HECMs as a Hedge Against Inflation?

The Industry Leader Update by Reverse Focus
February 20th, 2017

After several years of artificially low interest rates the Federal Reserve is beginning to raise interest rates - incrementally albeit. With home values still modestly appreciating across the country and interest rates beginning to rise, is there a window of opportunity for homeowners to hedge against inflation?

The Fed may tighten the money supply as fears of inflation begin to rise. In the wake of the Great Recession, many feared that prices for good would fall. However that fear may be put to rest and replaced with another - inflation. A recent CNBC article states that a .6% jump in the Consumer Price Index (CPI) in January, pushed the annual inflation rate to a five-year high of 2.5 percent.

Rising prices will put more pressure on older homeowners on a fixed income as the cost of goods and services increase. Rising interest rates will increase the cost of borrowing and also reduce the cash benefit that reverse mortgage borrowers can obtain. In this uncertain economic landscape some homeowners could benefit by leveraging a HECM line of credit as a hedge against inflation, states a recent article in the Wall Street Journal. Older homeowners may want to revisit the ‘wait and see’ approach to getting a reverse mortgage, and rather choose to secure the loan at a younger age.

“Now is an exceptionally good time to be considering adding a [reverse-mortgage] credit line to the retirement blueprint,” says Shelley Giordano, chair of the Funding Longevity Task Force at the American College of Financial Services. Interest rates are low, which increases the credit limit on reverse mortgages, she notes, and if rates rise over the life of the loan, that will add to the growth of the credit line. Since interest rates tend to rise alongside inflation, the growing line of credit would provide an inflation hedge, she says.

The deferred use of a HECM line of credit is often referred to as the ‘standby reverse mortgage, a strategy touted by some notable financial academics such as Barry Sacks, Jon Salter, Wade Pfau, and others. Such a strategy should consider both the upside and downside risks and only be employed as part of a long term plan. With the initial interest rate on a HECM determining available proceeds, the unused funds left (the Principal Limit) will continue to grow- up to a point.

“A reverse-mortgage line of credit can be a saving grace for the baby boomers who simply do not have enough retirement savings” if home equity is ignored, Prof. Jamie Hopkins said. “If home equity is incorporated more strategically in the future, we will see vast improvements in the financial security of retirees.”

Recently the principal limit growth factor has come under fire from some consumer groups. Also borrowers should weigh the overall closing costs and accrued interest in establishing a HECM for the purposes of deferred growth of the principal limit or line of credit.

Until then, now may be a window of opportunity for some to take advantage of today’s low interest rates in anticipation of rising inflation.