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BOOK REVIEW

Reverse Mortgages

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Reverse Mortgages: How to Use Reverse Mortgages to Secure Your Retirement, 2nd Edition, by Wade Pfau

Reviewed by Dirk Cotton

Editor's Note: Reverse Mortgages*, 2nd Edition is Wade Pfau's recent update of the original title.*

An amazing amount of misinformation has circulated on reverse mortgages: late-night TV ads misrepresent them on important topics. That may not be surprising, but some loan originators oversell reverse mortgages, and even usually reliable sources inadvertently get them wrong. A book on this topic faces many challenges. Reverse mortgages are very complicated and frequently misunderstood.

Baily and Harris (2018) said that "under the annuity payout structure, a retired couple will receive a payment as long as they live, but the issuer of the mortgage will then own the house when they die or move." Neither of these claims is correct. The loan provider will not necessarily end up owning your home if you die or move. You simply will have a loan with a lien that is due and you will own any equity remaining in the home. The tenure ("annuity") payments provide income as long as you (or your spouse) live in the home, not as long as you live.

An update to the previous edition became necessary when on "August 29, 2017, the Department of Housing and Urban Development (HUD) announced new rules effective on October 2, 2017 that reduce some of the momentum and value from reverse-mortgage line of credit uses." In other words, the costs of home equity conversion mortgages (HECMs) increased while some previous benefits were lost.

(Full disclosure, I borrowed a HECM before the 2017 HUD rule changes, though I wouldn't have with today's costs.) Interestingly, Pfau predicted these rule changes in the original edition of the book and predicts more in this edition.

Yet another challenge is the accessibility of complex information. This is probably as interesting a book on HECM reverse mortgages as can be written, but alas, it remains a book on HECM reverse mortgages.

To deal with these challenges effectively, retirees need an authoritative source they can trust to offer accurate subject knowledge and the writing skills to render the information accessible to at least a financially astute audience. Pfau's second edition meets the first requirement completely and meets the second as well as can reasonably be expected.

Reverse Mortgages begins with a readable overview of retirement income planning that includes the author's eight-point "Retirement-Researcher Manifesto." Most of this information can be gleaned from the author's retirementresearcher.com website, but the book organizes it well. The first chapter considers retirement finance topics well beyond reverse mortgages. This section alone might be worth the price of the book.

In the second chapter, Pfau provides a readable and informative overview of the challenges of housing. It covers broad housing issues such as downsizing and aging in place.

Chapter 3 addresses the background of reverse mortgages and ways they might play into the overall retirement-planning process.

Then, Chapter 4 explains in detail how reverse mortgages work, including how to qualify for the program, how much a household can borrow, how mortgage insurance works, how much upfront and closing costs are, and the HECM's growing line of credit. These changed significantly in 2017. It is at this point, however, that I fear many eyes will begin to glaze over.

The HECM for Purchase program (H4P for short) is introduced in Chapter 5. This is an interesting option that does not seem widely known. H4P combines obtaining a traditional mortgage and then obtaining a HECM to pay off the first mortgage into a single step. This may provide a solution for retirees who would have difficulty qualifying for the traditional mortgage first.

The next chapter suggests various strategies for using a reverse mortgage in retirement planning, introducing the important new issue of how to best use a retiree's home equity. Some of these suggested applications are debated elsewhere, and a potential borrower would do well to consider those alternative opinions, as is true for any strategy or product. Pfau suggests using a HECM to enable delaying Social Security benefits, for example, but I've read other arguments opposing this strategy.

More importantly, Chapters 4 and 5 raise the awareness that a HECM borrower must qualify for a loan, understand the product, and also decide the best way to use home equity—an important retirement resource. The book discusses how to determine if a reverse mortgage is right for the reader. I particularly appreciate the question regarding whether your incentive to borrow is your best use of home equity among competing opportunities.

Chapter 9 addresses the risks of reverse mortgages, including program complexity, reverse-mortgage loan servicing, irresponsible use, qualifying for means-tested benefits such as Supplementary Security Income (SSI) or Medicaid, and natural disasters.

Noticeably absent is the most basic risk of a reverse mortgage—losing the home. Many borrowers may plan to "lose the home" by selling it eventually to repay the loan, but borrowers also are exposed to the risk of needing or wanting to leave the home and triggering a loan call after much of the equity is spent.

In *Reverse Mortgages*, Pfau argues that HECM borrowers in these scenarios may well have been better off having the loan because they may have lost the home, regardless, or that the risk of triggering a loan call actually was reduced by the additional HECM income. This is probably true, perhaps even in most cases. Nevertheless, the borrower should be aware that HECM reverse mortgages come with these risks, however unlikely, and I would have preferred to see them in the list of reverse-mortgage risks, near the book's end.

The author repeats a widely circulated story of an Oregon woman who lost her reverse-mortgaged home to eminent domain in 2012. This is undoubtedly a low-probability outcome, but it is easy to imagine more common scenarios in which a HECM repayment might be triggered with extremely adverse effects—a bankruptcy or divorce, for example.

I don't know how that Oregon woman's situation was resolved, but I wonder if she understood when she applied for the reverse mortgage that this was even a possibility.

I also would like to have read more about which strategies are appropriate for various wealth levels. Some of those strategies suggested might make sense only for a well-funded household, for example. I make this same criticism of retirement research in general.

For perspective, I also recommend reading at least the introduction and conclusions of Warshaswsky and Zohrabyan (2016). Pfau mentions the paper in *Reverse Mortgages*, noting that the paper's authors believe that from 12 percent to 14 percent of all retired households are eligible for, and might sensibly use, HECMs.

The remainder of Warshawsky and Zohrabyan's conclusion isn't included in the book, but is also informative: "If coverage by long-term care insurance or a low bequest motivation are added to the use criteria, then the percent of retired households who can reasonably be expected to get a HECM falls further, to 4.6 percent or even as low as 1.3 percent."

Still, if your household falls within that sweet spot, a reverse mortgage can be a beneficial component of your retirement plan, and Pfau's book is the place to start.

Perhaps the best way for an advisor to use this book is as a trustworthy source of information on HECMs amid a vast amount of misinformation surrounding these loans. It also would be prudent to recommend the book to any client considering a HECM, although I suspect most clients are more likely to read the terms and conditions agreement for an iPhone game app. Many clients will likely trust the planner to understand these details and protect them.

Another useful strategy for planners would be to take Pfau's advice on finding the best use of home equity in retirement plans. Clients may have earmarked home equity for a reserve fund, as a long-term care alternative, or as a bequest. The challenge, then, is to determine if there is a better use, and *Reverse Mortgages* addresses when HECMs may be right for a household.

After reading Pfau's latest edition of *Reverse Mortgages*, my overall recommendation is that no retiree should obtain a reverse mortgage, and few planners should recommend one, without reading this book.

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