SPECIAL REPORT

The $125,000 Solution:

The Tax-Free, Lifetime Income Stream

by Robert Carlson

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The $125,000 Solution: The Tax-Free Lifetime Income Stream

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Introduction

Perhaps one of the most misunderstood and under-utilized financial strategies available today is what I call the ***$125,000 Solution***.

Since 1980, more than a million Americans have used this strategy to:

- Pay for living expenses from an (optional) lump sum, instead of their retirement nest egg…
- Pay off their home mortgages, or even purchase second homes…
- Fund their golden years and have the retirement they deserve…

However, one million Americans who know about this strategy doesn't seem like nearly enough, especially when you consider that the current population of the U.S.A. is more than 300 million.

The solution I'm talking about is a **Reverse Mortgage** (also known as a home equity conversion mortgage, or HECM).

Most folks who have heard of reverse mortgages probably have a lot of preconceptions about them – and how they work. I'm also going to bet that most of them are dead wrong.

So, in the following pages, I'm going to attempt to set the record straight. Hopefully, the information found below will help you decide if getting a reverse mortgage is a smart decision for you, your family, and your house.

What Exactly Is a Reverse Mortgage?

In short, a reverse mortgage is a type of home loan that allows homeowners to convert a portion of the equity in their home into cash, which they can then withdraw and use for whatever purpose they desire.

Available through an FHA-approved lender, reverse mortgages are increasingly used by seniors to supplement Social Security, or to pay for unexpected medical expenses and home improvements.

Because this type of loan is often misunderstood, though, it's important to first sort through the clutter and distinguish fact from fiction.

Here's how HUD (the agency that regulates and guarantees the loans) describes reverse mortgages:

> *"The equity that you built up over years of making mortgage payments can be paid to you. However, unlike a traditional home equity loan or second mortgage, reverse mortgage borrowers do not have to repay the loan until the borrowers no longer use the home as their principal residence or fail to meet the obligations of the mortgage."*

In a reverse mortgage, a lender makes a loan to the homeowner. Neither principal nor interest on the loan needs to be paid until the homeowner dies, moves, or sells the home. The loan and interest are paid off from proceeds of the sale of the home. The loan proceeds are tax free and do not affect eligibility for other benefits.

Here's an example to help you picture this better. The median home price in America today is about $200,000. For the sake of this argument, let's assume your home's value is at least 25% higher than that – $250,000.

Even if you haven't entirely paid of the mortgage on your current house, you could get a reverse mortgage loan equal to 50% of the home's value, or $125,000. Actually, that estimate may be on the conservative side.

Note: Before you go thinking about getting a 50% loan on your multi-million-dollar mansion, know that the government put a cap on how big a reverse mortgage could be. The maximum equity value that will be considered for 2019 is $726,525.

Reverse mortgage proceeds can be received in a lump sum, fixed monthly payments (for your lifetime or a set number of years), or a line of credit to be tapped as needed. Taken as a line of credit, interest accrues only on the amount actually borrowed, not on the entire amount authorized.

In general, reverse mortgages are guaranteed by the Federal Housing Administration. That means the lender is guaranteed to receive payment of the principal and interest, even if they exceed the final value of the home.

Disadvantages of Reverse Mortgages

So far, I've explained briefly how a reverse mortgage works and what to expect. Doesn't sound so dangerous, right? Here are some more things you should know about them, though:

1) You cannot borrow the entire value of the home. The lender for a reverse mortgage wants to make a profit on the loan, so the eventual sale price of the home must cover the loan principal, accrued interest, and perhaps the upfront costs of the loan.

As a result, you will only be able to borrow a portion of your home's value.

2) The amount of the loan can vary. The amount depends on current interest rates, the borrower's age, and the value of the home in question.

Lower interest rates mean a potential increase in the value of the loan, whereas higher rates can possibly lower the value. Also, be aware of your age, as the older you are, the higher the maximum loan amount can be.

3) Associated costs. This is the major disadvantage of a reverse mortgages, especially when the upfront costs and fees are factored in.

Associated costs can include:

- An origination fee. FHA-guaranteed loans can charge up to the greater of $2,500 or 2% of the first $200,000 of the home's value, plus 1% of the value over $200,000 up to a maximum fee of $6,000.
- An initial mortgage insurance premium, which is a flat 2% of the loan amount.
- Closing costs and costs associated with other mortgages (such as appraisal fees and surveys), which can be 1% to 2% of the loan amount. The closing costs depend on the lender and the prevailing practices in your area.
- Monthly loan servicing fee. After the loan closes, most lenders charge a monthly servicing fee of about $35. There can also be an annual mortgage insurance premium of 0.5% to the interest rate

If you factor all these costs together, they amount to about 6%, or more, of the total FHA loan amount. That's potentially tens of thousands of dollars in fees.

Thankfully, these upfront costs don't have to be paid in cash and can become part of the loan, but again, doing that will reduce the amount of cash you can borrow, and you will be accruing interest on those costs since they become part of the loan.

Alternatives to Reverse Mortgages

Because of the pricey additional costs, and other factors, a potential reverse mortgage borrower should **first** consider other alternatives. For example:

- Many areas allow senior citizens either to reduce real estate taxes or defer payment until the home is sold. Taking advantage of this break can increase cash flow.

- Consider other loans. Regular home equity loans usually have much lower upfront costs and lower interest rates. The disadvantage is that repayment must begin right after the loan is made.

- Consider selling the current home and move into a lower-cost home. The excess proceeds from the sale of the first home can be used to pay bills or be invested, with the income used to pay for living expenses.

Also, consider that some lenders offer reverse mortgages that are not FHA-guaranteed. These loans have no maximum amount, so they are appropriate for those whose home values exceed the FHA lending limit. Additionally, they might have lower costs because borrowers aren't paying for the FHA insurance.

My bottom line: Do your research. The benefits and risks of a reverse mortgage should be carefully weighed against each other and viewed in light of your own situation.

Advantages to Reverse Mortgages

Okay, now let's cover why reverse mortgages are something more people need to learn about. We've covered the basics of a reverse mortgage and covered some reasons to stay away from them, but it's time to leave the negativity behind.

1) A homeowner can be allowed to "age in place." This is the single biggest benefit of reverse mortgages.

More specifically, a reverse mortgages lets the person who took out the loan remain in their family home for as long as they wish. As the loan money can be used for whatever purpose the homeowner desires, this can be for house repairs or upgrades to the existing structure, such handicap access. Older generations are often quite attached to the spot they lived in, often for decades, and the ability to repair and upgrade the house as one ages can go a long ways in providing peace of mind and a sense of belonging.

2) The homeowner can meet the soaring costs of getting older. We already mentioned the ability to conduct major repairs and upgrades to the house, but the cash from the reverse mortgage can also help cover medical expenses, vehicle costs, and other related things.

To put it simply, the extra income you receive from this solution could mean the difference between living out your golden years to the full and working until you're 80 to make ends meet.

3) Reduce risk while maximizing income. A reverse mortgage moves more of your tax-advantaged dollars into your later years, which is when you need it.

These days, there are ways, but also more laws, to take into account when planning for retirement. While this strategy isn't right for everyone, there is clear demand among U.S. homeowners approaching or at retirement age.

For example, many widows and divorcees can benefit financially from a reverse mortgage if they have lower Social Security, 401(k) or IRA benefits.

Again, **do your research**. Carefully consider your own present (and future) situation to see if a reverse mortgage could help you.

What Are the Qualifications to Take out a Reverse Mortgage?

To take on a reverse mortgage, you must:

- Be at least 62 years of age.
- Own your home outright, or have a low mortgage balance that can be paid off at closing with proceeds from the reverse mortgage.
- Live in the home (primary residence).
- Have the financial resources to pay ongoing property charges (including taxes and insurance).
- Receive free or low-cost consumer information from an approved counselor before obtaining the reverse mortgage loan.

How a Reverse Mortgage Can Generate up to 76% MORE Than Social Security Each Month:

This is a simple, yet effective, strategy that can be broken down into only 2 steps.

Step #1:

Delay Social Security payments. This step is often lost on a majority of retiree-age Americans, but it can really pay off.

Simply put, by waiting longer, you get MORE.

For each year that you delay payments, instead of receiving Social Security at age 62, you'll get a higher amount. Actually, your benefit increases by 8% for every year that you delay receiving benefits.

If you wait to receive benefits until age 70, eight years of compounded payment increases means you net 76% more money each month (than if you started at age 62). In other words, you receive the *maximum allowable benefit*.

Step #2:

The "Social Security Swap-Out."

By taking out a reverse mortgage, you can use the extra cash as a powerful money machine in place of normal Social Security payments.

So, delay Social Security payments starting at age 62 and let the money compound by 8% each year.

Meanwhile, take out a reverse mortgage and use that tax-free money to pay your monthly living expenses.

Once you're ready to start receiving Social Security payments, you can even stop the reverse mortgage payments and have significantly higher income due to all the years you waited.

That's all there is to it. Simple and effective.

The Social Security "Mulligan":

How to Get "Bonus" Income Stream (Even If You're Already Getting Social Security)

If you have been receiving Social Security payments for LESS than 12 months, you can essentially cancel your Social Security and pay it back to Uncle Sam. This money will come back to you later, but at higher monthly payments since you'll be older.

Alternatively, if you have been getting Social Security for MORE than 12 months, you can suspend your Social Security benefits for the time being and receive credit for this period of delay. For example, if you're 68 and wish to suspend your SS payments until age 70, you'll get a higher benefit at that time.

Some Facts About Reverse Mortgages

- The average reverse mortgage borrower is a single woman age 75 or older.
- For a married couple, the age of the youngest borrower determines how much you can borrow.
- For homes worth more than $625,500, the reverse mortgage premiums and principal limit factors apply only to the first $625,500. (This limit is indexed for inflation and is $726,525 for 2019.)
- It is still possible for reverse mortgage borrowers to foreclose on their homes (you must continue to use it as your principal residence, pay property taxes or insurance, and keep your home in good repair).
- As of 2015, new rules require applicants to complete a lender financial assessment (to include credit reports, mortgage payment history and household debt).

- It's often a good idea to hire a reverse mortgage counselor to help review the short- and long-term benefits, the potential downsides, and the loan itself (in the context of your financial situation).
- Be cautious of reverse mortgage scams and unsolicited offers, and contact HUD at 1-800-347-3735 if you wish to file a complaint.

Reverse Mortgage Lenders

Here are some reputable reverse mortgage lenders for your consideration:

(Keep in mind that not all of these lenders do business nationwide, and also note that I receive no financial compensation from any of the following).

All Reverse: https://reverse.mortgage/

Signet Mortgage: http://www.signetmortgage.com/

First Bank: https://firstbankreversemortgage.com/

Retire Secure: http://retiresecurenow.net/

Goldwater Bank: https://www.goldwaterbank.com/

Longbridge Financial: https://longbridge-financial.com/

Centennial Home Mortgage: http://www.centennialmtg.com/

Additional Resources

For more information on reverse mortgages, consider these sources:

AARP (800-687-2277 or www.aarp.org/revmort) for its booklet *Home Made Money: A Consumer's Guide to Reverse Mortgages*.

National Council on Aging: 202-479-1200 or www.ncoa.org

Fannie Mae (800-732-6643) and its Home Keeper loans

National Reverse Mortgage Lenders Association at 866-264-4466 or www.reversemortgage.org

www.ltccounselor.org

Biography

Bob Carlson is editor of the monthly newsletter and website, *Retirement Watch.* He has served on the Board of Trustees of the Fairfax County Employees' Retirement System since 1992 and been chairman since 1995. The system has more than $4 billion in assets. Carlson was a member of the Board of Trustees of the Virginia Retirement System, which oversaw $42 billion in assets, from 2001-2005. He was appointed to the Virginia Retirement System Deferred Compensation Plans Advisory Committee in 2011.

His latest book is the revised edition of "The New Rules of Retirement" (Wiley, 2016; first edition 2004). He also co-authored "Personal Finance after 50 for Dummies" (with Eric Tyson; Wiley, 2015) and wrote "Invest Like a Fox…Not Like a Hedgehog" (Wiley, 2007).

He has written numerous other books and reports, including "The New Rules of Estate Planning," "Securing Your Lifetime Stream of Income," "Tax Wise Money Strategies, Retirement Tax Guide," "How to Slash Your Mutual Fund Taxes," "Bob Carlson's Estate Planning Files" and "199 Loopholes That Survived Tax Reform." He also has been interviewed by or quoted in numerous publications, including *The Wall Street Journal*, *Reader's Digest*, *Barron's*, *AARP Bulletin*, *Money*, *Worth*, *Kiplinger's Personal Finance*, the *Washington Post* and many others. He has appeared on national television and on a number of radio programs. He is past editor of *Tax Wise Money*.

Carlson also was a Commissioner on the Fairfax County Redevelopment and Housing Authority. Carlson is an attorney and passed the CPA Exam. He received his J.D. and an M.S. (Accounting) from the University of Virginia and received his B.S. (Financial Management) from Clemson University. He also is an instrument rated private pilot. He is listed in many editions of *Who's Who in America* and *Who's Who in the World*.

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