A Simple Alternative to Reverse Mortgages Which can Save Money

Asset Rich Cash Poor?

Asset Decumulation is the New Black. Clients with limited investment funds from which to draw an income are typically researching ways to release cash from their assets. We work through an example of a 69 yo male owning both a freehold home and a life policy, reaching average life expectancy of 86, who could be **$22K better off** by selling the life policy rather than taking out a Reverse Mortgage (refer Product Comparison below).

Creating Retirement Funds from Home Equity

Reverse Mortgages allow homeowners to draw down a portion of the equity in their homes, either in lump sums or by regular withdrawals. The older the homeowner, the higher the amount they can draw down since the loan provider anticipates a shorter repayment period compared with a younger homeowner. Full repayment is required when the homeowner/s either move out of their home (often into a retirement village or rest home) or die.

Reverse Mortgages typically incur upfront charges upon first taking out the loan, further charges for any additional drawdowns, and also floating interest rate charges. As the interest is compounding, the loan value can grow quickly over the long term.

The Life Policy Trading Alternative to a Reverse Mortgage

For people needing to exit their bonus-backed whole of life or endowment policy due to a financial event, Policy Exchange's trading platform provides an alternative option. For over 20 years Policy Exchange has purchased qualifying policies outright for a lump sum, of more than the surrender value offered by the life company. As owners of these bundled life policies age, we're seeing increasing numbers exit their policy to help supplement their retirement income, a trend we expect to continue.

Reverse Mortgage or Life Policy Trading: which will be Best?

When considering the effect of each option on 'overall net wealth' it's important to consider a) the cash amount being released under each option, and b) the life cover offered by the whole of life policy.

In the following example we compare the increasing value of the life cover under a policy to the built up value of a Reverse Mortgage, over time. Most importantly, we estimate the future point when the accumulating balance of a Reverse Mortgage exceeds the accumulating life cover of a whole of life policy (refer to 'crossover point' on the table). A policyholder deciding between the two options should consider their overall health, and assess for themselves whether life expectancy beyond the 'crossover point' is likely. If it is, there's a strong argument for cashing in the life policy rather than taking out a reverse mortgage.

Product Comparison: Reverse Mortgage vs. Life Policy Trading

We consider a 69-year-old male who owns both a whole of life policy and a freehold home. If he reaches average life expectancy he could be $22K better off trading his life policy rather than taking out a Reverse Mortgage. The impact over time on his 'overall net wealth' of each option is estimated below:

Life Policy		Reverse Mortgage	
Cash Value	$13,559		
Policy Exchange (PX) Enhancement	$363		
PX Payout	$13,922	Loan Value	$13,922
		same as PX payout)	
Sum Insured	$5,000	Valuation Fee	$550
Attaching Bonuses	$11,911	Loan Setup Fee	$895
Premiums	$0 (paid up)	Interest Rate	7.8%
Age of Life Insured	69	Age of Mortgagee	69

Age of Life Insured	Value of Life Cover (incl. terminal bonus)	Annual Interest	Value of Mortgage	Differential (i.e. Effect on Overall Net Wealth)
69	$25,495	$1,199	$16,566	$8,929
70	$26,061	$1,292	$17,858	$8,203
71	$26,638	$1,393	$19,251	$7,387
72	$27,228	$1,502	$20,753	$6,475
73	$27,830	$1,619	$22,371	$5,458
74	$28,444	$1,745	$24,116	$4,328
75	$29,071	$1,881	$25,997	$3,074
76	$29,711	$2,026	$28,025	$1,686
77 - Crossover Point	$30,365	$2,186	$30,211	$154
78	$31,032	$2,356	$32,568	-$1,536
79	$31,713	$2,540	$35,108	-$3,395
80	$32,408	$2,738	$37,846	-$5,439
81	$33,117	$2,952	$40,798	-$7,682
82	$33,841	$3,182	$43,981	-$10,140
83	$34,580	$3,430	$47,411	-$12,832
84	$35,334	$3,698	$51,109	-$15,775
85	$36,104	$3,987	$55,096	-$18,992
86 - Life Expectancy	$36,889	$4,297	$59,393	-$22,504
87	$37,691	$4,633	$64,026	-$26,335
88	$38,510	$4,994	$69,020	-$30,510
89	$39,345	$5,384	$74,404	-$35,059
90	$40,197	$5,803	$80,207	-$40,010
91	$41,067	$6,256	$86,463	-$45,396
92	$41,955	$6,744	$93,207	-$51,252
93	$42,861	$7,270	$100,478	-$57,616
94	$43,786	$7,837	$108,315	-$64,529
95 -Final Payout	$44,730	$8,449	$116,763	-$72,033

In this example, we've assumed all factors will remain the same over the entire period. If he survives through to the final payout age under the life policy (95 yo), he will be $72,033 better off.

The Importance of Assessing Case by Case

Note: the above example *is a guide only*, and should not be taken as indicative of all reverse mortgage / life policy comparisons. Factors such as the age of the insured and the prevailing interest rate environment will impact the crossover point on a case by case basis.

In all cases, assessing the financials and, just as importantly, the current health status of your client will help determine which option is best for your client.

Learn the cash value of a life policy quickly

For an immediate indication of whether Policy Exchange can make an offer on a life policy, plus the likely enhancement amount, feel free to use the pre-qualifying form on our website:

 www.policyexchange.co.nz/do-you-qualify

There's no charge, and no obligation to continue through to a quote if you don't wish to.

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