

# Episode 224: Reverse Mortgages: Misunderstood or Misused?

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## SUMMARY KEYWORDS

Reverse mortgages, retirement income, Home Equity Conversion Mortgage, financial planning, non-recourse loan, line of credit, mortgage insurance, property taxes, homeowner obligations, buffer asset, reliable income, tax planning, legacy asset, financial assessment.

## SPEAKERS

Wade Pfau, Alex Murguia, Briana Corbin

### **Briana Corbin** 00:00

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### **Briana Corbin** 00:41

Reverse Mortgages don't exactly have the best reputation, but there is a reason why they keep coming up in serious retirement plans. Wade and Alex explain why in this episode,

### **Alex Murguia** 00:55

Hey everyone, welcome to retire with style. I'm Alex, and I'm here with Wade, and you're I know you folks are getting tired of me being the one doing the introduction instead of Wade, but that's because we're reviewing Wade's book, and it would seem weird if he intros is himself and talks about his own book like that,

### **Wade Pfau** 01:15

right? Wade centric

### **Alex Murguia** 01:16

episodes, right now? Yeah. Oh, did you just refer to yourself in the third person?

### **Wade Pfau** 01:20

Yes, but I know there'll be some of our reviewers of the podcast.

### **Alex Murguia** 01:24

You Ricky Henderson and Reggie Jackson all have something in common, referring to ourselves in the third person, yes, yes, or you're the star. You're the straw that stirs the drink. I think it's a Reggie Jackson quote, but all right, Wade, we're doing the chapter we're still on. Chapter was it again? Chapter nine,

**Wade Pfau** 01:45

the second huh? The second half of chapter nine.

**Alex Murguia** 01:49

The second half of chapter nine. So, chapter nine, Part D, yeah, if you're talking about everyone's favorite topic, reverse

**Wade Pfau** 01:56

mortgages, that's right, yes, it's in, in the third edition of the retirement planning guidebook. It's pages 223, to 232,

**Alex Murguia** 02:06

now, do you hear that those are people turning off the podcast? No, no. Have patience. Have patience. You will see that it's actually a quite worthy of a topic. From a financial planning perspective, I myself was like, reverse mortgage. What the hell is this? This is like, you know, one of those things that you see washed up athletes pushing on mid afternoon TV. But I'm here to tell you that's not the case.

**Wade Pfau** 02:37

Any athletes spokesman have been there is.

**Alex Murguia** 02:41

He does something else.

**Wade Pfau** 02:44

Joe, name up, does Medicare or hearing aids? Something Right? Does hearing aids and Medicare?

**Alex Murguia** 02:49

I threw him in that. Who does this?

**Wade Pfau** 02:53

Tom Selleck. Tom Selleck, yeah, he was a big one for a while. Then back in the day, the originator the OG your sin for reverse mortgages.

**Alex Murguia** 03:03

All right, so absent of them. Why are you here to prove that it's actual? Not prove but why are you here to talk about that? This is actually before we talk about why it's actually a viable solution. Why don't we give a history of it so people can kind of assess why it's gotten a bad rap and why it's actually a very viable solution for a certain subset

**Wade Pfau** 03:22

of folks. And so this is relevant if you have a home that you're not renting or anything like that, and it's something you can think about with your primary residence. But yeah, it all goes back to 1961 in Maine. That was the first reverse mortgage, just setting up being able to use the home as collateral for a loan. Now, the what we're talking about, we're not talking about those kinds of proprietary reverse mortgages. Today. We're talking about the Home Equity Conversion

Mortgage, which was it's administered through Housing and Urban Development. It was set up the the legislation. It was called the 1987 Housing and Community Development Act that created the Home Equity Conversion Mortgage program.

**Alex Murguia** 04:07

Are you saying by today that there's another subset of reverse mortgages, or that they have evolved what they are today?

**Wade Pfau** 04:12

Well, evolved partly, but just there are still proprietary reverse mortgages, and it turns out they're becoming more popular today. They're relevant. Well, we're jumping ahead a little bit, but your HECM, your Home Equity Conversion Mortgage, you can use that on up to the housing value of about \$1.25 million your house could be worth more than that, but the reverse mortgage would only apply to that amount. So if you're somebody who lives in a multi million dollar home, you might have better options with a proprietary reverse mortgage outside of the Home Equity Conversion Mortgage program, like a

**Alex Murguia** 04:46

jumbo reverse mortgage. Those tend to be

**Wade Pfau** 04:48

proprietary another name, and we're not really talking about them today, though. They are becoming more popular,

**Alex Murguia** 04:55

all right, so then back to 1961 when Roger Maris cracked

**Wade Pfau** 04:59

that home. Right? The Yankees won the World Series that year. Yeah, yeah. But, well, I don't have much to say about that. That's just the first reverse mortgage. The Home Equity Conversion Mortgage program was set up in 1987 and they changed the regulations around it every used to be more frequently, every four or five years. At this point, it's we haven't had a major change to the rules since October 2017 so we're a bit overdue, but the efforts over time have been to improve the program, to improve safeguards, to improve the protections for the Mortgage Insurance Fund that's providing all the guarantees and protections for consumers using the program, there's now protections for non borrowing spouses. Is you have to be 62 or older to be a borrower, and so it used to be if your spouse was younger than 62 when you signed up for the reverse mortgage, the loan would become due if you passed away, even if your spouse still wanted to live in the home. Now we have those protections in all states but Texas, where an eligible, non borrowing spouse, they can no longer take money out of the reverse mortgage, but they don't have to pay it off until they leave the home as well. There's also financial assessments to help ensure it's not used as a last resort option where the homeowner may then not be able to maintain property insurance or other homeowner obligations, and that could have led to foreclosures, but we're talking more about like responsible financial planning cases where you're not using it as a last resort, you're using it to be more strategic with how you're thinking about your retirement assets, and then the risk of foreclosures less relevant.

**Alex Murguia 06:39**

Okay, that's

**Wade Pfau 06:41**

pretty much some background on the history. I think so.

**Alex Murguia 06:45**

Why was it getting a bad rap for a while?

**Wade Pfau 06:48**

Well, there's always been this myth, and I think you had shared this myth, just this idea you gave up the title day your home if you got a reverse mortgage. And that was really never true, especially not with the heckem program. But for whatever reason, that myth persists, and then I guess another aspect of why there was negative media coverage. Often you get articles written from the perspective of an adult child beneficiary.

**Alex Murguia 07:13**

I don't think that. But before you get into I don't think that one's a myth. I just think it's faulty logic. But go on

**Wade Pfau 07:18**

of losing the title to the home or

**Alex Murguia 07:20**

no of the kids complaining, because money's got to come from somewhere anyways, you know?

**Wade Pfau 07:25**

But gone, yeah, right, it was the adult child was saying, I thought I was going to inherit this house, but it turns out my parents spent the home equity through their reverse mortgage, and now I don't get the home as an inheritance. For me, that was kind of the basic gist of the story. But, yeah, you could write the same thing. My parents had an IRA, and I thought I was going to inherit it and have this big inherited IRA, but they and they spend it on their retirement instead. It's basically the same kind of logic. It's just somehow framed differently with with there's

**Alex Murguia 07:57**

also that emotional tie in where parents, I think my mom had this where it's like my house is something I can pass on. This sort of thinking that it really is antiquated, but it still exists, which is like the American dream of having house and I get to pass on that asset to the next generation. But the reality is, assets are fungible, and if you don't take advantage of it, all you're doing is acquiring debt or some liability elsewhere, and so on a net basis, it could be more harmful simply to keep the house for your kids, right, right?

**Wade Pfau 08:32**

It's the default was you leave the house as a legacy, but then, for the most part, kids don't want to live in that house, so they're going to immediately have to turn around and sell it. And the reverse mortgage can actually just first provide a way to be able to just donate the money instead of the house, necessarily. If you really took full advantage of the reverse mortgage,

maybe the loan balance exceeds the value of the home, but it's a non recourse loan, so then the kids simply could turn over the keys to the home and not have to deal with it. That's not the same as giving up the title to the home. And also, if the loan balance is less than you could sell the home for, you work with a lender to have up to a year to sell the home, and then you pay off the loan balance and any remainder you get to keep now, real quick, because

**Alex Murguia 09:15**

you said the kids can turn in the keys. Do the kids get dinged on their credit report for turning in the keys?

**Wade Pfau 09:21**

No, I don't think so. It this would no one's ever asked me that question before. I don't think so. I think this is really done before formally.

**Alex Murguia 09:31**

This will be a two parter,

**Wade Pfau 09:33**

being something that shows up in their credit reports,

**Alex Murguia 09:37**

but at the end of this episode,

**Wade Pfau 09:39**

stay tuned, Alex with the penetrating questions at the end

**Alex Murguia 09:42**

of this episode. Stay tuned, and we'll have that as a 32nd snippet at the end. I've got it.

**Wade Pfau 09:48**

Yeah, I've got a couple experts out there that when I get these kinds because I'm not in the reverse mortgage industry myself, but

**Alex Murguia 09:55**

you follow what I'm saying, right?

**Wade Pfau 09:56**

I have to check with others when these kinds of questions come up. And you follow what I mean, though, right? Yeah, I suppose. But you're not. You're not, it's not. You're not reneging on a no, you're you're doing what you're allowed to do, which is one way to repay the loan balance is to turn over the collateral the loan, and it's a non recourse loan. You're not on the hook to pay back more than the home is worth. That's part of the mortgage insurance premiums that create upfront cost and ongoing cost to set up the reverse mortgage. But those are protections you have. I don't it's not something negative to your credit. If you

**Alex Murguia 10:32**

do that perfect

**Wade Pfau** 10:35

and then you also

**Alex Murguia** 10:37

pulled that one out of a hat, you're like, you got it together. Man, real fast.

**Wade Pfau** 10:44

Yeah, penetrating questions.

**Alex Murguia** 10:47

I'm like the Barbara Walters of retirement income.

**Wade Pfau** 10:50

Yeah, we'll get Dan Holcliff on this show. He's, he's my reverse mortgage guru. If I have any questions

**Alex Murguia** 10:56

like that. All right, so what's the logic of why it could help?

**Wade Pfau** 11:01

Well, first, you also referenced the psychology, and that's another aspect of people have been working their whole life to pay off a mortgage, and the last thing they can think about is having a new mortgage, and it is a mortgage, it's just it works differently than a traditional mortgage. With a traditional mortgage, if you miss a payment, you can lose the home. With the reverse mortgage, you have no obligations to make payments until you either leave the home voluntarily moving or passing away, or whatever the case may be, or you are not maintaining basic homeowner obligations, such as having property and homeowners insurance, paying your property taxes and doing basic home maintenance.

**Alex Murguia** 11:45

Okay, so I repeat, no, yeah, well, is the logic of Hawaii could help?

**Wade Pfau** 11:52

Yeah, yeah. So you noted money is fungible. It's it's a good line. It's when I'm thinking about retirement to just simplify. I have Social Security. I have an investment portfolio. I have a home. What's the best way to coordinate those assets to get the most after tax spending power, either in terms of meeting spending needs and or providing a legacy at the end of retirement? And the default strategy is you, you don't touch the Home. It's the last resort. So you spend down your whatever you do with Social Security, and then in terms of claiming strategies, then you spend down your investments. And if your investments run out, then that's when you might consider a reverse mortgage. And with all the research done in this space, going back to some other authors, or a couple articles that came out in 2012 Barry Sachs and his brother, Steven. And then another group of researchers through Texas Tech, Harold avensky, John Salter, Sean Pfeiffer, they independently talked about how setting up a growing line of credit, and we need to also talk about the idea of a growing line of credit, but setting up a growing line in

**Alex Murguia** 12:56

reference to a HELOC, not necessarily a

**Wade Pfau** 12:58

no, not a HELOC. Growing line of credit from a reverse mortgage.

**Alex Murguia** 13:02

Oh, from a reverse mortgage. Okay, sorry, sorry. Gives you

**Wade Pfau** 13:06

the flexibility to coordinate spending from your investments with spending from the reverse mortgage. It's a powerful way to help manage sequence of returns risk, and it can actually lead to better long term financial planning outcomes. So I replicated the same work as well, and as many other people have done.

**Alex Murguia** 13:26

So the thinking is that you have a reverse mortgage established so you can draw from it if needed the markets go down, you don't want to take distributions from your portfolio. Hence, for, let's say, a certain time period, two years, just to say something, you take that as a way of activating the reverse mortgage. You take distributions from that line of credit that work, and then mortgage recover. You pay back something like that.

**Wade Pfau** 13:53

And it's really voluntarily, voluntary about whether you want to pay back, actually, with the kind of simulations I run, generally, I don't find a need to pay back, but you could voluntarily pay down the loan balance if you want, when markets do better. And yeah, that's the idea of the reverse mortgage as a buffer asset. It's a non correlated asset outside of your investments that can temporarily support spending to help protect your investments when they otherwise look to be in trouble. The other

**Alex Murguia** 14:21

before you get into that, before you get into that, though, just because I want people to understand the growing line of credit. How does that work?

**Wade Pfau** 14:27

Yeah, so that's the the secret sauce, and that's, it sounds too good to be true, so it's worth kind of just walking through what it is this program is administered through the government, so they set the rules for how it works. And I think that the obvious intention with reverse mortgages was you would use it because you actually want to spend it. So I open the reverse mortgage, I take out all the borrowing capacity I have, and I use it. And then the reverse mortgage becomes a loan, loan balance. And you can understand why that loan balance. Will grow with interest over time. Well, the interesting aspect that financial planners started to figure out going back now, over 10 years ago, was with the way the program works. You can open the reverse mortgage, and you do have to maintain a minimal loan balance, say, 50 to \$100 but the rest can be line of credit, and the line of credit grows at the same rate that the loan balance would grow. So that's the idea of the growing line of credit. I open it, and what I'm getting access to a principal limit, which is the borrowing capacity of the loan. And that principal limit equals loan balance plus Line of Credit Plus potentially set asides, but we'll set aside the set asides. That's my usual joke. So basically, loan balance plus line of credit, and that's now a pie. Whatever the percentage is between loan balance and line of credit, that pie is all growing at the same rate. All those the

pieces are growing at the same rate. Thanks. I'll be here all week tip your servers. But beyond that, though, I can then move money around. I could either borrow from the line of credit, and then that goes into the loan balance, changing the composition of the pie, and then it all subsequently grows at the same variable rate, I should say, or I can make the voluntary repayments on the loan balance, replenishing the line of credit, and then I have a new shape for the pie. But then all those pieces are again growing at the same variable rate. The line of credit only applies to variable rate hecms, which is more than 99% of hecms. But I should just note there is a fixed rate HECM also that doesn't

**Alex Murguia 16:39**

have a growing line of credit. But what's important that you're saying is this reverse mortgage, the way you're using it now, it's not for monthly income.

**Wade Pfau 16:47**

Well, it could be. There's different options,

**Alex Murguia 16:48**

but I just want them to realize, oh, wow, we can

**Wade Pfau 16:51**

use it for this too. Yeah. So we were talking more about this coordinated strategy where you use it as a buffer asset, you draw in an ad hoc manner, at times, to help protect your investments. You have spending needs, rather than selling from your investments at an inopportune time, such as after a big market downturn, you instead draw from the line of credit to meet expenses and but since it's proceeds from a loan, it's not adjusted gross income. It doesn't go on your tax form, it does not increase your adjusted gross income. And so then, with the whole tax planning conversation, there can be all these additional supplementary benefits. About it doesn't make more of your Social Security taxable. You're not triggering surcharges from Medicare. It's just it's not part of your adjusted gross income, so it's a non taxed spending resource to help meet your spending needs.

**Alex Murguia 17:39**

And you said the definition of a buffer asset. Can you just repeat that? Because I think it bears mentioning. Because sometimes people think a buffer asset is just, oh, I have an investment account I'm drawing assets from, and that investment account is a million dollars, and I'm withdrawing 35,000 but you know what? I've got so much money in there that if I need an emergency fund or whatever, I can just draw from that. And that's my buffer the investment amount above and beyond distribution. You know that people give their own taxonomy to buffer assets?

**Wade Pfau 18:08**

Yeah. So Buffer assets, there's something not part of the portfolio that can be that temporary spending resource. So I also it's different from a bucketing or time segmentation strategy. It's a more of a risk management overlay. And there's really only three buffer assets. There's cash. You could think of cash as a buffer asset if you really think it's outside the portfolio, or the growing line of credit on a reverse mortgage or some types of permanent life insurance borrowing from the cash value. There's a pretty parallel conversation about how you have this asset, assuming the cash value can't decrease, such as like whole life insurance, that can be

that temporary spending resource as well, through policy loans, through borrowing from the reverse mortgage line of credit,

**Alex Murguia** 18:54

those are your options. And now I was going to ask you this later, but because we've mentioned the head companies, why is that buffer different from a HELOC? Time to ask you this question, yeah,

**Wade Pfau** 19:07

so the traditional home equity line of credit, you can borrow based on the value of your home and so forth. But there's some key differences. One is just the HELOC does not have a growing line of credit. It has a fixed amount for a fixed period of time. But then the other big one, like, if you're thinking to use this as a buffer asset, it means you want to draw from it when markets are going down. And repeatedly we've seen when markets are going down, he lost, get frozen or canceled or and then repayment may be required at the worst possible time. So it's not really an alternative solution, and that's that Texas team, Texas Tech team of researchers, well, their financial values. Harold Levinsky is a famous financial advisor. He had HELOCs for his clients, and then going into the 2008 financial crisis, all his clients he locks were canceled or frozen. So it didn't work. Like the way it was intended. And then that's when he started learning about reverse mortgages, providing an alternative where you have guarantees. And again, that's why you're paying for mortgage insurance, but you have guarantees that you can access that line of credit when you need it, and therefore it works much better as a buffer asset. And then we saw that happening again, like within the pandemic, lines of credits were being frozen and canceled. It's just they you tend to not be able to use a HELOC at the exact time you want to use it when you're thinking of using it as this retirement income tool. Now we can you have

**Alex Murguia** 20:35

both open does that? Can you do that? No, no, you

**Wade Pfau** 20:39

can't really have other liens on the home with the reverse mortgage, so you would not be able to have a HELOC at the same time as a Peckham.

**Briana Corbin** 20:48

Are you getting close to or are you in retirement? Well, investing during retirement is a little bit different than during your working years. Your investments are there to help you pay for retirement, and now is when they need to earn their keep to make sure you're on the right track. Download retirement researchers, eight tips to becoming a retirement income investor by heading over to retirement. Researcher.com/eight tips again, get your copy of retirement researchers, eight tips to becoming a retirement income investor by going to retirement. Researcher.com/eight dot com, slash eight tips. That's the number eight tips.

**Alex Murguia** 21:28

Okay, now, how could, how could reverse mortgages be used for reliable income streams? We talked about it as a buffer asset. We talked about it as a go to, like, emergency kind of thing. How could it be used as a buffer asset, I mean, as a reliable income stream source? Well, yes, so

**Wade Pfau 21:44**

there's, right, there's different drawdown options. You could just take out a big lump sum. You could use it in an ad hoc manner through the line of credit, just taking distributions when you want them, or you have two other options, and that's getting into reliable income. You could use it for 10 year payments or for term payments. And the term payment is a fixed monthly payment for a fixed duration of time. The 10 year payment is a fixed monthly payment we have, we could say, for the rest of your life, but we have to put an asterisk on it. It's for as long as you remain eligible for the loan, which means you continue to live in the home and maintain homeowner obligations. But even if you've already borrowed more than the available line of credit, the principal limit of the loan, it's like an annuity in the sense that it has those mortality credits that you continue to receive those 10 year payments. And if you live a long time and stay in the home for a long time, you could get a lot more out of the loan than its borrowing capacity. And so you could think of it as an alternative to having an annuity in retirement. You get a fixed monthly payment, and we have a calculator on our retirement researcher website where you can just run the numbers and see, based on the characteristics you put in, what that 10 year payment could be, or what a term payment could be based on the value of your home and other characteristics that you enter.

**Alex Murguia 23:03**

Okay, yeah. And how does this program work? Well, you said it, but you said it earlier, but before, okay, I'm taking income payments. What happens if you live an extraordinary long life? How can that turn the reliable income stream and how can you, how can you benefit

**Wade Pfau 23:23**

if with a 10 year payment option, if you end up living in the home for another 30 years, you're probably getting a lot more monthly payments than the loan was worth, and at some point, you're continuing to get those monthly payments even though the the loan balance is way above the value of The Home, and because it's a non recourse loan, that's all a nice windfall that's not impacting legacy. It's like an annuity, where if if you had an annuity with a living benefit, and you spent down the account value of the annuity, you continue to receive those monthly payments for the rest of your life, and it's not impacting legacy negatively at all, because there's no asset that you're drawing from, it would be the same if you're getting 10 year payments and the loan balance has exceeded the value of your home because you've been in, lived there for so long that money is all just free money to you in terms of not negatively impacting your legacy.

**Alex Murguia 24:18**

You get paid out until you die, pretty

**Wade Pfau 24:20**

much, yeah, yeah, as long as you've maintained basic homeowner obligations,

**Alex Murguia 24:25**

and what are those that people know

**Wade Pfau 24:27**

it's you pay your property taxes, you maintain homeowners insurance and basic home upkeep. You can't let the property go completely grass,

**Alex Murguia** 24:36

cut your grass, boys and grass, your grass,

**Wade Pfau** 24:39

that sort of thing.

**Alex Murguia** 24:40

Okay, now, how does a program work? What are the calisthenics behind it?

**Wade Pfau** 24:47

Well, there's rules around it. You have as a borrower, we mentioned, you have to be 62 or older. You can have a younger spouse, and they have the tables going all the way down to age 18. So that's something. Wow. Right? But does

**Alex Murguia** 25:01

Frank Sinatra, did he get a point in his career?

**Wade Pfau** 25:05

Yeah, something like that. But yeah, are they setting this up for Brad Pitt, right? Or I thought that was Leo DiCaprio that?

**Alex Murguia** 25:12

Yeah. I meant Leo DiCaprio. You're right. You're right. I meant Leo DiCaprio, right. I stand corrected, good sir.

**Wade Pfau** 25:19

But yes, the borrower has to be 62 or older. You have to have equity in the home, but you could use the loan to rebalance or refinance a traditional mortgage or to pay off any other liens on the home. You have to there's a financial assessment to make sure you can maintain those homeowner obligations, such as property tax, homeowners insurance and so forth. But now there's the the financial assessment. You can have that life expectancy set aside, where you just carve out a portion of the line of credit to pay the future homeowner obligations so that you can actually fund that through the loan. But, but that's important. You have to have the financial resources that you're not expected to foreclose at any point, you can't have any other federal debt, and you do have to go through a certification. You have to get a certificate that you went through a session with a counselor, an FHA approved counselor, that people find annoying, but just to make sure you understand what you're getting into with the reverse mortgage, when you talk to a lender about the reverse mortgage, they can't steer you to anyone in particular, but they can give you a list of options, and you need to choose one of those options and have a counseling session, again, with an FHA approved counselor. And you do have to pay for that yourself. It can't be financed through the loan, and usually it's quoted at \$125 but that's something that might vary a little bit based on circumstances.

**Alex Murguia** 26:47

Wade, you may have said this. I missed it. If you did, I'm sorry, if you have an existing mortgage, can you get

**Wade Pfau 26:53**

a reverse mortgage? Well, you could have that existing mortgage when the process starts, but it has to be fully refinanced through the reverse mortgage. So that is a common use of reverse mortgages. I don't want that fixed mortgage payment in my early retirement years, so I instead refinance it into the reverse mortgage, and then I could voluntarily make that mortgage. Well, it's just then I don't have that fixed mortgage payment anymore. It gets pushed off to later in retirement,

**Alex Murguia 27:20**

and that goes into that's going to determine, though, the size of the heck I'm, I would imagine that.

**Wade Pfau 27:24**

Well, the remaining, yeah, yeah, the limit is the borrowing capacity. If I have a \$300,000 borrowing capacity and I have a remaining mortgage balance of 250,000 Well, I'm 250,000 goes to refinance that mortgage, and the other 50,000 would still remain as a line of credit

**Alex Murguia 27:44**

to reduce voluntarily, it will reduce the amount available.

**Wade Pfau 27:50**

Well, then the net amount available, not

**Alex Murguia 27:52**

that, yeah, yeah. That's what I

**Wade Pfau 27:53**

mean, yeah, yeah, yes. That's the idea you could voluntarily make payments to move money back into the line of credit, and that's where, if markets are doing well, maybe you continue to make like what your mortgage payments would have been, but then you have the option that if markets go down, you're not allowed to skip a traditional mortgage payment. They just say, Hey, I'm not going to pay this month because I want to preserve and protect my portfolio.

**Alex Murguia 28:16**

So you did that. If it was a net low number, you would almost do it, not so much as a buffer asset. You'd almost do it, because you may be under on that sooner than later, if you just take payments, and you can take payments for a much longer time, and it could, I mean, could you stack the cards, you know, on your side for reliable from a reliable income perspective, if you do a net, a net reverse mortgage with little left.

**Wade Pfau 28:44**

Well, you take the mortgage payment out of your budget, which helps with the sequence risk, and then, yeah, with the remainder, you could, like, also add a 10 year payment. You're creating a lot of relief for your portfolio that, just with the mathematics of spending from investments in retirement, gives your portfolio a good a better shot at growing over time. And then that's the whole the research points to it not 100% of the time, but you know, around two thirds of the time, and especially when markets are not doing well, the gains to the portfolio are more than the costs of the reverse mortgage, and you're giving yourself

**Alex Murguia 29:19**

a good chance to getting more than \$50,000 over the chance of the reverse mortgage just in distributions,

**Wade Pfau 29:25**

yeah, and then you later, you pay off the reverse mortgage balance due, and there's still net more money left over for errors after that.

**Alex Murguia 29:34**

Okay, what's the cost of this? The same way that, you know, folks think like a refinance doesn't cost me anything. It's always embedded in the in the itemization of the whole package. What's the typical cost of a reverse mortgage?

**Wade Pfau 29:50**

Yeah, so there's upfront setup costs, and then there's ongoing costs, and the upfront costs, this is where, prior to 2017 I mentioned that was the last. Big rule change reverse mortgages is becoming a really hot topic, because you could potentially set up a reverse mortgage for just the counselor fee, \$125 that went away when the government changed some of the rules, including they created a 2% upfront mortgage insurance premium, so you have to pay 2% of the home value as a mortgage insurance premium. And then there's cost, a cost to the lender that can be it depends on the home value, maximum of \$6,000 and then other just closing costs associated with mortgages. So if you have a more highly valued home, you could be looking at more than \$20,000 to set up a reverse mortgage that can be financed. Does that

**Alex Murguia 30:42**

come out of pocket, or does that come on in the package internally?

**Wade Pfau 30:46**

Well, you can either pay it out of pocket or finance it through the loan. Either way is fine, and then it just if it's financed through the loan, then it's going to grow with interest over time, and then the ongoing cost, there's a lender's margin that there's an interest rate, a variable interest rate based on short term treasuries, plus a lender's margin that you agree to, that could be anywhere from like one and a half to 3% or possibly more. And then plus a half a percent for ongoing mortgage insurance premiums, and then that's the rate that the loan balance grows. That's also the rate that the line of credit growth.

**Alex Murguia 31:21**

Okay, so in summary, here just a quick as we mentioned at the beginning, but I want to make sure everyone kind of sees it, because it's a program. It's a very viable program. As everyone can see, who is this? Could everyone? Could anyone benefit from it? Sure, but let's try to narrow that down. Who is this ideal for, and who is this not really ideal for

**Wade Pfau 31:42**

so in terms of ideal, well, you do need to own an eligible home to even have it as a consideration. So you own an eligible home, go figure. Yeah. And also to be ideal, this works best. Well, let's put it this way, like you know how Odysseus tied himself to the masked mask to avoid the siren song, like if, if you're someone the griser and Nolan movie coming.

**Alex Murguia 32:09**

Did you see, like a preview of it recently, and you thought, You know what I bring in, I'm going to bring in Iliad, or whatever, the Greek mythology sort of thing. Did you get inspired by that? Where'd you come

**Wade Pfau 32:21**

up with this? Out of a no, this is the classic thing, like, if having access to a new line of credit with a couple \$100,000 is too much of a temptation and you're just going to waste it on frivolous things, then you're not a good candidate for the reverse mortgage. It's better for people who are building responsible plans, who are not going to be tempted to overspend because they have this but are really looking to get the most efficiency out of their entire asset base for retirement. So you own an eligible home. Oh, and I should also say, and you're planning to stay in that home now, you might move at some point, but if you're planning to move in the next couple of years, it's probably worthwhile to just wait until you move into a home that you anticipate staying in to help make it worth paying those upfront costs for setting up the loan.

**Alex Murguia 33:08**

But is it an option of last resort? That's how it's framed at in the negative sense,

**Wade Pfau 33:14**

that's the worst way to use it, and the logic there is, I'll consider this in my back pocket if things go terribly wrong in retirement and I run out of other options, then I could open the reverse mortgage and start to use it. That's generally the worst possible way to use it, compared to opening it up sooner and letting the line of credit grow. Because with the way the math works about line of credit growth, the odds are really in your favor that you're going to have more credit available in the future by opening it sooner rather than later. And there's some cases where it might have paid off to wait

**Alex Murguia 33:53**

on that you could say the line of credit will grow, because we'll grow more than the degree that your house will appreciate if you were to do it later. Hence, you can get even a similar

**Wade Pfau 34:03**

your home will probably appreciate over time, but yeah, your home did appreciate depreciate, then you'd be better off opening it sooner, but no over time, you could expect more credit because the home is worth more. And then when you're older, you get a higher percentage for your principal limit factor. But usually that ends up still being less than if you opened it sooner and benefited from the line of credit growth. But then in the rare case where it would have been worth waiting, and this happened around the time of the pandemic, housing prices were shooting up and interest rates were getting so low that people could get more credit by opening now versus having opened in the past, but then you simply refinance your reverse mortgage, and then you get that higher borrowing capacity.

**Alex Murguia 34:46**

So about refinancing,

**Wade Pfau 34:50**

you're right, yeah, by opening it sooner, odds are you'll have more borrowing capacity over time, and in the rare case where you don't, you simply refinance. So now, so.

**Alex Murguia 35:00**

Think when I said the last resort, you answered it in the sense of, sooner is always better than later, but is it still an option as a last resort? If someone cannot, you know, pay their bills, they really have maybe an investment account that's just \$50,000 and they're sitting on a \$2 million home, can they just be resigned to the fact that, listen, I want to live here. I recognize that I may not, I'm not going to be able to pay this back. And, yeah, it won't be a legacy asset for my kids, but at least I won't be a liability to my kids asking them for money and the monthly distribution I can take from this, you know, with Social Security, will suffice for me to be able to live into my retirement. Yeah, but could that be, you know, is, is that wrong? Well, right,

**Wade Pfau 35:46**

in the extreme last resort cases, it might just be a situation of kicking the can down the road, and then, then the negative media coverage would be, this person opened the reverse mortgage as a last resort. Then eventually they ran out of funds, they were not able to maintain homeowner obligations, and then they were foreclosed upon, not

**Alex Murguia 36:06**

thinking that they're gonna take the line of credit all at once. They're just taking it in monthly distributions forever

**Wade Pfau 36:12**

and ever. Yeah, yeah. But then it eventually, oh, like turning on a 10 year payment, yeah? Well, yeah, you could do that. I don't know. Yeah, that's what,

**Alex Murguia 36:21**

sorry, that's where I'm going

**Wade Pfau 36:22**

with it. I think in most last resort cases, people aren't thinking ahead about the the wisdom of using a 10 year payment.

**Alex Murguia 36:29**

Oh, that's what I was, that's where I was going with it. Yeah, you

**Wade Pfau 36:33**

could do that. And as long as that, it's not going to grow for inflation over time. So you got to think about that.

**Alex Murguia 36:38**

Yeah, nothing. And at least it's, you know, yeah, yeah.

**Wade Pfau 36:43**

It's a well, it's a way to continue to live in the home and enjoy and maybe, ultimately, if you have a plan that's really unsustainable, this might have given you another five years of enjoyment in retirement before the inevitable happens and you really run out of options. But you might have

run out of options sooner without the reverse mortgage. It's just there's going to be negative media coverage about how the reverse mortgage caused you to be kicked out of your home, when the reality is it actually

**Alex Murguia 37:09**

you only get kicked out of your home, though, if you can't maintain the home or,

**Wade Pfau 37:13**

well, if you can no longer pay property taxes or the tax Okay,

**Alex Murguia 37:16**

taxes, but my thinking is okay if you're a certain age and if you're in a certain area, property taxes kind of plateau, you know they're not going to increase, increase, increase,

**Wade Pfau 37:27**

yeah, like we talked about last week, hopefully, if you're living in an area where they freeze increases at like age 65 plus, your property taxes can be manageable. Now, homeowners insurance is another issue, and that's we've seen rising prices in certain parts of the country. Yeah, that's, that's the issue. It's, it may help you have an enjoyable retirement for longer, but if

**Alex Murguia 37:52**

you're saying the expenses will eventually catch up to you, though, those expenses being the taxes, the Home Repair and the and what am I missing? The taxes, the Home Repair and the home insurance, yeah.

**Wade Pfau 38:05**

And then the location is catch

**Alex Murguia 38:07**

up with you, if you're just relying on the reliable income, the 10 year payment, the 10 year plus payment, because, you know you can get it

**Wade Pfau 38:15**

might work with the 10 year payment. I don't just, I don't know if there's ever been a last resort case where they use the 10 year payment.

**Alex Murguia 38:21**

I'm trying to think, trying to break this. I'm trying to break this thing. Wade, it's my job. All right. Now this is all in chapter nine, the second half of Chapter Nine of the third edition of the retirement planning guidebook. But know that Wade wrote a whole book on this as well. Wade, you may want to talk about it because, I mean, we're just skimming the surface here, to some extent, right?

**Wade Pfau 38:45**

If this is a topic that really fascinates you, you might want to go in deeper. And my book fascinates is a strong

**Alex Murguia 38:50**

word, Wade, but I'll let you, let you get

**Wade Pfau 38:52**

away with it at the end of the my books, if you're watched on YouTube, reverse mortgages, how to secure your retirement with a reverse mortgage, is a book length treatment of the chapter nine of the retirement planning guidebook is a summary of my reverse mortgages book. So if you want to go in deep, you could also have a look at the reverse mortgages book. But if you just want to the summary overview of things, Chapter Nine of the retirement planning guidebook provides that for you.

**Alex Murguia 39:20**

Alrighty, everyone that chapter nine is in the books, as they say, literally and both figuratively for the retirement planning guidebook. Wade, you want to send us off? Yeah, yeah,

**Wade Pfau 39:34**

we could do that. And yeah, the next chapter, chapter 10, is the tax planning, which we've covered a lot in podcast episodes. We're gonna have to figure out how deep to go this time. But stay tuned, because next in our series going through the retirement planning guidebook, Third Edition is tax planning chapter 10. So stay tuned, and thanks for joining us at retire with style.

**Briana Corbin 39:56**

Bye. Everyone. Wait an hour. Are both principles of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, 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.