Reverse Mortgages Enhance Retirement When Life Annuities Can't

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There are ways in which a reverse mortgage can be used similarly to, and even complement, a life annuity. But determining which product works best for a borrower's retirement plan requires careful consideration of the advantages and disadvantages of each strategy.

If used judiciously, both Home Equity Conversion Mortgages (HECMs) and life annuities can help retirees insure themselves against the prospect of running out of money by extending the life of one's assets during retirement, according to a series of recent articles from Jack Guttentag, also known as The Mortgage Professor.

In his most recent article, Guttentag describes two strategies for using HECMs among retirees who are dependent on financial assets as well as those dependent on pensions.

For both examples, Guttentag considers a 65-year-old retiree with assets of $600,000. From this amount, the retiree could draw $3,000 per month until reaching age 100, at which point his assets would be depleted. To eliminate the risk of impoverishment, Guttentag suggests this retiree could use $200,000 of his nest egg to purchase a longevity annuity that began payments of $3,000 after 10 years.

"If the retiree described above had equity in his home, he could draw on a reverse mortgage credit line to strengthen his retirement further," Guttentag writes in the article. "A $200,000 line, for example, if added to his other financial assets, would extend the period within which he could draw $3,000 a month without running out of money until he was 110."

An alternative strategy, Guttentag notes, would be to increase his monthly draw from $3,000 to $4,000 and insure the continuity of the payment by investing $150,000 in a longevity annuity. In this strategy, a HECM line of credit could be the payment source for the annuity.

"In sum, the retiree dependent on a stock of financial assets could use a HECM credit line either to increase security as a replacement for longevity insurance, or to increase spendable income with a longevity annuity used to provide security," Guttentag writes.

For retirees with equity in their home, who depend on pensions rather than a nest egg of financial assets, may choose to supplement their income using a HECM in either of two possible ways.

One way would be to use the tenure reverse mortgage payment option. This would allow the retiree to receive a fixed annuity payment for as long as he lives in the home. The second option, Guttentag suggests, would be using funds from the reverse mortgage line of credit to purchase an immediate annuity from a life insurance company.

Researching price quotes from various lenders reporting their prices to The Mortgage Professor website, Guttentag found that in January 2016, for a 70-year-old female with a house worth $400,000 and no existing mortgage, this retiree could draw $1,256 per month

Alternatively, this same retiree could choose the largest credit line available from those lenders, which Guttentag notes was $224,280, and use these funds to purchase an immediate annuity.

"Note that these purchases must be done in two stages because part of the HECM credit line is not available for 12 months," Guttentag writes.

Although the HECM tenure strategy pays less than the life annuity, per Guttentag's price analysis, the reverse mortgage retains ownership of the reserve funds underlying the HECM. This, Guttentag suggests, would allow the borrower to change his mind after a few years and switch to a line of credit for the reserve amount that is still available.

And if the borrower dies early, another benefit of the HECM strategy is the remaining equity in his home goes to his estate, whereas on a life annuity, early death terminates all payments unless the policy has a guaranteed payout.

On the other hand, if the borrower experiences a health issue and requires extended care in a skilled nursing facility or assisted living community, the HECM will become due and payable after one year of non-occupancy in the borrower's primary residence.

"The lender takes the house after the year and sells it, with any equity remaining going to the borrower's estate," Guttentag writes. "With a life company annuity, in contrast, the senior could be in a nursing home indefinitely without shutting off the annuity."

In concluding his article, Guttentag highlights regulations that prevent a reverse mortgage lender from disbursing funds at loan closing that will be used to purchase an annuity. While the law prohibits this type of cross-selling of financial products, it does not impede seniors' abilities to buy a life annuity with their loan proceeds later down the road.

"They need only to take a HECM credit line at closing, then draw on the line later to pay for the annuity," Guttentag writes. "This keeps the HECM transaction and the annuity transaction separate, as they should be, and allows the senior to shop for them separately."

Read The Mortgage Professor article.

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