Integrating Home Equity into Retirement Solutions

This is for you if...

- ✓ Your clients are counting on income coming from investments
- ✓ Your clients have concerns about health care or unexpected expenses in retirement
- ✓ You believe it's important to have access to liquidity as part of a sound financial plan
- ✓ You're interested in more sophisticated strategies for better outcomes
- ✓ Your clients would like to better understand how to maximize the use of *all* of their assets in designing an effective financial plan

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Our Roadmap

I. Economic Realities

II. Home Equity as an Asset Class

III. The Home Equity Conversion Mortgage

IV. Strategic Uses

V. Final Thoughts

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Economic Realities

73 million	→	Number of baby boomers currently in the United States –US Census
10,000	→	Boomers turning 65 each day, a trend continuing for 11 years -PewResearch
15 million	→	Baby Boomers estimated to be mass affluent; net worth of $1.5 million to $3 million
64%	→	Households age 65+ with free and clear homes –Harvard Univ Joint Cntr for Housing Studies
$7.1 trillion	→	Dollars tied up in home equity for homeowners age 62 and better -NRMLA
47,000	→	Average number of *monthly* inquiries to AAG about Home Equity Conversion Mortgage

Here's what most are trying to solve:

- ✓ Will I have enough income to meet my basic needs?
  (Longevity)

- ✓ Will I be able to do the things I want to do? Eat out when I want, spend money on grandkids, travel, etc.
  (Lifestyle)

- ✓ Will I have access to funds in the event of unforeseen expenses such as health care, in home care, home renovation, etc.
  (Liquidity)

- ✓ Will I have something to leave for my children, grandchildren, or others? What am I leaving beyond my money?
  (Legacy)

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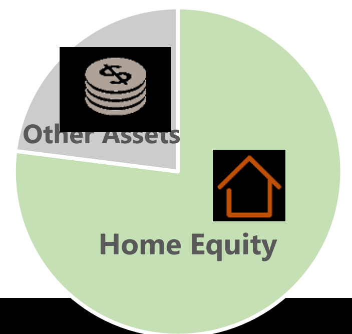
Primary Assets & Income Streams

- **Social Security**
- **Pension**
- **Savings and Retirement Accounts**
- **Home Equity**

*What most don't realize is that according to Market Watch, **77%** of most retirees' net worth is tied up in their homes!*



Avg. Retiree Net Worth

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Why is Home Equity *not* included in most financial plans?

"The greatest challenge with the inclusion of home equity has been our inability to effectively access *the equity."*

Accessing Home Equity

1. Sell Home
2. Cash Out Refinance
3. Home Equity Line of Credit (HELOC)
4. Home Equity Conversion Mortgage (HECM)
5. HECM for Purchase

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Home Equity Conversion Mortgage

How does it work?

- ✓ FHA, government-insured, non-recourse loan on a primary residence, for people at least age 62
- ✓ Borrowers have the *option* of whether or not to make monthly mortgage payments as long as they continue to live in the home, pay for property taxes, homeowner's insurance, and home maintenance costs, and otherwise comply with the loan terms
- ✓ The loan becomes due when the home is sold, the borrower changes residence, the last borrower (or eligible non-borrowing spouse) dies, or the last borrower is in a continuing care facility for 12 consecutive months
- ✓ Like any loan, reverse mortgage proceeds are paid out tax-free. (Consult a tax advisor.)

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Home Equity Conversion Mortgage

How can we access the funds?

- ✓ A Line of Credit
- ✓ Monthly Installments (“tenure” or “term”)
- ✓ Lump Sum
- ✓ A Combination

Home Equity Conversion Mortgage

What are the tax implications?

1. Loan proceeds are not taxable income

2. Deducting mortgage interest -IRC Section 163(h)(3)

<u>Acquisition Indebtedness</u>

Section 163(h)(3)(C)(i)

"Any indebtedness which is: (I) incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and (II) is secured by such residence."

<u>Home Equity Indebtedness</u>

Section 163(h)(3)(B)(i)

"Any indebtedness other than acquisition indebtedness secured by a qualified residence to the extent the aggregate amount of such indebtedness does not exceed (I) the fair market value of such qualified residence, reduced by (II) the amount of acquisition indebtedness with respect to such residence."

3. Claiming the mortgage interest deduction

4. Property tax deduction

   (Subject to $10,000 deduction tax on state and local taxes, 2018 Tax Cuts and Jobs Act)

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Line of Credit Growth

Borrowers with sufficient equity may have access to growth on their total credit facility

Line of Credit Growth

Principal Limit: The amount available to the borrower

1. Age of the youngest borrower or eligible non borrowing spouse
2. Max Claim Amount (appraised value of the home up to $726,525)
3. Current interest rates

Note Rate: Index Rate + Lender's Margin + HUD MIP

Initial MIP:	2.0% of Max Claim Amount
Annual MIP:	0.50% of outstanding balance

Credit Lines are only available with an adjustable rate note.

Outstanding Balance: The amount of the loan that has been utilized

Line of Credit: The difference between the Principal Limit and the Outstanding Balance

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Strategic Use of HECM

HECM Line of Credit Growth

Example:

Home Value:		**$650,000**
1st Mortgage:		**$0**
Age:		**75**
Principal Limit:		**$307,450**
Financed Costs:	**MIP:**	**$13,000**
	Max Orig.:	**$6,000**
	3rd Party:	**$2,737**

Interest Rate:	**5.231%**
Expected Rate:	**5.340%**
HUD MIP:	**0.50%**
Outstanding Bal.:	**$21,737**
LOC:	**$285,713**

Now let's do some math!

This example is based on HUD MIP changes effective 10/2/2017, the youngest borrower age 75, appraised home value of $650,000, IMIP of $13,000, origination fee of $6,000 and other settlement costs of $2,737 HECM ARM 2017 as of 11/16/2017.

Strategic Use of HECM

HECM Line of Credit Growth

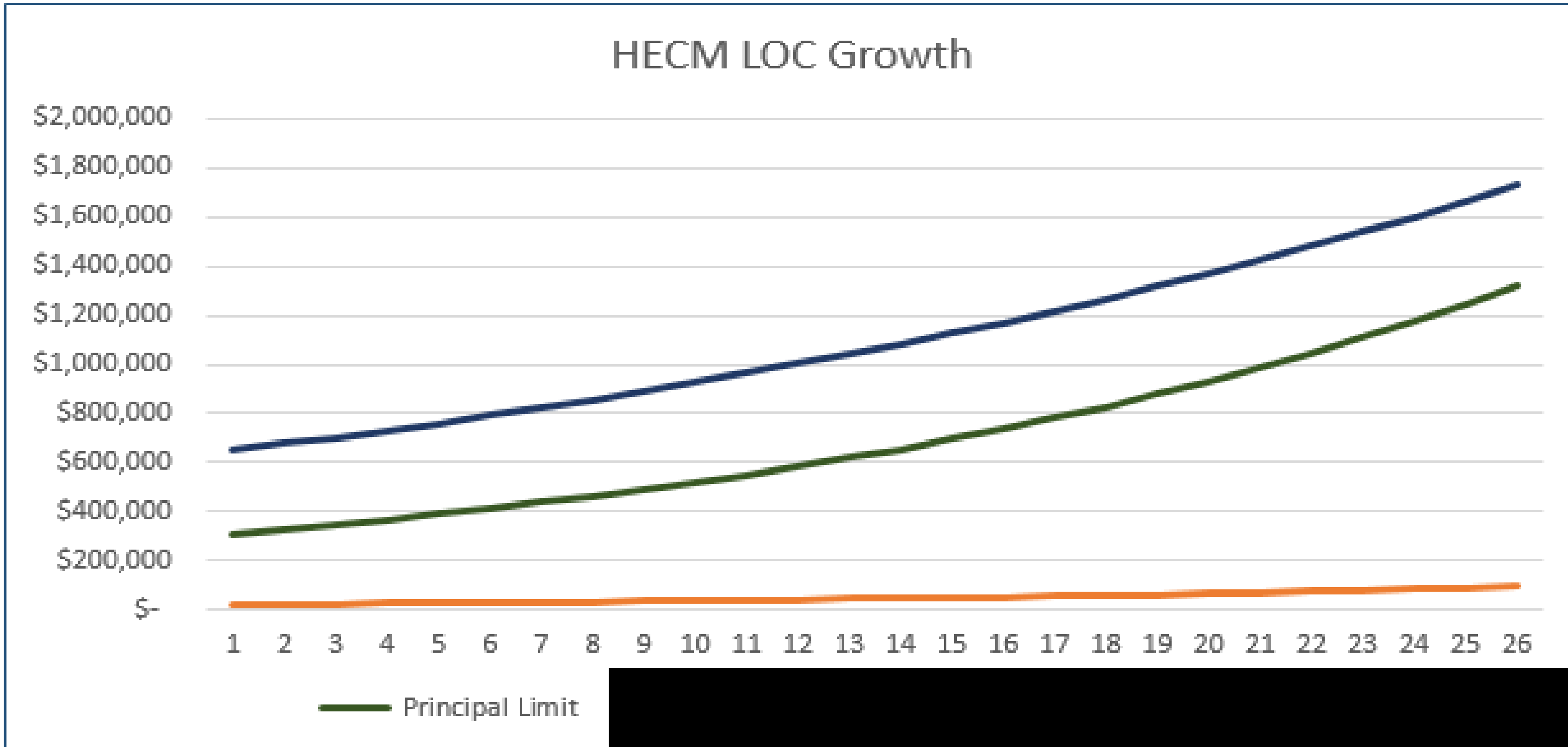
	Start	Year 1	Year 5	Year 10	Year 20	Year 25
Principal Limit	$307,450	$325,894	$411,416	$550,538	$985,826	$1,319,324
Outstanding Balance	$21,737	$23,041	$29,087	$38,923	$69,699	$93,268
Line of Credit	$285,713	$302,853	$382,328	$511,615	$916,127	$1,225,920
Home Value*	$650,000	$650,0[redacted]				

*Home value appreciation assumed at 0%

This example is based on HUD MIP changes effective 10/2/[redacted]
$650,000, IMIP of $13,000, origination fee of $6,000 and ot[redacted]

Strategic Use of HECM

HECM Line of Credit Growth



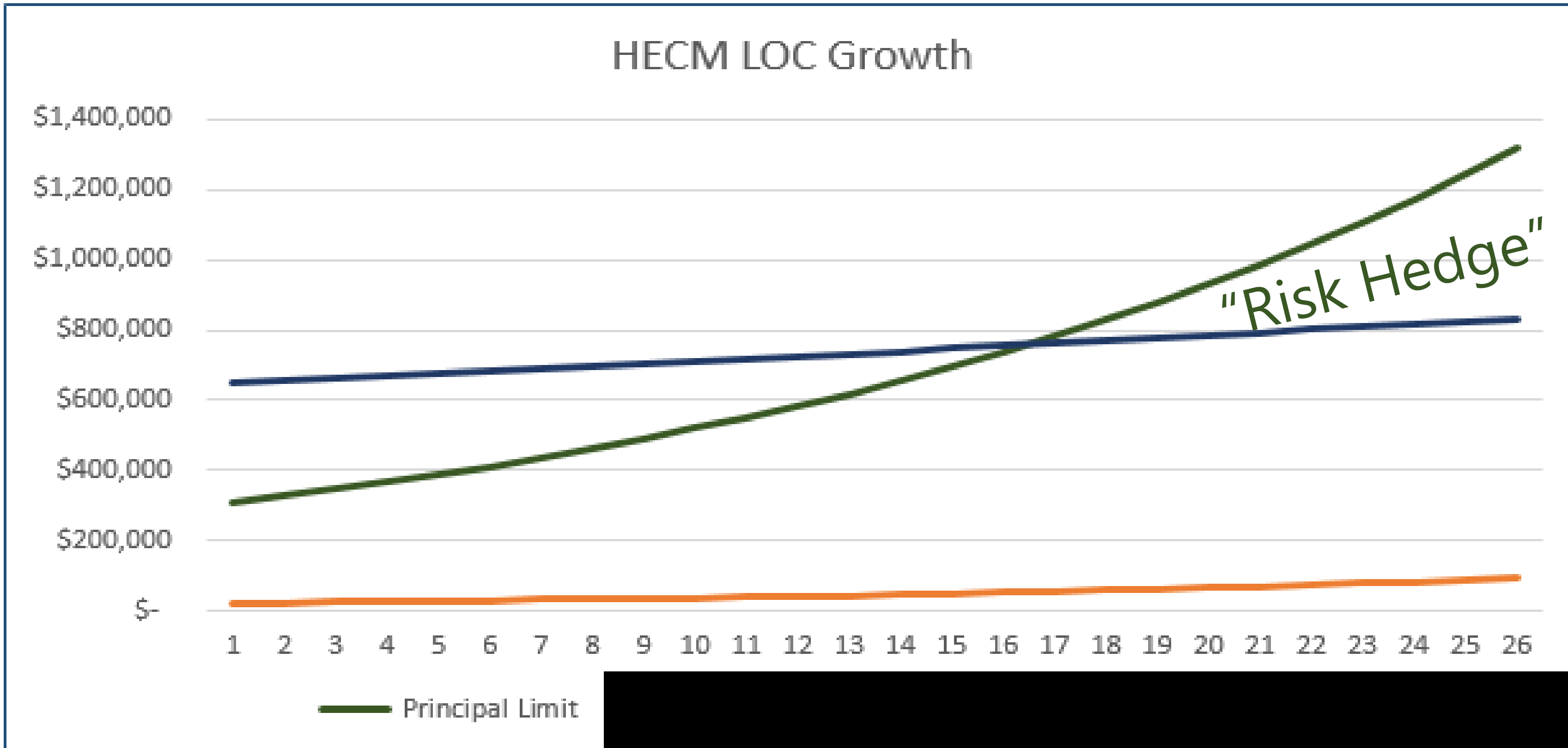
Home value appreciation assumed at **4.0%*

This example is based on HUD MIP changes effective 10/[redacted]

$650,000, IMIP of $9,000, origination fee of $6,000 and [redacted]

Strategic Use of HECM

HECM Line of Credit Growth



[redacted]

Home value appreciation assumed at* ***2.0%*

This example is based on HUD MIP changes effective 10/2/[redacted]
$650,000, IMIP of $13,000, origination fee of $6,000 and ot[redacted]

HECM Line of Credit

Providing access to equity, at a predictable growth rate, regardless of the performance of your real estate.

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What are the implications of investment withdrawals in a down market?

Sequence of Returns Risk

Sequence of Returns Risk

Distribution Phase

Portfolio starting value: $1,000,000

Target withdrawal of 5% with 3.5% annual

	Client A: early losses			Client B: early gains		
Age	**Return**	**Withdrawal**	**Acct. Value**	**Return**	**Withdrawal**	**Acct. Value**
65			$1,000,000			$1,000,000
66	-23.1%	$50,000	$719,000	20.8%	$50,000	$1,158,000
67	-6.1%	$51,750	$623,391	19.6%	$51,750	$1,333,218
68	-3.5%	$53,561	$548,011	17.0%	$53,561	$1,506,304
69	20.5%	$55,436	$604,917	20.5%	$55,436	$1,759,660
70	17.0%	$57,376	$650,377	-3.5%	$57,376	$1,640,696
71	19.6%	$59,384	$718,467	-6.1%	$59,384	$1,481,229
72	20.8%	$61,463	$806,445	-23.1%	$61,463	$1,077,602
80	-23.1%	$80,935	$199,628	20.8%	$80,935	$1,241,458
81	-6.1%	$83,767	$103,683	19.6%	$83,767	$1,401,017
82	-3.5%	$86,699	$13,355	17.0%	$86,699	$1,552,490
83	**20.5%**	**$0**	**$0**	20.5%	$89,734	$1,781,017
84	17.0%	$0	$0	-3.5%	$92,874	$1,625,807
85	19.6%	$0	$0	-6.1%	$96,125	$1,430,508
86	20.8%	$0	$0	-23.1%	$99,489	$1,000,571
94	-23.1%	$0	$0	20.8%	$131,009	$734,345
95	-6.1%	$0	$0	19.6%	$135,594	$742,682
96	-3.5%	$0	$0	17.0%	$140,340	$728,599
97	20.5%	$0	$0	20.5%	$145,252	$732,710
98	17.0%	$0	$0	-3.5%	$150,335	$556,730
99	19.6%	$0	$0	-6.1%	$155,597	$367,172
100	20.8%	$0	$0	-23.1%	$161,043	$121,312
AVG	**6.5%**	**$1,135,251**	**$0**	**6.5%**	**$3,333,701**	**$121,312**

Annual returns, and sequence of returns can have a profound impact on longevity of a distribution portfolio

How do we protect against this risk?

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Sequence of Returns Risk

A study by Barry Sacks & Mary Jo LaFaye

Year	Conventional Thinking: Last Resort Draw from Portfolio until gone				
	Portfolio at Start of Year	Investment Performance	Draw from Portfolio	Draw from LOC	Portfolio at End of year
1973	500,000	-9.3%	27,500		428,652
1974	428,652	-15.5%	28,463		338,120
1975	338,120	22.3%	29,459		377,493
1976	377,493	17.9%	30,490		409,013
1977	409,013	-4.1%	31,557		361,905
1978	361,905	2.2%	32,661		336,552
1979	336,552	8.0%	33,805		326,998
1980	326,998	15.4%	34,988		337,009
1981	337,009	-1.4%	36,212		296,706
1982	296,706	25.2%	37,480		324,655
1983	324,655	13.3%	38,791		323,941
1984	323,941	8.9%	40,149		308,935
1985	308,935	25.2%	41,554		334,734
1986	334,734	15.2%	43,009		336,068
1987	336,068	3.4%	44,514		301,496
1988	301,496	10.3%	46,072		281,809
1989	281,809	20.9%	47,685		283,150
1990	283,150	1.0%	49,354		236,087
1991	236,087	21.4%	51,081		224,524
1992	224,524	5.6%	52,869		181,268
1993	181,268	7.9%	54,719		136,559
1994	136,559	-2.8%	56,634		77,718
1995	77,718	25.7%	58,617		24,007
1996	24,007	11.1%	24,007	36,661	0
1997	0	19.3%	0	62,791	0
1998	0	17.0%	0	64,989	0
1999	0	7.8%	0	67,264	0
2000	0	-0.9%	0	69,618	0
2001	0	-3.7%	0	72,055	0
2002	0	-8.6%	0	74,576	0
			End Balances:	$538,773	$0

Strategy: HECM as a last resort

Invested Assets: $500,000

Withdrawal Rate: 5.5%

Net Outcome

Portfolio Lapse: Year 26
AUM Balance: $0
Net to Heirs: $722,719
AUM Fees: $70,874

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Source: Sacks & Sacks, Journal of Financial Planning

Sequence of Returns Risk

New Wisdom: Coordinate with Investments Draw from LOC after down market				
Portfolio at Start of Year	**Investment Performance**	**Draw from Portfolio**	**Draw from LOC**	**Portfolio at End of year**
500,000	-9.3%	27,500		428,652
428,652	-15.5%		28,463	362,168
362,168	22.3%		29,459	442,932
442,932	11.5%	30,490		486,145
486,145	-4.1%	31,557		435,859
435,859	2.2%		32,661	445,535
445,535	8.0%	33,805		444,710
444,710	15.4%	34,988		472,861
472,861	-1.4%	36,212		430,710
430,710	25.2%		37,480	539,422
539,422	13.3%	38,791		567,314
567,314	8.9%	40,149		573,872
573,872	25.2%	41,554		666,408
666,408	15.2%	43,009		718,156
718,156	3.4%	44,514		696,613
696,613	10.3%	46,072		717,742
717,742	20.9%	47,685		810,367
810,367	1.0%	49,354		768,472
768,472	21.4%	51,081		870,625
870,625	5.6%	52,869		863,551
863,551	7.9%	54,719		872,810
872,810	-2.8%	56,634		793,650
793,650	25.7%		58,617	997,459
997,459	11.1%	60,668		1,040,493
1,040,493	19.3%	62,792		1,165,909
1,165,909	17.0%	64,989		1,287,967
1,287,967	7.8%	67,264		1,315,795
1,315,795	-0.9%	69,618		1,234,712
1,234,712	-3.7%		72,055	1,189,275
1,189,275	-8.6%		74,577	1,086,997
		End Balances:	$692,007	$1,086,997

Strategy: HECM in coordination with inv withdrawal

Invested Assets: $500,000

Withdrawal Rate: 5.5%

Net Outcome

Portfolio Lapse: N/A
AUM Balance: $1,086,997
Net to Heirs: $1,656,681
Estate Increase: $933,764
AUM Fees: $221,402

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Did you know...

32% of home purchases in 2019 were made by Baby Boomers

– National Association of Realtors

Have you worked with clients looking to move or downsize…

… but the math doesn’t seem to work?

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HECM for Purchase

John & Mary (65)

<u>Current Home</u>

MV: $300,000
1^{st}: $100,000

Estimated proceeds after sale:

(Assumes 7% cost to sell: $21,000)

$179,000

HECM for Purchase

Purchase Price of Home

$300,000

HECM Loan Proceeds

$124,260

(not including financing and closing fees, calculation based on age of youngest borrower, interest rates, and home value)

Funds Due from Borrower at Closing

$175,740

Monthly Mortgage Payment

$0

Borrowers must continue to pay for homeowners insurance, property taxes and home maintenance.

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Other Strategic Uses

Bridge Social Security

Funding In Home Care

Tax Bracket Optimization

Divorce Financial Strategies

Roth Conversion

RMD Strategies

Estate Transition

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Home Equity:

Something to consider only as a last resort?

Or, an asset that can be intelligently utilized for better retirement outcomes?

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What Now?

1. Connect with our team or your local loan officer for a specific illustration. (In-home care, social security bridge, line of credit, etc.)
   a) Age of borrowers
   b) Market value & zip code of home
   c) Current outstanding mortgage
   d) Strategy you'd like to see

2. Schedule a call or meeting with our team to answer your specific questions and learn how we can help you grow your business (email to follow)

3. *Tell a friend or colleague!*

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“In my opinion, not including home equity and reverse mortgages in the financial planning process is the largest failure of the financial services profession at this time.”

Jamie Hopkins, Esq., CFP, RICP - Director of Retirement Research at Carson Wealth and a Finance Professor of Practice at Creighton University Heider College of Business. Author of Rewirement. Former professor at The American College of Financial Services and co-creator of the Retirement Income Certified Professional Designation

Thank you.

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When the loan is due and payable, some or all of the equity in the property no longer belongs to borrowers, who may need to sell the home or otherwise repay the loan with interest from other proceeds. AAG charges an origination fee, mortgage insurance premium, closing costs and servicing fees (added to the balance of the loan). The balance of the loan grows over time and AAG charges interest on the balance. Not all interest on a reverse mortgage loan is tax-deductible and to the extent that it is, such deduction is not available until the loan is partially or fully repaid. Consult your tax advisor.

Borrowers are responsible for paying property taxes, homeowner's insurance, maintenance, and related taxes (which may be substantial). We do not establish an escrow account for disbursements of these payments. A set-aside account can be set up to pay taxes and insurance and may be required in some cases. Borrowers must occupy home as their primary residence and pay for ongoing maintenance; otherwise the loan becomes due and payable. The loan also becomes due and payable (and the property may be subject to a tax lien, other encumbrance, or foreclosure) when the last borrower, or eligible non-borrowing surviving spouse, dies, sells the home, permanently moves out, defaults on taxes, insurance payments, or maintenance, or does not otherwise comply with the loan terms. V2018.09.19_OR

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