HOUSING WEALTH CONVERSATIONS

10 Reasons to Eliminate Mortgage Payments in Retirement

Unlocking the Power of the Modern Reverse Mortgage

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Executive Summary

In ***"10 Reasons to Eliminate a Mortgage Payment in Retirement: Unlocking the Power of the Modern Reverse Mortgage,"*** Don Graves presents a compelling argument for the strategic use of reverse mortgages to alleviate financial stress among retirees. He emphasizes the significant burden that monthly mortgage payments can place on retirees, particularly those carrying substantial housing debt, and explores how eliminating these payments can dramatically improve their financial outlook.

Graves uses the real-life case study of a couple, Pierce and Linda, to illustrate the practical benefits of reverse mortgages. Through their story, he demonstrates how the modern reverse mortgage can effectively extend retirement funds, reduce tax liabilities, and enhance overall lifestyle choices. Pierce and Linda's experience serves as a vivid example of the transformative potential of carefully structured reverse mortgages in retirement planning. The article highlights that reverse mortgages can provide financial assistance for grandchildren's education, ensure adequate coverage for life, health, and long-term care insurance, meet unexpected medical expenses, and establish a safety net for unforeseen financial challenges.

By eliminating monthly mortgage payments, retirees can unlock the equity in their homes to support various financial needs and goals.

What Would Retirement Be Like If You Didn't Have to Make a Monthly Loan Payment?

Imagine the financial freedom you could achieve if you no longer had to make a monthly mortgage payment. Reverse mortgages can be strategically utilized to manage and reduce debt obligations, enabling retirees to maintain financial stability and enhance their lifestyle.

According to the Consumer Financial Protection Bureau, an increasing number of retirees carry mortgage debt into their retirement years. Some studies estimate that 50-68% of new retirees will have some form of loan payment, including home equity loans and lines of credit. For the mass affluent baby boomer demographic, this percentage might be even higher.

Consider the last social gathering you attended where you spoke with homeowners over the age of 55. How many of them had a mortgage, home equity loan, or line of credit against their property? It's likely that a significant portion of them did. In fact, it wouldn't be surprising if the number was somewhere between 75-99%. This highlights the prevalent issue of mortgage debt among older homeowners, making the case for exploring debt management strategies such as reverse mortgages.

For retirees aged 75 and older, housing expenses, including mortgages, property taxes, insurance, utilities, and home maintenance, account for a substantial 43% of their monthly spending. With low savings rates, longer life expectancies, and global uncertainty, eliminating a monthly mortgage payment and creating additional cash flow could be a considerable relief.

Reverse Mortgages: A Brief Overview

A reverse mortgage is a loan available to homeowners aged 62 or older, allowing them to convert a portion of their home's value into tax-free dollars without giving up home ownership or title and without making monthly loan payments. The loan amount is based on the age of the youngest borrower, the home's value, and current interest rates. Importantly, a reverse mortgage must be the first mortgage on the property, meaning any existing loans must be paid off with the reverse mortgage proceeds before the homeowner can access the remaining funds.

Today, let's consider the impact of eliminating a mandatory monthly mortgage payment.

Case Study: Pierce and Linda

Meet Pierce and Linda, a couple aged 65 who are planning to retire at the end of the year.

Here are their financial details:

Home value:

$650,000

Mortgage:

$200,000

Monthly principal and interest payment:

$1,750

Total retirement savings:

$650,000

Desired initial withdrawal amount:

$45,000 per year (around 7%)

Pierce and Linda are concerned about running out of savings or having to cut back on their lifestyle to make their savings last.

While researching their retirement success rate, They discovered that many financial advisors and online calculators suggest a safe initial withdrawal rate of around 4%, which for them would be $26,000 per year instead of $45,000.

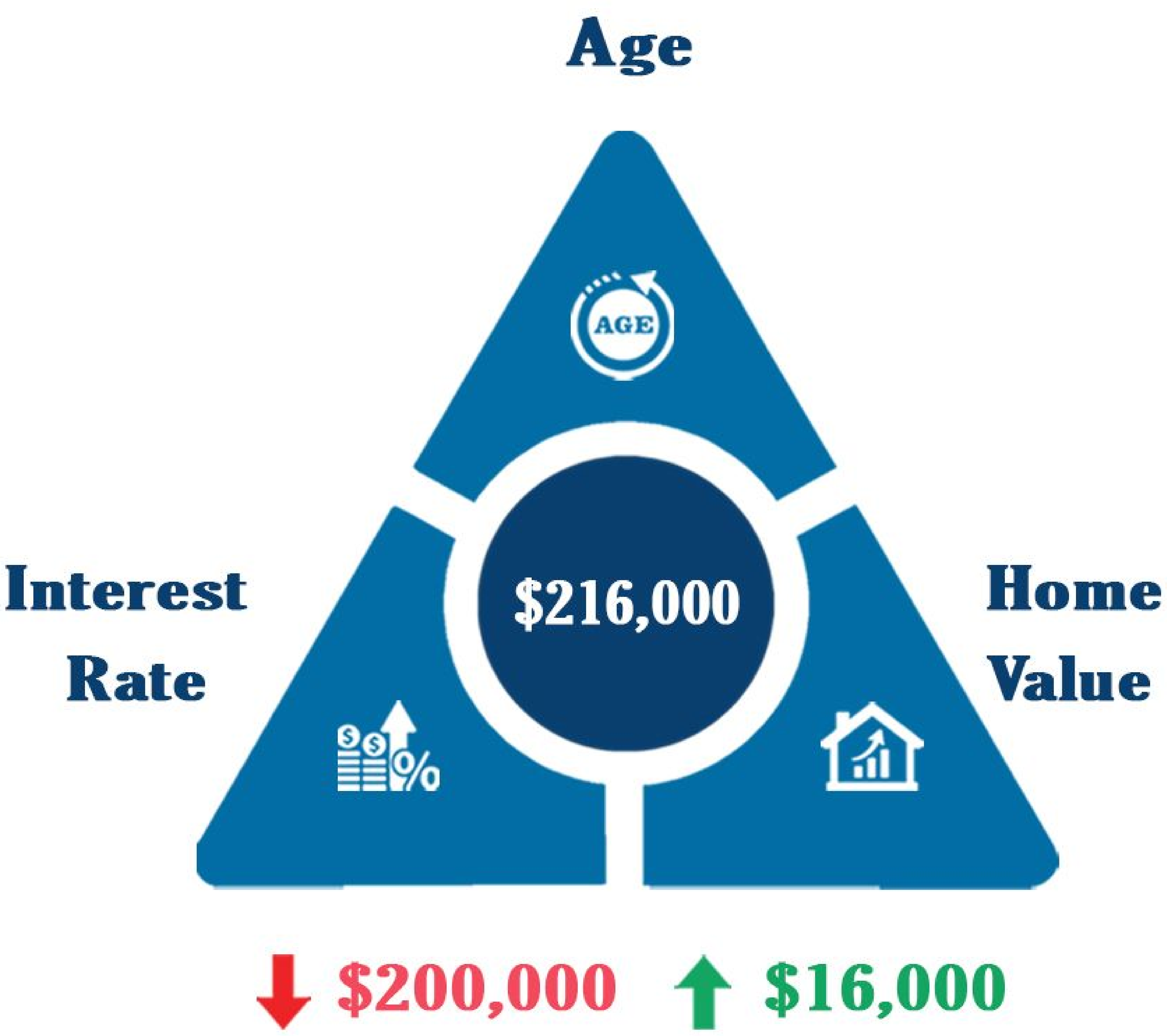
This realization was disappointing, but it prompted them to explore alternative options. Through further research, Pierce and Linda decided to consider a reverse mortgage to see if it could work for them.

Although they are fully comfortable making their monthly payment, they want to explore all possibilities, especially if it could increase the amount of spending they could enjoy without jeopardizing their nest egg.

During their research, they encountered two thought-provoking questions: (1) What would retirement be like if you didn't have to make a mandatory monthly mortgage payment? (2) If you had a choice, would you rather your monthly payment be mandatory or voluntary? These questions led them to consider a reverse mortgage as a viable option to enhance their retirement plan.

The Reverse Mortgage Solution

Based on their ages, home value, and current interest rates, Pierce and Linda qualify for a reverse mortgage of $216,000.After paying off their $200,000 mortgage,they have a remaining line of credit of $16,000.



Top 10 Benefits of Eliminating a Mandatory

Monthly Mortage Payment

Let's explore ten retirement-enhancing benefits of eliminating their mandatory monthly loan payment.

1. Extending Retirement Savings

Years ago, my friend and mentor Ed Slott, CPA, asked me, ***"How much money does a client save when they use a reverse mortgage to eliminate their existing payments?"*** Initially, I thought the answer was obvious: in the case of Pierce and Linda, they would save $1,750 a month.

"Not necessarily," he replied, and what he explained next was eye-opening."

Eliminating a $1,750 monthly mortgage payment translates to significant savings for retirees like Pierce and Linda. With $650,000 in tax-deferred accounts like IRAs or 401(k)s, they would need to withdraw approximately $2,250 monthly (considering taxes) to net the $1,750 needed to cover their mortgage payment.

By using a reverse mortgage to eliminate this payment, they retain around $27,000 annually in their savings ($2,250 x 12).

This substantial retention can significantly extend the longevity of their retirement funds, ensuring greater financial stability throughout their retirement years.

By leveraging a reverse mortgage to eliminate their monthly mortgage payments, Pierce and Linda can preserve their savings potentially extending their retirement funds significantly and providing them with greater financial security and peace of mind.

2. Reducing Income Taxes

By retaining nearly $27,000 in pre-tax dollars, Pierce and Linda not only lower their income taxes but also reduce their provisional income, which could prevent their Social Security benefits from being taxed.

3. Bridging the Budget Gap

Initially, Pierce and Linda desired an annual withdrawal of $45,000 but considered a more conservative $26,000. The $19,000 difference can be bridged by the reverse mortgage. By eliminating their mortgage payment, they free up $27,000 per year in pretax dollars. Meaning they only need to withdraw around $18,000 from their retirement accounts in the first year.

Looks like they can use the additional dollars per month to enhance their lifestyle, travel, and enjoy the go-go years of retirement. In other words, they can have their cake and eat it too!

4. Supporting Grandchildren's Education

With the extra $1,750 per month saved from the reverse mortgage, Pierce and Linda could contribute to their grandchildren's education. This money could provide a monthly tuition stipend, a gift, or even a low-interest loan, offering significant financial support and creating a lasting legacy.

The rising costs of higher education can be a burden on younger generations, and this contribution can make a meaningful impact on their grandchildren's lives and futures.

5. Funding Life Insurance Policies

The monthly savings can be directed towards purchasing cash value life insurance policies for their grandchildren. These policies are inexpensive, offer tax-deferred growth, and provide guaranteed returns, ensuring financial security for future generations. By securing life insurance for their grandchildren Pierce and Linda can help ensure that their family has a financial safety net in place, which can grow over time and provide substantial benefits as their grandchildren reach adulthood.

6. Enhancing Lifestyle and Covering Healthcare Costs

Pierce and Linda can use the additional $1,750 per month to cover unexpected healthcare costs. This extra cash flow can provide peace of mind and improve their quality of life. Retirees often worry about healthcare expenses, and having a reserve from their reverse mortgage savings can help cover out-of-pocket medical costs, prescriptions, or even long-term care, ensuring they receive the best possible care without financial stress.

7. Delaying Social Security Benefits

By using the funds from the reverse mortgage to cover their expenses, Pierce and Linda can delay claiming Social Security benefits. This strategy can result in a higher monthly benefit when they do decide to claim, increasing their long-term financial security. Delaying Social Security can be a crucial strategy for many retirees, as each year they defer can significantly increase their benefits providing more substantial income later in life when they may need it most.

8. Protecting Against Insurance Policy Lapses

The additional monthly savings can help ensure that premiums for life insurance, long-term care insurance, or medical coverage plans are paid consistently, protecting these essential policies from lapsing due to financial strain. Insurance policies are vital for protecting against unexpected events, and maintaining them is crucial for long-term financial stability and security.

9. Creating an Emergency Fund

Pierce and Linda can allocate part of their monthly savings to build a robust emergency fund. This fund can provide a financial cushion for unexpected expenses, reducing stress and ensuring they are prepared for any unforeseen circumstances. An emergency fund is a critical component of a sound financial plan, offering protection against unplanned events like home repairs, medical emergencies, or other sudden expenses that can arise during retirement.

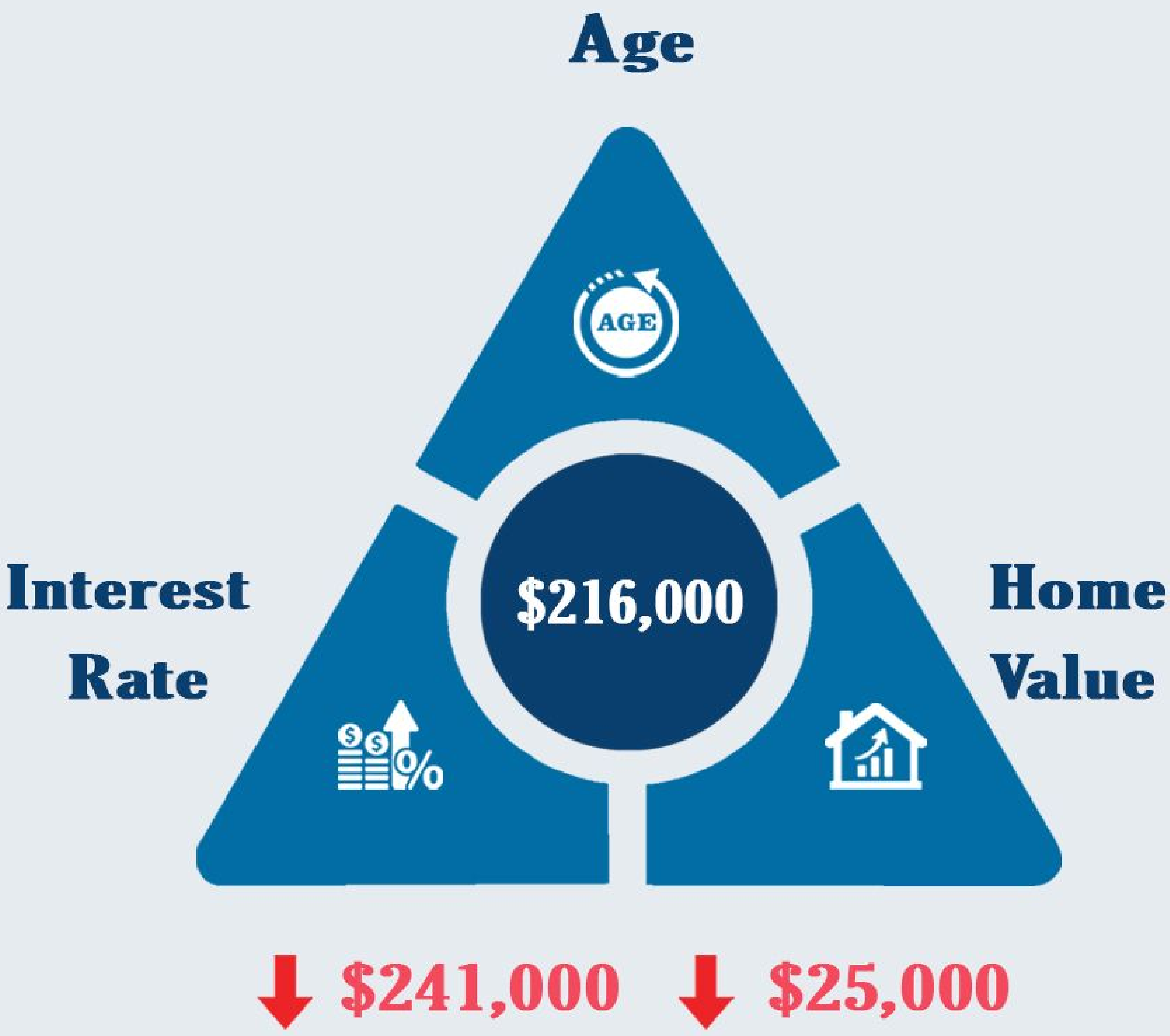
10. Increasing Charitable Giving

With the additional $1,750 per month saved from eliminating their mortgage payment through a reverse mortgage, Pierce and Linda can increase their charitable contributions. This extra cash flow allows them to support causes they care about more substantially and consistently. Charitable giving can provide personal fulfillment and potentially offer tax benefits, enhancing both their financial and emotional well-being. By being able to give more, they can make a greater impact on their community and the organizations they support, leaving a lasting legacy.

What Should I Do If a Reverse Mortgage Doesn't Entirely Eliminate My Existing Mortgage?

Sometimes the proceeds from a reverse mortgage are not enough to pay off the existing mortgage obligations (which is a requirement). Many retirees are tempted to dismiss the reverse mortgage at this point, but that could be an opportunity lost.

Suppose Pierce and Linda's scenario was different. They still have a $650,000 home but now, they have a $241,000 mortgage balance instead of $200,000.



Recall that the reverse mortgage made $216,000 available, but their existing mortgage debt now totals $241,000. This means there are not enough proceeds from the reverse mortgage to totally pay off their existing loan balances. They have a shortfall of $25,000!

This happens every day. The good news is that there are a few options to consider.

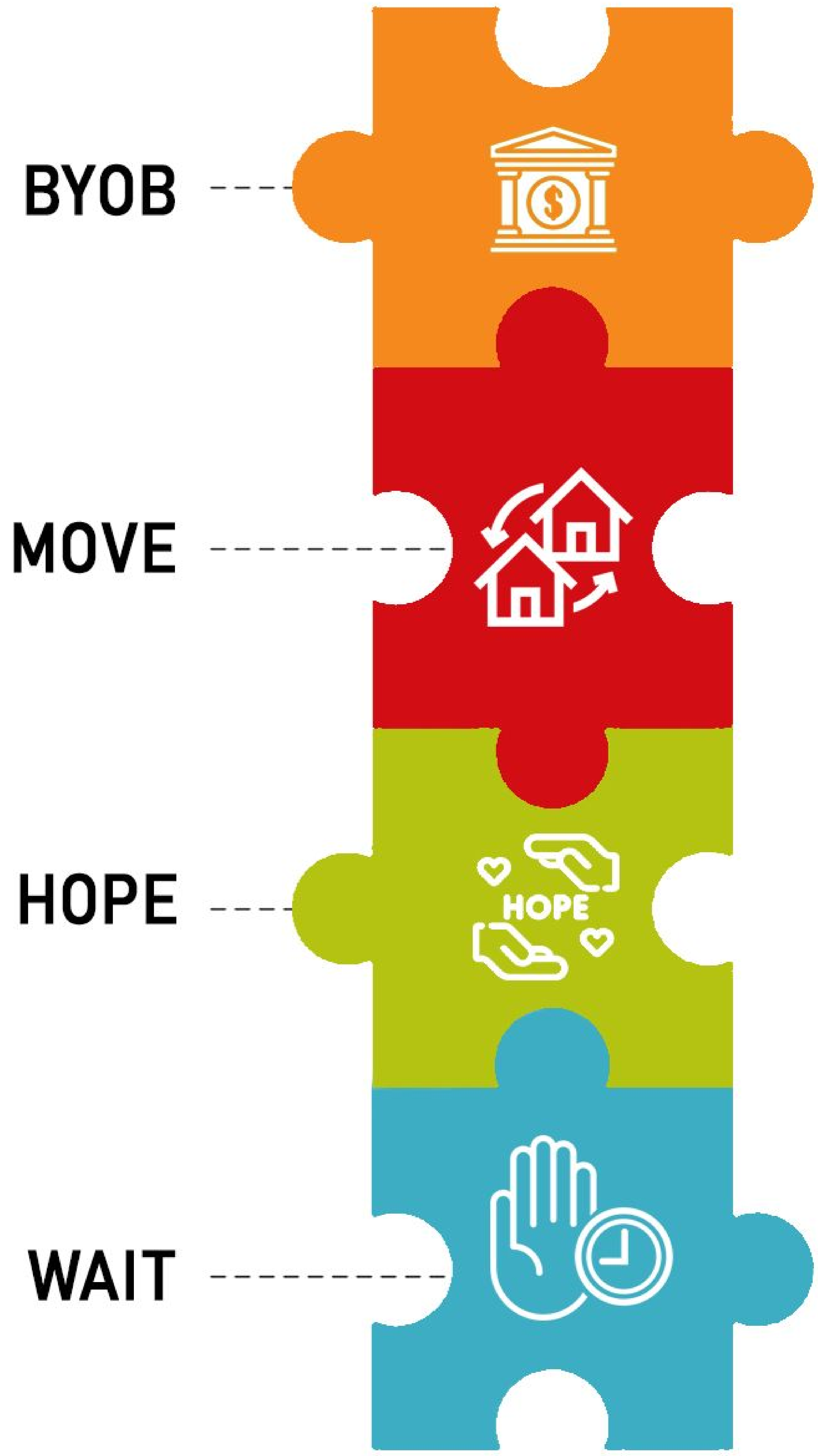
FOUR OPTIONS:

1. BYOB (Become Your Own Bank):

Pull the additional dollars needed from savings. Pierce and Linda have $300,000 in their investment account, money in cash equivalents, a small annuity they aren't drawing from, and $50,000 of cash value in life insurance. They could choose to draw the $25,000 shortfall from one of those accounts and combine it with the HECM proceeds to pay off their current mortgage.

2. MOVE

with a different type of reverse mortgage: If Pierce and Linda are open to moving, they could sell their current home, pay off the mortgage, and then use the remaining proceeds to rent, move to a smaller home and pay cash, or use the HECM for Purchase strategy to right-size into their next, last, and best retirement home. This is often a great strategy!



3. HOPE

for a better appraisal value: Pierce and Linda could choose to pursue the HECM and hope that their home's value comes in higher, eliminating any potential shortfall. With the current online tools available to consumers, I have found that most estimates are very close to the actual appraised value. Hoping for a better appraisal is usually not the best course of action.

4. WAIT

and continue paying down the current mortgage: Pierce and Linda could wait a few years and then revisit the reverse mortgage. The hope would be that their loan balance would be less, and their home's value would be more. This strategy depends on the assumption that their house will be worth more and that the HECM program and interest rates will remain about the same. Sometimes, this is the only option a person has.

When Does It Make Sense to Pull from Savings?

Of the four options, Pierce and Linda chose the first: to bring the extra $25,000 from their CDs. They are not alone; I have found several clients happy to bring upwards of $100,000 to the table to get rid of their mandatory mortgage payments.

When does it make sense to do this? The answer lies mainly in how important it is to your retirement savings, lifestyle, and happiness to be free of the monthly mortgage payment.

Is your monthly loan payment:

- Causing significant emotional concern and worry?
- Prematurely draining retirement savings?
- Preventing funds from being used for other resources?
- Forcing you to prematurely pull from an annuity?
- Keeping you from delaying Social Security?
- Inducing high credit card debt?

What you may discover is that drawing from savings to rid yourself of the burden of having a monthly loan payment is well worth it.

Conclusion

The benefits of eliminating a mandatory monthly mortgage payment through a reverse mortgage are extensive. From extending retirement savings and reducing income taxes to supporting family and maintaining crucial insurance policies, the financial freedom gained can significantly enhance a retiree's quality of life. Reverse mortgages provide a flexible, strategic solution to managing retirement finances, allowing retirees to focus on enjoying their golden years with less financial stress. By considering a reverse mortgage, retirees like Pierce and Linda can unlock the equity in their homes and use it to secure a more comfortable and financially stable retirement.

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About the Author

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Is the president and founder of the Housing Wealth Institute and an Adjunct Instructor of Retirement Income at The American College of Financial Services. With 25 years of experience in the reverse mortgage industry, Don has educated over 30,000 financial professionals and served nearly3,000 clients. He is an accomplished author of threebooks on reverse mortgages and retirement strategies, and a sought-after speaker. Don is dedicated to empowering consumers and financial professionals on the strategic benefits of reverse mortgages for enhanced retirement security.

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