Gray Divorce

How Reverse Mortgages Can Help

By Steven J. Sless, CLTC®

As you and your clients are well aware, divorce among baby boomers, commonly known as "gray divorce" or "silver divorce" is on the rise. While the overall divorce rate has declined over the past 20 years, it has doubled among those age 50 and older.

Couples coming out of a long-term marriage face additional challenges that most younger divorcees don't. Dividing real estate assets, retirement accounts, insurance policies and other wealth accumulated during longer marriages is a delicate and sometimes arduous process for those divorcing and their families.

For baby boomers in particular, the risks and stakes are high. The worry that there may not be enough of a financial cushion to live independently may lead to further complications and financial concerns. These concerns have been amplified in recent months as the U.S. inflation rate has risen to 7.5 percent as of February 2022, the highest level of inflation since 1982.

With increased cost of goods, soaring inflation and rising interest rates, couples exiting long-term marriages may need to dip into their retirement portfolio even more than their financial plan may allow just to get by. This

could have major sequence of return implications and may result in reducing the longevity of their investment portfolio, putting them at greater risk of outliving their money. For some, this could mean having to remain in the workforce far into their later years of life or make lifestyle changes and sacrifices to stretch retirement savings and assets.

A solution that often goes overlooked is leveraging equity in the marital home with a reverse mortgage loan. Some attorneys and financial advisers have refrained from recommending equity release solutions such as reverse mortgages in the past due to lack of understanding. However, with a growing number of CDFA® professionals and advisors acting as fiduciaries charged with acting in the best interest of their clients, ignoring one of their largest assets (if not the largest) doesn't seem very prudent or in their client's best interest.

While still considered out-of-the-box, reverse mortgages have become far more mainstream and widely accepted by financial professionals and retirement researchers in recent years as senior housing wealth levels continue to rise. In fact, a recent study by The National Reverse Mortgage Lenders Association NRMLA in conjunction with RiskSpan points out that U.S. homeowners 62+ have amassed $10.1 trillion in home equity.

Understanding how to strategically and tax efficiently use this wealth while dividing marital assets can extend the longevity of both parties' finances, helping them to part ways amicably with neither spouse holding the short end of the stick.

Retirees have been conditioned to spend down money from their investment portfolios while preserving their housing wealth. Often, the home is viewed as an untouchable asset or a means of last resort to be passed down through generations. The American dream of buying a home, paying it off and passing it to children and loved ones is more of an emotional decision than a sound financial one.

Historically, the home is a low growth asset. Except for several short-term housing market booms, a well-diversified and professionally managed investment portfolio typically outperforms gains made in home equity in the long run.

Senior housing wealth levels are at all-time highs in large part because many of these homeowners have lived in their homes for a long time and have paid down their mortgage loans or have paid them off completely. Since 2020, many of these homeowners have seen tremendous gains in their home equity level due to low inventory and the COVID-19 pandemic spurring tremendous housing demand.

The old adage of using a reverse mortgage as a means of last resort has changed since 2015 due to product evolution, government regulation and advanced research. Homeowners age 62+ (or 55+ for those with higher valued homes) have several reverse mortgage options to ease the financial difficulties of divorce.

1 REVERSE MORTGAGE FOR PURCHASE

Qualified borrowers can buy their next primary residence with a Home Equity Conversion Mortgage (HECM) for Purchase loan with a one-time down payment of roughly 50 percent—provided that they pay property taxes and homeowner's insurance and maintain the property.

The down payment can come from proceeds of a previous marital home or from other savings or assets. Once the purchase is complete, payments may be made on the home or payback may be deferred until the last remaining borrower permanently leaves the home. There is no mandatory mortgage payment obligation making this option a great way to preserve cash flow later in life and move into a home to accommodate long-term needs.

It is also an attractive option for would be cash buyers. Instead of liquidating assets or utilizing most or all the proceeds from the sale of a previous home to purchase their next home, buyers using the HECM for Purchase program can put down roughly half of the purchase price keeping more assets liquid or invested, preserving, and enhancing their retirement portfolio. As with all reverse mortgage loans, payments of any denomination can be made anytime at the digression of the borrower.

2 DIVIDING HOME EQUITY

If one spouse wishes to keep the home, there are several advantages to accessing equity. For starters, using home equity with a reverse mortgage tax free. When incorporating tax free cash flow from the clients housing wealth into a comprehensive financial plan, homeowners can mitigate tapping into other retirement accounts, thereby preserving assets, maximizing future growth and allowing for a more comfortable retirement. With flexible repayment options, there is no cash flow burden of a monthly mortgage for the spouse who remains in the home.

3 REPLACING A TRADITIONAL MORTGAGE

If the remaining spouse is still paying on a mortgage and suddenly has difficulty adjusting to living on a single income, replacing that traditional mortgage loan with a reverse mortgage could be the solution. With no cash flow burden of a monthly mortgage, the spouse will see immediate savings. The key here is flexibility. From a planning standpoint, by removing the fixed mortgage payment from the budget, the borrower can mitigate sequence of return risk by reducing the withdrawal rate from their investment portfolio. The monthly savings can be re-allocated to pay for other lifestyle expenses, long-term care insurance premiums, or to help directly fund care.

4 ESTABLISHING A BUFFER ASSET

A reverse mortgage line of credit can be established as a guaranteed buffer asset or source of tax-free money outside the investment portfolio. The line of credit comes with a guaranteed increase each year (known as a growth rate) providing more borrowing power over time. With FHA HECM Reverse Mortgage loans, the unused portion of the credit line grows at a rate of 0.5 percent above the current loan interest rate.

Your client can set up the line of credit at very little cost. It is federally insured, can never be suspended, frozen or reduced regardless of what happens to the home value or market conditions so long as the terms of the loan are met.

This "buffer asset" can come in handy to help meet unexpected future income needs. For example, in the event of a downturn in the market, by drawing from the credit line first instead of pulling from other investments, particularly during bear markets, your client can avoid locking in losses and give their portfolio an opportunity to recover.

5 LUMP SUM DISBURSEMENT

Taking reverse mortgage proceeds in a lump sum payment may assist in a buyout situation, where the equity in the marital home is divided while one spouse remains in the home. Instead of using a traditional cash out refinance to draw out equity, the remaining spouse can leverage roughly 50 percent of the home's value to buy out ownership interest. Unlike a traditional mortgage or home equity line of credit, there is no cash flow burden of a monthly mortgage payment.

As with any product or service, education is paramount. To be clear, reverse mortgages won't suit all your 55+ clients, but they should be part of the conversation when it comes to dividing equity fairly.

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