

Financial security in sickness and in health



Using home equity as a more flexible, lower-cost
alternative to long-term care (LTC) insurance



Rethink. Remortgage. Retire.

Executive Summary

Every day, 10,000 people turn 65 in the United States¹. As these Baby Boomers begin planning for retirement, many find that today's increasing life expectancy is a double-edged sword. Retirees can look forward to a long retirement, but they must also plan for the possibility of declining health and the associated cost of care — and unfortunately, those costs are soaring. Faced with average lifetime long-term care (LTC) expenses that now total \$138,000 per retiree, many Boomers are considering LTC insurance that will offer protection in the event of a debilitating health event. Another, seldom-explored alternative to LTC insurance is the federally-backed Home Equity Conversion Mortgage (HECM), a home-equity line of credit that can be used by qualified homeowners to fund LTC insurance or to pay for in-home LTC in lieu of an insurance policy.

This paper makes a case for the importance of formulating a LTC strategy and explains how the HECM program should be factored into LTC planning. Included are examples illustrating how homeowners can leverage their home equity to gain peace of mind that all of their healthcare needs will be met in retirement.

The sudden need for long-term care (LTC) can be financially and emotionally devastating for many aging seniors. The most difficult time to plan for a debilitating life event is once an individual has already experienced a loss of health, independence and income. Yet, despite the fact that most Americans will require LTC in their lifetimes², only one-third believe that they will one day need it³.

LTC describes a wide range of medical care and activity assistance services for senior adults whose ability to perform self-care has been impaired by a chronic illness, injury or the aging process. Common reasons people require LTC include injury, cancer and the onset of Alzheimer's. LTC is not intended to cure an individual, but rather assist in nonmedical care as that person continues to age.

LTC services can include assistance with daily living activities such as bathing, dressing and housework, as well as more advanced care, such as medication management and dressing wounds. These types of services can be provided in many settings and are most commonly administered in individuals' households (in-home), assisted living facilities and nursing homes. It is important to note that neither traditional health insurance nor Medicaid will help cover the costs of LTC.

As the lifespan of the average Americans increases, so does the amount he or she will need to spend on LTC. On average, Americans who turned 65 in 2015 will incur lifetime LTC expenses totaling \$138,000. According to the Center for Disease Control and Prevention (CDC), the number of individuals over age 85 – the "oldest old" – will nearly triple by the year 2050, accounting for 17.9 million people, or 4.5% of the U.S. population⁴. This age demographic experiences the highest rates of disability and greatest LTC requirements.

Despite these facts, many individuals underestimate both the likelihood that they will need LTC as well as the price tag of LTC services. Alarming, only 55% of Boomers report that they have any

retirement savings, and of that number, only 13% report having accumulated more than \$100,000 to fund their retirement⁵.

In light of these challenges, how can retirement-age homeowners feel secure in their ability to afford care if they experience a debilitating health event?

Paying for LTC

The most obvious choice for funding essential care that is not covered by health insurance or Medicare is LTC insurance, which can be purchased as its own policy or as a combination life insurance-LTC policy.

In order to purchase a stand-alone LTC policy, insurance companies first require applicants to undergo a health assessment. An individual's overall health determine if that person is eligible for LTC, and if she is, it will determine the cost of the policy premiums. If an LTC policyholder develops a condition that requires LTC, that person's insurance policy will reimburse the cost of the individual's care up to the daily and lifetime benefit caps outlined in her policy.

Purchasers of LTC insurance policies should be aware that while these plans can carry costly premiums, hefty annual premium costs can be mitigated by purchasing an LTC insurance plan early and while applicants are in good health. The American Association for Long-Term Care Insurance (AALTCI) advises individuals to purchase LTC insurance policies in their mid-50s. Waiting longer to purchase LTC insurance puts individuals at greater risk of developing a condition that could substantially increase annual premiums or disqualify individuals from plan eligibility.

Additionally, purchasers of LTC insurance policies should be prepared to afford large, periodic hikes in annual premiums. LTC insurance is "guaranteed renewable" – meaning that an LTC insurance policy cannot be altered or cancelled as long as the policyholder continues to make premium payments. Although an LTC insurance provider may never

change a policyholder's premiums due to circumstances specific to that individual, providers can, and almost certainly will, increase premiums across broad groups of policies for actuarially-justified reasons. For instance, premiums for the Federal Long-Term Care Insurance Program (FLTCIP) experienced a 25% average increase in 2009 followed by an 83% average increase in 2016.⁶

As an alternative to a standard, stand-alone LTC insurance policy, many people opt for a combination life and LTC policy. Combination life and LTC insurance policies can be used to cover LTC expenses. With combination policies, an individual will typically pay either a lump-sum premium up front or large annual premiums over a term of fewer than ten years. As with stand-alone LTC insurance policies, if policyholders develop a condition that limits their ability to perform activities of daily living, they may begin to receive LTC benefits capped at predefined amounts. However, unlike standard LTC policies, unused LTC benefits can be transferred to a beneficiary in the form of a death benefit upon the passing of the policyholder.

Another, seldom-explored alternative to LTC insurance is the federally-backed Home Equity Conversion Mortgage (HECM). A HECM is a home-equity line of credit that can be used by qualified homeowners to fund LTC insurance or to pay for in-home LTC in lieu of an insurance policy.

What Is a HECM?

Social security is the main source of retirement income for most American seniors because it is a benefit that is "built in" to a lifetime of income earnings. Similarly, home equity is a benefit that is "built in" to a lifetime of homeownership. Yet interestingly, many of us do not think of our home equity as a source of income. For households with a median age of more than 62 years, almost 40% of total wealth is represented by home equity. For almost 50% of homeowners, home equity is twice that of all of their other assets combined⁷.

Considering these facts, many Americans can find the wealth required to fund LTC in their home equity.

A Home Equity Conversion Mortgage (HECM) is a type of loan that homeowners over age 62 can use to draw income from their home's equity. With a HECM, homeowners can choose among several ways to make draws from their home equity: receiving a single lump-sum payment; receiving regular, fixed cash payments; or taking out a line of credit. The line of credit is the most flexible option and can be an excellent vehicle for funding LTC.

In order to qualify for a HECM, borrowers must be 62 years of age or older, must have either paid off their home or have a low mortgage balance, must use their home as a primary residence and must continue to pay property taxes, homeowner's insurance (HOI) and other fees, such as homeowner association (HOA) dues.

As long as the borrowers continue living in their home, performing critical home maintenance and paying their property taxes, HOI and required fees, they will enjoy flexibility with future mortgage payments, including the option to skip or stop making principal and interest payments altogether, until they move out or pass away.

When the Borrower Dies

After a HECM borrower dies, a non-borrowing spouse may continue to live in the home as long as that spouse meets eligibility requirements, ensures that property taxes, homeowner's insurance and applicable fees are paid and maintains the home to minimum standards. In the event that both spouses are listed as borrowers on the HECM, the surviving spouse may remain in the home and continue to receive HECM benefits so long as the previously mentioned requirements are upheld.

When all of the borrowers have died or no longer live in the home, the heirs can pay off or refinance the mortgage balance to keep the home, or

alternatively sell the home themselves to settle the remaining loan balance. Any remaining equity is the heirs' to keep.

HECMs are non-recourse loans, and therefore only the value of the home itself stands as collateral for the debt. If for any reason there is not enough value left in the home to settle the entire loan balance, the heirs or estate are not held responsible for the difference. The lender would instead look to the FHA mortgage insurance to cover the difference.

Estate heirs may purchase the home for the remaining HECM balance after the death of the borrower. Even if the deceased has borrowed more than the home's value, estate heirs will never have to pay more than 95% of the home's value to recover the home.

How a HECM Pays for In-Home LTC

In 2000, Congress passed the American Homeownership and Economic Opportunity Act (H.R. 5640) to promote the use of HECMs to fund LTC and LTC insurance⁸. Depending on a homeowner's circumstances and future plans, a HECM could be the best choice for funding future LTC.

One way that homeowners can fund LTC with a HECM is by taking out a HECM line of credit to fund LTC insurance premium payments. Homeowners can schedule recurring monthly or annual draws from their HECM in the amount of their LTC insurance annual premiums to ensure timely and continuous payments.

Alternatively, homeowners may use a HECM to directly fund LTC costs if and when they occur. With a HECM, homeowners can take out a line of

credit and leave the available funds untouched for years or decades – until they are needed. Borrowers who leave HECM funds untapped for lengthy periods of time will benefit from a continuously increasing line of credit.

Using a HECM to fund LTC is especially sensible for homeowners who want to age in place. Taking out a HECM enables borrowers to remain in control of their most treasured asset and age in the comfort and familiarity of their own home (with qualifying spouses) until they pass away. Moreover, borrowers are not limited in how they may use their HECM draws, giving them a great amount of freedom in funding their best retirement.

For instance, borrowing homeowners may allocate HECM funds to help them age in place, including: home modifications, such as installing a walk-in bathtub, widening doorways or building an addition for a family caretaker; purchasing mobility enhancing implements, like an accessible vehicle or motorized scooter; and for LTC, such as home health aides, occupational therapists, family caregivers and respite care.

Because a HECM requires borrowers to occupy their home as a primary residence, using a HECM to fund LTC is an excellent option for those who want to age in place, opting for in-home care as opposed to moving into a nursing home. For homeowners who would prefer to receive LTC in a professional, live-in facility, a better option may be to sell their home and liquidate its value. It should be noted that homeowners may not continue to hold a HECM if they move into a nursing facility permanently or are away from their primary residence for longer than 12 months.

¹ "Baby boomers retire." Pew Research Center. December 2010.

² "Long-term services and supports for older Americans." U.S. Department of Health & Human Services. July 2015.

³ "Long-term care planning misconceptions are holding back advisors and consumers" by Jamie Hopkins. Forbes. April 2018.

⁴ "Long-term care services in the United States." Centers for Disease Control. December 2013.

⁵ "Are we in a Baby Boomer retirement crisis?" by Barbara Friedberg. Investopedia. June 2017.

⁶ "Another big long-term care insurance premium hike" by Howard Gleckman. Forbes. August 2016.

⁷ "Aging in the 21st century." University of Michigan Institute for Social Research. January 2017.

⁸ "Using a reverse mortgage" by Stephen Lamoreaux. National Care Planning Council. 2017.

Example

Chris and Anna Williams, both age 63, are a recently retired married couple. Between personal savings, pension annuity and social security, the couple has saved enough money to fund their living expenses and modest spending during their retirement. Chris and Anna love living together in their home and do not want to relocate as they age. However, their retirement plan does not contain the funds necessary to pay for the high cost of in-home LTC.

The Williams' turn to a financial planner to help them evaluate their options for funding LTC should they ever need it. Their current home, which they own outright, is valued at \$440,000 and conservatively expected to appreciate at a 2% annual rate. The Williams' have decided that if one of them falls ill, they will receive in-home care rather than moving into a nursing home. Selling their home is not an option that the Williams' are willing to consider.

Statistics bear out that individuals are most likely to develop the need for LTC in their early eighties, so the financial planner bases his models on the assumption that Chris and Anna will need LTC starting in about 20 years, at age 83.

Option 1: Purchase a LTC Insurance Policy Out of Pocket

The Williams do not currently have any health conditions that indicate they are more likely to require LTC than the average senior. However, they also are mindful that the likelihood of requiring LTC increases significantly with age. The Williams compare available insurance products and determine that their potential LTC needs would be best met by a life insurance policy with a \$300,000 death benefit that can be converted to a LTC benefit. The Williams contact several insurance carriers for a quote, and the best price they receive is \$8,038 a year, or \$160,760 over the course of 20 years.

- **Total Cost:** \$160,760 out of pocket
- **Total Benefit after 20 years:** \$300,000

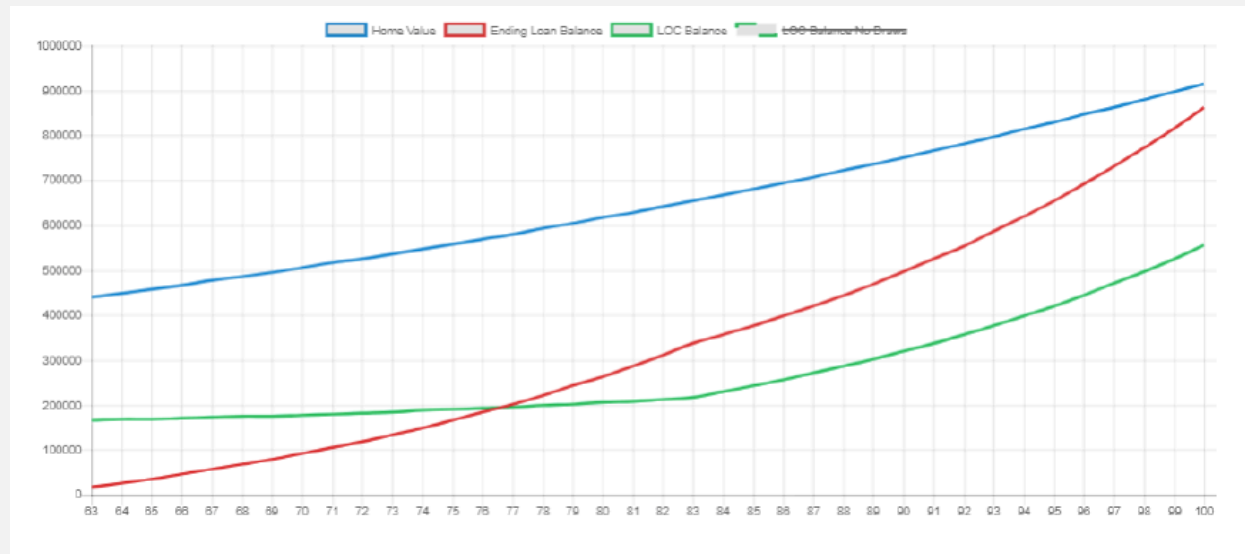
At this price point, the Williams cannot afford to purchase an insurance policy to cover projected LTC expenses. Therefore, their financial advisor suggests tapping into their home equity.

Option 2: Use HECM Funds to Purchase a LTC Policy

The Williams' financial planner models a scenario in which the couple takes out a HECM line of credit at their current age (63) and uses it to fund their LTC insurance policy's annual premium of \$8,038. The couple's financial planner models a situation in which Chris and Anna continue making yearly draws — and paying their LTC insurance policy — for 20 years. At age 83, Chris and Anna will discontinue making draws from their HECM line of credit, stop paying into their insurance policy and begin receiving their insurance policy benefits for in-home LTC expenses that they incur.

The financial planner finds that the total cost to the Williams after 20 years is \$337,000, which represents 20 years of draws plus compounded interest on the loan. Because the Williams' home has continued to appreciate, they can still use the HECM to tap into additional home equity if they need it.

- **Total Cost:** \$337,000 in HECM funds
- **Total Benefit after 20 years:** \$300,000 + remaining untapped HECM line of credit



The Williams like that this option doesn't require them to pay out of pocket for LTC expenses, but \$337,000 seems like a lot to pay for an insurance policy with a maximum \$300,00 benefit. So, the financial advisor suggests another approach.

Option 3: Set Aside a HECM Line of Credit to Pay for LTC in Lieu of an Insurance Policy

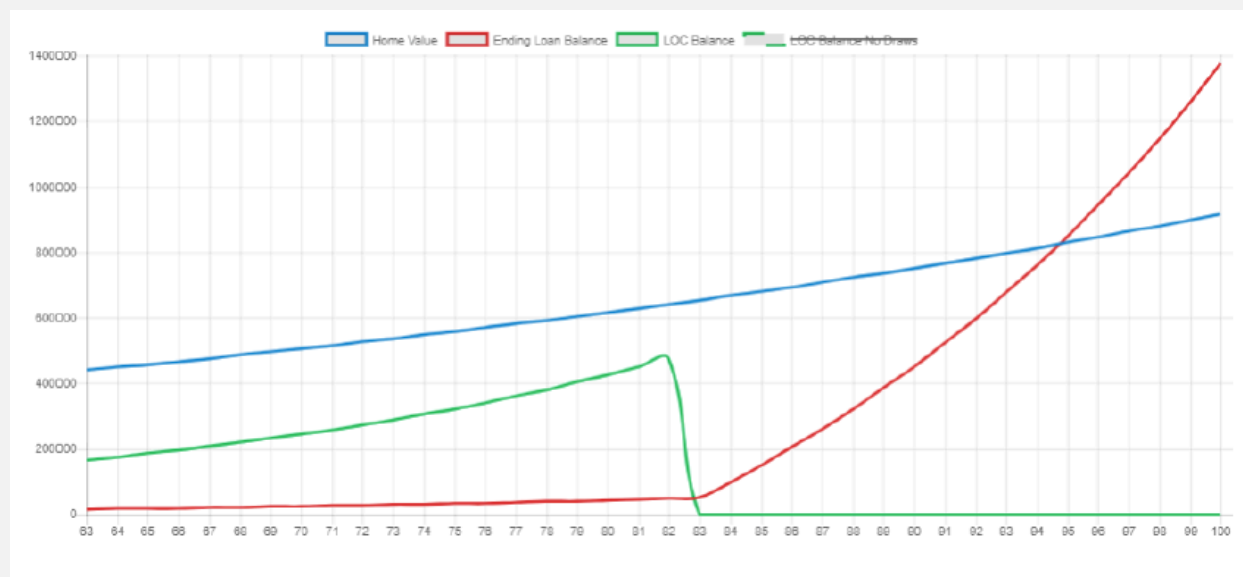
The financial planner models another option for the Williams. In this scenario, instead of buying an LTC policy, the Williams will take out a HECM to generate a line of credit from which they can draw funds in the event that they require costly LTC later in life. As in the previous scenario, Chris and Anna take out a HECM now, at age 63. This time, however, Chris and Anna will make no draws for 20 years, which will allow the couple's line of credit to grow until they anticipate needing LTC in their eighties.

If Chris and Anna do not make any draws from their HECM for 20 years, their available line of credit will have grown to more than \$400,000, which can then be converted into cash flow to cover LTC expenses, should they arise.

Since the Williams leave their HECM line of credit untouched for the first 20 years, only the closing costs of the loan are accumulating interest, which keeps the loan balance low. All the while, the line of credit — which appreciates faster than inflation — will continue to grow.

The financial planner finds that the total cost to the Williams after 20 years is \$54,000.

- **Total Cost:** \$54,000 in HECM funds
- **Total Benefit after 20 years:** \$400,000 and growing HECM line of credit



After evaluating Chris and Anna's options, the financial planner recommends that the couple chose option 3, which makes more money available to Chris and Anna to pay for LTC at a lower cost than purchasing LTC insurance. Additionally, if Chris and Anna do not end up requiring LTC, they can spend draws from their line of credit in any way they please.

About ReverseVision

Since 2007, ReverseVision (RV) has been the leading reverse mortgage technology provider, serving 50 of the top reverse mortgage lenders, 100 percent of reverse investors, and more than 10,000 daily users. RV's award-winning technology offers new APIs (Reverse-as-a-Service) that open the total addressable market, creating new technology synergies that allow forward and reverse mortgages to coexist in the lender's core systems, helping break down adoption barriers so that mortgage bankers can serve their borrowers for life. ReverseVision's core platform, ReverseVision Exchange (RVX), is comprehensive and proven to automate the entire reverse lending process from origination through secondary marketing. The company's technology is being successfully leveraged as a springboard that helps lenders get into the reverse space easily and efficiently.

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