Reverse Mortgages are 'Triple Win' for Retirees, Advisors and Mutual Funds

Home Equity Conversion Mortgages (HECMs) can offer many benefits to the borrowers they serve, but they can also be attractive to financial advisors and even mutual funds, says one reverse mortgage researcher.

Reverse mortgages can be valuable asset when used as part of a coordinated retirement strategy, especially when using a standby line of credit strategy, said Barry H. Sacks, a practicing tax attorney in San Francisco, during a recent webinar provided by the Financial Planning Association (FPA).

"This strategy is meant to help retirees and, specifically, the mass affluent retirees drawing on securities portfolios such as 401(k) accounts or rollover IRAs, as well as those who own their homes and want to draw more," Sacks said during the webinar.

A small draw from a reverse mortgage credit line at the right time can increase the long-term growth of a person's securities portfolio, which may include a 401(k) or rollover IRA account, said Sacks, who co-authored a paper that analyzed how a reverse mortgage line of credit can be used to supplement retirement income. The report was published in the Journal of Financial Planning in February 2012.

For these reasons, Sacks suggests reverse mortgages can also benefit mutual funds and financial planners by providing their clients with extra duration of their securities accounts.

"This is definitely a positive sum game and it's a triple-win because reverse mortgage providers themselves will also benefit from this strategy," Sacks said.

But how much does it benefit financial planners and mutual funds—or how much of a "win" is this strategy for them?

Although difficult to predict, Sacks' calculations suggest that a "reasonable estimate" of the additional fees resulting from the use of the reverse mortgage line of credit "active strategy" (taking a reverse mortgage line of credit early in retirement), as compared with the use of the conventional strategy (using a reverse mortgage as a last resort once you've run out of money), are approximately equal to 5%-10% of the account value at the beginning of retirement.

"Thus for a $1 million account, over a 30-year period, a mutual fund or financial planner would earn an extra $50,000 to $100,000 in fees," Sacks said.

This is "over and above" the fees that would be calculated ordinarily, Sacks said, adding that this is also based on a 50 basis points assets under management fee.

"So, for a large mutual fund that holds hundreds of billions of dollars of 401(k) and IRA accounts, if only a tiny fraction of those accounts—say $1 billion of those accounts—adopt this strategy, the additional fees earned by the mutual fund would be over $50 million," he said. "That's significant and it's not recognized yet by the mutual fund and the financial planning community."

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