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# MALLARD ADVISORS LLC

Comprehensive Financial Planning  
& Wealth Management Solutions

## THE QUARTERLY MALLARD CALL

## Notices

### Gear Up for Tax Time

True comprehensive planning must integrate income tax planning. Over the next month we will begin the tax preparation process designed to harvest the fruits of tax planning done during the 2017 calendar year. If you receive financial planning services, we may be preparing your 2017 tax returns. Within the next two weeks, you will receive your annual tax letter and organizer. Once you have gathered all relevant tax documents, please drop off the information as soon as practical so that we can get started!

### Use ShareFile

When sending confidential information to us, please remember to use the **secure ShareFile link** contained at the bottom of each of our email signatures rather than using the attachment function of your email software. This link is also located at the top of every page of our website.

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## Spending Down Your Home

William D. Starnes

Retired homeowners likely have some equity in their homes that is actually a large "asset" that they don't think about, or consider valuable in any way. However, for most clients, their home equity is a large asset that should be evaluated and considered as part of their overall "portfolio". The best way to do this is to think of your home's equity the same way you would think about an IRA. They are both assets that are available for withdrawals. Spending down your IRA is easy to understand and to execute, but *how do you spend down your home?*

### Common Methods of Spending Home Equity

There are three common strategies to spending down your home, including downsizing to free up equity, taking a traditional home equity line of credit (HELOC) for spending, and establishing a **reverse mortgage**. In this article, I will only focus on the misunderstood and maligned reverse mortgage. More specifically, I will only refer to the Home Equity Conversion Mortgage (HECM), which is a federally regulated and an insured loan program overseen by HUD and the FHA. Almost all reverse mortgages are HECM's these days, therefore, I will use the terms HECM, and reverse mortgage interchangeably for this article. I will provide a high level overview of how a HECM works, and who would be the best candidates for one (which may surprise you). I will need to skip important details and considerations, so don't make any decisions based upon this one article. Instead speak with us and a qualified specialist in this area before taking any action.

### Home Equity Line of Credit Versus the Reverse Mortgage Line of Credit

	HE LOC	RELOC
Is the interest rate variable?	Yes	Yes
Are there upfront costs?	<b>Yes - Small</b>	Yes - Large
Are there income/credit requirements?	Lots	<b>Minimal</b>
Are monthly payments required?	Yes	<b>No</b>
Is there a mandatory payoff date?*	Yes	<b>No</b>
Is the credit line guaranteed?*	No	<b>Yes</b>
Does the credit line grow?	No	<b>Yes</b>
Can the credit line be frozen by the lender?	Yes	<b>No</b>
Can heirs be required to repay more than the home is worth?	Yes	<b>No</b>

*\* Assuming you are still alive and maintaining the property and taxes/insurance.*

### What is a Reverse Mortgage?

The easiest way to understand a reverse mortgage is to compare it to a similar product that is widely understood – the home equity line of credit (HELOC). Think of a reverse mort-



# Spending Down Your Home...continued

gage as similar to a regular HELOC where you can access equity funds as desired - lump sum, monthly payments, or draws as needed. Like a HELOC, a reverse mortgage can be taken in the form of a line of credit. Therefore, let's call this a RELOC (REverse Line Of Credit). Unlike a HELOC, with a RELOC you *don't* pay the loan back over time via regular monthly payments. Instead, no monthly payments are made to the bank (unless desired) and the loan balance and interest accrues over time. The bank is paid back within 12 months of when you *leave the home* (usually due to death or a move to a nursing home).

Since most of us understand how a HELOC works, the table on the first page, which compares and contrasts a HELOC to a RELOC, may be helpful in better understanding reverse mortgages.

Let's consider a simple, yet typical, example with a 75 year old client who has a home worth \$350,000. They can open a RELOC with a \$175,000 credit line available to use as desired over time. They may use some of it to make home modifications, or pay in-home care expenses later in life. The credit line grows over time (with the rate of interest charged), and they withdraw the funds as desired *and never have to make a payment to the bank*. Then, after their death, the heirs inherit the house, sell it, and receive the remaining equity (after paying back the loan and accrued interest).

Below is a visual of two important differences between a HELOC and a RELOC. First, RELOC grows over time

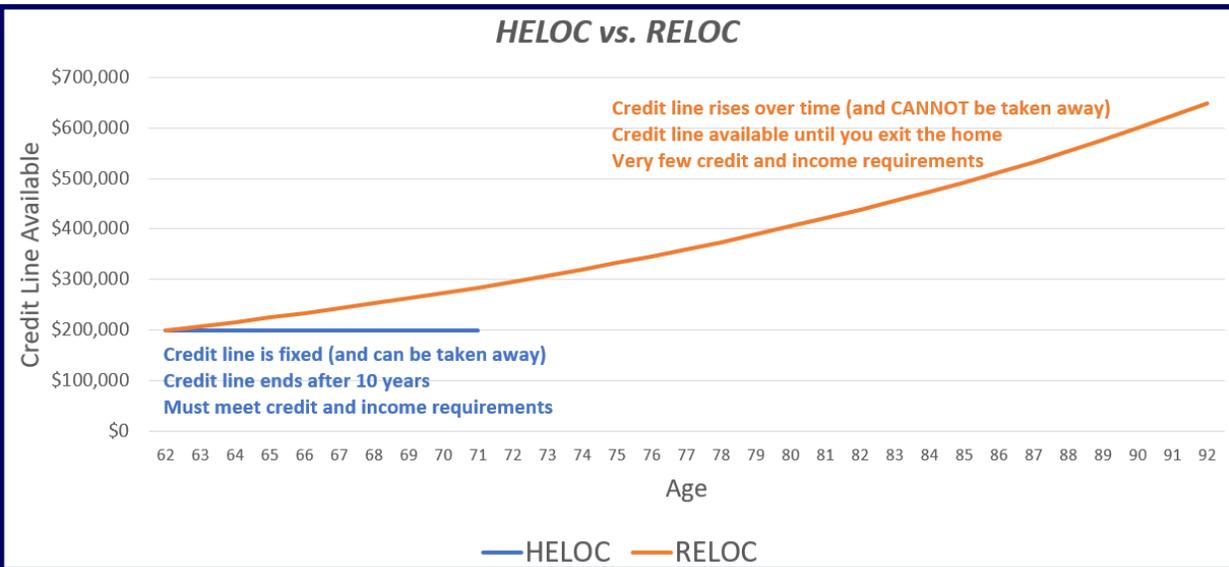
while a HELOC is fixed. Second, it continues as long as you remain in the home while a HELOC has a set duration, such as 10 years.

While it is easiest to think of the reverse mortgage as a line of credit (RELOC), in fact you can spend down your home equity by not only taking a line of credit, but also by taking a lump sum, or even a monthly income stream (or some combination of all of these).

As you can see, a reverse mortgage turns the value of your home equity into usable cash, but without the cash flow burden of having to make payments to the bank or the need to move and downsize. The cash from a RELOC is incredibly flexible and can even be used to pay off an existing mortgage in order to stop those mortgage payments altogether.

### Aren't Reverse Mortgages Bad?

Reverse mortgages do have a bad reputation thanks to slick TV commercials and irresponsible lending, (and borrowing) which has resulted in misunderstandings and to outdated conclusions regarding this product. However, as a result of policy changes designed to ensure the borrowers are appropriate for the product, the worst-case events have declined. Now, reverse mortgages are not only more attractive, but recent research has shown how the proper use of reverse mortgages helps retirees better manage cash flow and improves their financial security.



### Who is Eligible to Take & Keep a Reverse Mortgage?

To be eligible for most reverse mortgages, the youngest borrower must be age 62 and your home must be your principal resi-



### Reverse Mortgage Myths

Let's get a few of the myths out of the way, so that readers can continue on without these questions in the back of their minds.

**MYTH:** You can't get a reverse mortgage if you currently have a traditional mortgage.

**TRUTH:** Yes, you can refinance the traditional mortgage into the reverse mortgage.

**MYTH:** When you take a reverse mortgage, you lose title to the home.

**TRUTH:** You retain the title of the home until you sell the home.

**MYTH:** If your house falls in value and the loan is greater than the value of the home, your heirs will have to come up with the difference.

**TRUTH:** A reverse mortgage is a non-recourse loan and therefore, regardless of the loan amount or whatever happens to the value of the home, you will never owe the bank more than the value of the home itself.

**MYTH:** After your death, the house goes to the bank.

**TRUTH:** After your death, the heirs own the home and can either keep it (and pay off the loan with other funds) or sell it (and pay off the loan with the sales proceeds).

**MYTH:** The bank will choose the selling price and sell the home.

**TRUTH:** The heirs will set the price, hire a realtor, and sell the home.

**MYTH:** Once you get a reverse mortgage, you can never move.

**TRUTH:** You can move anytime, and must then pay off the loan balance and accrued interest.

**MYTH:** All reverse mortgage lenders prey on the elderly who have no other options.

**TRUTH:** Of course not, and in fact the ideal borrower is one that is not getting the reverse mortgage as a result of having no other choice.

dence. Unlike a traditional mortgage or HELOC, there is not much in the way of income or credit requirements other than to ensure the borrower's ability to pay property taxes, home insurance, and basic maintenance, etc. If you think about it, income requirements are less relevant since you don't have to make any loan payments to the bank. Assets are irrelevant since the loan is backed by the value of the home. Finally, there is a mandatory 1-hour telephone counseling session to help stop inappropriate borrowers from taking this type of loan.

To maintain the reverse mortgage (i.e., not be required to pay it off), you must continue to reside in the home as your primary residence, and keep up with the needed homeowner's insurance and property taxes. In addition, the home must be maintained in "good repair". In other words, the mortgage is due when you stop living in it, don't maintain it, or fail to pay taxes and insurance.

#### What About Costs?

Like most mortgages, reverse mortgages have costs, such as interest payments, origination fees, and closing costs. The largest *additional* costs are the government-mandated mortgage insurance premiums (2% of the home value in the form of an upfront premium PLUS 0.5% of the loan balance). This insurance is there to protect the bank from ending up with a house worth less than the loan, and to protect the borrower from a bank that goes under. These upfront costs are rolled up into the loan amount resulting in no out-of-pocket expenses for the borrower. Think of the ongoing mortgage insurance premiums as an addition to the interest rate.

The upfront 2% mortgage insurance premium is indeed bothersome. However, **think of it as the cost of converting some of the equity in your home into cash flow.** Most people pay fees associated with their portfolio (such as management, trading, and expense ratios), and like a portfolio, the reverse mortgage also has required fees.

#### How Much Equity is Available?

The amount of equity available to you is computed by taking into account your age and life expectancy, the value of your home, current interest rates, and closing costs. Gener-



ally, about 45%-55% of your home equity is available. The older you are and the lower the interest rate will increase the available equity. However, only a maximum of \$625,500 of equity is eligible to be used for reverse mortgage purposes.

### Will a Reverse Mortgage Enhance My Standard of Living or Increase My Wealth?

Ideally, retirement income planning is done with the goal of maximizing a client's lifestyle without risking their financial security. However, recent research suggests that not only does the RELOC provide more cash flow for spending, but it actually can also lead to a larger legacy for heirs if used correctly. This is done by considering both investment accounts AND home equity. Unfortunately, most financial and investment advisors only concern themselves with investment accounts.

Old school thought on how to consider home equity in retirement was to preserve it as a last resort, and if it was not needed, then the home would go to heirs or charity. However, recent objective research has shown that instead of using the home as an asset of last resort, strategically spending the home equity down over time will likely result in greater total wealth.

In my video *The Real Retirement Risk*, I discussed one of the biggest risks facing a retiree were large portfolio losses early in retirement (also known as "sequence of return" risk). Think how a RELOC could mitigate this risk.

If at age 62, you took a \$200,000 RELOC (just to have the funds available if needed) and at age 65 you retire with no pension and the intent to defer collecting Social Security until your age 70, this leaves you with a 100% reliance on your portfolio. Since your portfolio is composed of some stocks, it is also subject to fluctuations. If at age 66, the stock market begins a 12-month bear market and takes several years to recover, imagine the value of having that \$200,000 RELOC to withdraw from while the market is down. Better yet, since you don't have to take taxable IRA withdrawals, you may now have the option to perform valuable Roth IRA conversions.

Once the market rebounds, you may even elect to pay off the borrowed amount (and interest). In other words, a RELOC can be a very effective method of mitigating sequence of return risks, managing taxes, and generating tax-free income as desired.

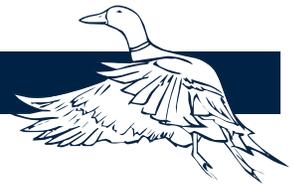
### Research Supports the Benefits of Reverse Mortgages

Recent research has helped identify the best uses, timing, and ideal candidates for a reverse mortgage. The following are the general findings from the academic research:

- Reverse mortgages are often more effective if opened and used strategically early in retirement, rather than as a last resort. This is especially true in a low interest rate environment. (Pfieffer, Schael, and Salter, 2014).
- Coordinating withdraws from a RELOC when investments like stocks and bonds are down, so the client can ensure a steady income while giving the investments time to recover can significantly increased clients' financial security – as measured by Monte Carlo Success Rates. It was also found that reducing portfolio withdrawals when markets are down by using a RELOC as a bridge is an effective method of mitigating sequence of return risk. (Sacks & Sacks 2012).
- In one study, six different reverse mortgage strategies were evaluated and they found that opening the RELOC early, and using it strategically, greatly improved Monte Carlo Success Rates compared to leaving home equity as a last resort (Pfau 2016).

Based on this research, practitioners are now utilizing reverse mortgages in other beneficial ways. For example, a reverse mortgage can be used to:

- pay off an existing mortgage in order to eliminate ongoing mortgage payments.
- create a monthly income stream (which if it minimizing IRA withdrawals, has the added benefit of reducing income taxes).
- finance a new home purchase.
- delay collection of Social Security benefits until age 70 in order to maximize their long-term value.
- minimize IRA withdrawals prior to age 70 & ½ which allows Roth Conversions to occur during these low tax bracket years.



- open a credit line as early as possible in a low interest rate environment so that as interest rates rise (and the credit line rises as well), eventually (if you live long enough) the amount borrowed will become greater than the home value. Since this is a non-recourse loan, you end up with more (in borrowed funds) than what your home is worth, thus walking away wealthier. As this strategy becomes popular, it is likely that this opportunity will be eliminated via new FHA and HUD rules.

The worst candidates for a reverse mortgage are those who are desperate and need to take it as a last resort. They may have no other investment assets, so they may end up using their only remaining asset for lifestyle related expenses rather than maintaining the equity for a potential long-term care need. In this case, it may be better to trade down to a less expensive home, or even rent. If you don't plan on staying in your home for more than 3-5 years, the up-front costs won't be worth it and a reverse mortgage is not for you.

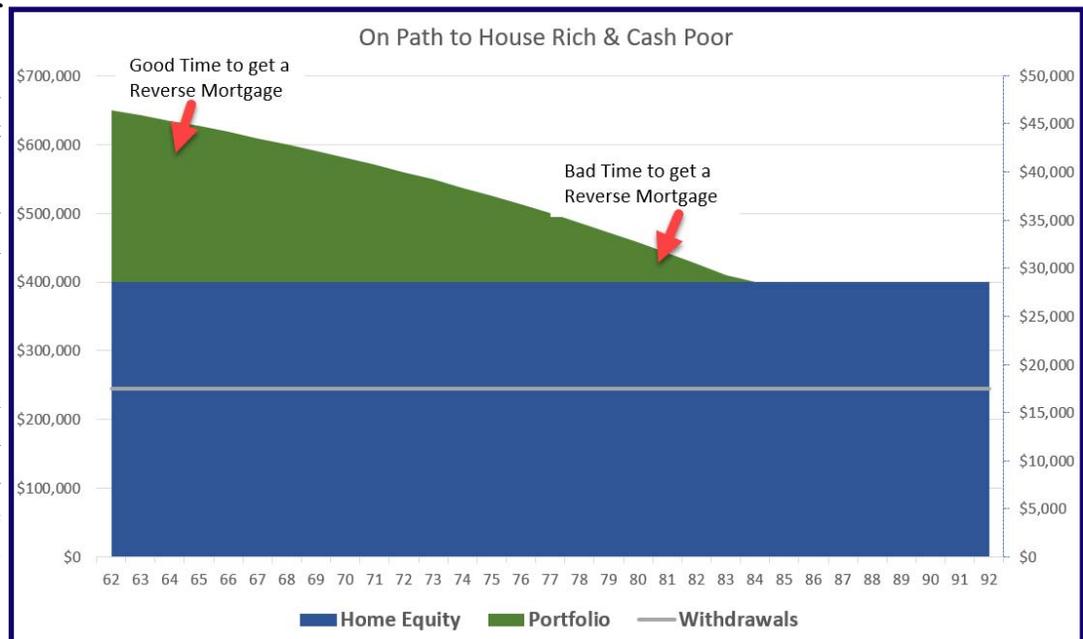
### What Are the Downsides of a Reverse Mortgage?

There are downsides to a reverse mortgage that must be considered carefully.

**First**, most HECM's have a variable interest rate which can rise and increase the balance owed more quickly. **Second**, they are expensive (relative to a HELOC) and complicated. **Third**, if you leave the home within just a few years, it would have been better to avoid the up-front costs of the reverse mortgage. **Fourth**, the costs are not trivial when compared to a traditional mortgage or HELOC. **Finally**, heirs may be irritated as they may have been hoping to have inherited a house free and clear. However, as the research mentioned above shows, correct use of a reverse mortgage increases the chances that total remaining wealth ends up being larger.

### Who are the Best and Worst Candidates?

The best candidates are those with other investments, a desire to remain in their home, and can afford to maintain the home and pay taxes and homeowner's insurance. Also, the best candidates are those who are between age 62 and 70 and are on track to be house rich and cash poor as shown in the image above. If the candidates wait until they have few investments left, the strategic value of the HECM will be lost.



### Conclusion

As you can see, it is indeed possible to spend down your home, like you would an IRA. This would be the home you want to remain in for the rest of your life. The reverse mortgage can help with cash flow for repairs and medical costs as you age at home, or used more strategically to build wealth. If after reading this, you find that a reverse mortgage meets your needs and lifestyle objectives, it could be one way to increase income during your retirement years. However, because of the costs and complexities involved in a reverse mortgage, you should weigh your options carefully and consult with a professional who can explain the full implications.

*Bill Starnes is the founder and senior advisor at Mallard Advisors, LLC*



## Mike Tolliver Joins Mallard Advisors



Mike Tolliver joined Mallard in 2017 as a financial advisor and brings several years of advisory experience to us. More importantly, Mike is passionate about financial planning, cares about helping clients, and is extremely knowledgeable and skilled. We would like to introduce Mike by asking him a few questions.

***Tell our readers why you elected to move to Delaware and begin working with Mallard Advisors in a fee-only financial planning capacity?***

My wife Emily and I were excited to move across the country, primarily to be closer to her family. I began looking for jobs in the area and applied to over 20 different positions that were in my field. Right away, Mallard Advisors stood out. It was the only firm I was interviewing with that did not have any product sales as a part of the job. I signed on with Mallard Advisors and have loved being able to focus my energy on providing the best possible advice to help our clients pursue their financial goals.

***Tell us about your family and personal interests.***

I am originally from St. Louis and moved to Boston for work prior to moving to Denver where I met my wife Emily. While we do not yet have any kids, there has been recent talk of adding some sort of canine to the family. Recommendations of breed are welcome!

I am interested in everything, but would primarily break my interests into the categories of 1) Mental Challenge and 2) Physical Challenge. Mental Challenge would include things like complex board games, reading on a variety of stimulating topics, learning to brew beer, etc. Physical challenge would include things like powerlifting and climbing 14ers, as well as traditional sports like soccer and tennis.

***What is your educational and employment background?***

I have a B.S. in Business from Truman State University and have been interested in finance since I was little. I remember my dad sharing all sorts of financial wisdom and showing me his collection of stock certificates (way back when they used to mail out the physical certificates). This love of finance manifested itself over the years as I was recruited by Northwestern Mutual, Larson Financial Group, LPL Financial, and Navy Federal. In every case I was exposed to a new facet of the personal finance industry but never really felt like I had found the kind of firm I was hoping to work for—until now.

I also have Masters Degrees in Divinity, Theology, and Philosophy. I have taught Business Ethics to Undergraduate and Graduate students at the University of Missouri Saint Louis as well as Northeastern University in Boston.

Total Return as of 12/31/2017					
	Dec	4th Qtr	2017	Annualized	
				3 Years	5 Years
<b>GLOBALLY DIVERSIFIED BALANCED PORTFOLIO**</b>					
60% Equity / 40% Bond	1.06%	3.99%	14.04%	6.95%	8.03%
<b>STOCKS</b>					
Larger-Cap	1.10%	6.61%	21.67%	11.26%	15.62%
Smaller-Cap	0.37%	5.07%	16.10%	9.70%	14.30%
International - Developed Mkts	2.01%	4.80%	27.40%	8.43%	7.03%
International - Emerging Mkts	3.49%	6.23%	31.15%	7.32%	3.31%
Real Estate	(0.23%)	1.37%	4.83%	5.10%	9.10%
Inflation Hedges*	4.47%	7.16%	16.61%	4.89%	2.65%
<b>BONDS</b>					
U.S. Investment Grade Bonds	0.44%	0.38%	3.46%	2.08%	1.91%
Global Bonds	0.08%	1.18%	2.46%	2.75%	-

\* Each asset class is represented by a relevant Vanguard Index fund except for Inflation Hedges where the Morningstar Category average for "Natural Resources" is used.

\*\* The portfolio is represented by the DFA Global Allocation Fund (60% Equity / 40% Bond)