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SUMMARY OF FORBES
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SIX STRATEGIES

For Carrying A Mortgage Into Retirement

Entering Retirement with Mortgage Debt: Planning Challenges

More Americans are now entering retirement while still carrying a mortgage. In 2014, the Consumer Finance Protection Bureau reported that the percentage of Americans aged sixty-five and older with a mortgage rose from 22 percent in 2001 to 30 percent in 2011—a rise from 3.8 million to 6.1 million. Among individuals over seventy-five, those who still had mortgages rose from 8.4 percent to 21.2 percent.

Mortgage debt in retirement presents an additional planning challenge. For retirement distributions, fixed payments related to paying off debt create a strain for retirees due to the heightened withdrawal needs triggering greater exposure to sequence-of-returns risk.

Exposure rises because the debt payments are fixed and require greater distributions than otherwise, so if there is a market decline early in retirement, the portfolio is further strained as an even greater percentage of what is left in the portfolio must be taken to meet these fixed expenses. Sequence risk is further exacerbated by having a higher distribution need in early retirement on account of the mortgage payments.

How the Reverse Mortgage Can Help

The general idea is that a reverse mortgage used primarily to refinance an existing mortgage creates more flexibility for distribution needs from the investment portfolio by removing a fixed expense from household budgeting in the pivotal early-retirement years.

During pre-retirement, it is common to pay off the mortgage more slowly in hopes that investment returns will outpace the borrowing costs on the mortgage. This approach becomes riskier in retirement, as distribution needs heighten the retiree's vulnerability and exposure to market volatility.

In addition, a changing tax situation with the loss of wages and the dwindling mortgage balance in retirement could mean losing potential tax deductions for mortgage interest that were taken prior to retirement.

Making a Voluntary Payment

By refinancing the existing mortgage with a reverse mortgage, one could voluntarily continue making the same monthly payments on the loan balance of the reverse mortgage to reduce it and increase the growing credit-line amount for future use. Unlike with a traditional mortgage, these voluntary repayments can be stopped without triggering foreclosure. Voluntary payments can be made strategically when markets are performing well and then stopped when it is necessary to sell assets at a loss to make payments.

Weighing Your Clients' Options

The benefit of replacing a mortgage with a reverse mortgage, then, is the reduced exposure to sequence risk. However, it is also important to note that the growth rate on the reverse-mortgage loan balance can exceed the interest rate on the preexisting mortgage, especially if interest rates rise from their current levels.

One must balance the trade-offs between the increased flexibility and reduced cash flows to be supported earlier in retirement against the possibility that the final legacy value for assets could be hurt if the HECM loan balance is not repaid for many years.

Whether the final legacy increases or decreases when using a reverse mortgage in this way also depends on the performance of the investment portfolio, which may benefit from greater potential growth due to lower distribution needs,leaving more financial assets with more time in the market.

We can analyze these complexities using my standard Monte Carlo simulations, which allow interest rates to start at their lower, current levels but gradually fluctuate toward their historical averages over time. For a retiree carrying a traditional mortgage into retirement, the question becomes what to do with it.

Let's consider six options for those reaching retirement with a traditional mortgage still in place.

Six Ways to Eliminate a Mortgage in Retirement with the Reverse Mortgage

1. Use a HECM to refinance the mortgage balance and use the remaining line of credit last to cover retirement spending if the investment portfolio is depleted. Make voluntary payments equal to those of the traditional mortgage in years after portfolio gains to reduce the loan balance and shift more of the principal limit into the line of credit for potential subsequent use.

2. Use a HECM to refinance the mortgage balance and use the remaining line of credit last to cover retirement spending if the portfolio is depleted. Do not make any voluntary payments to reduce the loan balance.

3 Pay off the mortgage at retirement with financial assets; open a HECM as a last resort—only if portfolio assets are depleted later in retirement.

4 Keep the mortgage into retirement, making the required ongoing payments until the mortgage has been fully paid off; open a HECM as a last resort—only if portfolio assets are depleted later in retirement.

5 Keep the mortgage into retirement, making the required ongoing payments until the mortgage has been fully paid off; open the HECM line of credit after the mortgage is paid off and use it last.

6 Pay off the mortgage at retirement with financial assets; open the HECM line of credit and use it last.

These possibilities can provide a sense of how keeping a mortgage compares with using a HECM to refinance it.

This is an excerpt from Wade Pfau's book, Reverse Mortgages: How to Use Reverse Mortgages to Secure Your Retirement (The Retirement Researcher's Guide Series). To see the full Forbes article: http://bit.ly/2M8Br2P