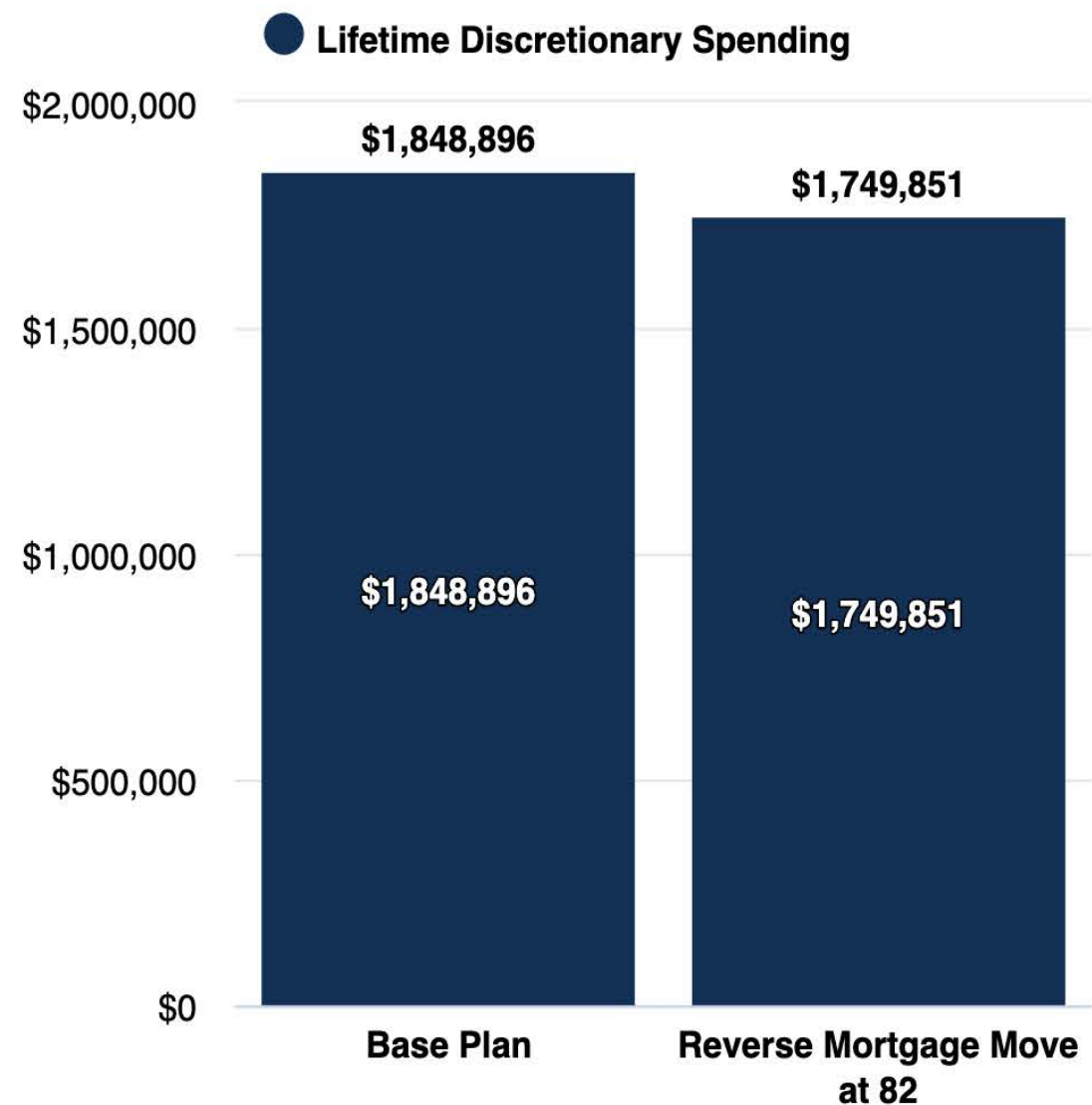
RM Can Be a Loser If You Have to Move

Lifetime Discretionary Spending

The chart below shows the difference in Lifetime Discretionary Spending between the Base Plan and Reverse Mortgage Move at 82.



Congratulations! Base Plan dates provide the maximum Lifetime Discretionary Spending.



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Charts Assumes Couple Lives to 100, But Knows at 62 that They Will Move at 82.

Biggest RM Danger Is Moving Unexpectedly

- Suppose Jim and Sharon Spend RM Proceeds Assuming No Move
- At 82, Jim and Sharon Unexpectedly Have to Move
- They'll Owe \$272,290 on their RM, But Only Have \$76,631 in Regular Assets
- Their Combined 401(k)s Will Total \$218,136

Note: All Amounts Are in Today's Dollars.

Biggest RM Danger Is Moving Unexpectedly (Continued)

- If They Sell for \$350K Less 6% Commission, \$56,710 Is Left Post RM Repayment
- The \$56,710 Plus \$76,631 Leaves them with \$133,341 in Regular Assets.
- To Buy a New \$350K House, They'll Need to Cash Out \$132,991 from 401(k)s
- This Leaves Them With Zero Regular Assets and \$85,145 in their 401(k)s

Note: All Amounts Are in Today's Dollars.

Biggest RM Danger Is Moving Unexpectedly (Continued)

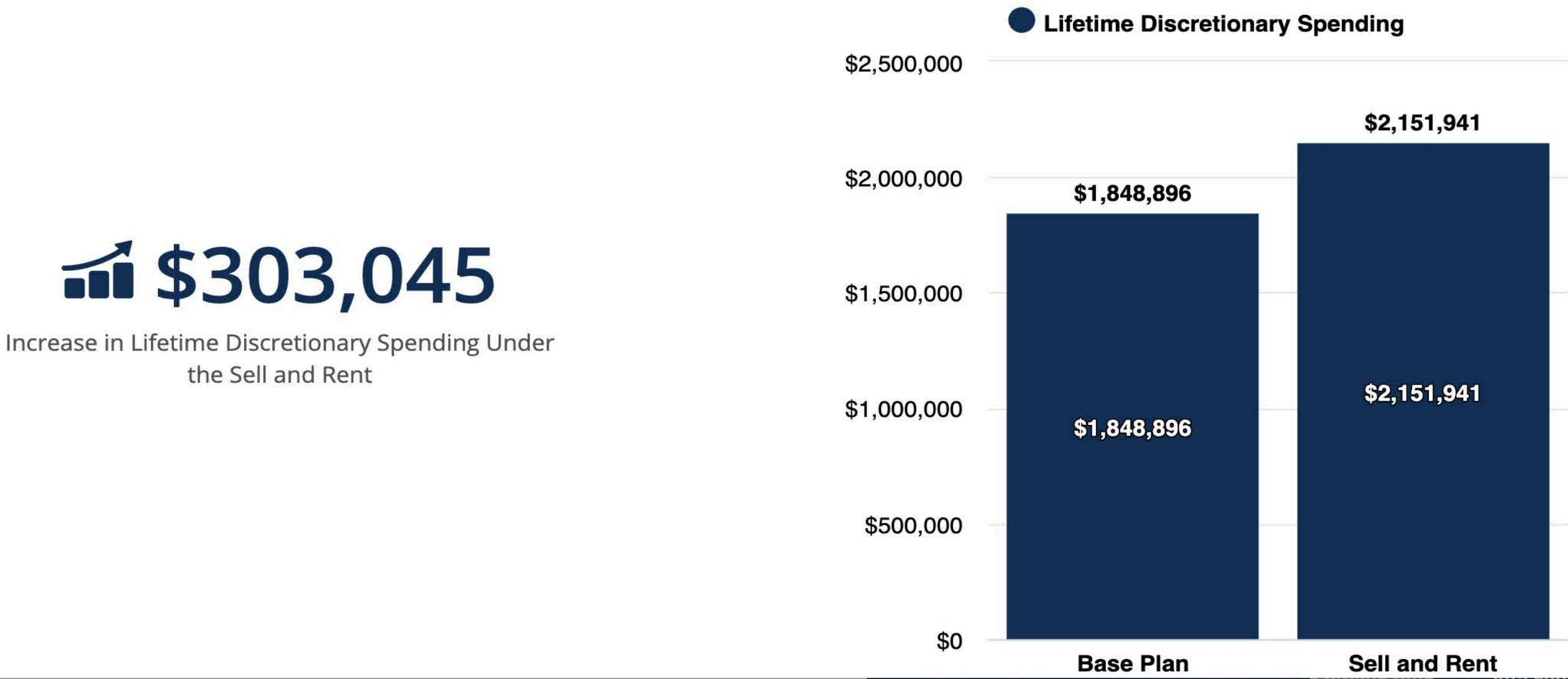
- Their Remaining Discretionary Spending Drops from \$944,874 to \$735,252
- I.e., They Suffer a 22 Percent Reduction In their Living Standard
- This is 12 Percent Lower than their No-RM Living Standard
- If They Rent, Age 82 Remaining Discretionary Spending Drops to \$857,080.
- I.e., They Suffer a 9 Percent Reduction in their Living Standard
- This is 3 Percent Higher than their No-RM Living Standard.
- Bottom Line – Decent Chance RM Will Require Renting at End of Life
- RM Also Entails a Much Smaller Security Blanket Re End-of-Life Expenses

Note: All Amounts Are in Today's Dollars.

Selling and Renting May Be a Better Way to Free Home Equity

Lifetime Discretionary Spending

The chart below shows the difference in Lifetime Discretionary Spending between the Base Plan and Sell and Rent.



Calculation Assumes Couple Rents for \$8,028 Per Year.



But Selling and Renting Is Risky Too

- This Produces a 16 Percent Increase in Annual Discretionary Spending
- But Your Rent Can Be Raised
- But Your Lease May Not Be Renewed
- But Your Landlord May Not Provide Good Maintenance
- But You Lose the Tax Benefits from Home Ownership
- Loss of Tax Benefits Explains Why Discretionary Spending Rises by \$303,045, Not \$350,000 When from Selling and Renting
- Loss of \$350K End-of-Life (e.g., Nursing Home) Security Blanket

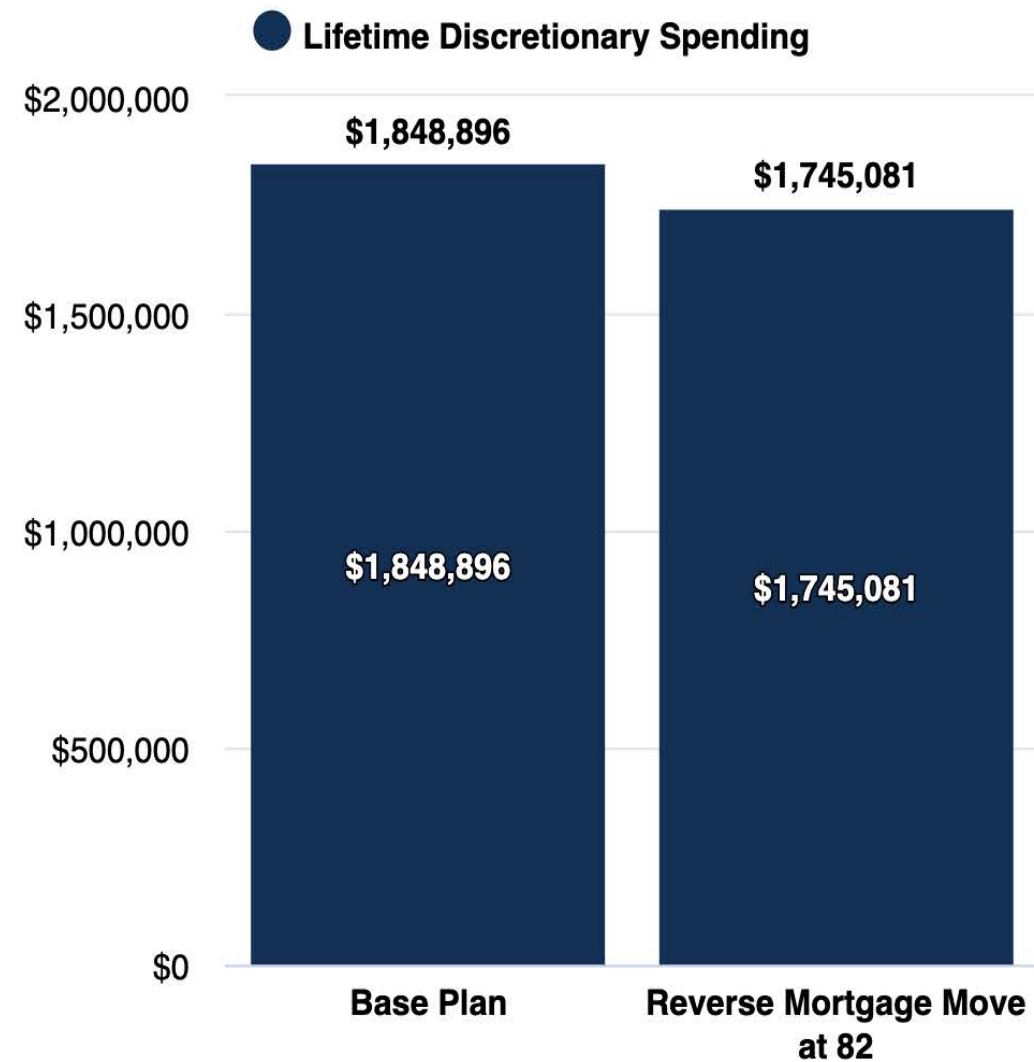
RM Can Be a Loser If You Have to Move

Lifetime Discretionary Spending

The chart below shows the difference in Lifetime Discretionary Spending between the Base Plan and Reverse Mortgage Move at 82.



Congratulations! Base Plan dates provide the maximum Lifetime Discretionary Spending.



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Big Moving Danger is Not Expecting You'll Have to Move

- Your Rent Can Be Raised
- Your Lease May Not Be Renewed
- Your Landlord May Not Provide Good Maintenance
- You Lose the Tax Benefits from Home Ownership
- Loss of Tax Benefits Explains Why Discretionary Spending Rises by \$303,045, Not \$350,000 When You Sell and Rent

Big Moving Danger is Not Expecting You'll Have to Move

- Your Rent Can Be Raised
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Other Ways to Up-trap Trapped Equity

- Downsize
- Take in Renters
- Take in your Kids and Have them Help Cover Expenses
- Sell your Home to your Kids with Right to Rent Till You Die
- Buy Apartment in Extended Living Community with End-of-Life Care

Contact Information



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The text "Thank you for participating!" is written in a white, sans-serif font. It is positioned below the MAXIFI logo and is centered horizontally. The background of the entire slide is a blue-tinted image of a person's hands using a laptop, with the laptop screen displaying a financial planning software interface.

Thank you for participating!