Episode 112 RWS Live (not real...erse Mortgage Questions Part 6

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SPEAKERS
Alex Murguia, Bob French, Wade Pfau

Bob French 00:00
The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Not only have to actors from Law and Order endorse reverse mortgages, but also the Fonzs and Tom Selleck. It's hard to believe they've had a bad rap in the past with endorsements like that. Hey, everyone, welcome

Wade Pfau 00:53
to retire with style. I'm Wade, and I'm here with my trusty co host, Alex. Hi, hello. And we're continuing our arc on answering your questions that were part of the Live episode we did in early January, but got so many questions. We're just running with it. Maybe two months worth of podcasts. But we're continuing with the theme this week will be on housing and reverse mortgages. We got to this may be a shorter episode. But we did get enough questions that we felt it was worth its own episode to address these. But

Alex Murguia 01:33
before we dig into it, wait, we've got an announcement to make and maybe a little bit of a bone to pick.

Wade Pfau 01:42
Well, they Yeah, at this point, you've had the opportunity, the Retirement Planning Guide. But 2024 edition is out there. We did a webinar on it with the retirement researcher community to talk about the tax planning. If you've listened every episode of this podcast, you've also heard that story already. I've switched over to using effective tax rate management. It's something Joel Sasser does. With tax maps and so forth. I think it's much more useful way to think about the tax efficient retirement distributions. And that was the biggest update in the book. Because fully out there live. And yeah, the other issue is just the this is something that it's not new, but it's the first I posted about it at LinkedIn. Every month or two. People are pirating books on Amazon. And so there was now a retirement planning guide book that actually looked pretty similar black cover

said retirement planning guide book had a picture of a map on it had a different author's name, but otherwise the interior contents it's not. I think they run it either through they ask AI to make slight modifications to the text or maybe they translate it into another language and back in English. It's really stilted, but otherwise it was my book, pirated who wrote it? What was that Rudy? I forget the name Jake. Jake, something.

Alex Murguia 03:02
Yeah, just FYI. It's like one of those things where Yeah, I don't know what they do. But you know, weights book has become pretty popular. So I guess they have algorithms. They'd look at bestsellers and they try to, you know, remake them. It's almost like, wait, you know what this reminds me. Do you see coming to America?

Wade Pfau 03:22
Way back when?

Alex Murguia 03:25
Yeah, not coming to America to the original. Back in the year when when the guy remember. I forgot his name from good times. Definitely good times. Is a is telling Eddie Murphy. I got McDowell's, you know, they you know it's a take off on McDonald's, you know that he's that they got the golden arches. Mine is the golden arcs. So I'm like, they got the Big Mac, I got the big MC. That's effectively what's happening, right?

Wade Pfau 03:53
Yeah. Well, it was actually worse than that, because I got an email from a reader. Hey, I downloaded your book through Kindle and only half of the book is there. And then because I had recently updated the 2024 edition, I when made sure that the full Kindle version was available and like oh, maybe you just some glitch or something. And then I found out he was actually he purchased this pirated copy, but still had my address listed as the person that can't really do anything. So now I'm having customer service on people buy in, even like, they're not even trying. No, they're not even trying. It's really a replica. It's slight modifications due to whatever. But

Alex Murguia 04:34
is that worth the effort to make like a couple of bucks.

Wade Pfau 04:37
This particular book does seem to be selling better than some of them that are out there. But yeah, generally, by the time actually, by the time you're listening to this, hopefully Amazon will have gotten it taken out. Or maybe this is this book was one of the big winners, they might make $100 off of it. Doesn't seem like it's worth the effort. But

Alex Murguia 04:55
then they do this to like 1000 books, and there it is, you know, that kind of thing.

Wade Pfau 05:00
Yeah, and it's all the author names are always made up. This is not a new thing. It happens every month or two,

Alex Murguia 05:06
what are we to make a living? Well, you know, the real deal. What's the name? What's the official name of the book and good.

Wade Pfau 05:13
It's retirement planning guide book. And there's actually probably now 20 different books on Amazon called retirement planning guide book, really, they don't all fall into the trap of being exact replicas of my book, some of them are different, but they're mostly just scammy type books trying to bank off the retirement planning guide book name. So make sure you do see one that's actually authored by Wade Fouchier. Looking to purchase,

Alex Murguia 05:36
not the golden arcs, the golden the golden. All right. Okay, well, there you have it, everyone. But more importantly, the 2024 version is out. Check it out. And there it is. We look forward to what's the when you start to talk about in that one. In the new version, what's like new about it?

Wade Pfau 05:58
Well, it's updating all the numbers to 2024. And then the tax planning, using tax maps and the effective marginal rate method for thinking about when to do Roth conversions and so forth. Okay.

Alex Murguia 06:11
All right. Now off now for reverse mortgage portion of the podcast.

Wade Pfau 06:19
We had four questions

Alex Murguia 06:20
on, okay, get off my spouse, and I just moved back to Seattle, and we wanted to buy a house. Beautiful area, by the way, the question is, whether we should use some or all of our Roth IRAs, or other retirement savings towards the purchase price and get a reverse mortgage, LLC, to pay off my line of credit to pay for the to pay for long term care, or other contingencies, which is currently what the Roth's are intended for, we don't have enough cash from the sale of our previous house to buy the kind of house we need here.

Wade Pfau 07:01
Yes, so strictly speaking, I'd be a little nervous about doing what this individual is specifically saying, which is sell off all your investments to buy the house and then rely on a reverse mortgage line of credit for everything else. Another option not mentioned, but you might look at is the idea of the heckum. For purchase, you can actually use the reverse mortgage as part of purchasing a house. In that way, you won't have to sell off all your investment assets. At the same time, you'll have the housing part covered you do, you may have to sell off some of the investment side. But hopefully between the heckum for purchase and between what you're getting when you sell your previous house, you may be able to cover most of the home price this way without tapping too much into your investments. And I'd at least think about that as a more practical way to incorporate a reverse mortgage into the strategy then relying fully on the line of credit. Because you've depleted everything else.

Alex Murguia 07:57
I agree. And this is where I'm going to be a wet blanket, and maybe it's already too late. And I get it, you know, you can look at me and say yeah, whatever. Right. But with my Dave Ramsey head on.

Wade Pfau 08:10
Right, yeah, that's another issue here. The math can you actually afford? Yeah,

Alex Murguia 08:14
maybe it is what it is right? And sometimes, you know, buy a house that's affordable, I get it. There's a there's a I don't know there's there's a prickliness to that answer. But sometimes we just have to look in the mirror and and call it. So there's also that.

Wade Pfau 08:37
Right, it's using a reverse mortgage as part of a responsible retirement income plan. And that's where I'm a little nervous about it being a responsible plan if you have to sell off all your investments to afford a much more expensive house. And I don't think the reverse mortgage can completely save that scenario. Already, but the heckum for purchase, at least I would look at that as a better starting point than the purely line of credit as a contingency fund approach. Okay.

Alex Murguia 09:09
Next question, how to current mortgage rate levels and in parentheses compared to prior ultra low rate environment? So how do current mortgage rate levels affect the evaluation slash benefit of a heckum line of credit, intended to be used as a buffer asset to mitigate sequence risk?

Wade Pfau 09:30
Yeah, this is an important question that's coming up a lot these days because usually, you're better off when interest rates are higher. For most financial planning tools, whether owning bonds, whether it's annuities, whatever the case may be, except for a mortgage was sorry for having a mortgage. Oh, yeah, well if you're a borrower, but the reverse mortgage was the one like I guess a traditional mortgage to from a retirement income context. Reverse Mortgages the one tool that benefited more from lower interest rates. So now that interest rates are normalized and again, the question is, did we miss out on our chance to really benefit from using reverse mortgage? I think the answer is is no, that it's not as though interest rates are at historic highs or anything. They're still relatively slightly below historical averages. So it's still within the realm where there can be benefits from using a reverse mortgage way just because

Alex Murguia 10:28
I'm realizing now we didn't kind of give a primer on reverse mortgage. We're just doing q&a. So assuming everyone knows what that is, unfortunately, I think a lot of people when they see reverse mortgage they associate who's like Joe Namath, who does reverse mortgage commercials. No, no, he's

Wade Pfau 10:43
on Medicare Advantage. Okay. Wilford Brimley? No, right. No, no, no. Tom Selleck? Yes. Tom Selleck is one of them are

Alex Murguia 10:55
the ShamWow guy.

Wade Pfau 10:58
Well, Elektra, Beck was doing it. Henry Winkler has done it. Fred Thompson going way back. All right, well, probably Tom Selleck is who your people

Alex Murguia 11:05
don't like other than, like, reverse mortgage? Oh, that's a scam, you know, that kind of thing? Or that's like a B level actor kind of pushing it? It can't be good. You know, those kinds of things? What, what are you talking about? When you say, line of credit on the heckum, etc, etc. Just just tell us a little bit in case people are just listening in. And they're like, I don't even know the first thing about a reverse mortgage? Because every time I hear it, I just change the channel.

Wade Pfau 11:31
Yeah, good point. And I don't think we've done an arc on reverse mortgage. It's probably come up in the context of q&a type things before but yeah, we got to do an arc at some point. Or updated, get in line.

Alex Murguia 11:44
got so many big long term cares. The next one we've been getting questions for but I stopped. I'll stop. Go ahead. Yeah,

Wade Pfau 11:52
long term care is our next arc. But I wrote a book, my first book was on reverse mortgages. And I do have a 2024 updated edition out. It's really just, it's a way to create liquidity for your housing wealth. So you have an investment portfolio, we're all used to Okay, I'll spend from my portfolio to fund my retirement expenses. But homes are not liquid like that, you either have to sell the home, to be able to spend it or you can try to use a traditional home equity line of credit. But that may not work so well could because it can be frozen or cancelled, especially during market downturns when you might want to really tap into that buffer asset resource. So the Home Equity Conversion Mortgage program, it's administered through the federal government, it was created 1987 It's a way to create liquidity for your home. There's a fee is a variable rate Home Equity Conversion Mortgage, which much more than 90% of headphones are variable rate Huckins. There is also a fixed rate option that doesn't have the line of credit. But if you have a variable rate heckum, you have a line of credit that grows at the same rate, the loan balance would be growing. And so if you you have to be at least 62. But if you open this, you let the line of credit grow, you can have a significant contingency fund to use in retirement and it's a non recourse loan, you don't give up the ownership of the home as part of the reverse mortgage. If the loan balance due is less than the home is worth, you can your heirs or you or whoever the case is, can sell the home, refinance the home, pay off the loan balance and keep the home. If the loan balance is greater than the home is worth, then it's non recourse you can effectively hand over the keys of the home and not be on the hook for the different sets, their setup costs, there's insurance premiums that go in part towards providing those advantages to the consumer, because the Mortgage Insurance Fund will make the lenders whole. But that's the idea you can potentially set up this home equity line of credit, growing line of credit and use. That's what the first question we addressed was about if I spend all my investments that were

meant as my contingency fund to buy the house, can I open the growing line of credit on the house Home Equity Conversion Mortgage, and then tap into that as needed to cover contingencies throughout retirement. And that benefit and more when interest rates were low because you get a higher initial borrowing capacity. The line of credit would grow more slowly if interest rates were lower. But usually you benefited more from higher initial value with less future growth versus when interest rates are higher, less initial borrowing capacity but greater future growth. And that's where this question is becoming relevant as well. Now that interest rates are higher, I don't get to borrow as much the the idea is since it's a non recourse loan, where you're not responsible for more than the home is worth the government doesn't want it set up so that people are getting these windfalls out of their reverse mortgages where they they have this line of credit that's worth more than the home and they can take out the difference and get this free money. That's, so they tried to design the program that so that doesn't happen. The ideas by age 100, they don't want the borrowing capacity, the reverse mortgage should be worth more than the home. So it's just a present value calculation at that point. If interest rates are low, you can borrow more initially, because it's, it's gonna grow at a slower, slower pace, so it's less likely to exceed the home value. If interest rates are higher, you're forced to borrow less initially, because there's greater risk that anything you borrow, could grow to be worth more than the home is worth.

Alex Murguia 15:31
Gotcha.

Bob French 15:32
Curious if you should be looking at a Roth conversion, or what a Roth conversion even is, head over to McLean am.com/roth to get Macleans free ebook is a Roth conversion right for you, and learn about when you might want to do a Roth conversion. And when you might not just head over to McLean am.com/roth To download your free ebook today. Wait.

Alex Murguia 15:57
Another thing I'd like to address? It's a question. Since we're talking about a topic that's not well, well known, it's more niche, but you know, it should be at least in the arsenal, what are the what are the kind of the reasons in the popular media are the like, why are an advisor talking to somebody why reverse mortgage suggesting is frowned upon, you know that people just don't think about it. And this happens. We were I remember when you first wrote the first edition of the book, we had a client, Kyle we and Kyle had a client and he mentioned the reverse mortgage. And the client, you know, asked a friend, hey, talking to my advisor, and this person was spendthrift was a spendthrift and was gonna it was just like, going through the assets. And, you know, even though you say it, it's like, yeah, whatever, send me the wire, you know, that kind of thing. And ultimately, it's their money. So it is what it is. But Kyle even recommended a reverse mortgage, just like, you know, you know, be a little more liquid. And she mentioned it to I think an advisor, friend, the advisor friend was like, that's crazy. You know, if you know, you know, the whole kind of myths thing, you the misconceptions about it, that's crazy, you should never do that. And that kind of ended up leaving, even though it was the right advice, just because the word of reverse mortgage was like saying Voldemort, or something like that. Right. So what, since we're on the q&a, and you know, we got plenty of time, what, what are these misconceptions that folks have? And listen, we don't care, you know, what you use or don't use, we're just trying to apply the right tool for the right situation. Wait,

Wade Pfau 17:42
while the biggest misconception is that most people just think you, you're effectively giving up your home if you use a reverse mortgage. And that was never the case, at least not with the Home Equity Conversion Mortgage, that there are some proprietary reverse mortgages out there that also you don't give up the keys to the home, to just have it. But I think that's the biggest misconception. Also, in the conventional mindset, when people talk about reverse mortgages, they're usually talking about last resort type scenarios, where the individual had no other options, they spent all their other resources. And now they tap into the reverse mortgage. And there's two different negative media articles that could come out of this. One is the children thought they were going to inherit the home. And then they find out that their parents actually spent the home equity on their own retirement rather than leaving it to their kids. And then they run off to the journalists saying, Oh, look, this reverse mortgage took my inheritance. And those articles usually miss out on Well, it wasn't your money anyway, it was your parents, and they wanted to use it for their own retirement, and they did. So tough luck to you. But the article usually still ends up as somehow this was a bad thing to do. The other potential, no, go ahead.

Alex Murguia 19:00
Heaven forbid the kids work, but go on.

Wade Pfau 19:05
The other potential negative story is when it's used as a last resort, there are homeowner obligations, you have to pay your property taxes, you have to maintain homeowners insurance. And if you don't, there can be a foreclosure. And so then you can get the story about 80 year old foreclosed upon by reverse mortgage lender because they didn't pay their property taxes or they didn't do basic home upkeep or homeowners. If

Alex Murguia 19:32
that's why you lost the reverse mortgage. Trust me, you would have lost the regular mortgage before but it's still your problems. It

Wade Pfau 19:43
helps to kick the can down the road, basically because they're not in a sound financial position and the reverse mortgage, let them continue to enjoy the life they had a couple more years whereas without the reverse mortgage. You know that What are they gonna do at that point, they could have sold the house and then I guess rent something with the proceeds from selling the house. But I mean, they're eventually gonna run into financial problems. And the reverse mortgage may have just pushed that off a little bit for them. So you say it wasn't necessarily a bad outcome either, but that it's a negative media story. And what we're talking about is not these last resort.

Alex Murguia 20:25
That's not how we're framing it. Going back to the kids, though, what could the kids pay off the reverse mortgage and keep the house?

Wade Pfau 20:33
Yeah, if they want, that's another another misconception is a lot of people think their kids want to inherit the house, which is usually not the case. But if it is, yes, they can. This whole idea of using it as part of a responsible retirement strategy is helping them manage the sequence of

returns risk and so forth. Money is fungible. And if you borrow from the reverse mortgage, you may have less than the home equity bucket. But that can help facilitate having more in the investment bucket. And so the kids inherit the value of the home through their investments, and they're better off, they've got a bigger net legacy at the end, when it was done as part of a responsible plan, not when it's the last resort where there's not going to be anything anyway. But as part of the responsible plan, the kids inherit the value of the house plus some extra amount potentially. And then if they did want to keep the house, yes, they can pay off the loan balance, it's non recourse again, so they actually 95% of the appraised home value, they can if the loan balance exceeded that, they can pay that and keep the house and if they want to refinance that into a traditional mortgage, that that's also a potential option for them.

Alex Murguia 21:39
So I mean, bottom line is this, it's a tool that could be used. Yeah, it shouldn't be that last line of defense, if you will, like like Hail Mary, because as Wade said, you're most likely just kicking the can anyways. But you know, if you're using it to as a buffer against the cash value as a buffer, for sequence risk for, you know, you're five years into retirement, the market tanks, and you don't want to tap into it, you want to give yourself to through your cushion, you have access to capital, you know, that lets you, you know, remain invested for a few years. And then you can, you know, replenish it later, as you know, if you believe in time diversification or not. Sounds about right, wait.

Wade Pfau 22:22
Yeah, yeah. And that's so the first question was putting it that way in that context, opening a line of credit, getting that growing line of credit, and then using that as their reserve fund for any sort of contingencies in retirement, which is a popular financial planning strategy. But

Alex Murguia 22:38
we but just to come full circle, you're, you're saying that sounds a little bit too much like a potential Hail Mary, the way it's intended to write here?

Wade Pfau 22:47
Well, yeah, that's where we were a little concerned, is this truly a responsible retirement plan? If we're having to use all our investments to purchase a house, and then coming to rely on the reverse mortgage to save any other issues that come up,

Alex Murguia 23:06
like essential expenses and stuff like that?

Wade Pfau 23:11
Well, that Yeah, the question didn't get into enough details. Yeah, it sounded like they've got their essentials covered already. It's just if they have a spending shock, they don't have anything to help.

Alex Murguia 23:21
Yeah, I think sometimes it's just live within? Well, I don't want to get into a preachy sort of answer. So I'll leave it at that. The next question we did, no did we had Yeah, we did, which is the low interest rate environment, it's effectively the present value. So this is kind of one of the few times where high interest rates go against you, because the money you can borrow is less

because the bank doesn't want to, you know, be out of pocket more than what the house is worth. The next question, the

Wade Pfau 23:54
mortgage insurance, the US government mortgage, it's really the one that

Alex Murguia 24:00
big. Are there any metrics that help guide the decision whether a heckum line of credit is worth implementing, for example, less beneficial as the amount of the heckum available credit diminishes as a percentage of the size of the investment portfolio? Thank you, for all the great information resources and perspective offered through retirement research are weighed book, weights book and the podcast. They've been a great benefit to me over the last three years of my retirement planning, education and preparation. Sincerely, Bob French. That's nice for him.

Wade Pfau 24:41
Right, but yeah, so metrics to help guide the decision of whether it's worth implementing the heckum. And the example given was the ratio of home value to investment portfolio balance. I'd say the bigger metric is just you want to plan to stay in In the house, of course, no one knows. But if you're planning to move in three years, you might just wait till you're in a home that you're thinking you'll be in more permanently before considering the reverse mortgage, that's a pretty important metric. Specifically, what was being asked about the ratio of home equity to investment portfolio, that's a relative thing that you know that the higher the value of the home relative to the investment portfolio, the more absolute benefit you get for your plan from having the reverse mortgage and the typical the average American household. In their 60s, two thirds of their net worth is home. 1/3 is investments, not counting Social Security. So that's because it's such a big asset on the household balance sheet, you're gonna get more relative benefits, in that case, with the heck admin and then as the investment portfolio grows, it's just as the home becomes a smaller portion of the asset base, you always could potentially create these benefits, it's just going to be less on a relative basis. So in my reverse mortgages, but the case study I use is the investment balances, double the home value. It's kind of the inversion of the average American household. But the average American households probably not listening to the podcast anyway. The people listen to this podcast, probably their dad attitude

Alex Murguia 26:20
wait now. Right? Come on, man.

Wade Pfau 26:29
Probably a lot of our listeners, their home equity is that their investment balance is going to be at least comparable to their home at Yeah, no,

Alex Murguia 26:37
I think we probably have a higher net worth type of stuff we talked about. All right. So you think we should roll over our credit card debt all into one card? Or pain? What are you laughing? How does it work again? How does that roll up thing work?

Wade Pfau 26:59
Hmm, like this?

Alex Murguia 27:02
I have no idea, isn't it? Like, yeah, it was going up into some sort of Ramsey rift way, right? Like, they think

Wade Pfau 27:11
you're getting a win.

Alex Murguia 27:14
That's the extent of my knowledge about credit card consolidation. All right. What impact of higher mortgage rates? Wait, what is the impact of higher mortgage rates on obtaining a reverse mortgage, to higher interest rates negate the advantages of a reverse mortgage? Since a reverse mortgage is essentially a negative amortization loan? I assume a higher interest rate eats into the retirees home equity more quickly. Good question.

Wade Pfau 27:47
Yeah, actually, and actually, we we've kind of addressed this because it was similar to it's a popular question these days. But yeah, it's just with the higher interest rate, you'll have a smaller initial borrowing capacity, the principal limit is a name for the borrowing capacity, your principal limit is equal to loan balance plus line of credit, plus potentially some set asides. But we'll we'll set those aside for now. So principal limit is equal to a line of credit PLUS loan balance, and they're all growing at the same variable rate. And so when interest rates are higher, smaller initial principal limit, but then it will tend to grow faster. And so if that's our loan balance, it's going to be growing faster. If that's all line of credit, it's going to be growing faster. But it does take some time to catch up. It's starting from a lower base. And so what I what in the question Is there?

Alex Murguia 28:41
That's That's all a mortgage, reverse mortgage, once we've got it, we're good. Well, I

Wade Pfau 28:45
think it's really just our interest rates too high to benefit from the reverse mortgage. And and no, that's still not the case. In the historical simulations I did in 1982, was really one of the rare cases where interest rates got so high in my assuming the reverse mortgage program as it exists today, existed back in 1982. You're saying it's kind of a tough sell. But But today, we're nowhere near that kind of level of interest. Am

Alex Murguia 29:11
I Am I right in just rephrasing this and saying, yes, interest rates are higher than they were like, I don't know what, two years ago, right? But still, but they're still they're not prohibitive to a reverse mortgage at all. What they do, though, is effectively limit the amount you can borrow immediately because the government doesn't want to be on the hook for a loan that's worth more than the house, you know, at your expected time of death. Is that Is that about the right way to say that?

Wade Pfau 29:43
Yeah, you Nailed it. Nailed it. You

Alex Murguia 29:47

weigh in cake. Well, we'll have to stop the podcast right now. And we're gonna record this clip and make it into YouTube short, and everything like that the past 30 seconds now. I think that's good. I think that's a lot for reverse mortgages that people's brains can handle. My add is kicking into so what do you think man?

Wade Pfau 30:11
All right, yeah, yeah. And the next episode I think we're moving more into, well, there's gonna be some safe withdrawal rate questions. There's some recent type questions. There's some annuity patients. Still a lot more to come.

Alex Murguia 30:24
The fun continues as we roll on with retirement, retirement style q&a edition. Alright, everyone, thank you so much. Thank you for listening in and we look forward to speaking with you folks next week. Let's keep it going right way, everyone.

Wade Pfau 30:41
That's right. And

Alex Murguia 30:43
be careful with invitations on

Wade Pfau 30:47
Yes, don't get that wrong retirement planning guide book

Alex Murguia 30:49
by everyone.

Bob French 30:53
Wade and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you. consult your financial advisor. All investing comes with the risk including risk of loss. Past performance does not guarantee future results.