FINANCE *of* AMERICA
– REVERSE –

Home Equity Conversion Mortgage (HECM) Training for Financial Professionals

Reverse Mortgages and Retirement Plans

Created January, 2017

- Financial professionals and reverse mortgages
- HECM eligibility and statistics
- How the program works
- Types of reverse products
- HECMs for estate planning and wealth management
- Strategy examples
- Summary and resources

The HECM Product
(Reverse Mortgage)

Clients who need a comprehensive retirement plan can unlock their home equity – and use it – with a reverse mortgage. By doing this, they open up a greater range of possibilities to strategically manage and enhance their wealth.

Reverse Mortgages

A reverse mortgage (also known as a “HECM”) is a non-recourse loan that allows homeowners to access a portion of their home equity.

Borrowers can access equity as cash, term or tenure payments, a line of credit (also known as a “HECM LOC”), or any combination of these.

Reverse Mortgages, cont.

Your clients can use a reverse mortgage:

- As a fixed income retirement planning product.
- As a risk management tool that enables them to retain ownership of their home.
- As an option to extract home equity, rather than liquidate other assets.
- To supplement investment income.
- As a hedge against declining real estate values.
- In Social Security planning.
- To manage tax liabilities.
- To purchase a new home.

Eligibility Requirements

Borrowers

In order to qualify for a HECM, borrowers must:

- Be age 62 or older,
- Live in the property as their primary residence, and,
- Be able to pay taxes, insurance, and property maintenance charges.

How the HECM Program Works

Government Oversight

HUD through the FHA HECM program requires counseling, mortgage insurance, and safeguards against financial abuse against older adults.

In order to protect consumers, HUD requires the following:

- Prospective borrowers must receive counseling before submitting an application for a reverse mortgage.
- Counseling is conducted by independent, third-party advocacy organizations and housing counseling agencies.
- Counselors are HUD-approved, exam-qualified professional housing counselors.
- Borrowers receive documentation to prepare for the session.

FHA Mortgage Insurance

FHA mortgage insurance protects the borrower if the sale price of the home does not repay the loan in full. When this occurs, FHA insurance pays the lender the difference between the sales price and the loan balance at the end of the reverse mortgage so the borrower does not have to pay it.

This "non-recourse" feature also protects lenders against losses that result from homeowners defaulting on their mortgage loans.

Both lenders and borrowers assume less risk.

HECM Proceeds

The Principal Limit Factor (PLF) is based on three components:

- Age of the youngest borrower (or non-borrowing spouse, if under age 62)
- The Maximum Claim Amount (MCA), which is the lesser of the lending limit of $636,150 or the appraised value of the property.
- The fixed rate or LIBOR expected rate (10-year swap plus margin) for the product the borrower selects.

HECM Proceeds Available Funds

The amount of available funds increases with the age of the borrower at application.

	Age 62	Age 76	Age 90
Available Funds	$333,343	$395,685	$477,113
Principal Limit Factor	52.4%	62.2%	75%

Note: In these calculations we used the MCA of $636,150 as the home value with an expected rate of 5.06%.

The Costs

The cost of a HECM includes:

- Traditional third-party closing costs
- A possible origination fee
- Mortgage Insurance Premium (MIP) charges are :
  - 2.50% of the MCA if the first year distributions exceed 60% of available funds,

  Or,
  - 0.50% of MCA if the first year distributions are less than 60% of available funds,

  Plus,
  - 1.25% of the outstanding balance annually.

Distribution of Proceeds

Borrowers can choose to receive their reverse mortgage proceeds as:

- A line of credit
- Monthly term payments
- Monthly tenure payments
- A combination of these

Proceeds are not taxable because they are considered “home equity” rather than “income.”

Benefit Limits

Borrowers must retain sufficient equity to pay taxes and insurance throughout the life of the loan. To ensure this, disbursements at loan closing, and throughout the first 12 months, cannot exceed the GREATER of:

- 60% of the Principal Limit,

Or,

- Mandatory obligations (closing costs, repairs, etc.) plus 10% of the Principal Limit.

Repayment

No payments are required toward principal, interest or mortgage insurance if at least one borrower still lives in the home as his or her primary residence. When the last borrower either passes away or permanently moves, the loan becomes due and payable.

The loan's non-recourse feature ensures that the borrowers or their heirs will never owe more than value of the house, regardless of the outstanding loan balance.

Note: If the loan balance exceeds the value of the property, family members can choose to purchase the property for 95% of the appraised value.

Types of Products

HECM Product Options

FHA-Insured Products

FHA-insured HECM products include:

- Fixed Rate
- Monthly Adjustable (10 point cap)
- Annual Adjustable (5 point cap)

Note: The national lending limit for all FHA-insured HECM products is $636,150.

Proprietary Program

FAR's HomeSafe® jumbo program is a fixed-rate only product with a maximum loan amount of $2,250,000

HECM Proceeds Distribution

Fixed Rate Products

Fixed rate products offer single lump sum distribution only. The lump sum amount cannot exceed the greater of:

- Mandatory obligations (payoffs and closing costs) plus 10%,

Or,

- 60% of available funds.

Note: The most appropriate use for lump sum payments is to eliminate monthly mortgage payments and other debt.

HECM Proceeds Distribution, cont.

Libor Adjustable Products

Distributions can be in cash, term or tenure payments, line of credit (HECM LOC), or any combination of these.

The borrower can change the distribution method at any time. If the borrower chooses to repay all or a portion of withdrawals, he or she can make future draws later.

Most appropriate product for strategic planning purposes.

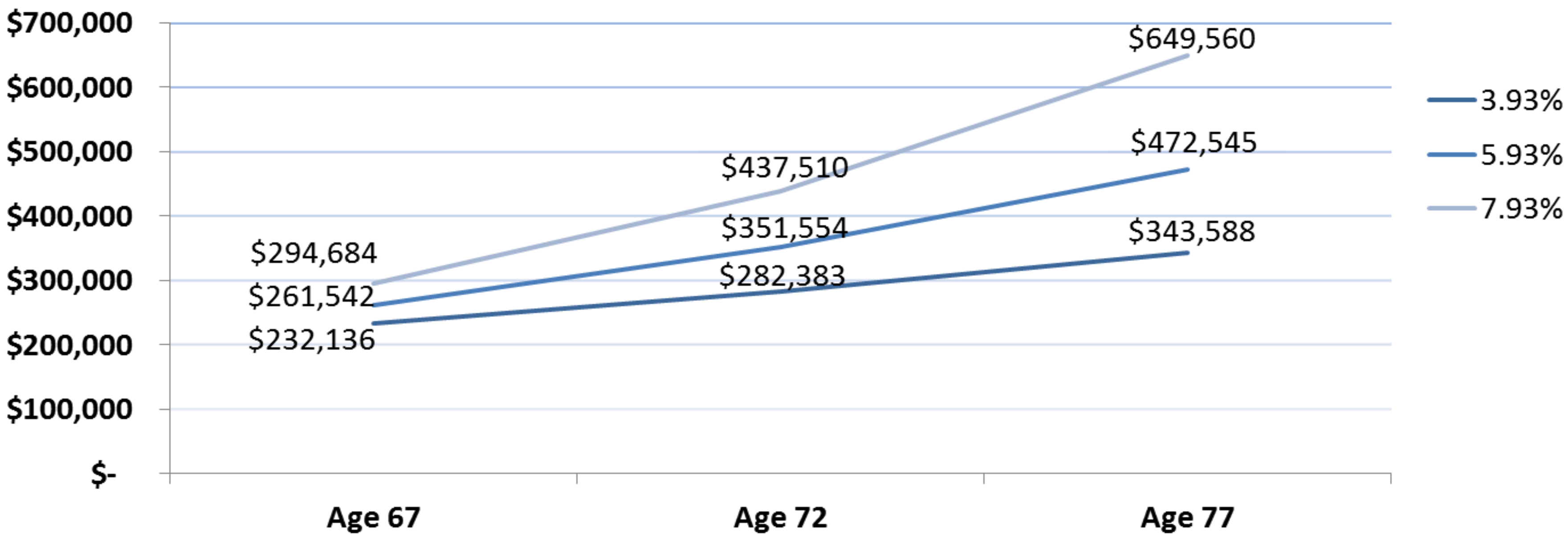
LIBOR Line of Credit

Adjustable rate HECMs offer a credit line growth rate, so the unused portion of the credit line increases. The growth rate is always the Note rate plus 1.25% for the mortgage insurance premium. It compounds monthly, at the same rate as the loan balance.

The line of credit option is only available with an adjustable rate reverse mortgage, and when there is enough equity remaining after any mandatory obligations are satisfied.

Line of Credit Growth Rate

A 62-year-old borrower owns property appraised at $350,000. The initial line of credit for a LIBOR Margin 250 product is $183,400. The chart illustrates the line of credit balance if the growth rate increases in the first five years to 3.93%, 5.93% and 7.93%.



Estate Planning and Wealth Management

The HECM LOC Option

When you compare a HECM line of credit with a traditional home equity (HELOC) line of credit:

- **HECM LOCs have no payment requirements**. Traditional lines of credit require at least interest payments.
- **HECM LOCs have no term limits** as long as residency and maintenance requirements are met. Traditional lines of credit have term limits, generally 10 or 15 years. Then they amortize or have balloon payments.
- **HECM LOCs cannot be canceled** as long as residency and maintenance requirements are met, regardless of what happens to the value of the collateral. Traditional lines of credit can be canceled.

The HECM LOC Growth Rate

The HECM LOC has a growth rate, unlike traditional lines of credit. The rate is equal to the LIBOR Index, plus the product margin, plus 1.25%. It compounds monthly on the available line of credit.

Example: A 62-year-old borrower has property valued at $350,000. The initial HECM LOC $183,400.

Age	3.93% *	5.93%	7.93%
67	$232,136	$261,542	$294,684
72	$282,383	$351,554	$437,510
77	$343,588	$472,545	$649,560

* Rate as of 5/15/2015 with Libor Margin 250.

The HECM LOC, cont.

The borrower can pay back a portion of the outstanding loan balance to INCREASE the available credit line, dollar for dollar.

Then, he or she can withdraw funds again at a later date.

The payment flexibility, permanency, and growth rate features make the HECM LOC a key component in the strategic use of home equity for wealth management.

Meeting Retirement Goals

Reverse mortgages offer your clients an increased likelihood of meeting their retirement goals because clients can:

- Avoid selling assets to maintain cash needs during a bear market.
- Use funds to purchase a vacation property without depleting significant amounts of assets.
- Receive tax-free proceeds to assist with daily living expenses.
- Use the proceeds as an emergency line of credit.
- Use the proceeds to fund long-term care services. According to studies, 58% of men and 79% of women will require some form of long-term care in their lifetime. The average cost of nursing home care, not including therapy, rehabilitation or medication is $94,000.

Note: The Affordable Care Act ("Obamacare") does not impact long-term care planning, and makes no changes to long-term care insurance.

Tenure or Term Payments

The adjustable rate HECM enables the client to choose either tenure or term monthly payments:

- **Tenure**: Monthly payments for the life of the loan. The client receives the same monthly payment amount for as long as he or she occupies the property. The monthly amount is based on home value, age of the youngest borrower, and interest rate.
- **Term**: Monthly payments of a set amount for a specified number of years. The client decides how much to receive each month, and for how long.

At any time (for a $20 fee) the client can choose a different option, or combination of options, for the remaining available balance. If there is no remaining available balance, the client can still remain in the property. The loan becomes due when he or she no longer occupies the property.

Enhance and Manage Wealth

"New academic research demonstrates how HECMs can play a vital role in retirement planning – not just as a tool of last resort but as a strategic way to provide greater financial flexibility to seniors with ample savings."

Source: Salter, Pfeiffer and Evensky, "Standby Reverse Mortgages: A Risk Management Tool For Retirement," Journal of Financial Planning, 2012.

Strategy Examples

Strategy: Fixed Income Planning

Advise customers who are considering an annuity to compare it to a HECM.

When people choose an annuity they use upfront cash to purchase an income stream. Annuity payments in excess of original purchase basis are taxable.

However, a reverse mortgage leverages their equity so they can save their cash. The HECM enables them to establish a line of credit, and offers the flexibility to convert it to tenure payments later. Borrowers can stop and start payments at any time, subject to a $20 payment plan change fee.

In addition, payments from a reverse mortgage are loan proceeds, and not taxable.

Strategy: Manage Investment Risk

Financial advisors have traditionally suggested that 4% is a sustainable withdrawal rate from investment funds when a portfolio is between 50% to 75% invested in equities.

However, if the borrower makes withdrawals when investments are performing poorly the success rate can drop by as much as half, based on Monte Carlo simulations.

One management strategy addresses this risk by drawing cash flow needs from a HECM LOC when the market has a negative return, and repaying it when investment performance exceeds both the original portfolio basis and current cash flow needs.

Strategy: Diversify Real Estate Holdings

A 70-year-old woman wants to purchase a $350,000 vacation condo in Florida. She owns a $650,000 home in Connecticut, and is eligible for $352,396 in HECM proceeds.

During the first year she can only withdraw 60% of the HECM proceeds, or $205,827. She withdraws that amount, and uses it as a down payment on the condo, leaving a balance due of $144,173 on the purchase price. She leaves the remaining HECM proceeds ($352,396 - $205,827 = **$146,569**) in a HECM LOC.

During Year 2 the balance of the HECM proceeds becomes available to her, so she withdraws $144,173 from her HECM LOC to pay off the condo.

She now owns two homes with NO payments other than taxes, insurance and maintenance. She also still has **$2,396** ($146,569 - $144,173), in her HECM Line of Credit, PLUS any line of credit growth she earned during Year 1 on $146,569.

Her real estate holdings are diversified, and help to hedge against potential declining real estate appreciation rates in the two regions where she owns property.

Strategy: Hedge Against Declining Values

The HECM line of credit has a guaranteed growth rate, regardless of what happens to the value of the property. It can insure against stagnant or declining values.

Since 1987 residential real estate has appreciated 3.4% on average, but certain regions experienced much higher or lower rates.

Example: In 2006 a 62-year-old man owned a home in Las Vegas that was worth $400,000. He obtained a HECM and opted for a line of credit. He made no withdrawals.

By 2011 that home was worth only $262,000. However, the value of his HECM line of credit had increased to $281,720.

Strategy: Social Security Planning

A 66-year-old man is now eligible for $2,379 per month in Social Security benefits. If he waits until age 70, the monthly payment increases to $3,295.

He is healthy and anticipates a long life, and needs the higher monthly benefit, but wants to retire now.

He owns a $350,000 house.

He obtains a reverse mortgage now, and opts to receive term benefits of $3,295 per month until age 70, when Social Security benefits begin.

At that point he can opt to keep the remaining funds in a line of credit, or manage his distributions another way.

What are four additional years of retirement worth?

Strategy: Manage Tax Liabilities

Funds from a reverse mortgage are tax-free because they are loan proceeds, not income.

Clients can use HECM proceeds as income before selling assets subject to capital gains taxes, or taking other tax-deferred options. Their taxable investments remain tax-deferred, and compounding.

If clients use HECM proceeds instead of selling their investment assets, **they avoid taxes on capital gains** while they receive tax-free growth in the HECM LOC.

They can then use CDs or savings accounts to restore the line of credit balance and avoid taxes on bank interest earnings, while earning a higher rate of return from the HECM LOC than they would receive from a bank.

Strategy: Fund Education

Clients can use home equity to fund college savings plans or pay current tuition bills.

HECM proceeds are also an option for funding education expenses. Clients have the benefit of helping family members with educational needs, without a disruption to household cash flow, or having to sell income generating investments

Strategy: Purchase New Home

One in three Baby Boomers say they want to move, and want a lifestyle equal to or better than their current one.

Moving does not necessarily mean downsizing. Some people want a community-based lifestyle in planned developments or urban centers. Others want to be closer to family or move to a different climate.

The HECM for Purchase program enables the client to purchase a new home, and build a line of credit at the same time.

The HECM Purchase program uses the same calculations as the regular HECM refinance program. LIBOR options also allow the homeowner to pay down the outstanding balance and build a line of credit for future use, if desired.

Example: HECM for Purchase

A 66-year-old couple sells their home in the Northeast, and moves to a planned community in the South.

They sell their existing home for $300,000, and purchase a new home for $400,000.

With a HECM for Purchase, they need $203,507 at closing for the new house, based on their age and an Expected Rate of 5.06%.

This leaves $98,142 left over from the sale of the home. The couple can put this money in the bank, and earn 0.25% in taxable interest.

OR…they can pay down their HECM loan and establish a line of credit (HECM LOC).

For example, after 10 years, **this HECM LOC would be worth $119,400**. If interest rises just 2%, it would be worth **$145,409**.

Strategy: Refinance with Payments

Forty-nine percent of all Baby Boomers intend to work to age 66 or older, while 1 in 10 never intend to retire.

If they refinance their existing debt with a HECM while they are still working, and pay the amount they would have spent on their debt toward the HECM loan balance, they can grow a substantial line of credit for use in their later years.

They can also use reverse mortgage funds for long-term care or home healthcare needs.

Strategy: Long-Term Care

Statistics show that **one out of every two** people will need long term care for an average of two and a half years, at a cost of up to $15,000 per month, depending on location. These expenses can represent a substantial risk to household wealth.

Insuring against this risk has been difficult due to high premiums for long term care insurance, with no guarantee of return.

There is also concern that there could be premium increases in the future - John Hancock raised long term care premiums in 2014 by 45%!

Using home equity can offset the costs of long term care, and provide older adult homeowners with peace of mind having this safety net in place.

Common Questions and Consumer Protections

The Cost of Waiting

What if the previous couple waited until age 67, and obtained a reverse mortgage when their house was paid in full? Consider the rise in interest rates over that five-year period, as they paid $1000 per month toward their mortgage instead of the HECM.

Rise in Interest Rates 1%

Age	HECM LOC Amount – Apply for HECM at 62 Years	HECM LOC Amount – Apply for HECM at 67 Years	Loss of Available Credit
67	$233,869	$174,057	**($59,811)**
70	$299,243	$222,711	**($76,532)**

Rise in Interest Rates 2%

Age	HECM LOC Amount – Apply for HECM at 62 Years	HECM LOC Amount – Apply for HECM at 67 Years	Loss of Available Credit
67	$239,270	$139,806	**($99,464)**
70	$321,778	$188,009	**($133,769)**

Biggest Fear

The biggest fear during retirement is "running out of money."

According to the Boston College Center for Retirement Research:

- Fifty-three percent of households are "at risk" of not having enough to maintain their living standards during retirement.
- A reverse mortgage lowers that risk.

Common Questions

"Does the lender take ownership of the home?"

A reverse mortgage is a loan. The homeowners retain full ownership.

"Can I be forced to leave my home?"

Homeowners can stay in the home until a loan maturity event occurs, such as death, moving out, or selling the home. The property must be the homeowners' primary residence. The homeowners must pay taxes and insurance, and must maintain the home. If they do not, the loan becomes payable.

Common Questions

"What are the borrower's options?"

To terminate the loan at any time, whether or not it is due and payable, the borrower can:

- Pay the mortgage debt in full, and retain ownership of the property.
- Sell the property for at least the lesser of the mortgage debt or the appraised value.

When the mortgage is due and payable, the borrower or estate can:

- Repay the debt in full to retain the property. Lenders can assist the borrower (or estate) in obtaining other financing to pay off the HECM loan.
- Sell the property for at least the lesser of the unpaid mortgage balance, or 95% of the appraised value.

Common Questions

"Must my home be 'free and clear' to obtain a reverse mortgage?"

No. However, you must have enough equity in the home to pay off any existing loans.

"Can I ever owe more than my home is worth?"

The HECM is a "non-recourse loan." This means that the HECM borrowers, or their estate, will never owe more than the loan balance or value of the property, whichever is less.

In other words, with a non-recourse loan the borrowers (or their estate) can pay the loan balance when it comes due. If they do not, the lender's only remedy is to foreclose. The borrower is not personally liable for any loss resulting from the foreclosure.

"How can a reverse mortgage help?"

Your clients have an increased probability of meeting their retirement goals with reverse mortgages because they can:

- Avoid selling assets to maintain cash needs during a bear market.
- Use funds to purchase a vacation property without depleting significant amounts of assets.
- Receive tax-free proceeds to assist with daily living expenses.
- Use the proceeds as an emergency line of credit.
- Use the proceeds to fund long-term care services.

Consumer Protections, cont.

In order to ensure that borrowers retain sufficient equity, and to ensure they have money to cover taxes and insurance throughout the lifetime of the loan, disbursements at loan closing, and within the first 12 months of closing, cannot exceed the greater of 60% of the Principal Limit, or mandatory obligations (closing costs, repairs, etc.) plus 10% of the Principal Limit.

In addition, lenders can create “Lifetime Expectancy” set-asides at closing that are payable ONLY toward taxes, assessments, and insurance (hazard and flood). Borrowers who do not have set-asides, and borrowers whose set-asides are insufficient or depleted, are responsible for their own taxes and insurance.

IMPORTANT: Borrowers with mandatory obligations in excess of 60% can still take the additional 10%, as long as disbursements do not exceed the Net Principal Limit or Principal Limit. However, mortgage insurance premium goes up from 0.5% to 2.5% if the disbursement exceeds 60%.

FHA Insurance

FHA mortgage insurance provides lenders with protection against losses that result when homeowners default on their mortgage loans.

The lenders bear less risk because FHA pays a claim to the lender in the event of homeowner default.

FHA mortgage insurance protects the borrower if there is not enough money from the sale of the home to repay the loan in full. When that occurs, FHA Insurance pays the difference. This "non-recourse" feature ensures that the borrower is not liable for the difference between the sale price and the loan balance at the end of the reverse mortgage.

Note: Reverse mortgage proprietary products are not FHA-insured. Please ask for additional details.

IMPORTANT: The non-recourse feature is exclusive to FHA reverse mortgages.

Appendix

Glossary

- **ARM:** Adjustable Rate Mortgage. A HECM with an interest rate that is subject to adjustments.
- **FHA**: Federal Housing Administration.
- **Fixed Rate HECM**: A HECM loan with an interest rate that does not change for the life of the loan.
- **Good Faith Estimate**: A list of the approximate closing costs to obtain a loan.
- **HECM for Purchase**: A HECM that helps finance the purchase of the borrower's principal residence.

Glossary, cont.

- **HUD**: US Department of Housing and Urban Development.
- **Lender**: A bank or institution licensed to originate residential mortgage loans.
- **LIBOR**: London Interbank Offered Rate. The average interest rate that leading banks in London charge when lending to other banks. It is the index used for adjustable rate HECMs.
- **LOC**: Line of Credit. Also called a “credit line.” The borrower chooses how much money to borrow from the HECM loan, and when to borrow it.

Glossary, cont.

- **Lump Sum**: A distribution method that gives the client all proceeds at once at loan closing.
- **MIP**: Mortgage Insurance Premium. Protects the borrower and lender if the loan balance grows higher than the home value.
- **NRMLA**: National Reverse Mortgage Lenders Association. The national voice of the reverse mortgage industry, founded in 1997. It serves as an educational resource, policy advocate, and public affairs center.

Glossary, cont.

- **Non-Recourse Loan**: A HECM loan provision that states a borrower or the borrower's heir will not be responsible for more than the sale price of the home, or the loan balance, whichever is less.
- **Originator**: The person or firm that originates a loan on behalf of the borrower.
- **Principal Limit**: The lesser of the home's appraised value or the FHA 203b HECM lending limit of $636,150.
- **Proprietary Reverse Mortgage**: A non-HECM reverse mortgage that is owned by a private company.

Glossary, cont.

- **Reverse Mortgage**: A home loan for older clients that is based on home equity. It does not need to be paid back until the borrower moves out of the property, sells it, fails to pay taxes and insurance or maintain the property, or dies.
- **Right of Rescission**: A time period of three business days after loan closing during which the borrower has the right to revoke the loan.
- **Servicing**: The maintenance of the loan after loan origination. It includes providing regular statements, updating information, and providing funds to the borrower on request.

Glossary, cont.

- **Tenure Payments**: Monthly payments throughout the life of the loan.
- **Term Payments**: Monthly payments for a specified period of time.
- **TALC Rate**: Total Annual Loan Cost Rate. The estimated cost of the loan expressed as an annual rate.

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