CHARITABLE GIVING WITH A HECM

Charitable gift giving can be facilitated with a Home Equity Conversion Mortgage (HECM). The unique features of a HECM make it an excellent alternative to gifting a remainder interest in a residence with a gift annuity, or other forms of investment or cash gift annuities, with much less risk to the charity and to the donors.

Gift of a Remainder Interest in a Residence for a Gift Annuity

Many individuals would be willing to transfer title to their residence to a charity provided they can continue living in the home and additionally receive annuity type payments while they stay in their home. They may also obtain a large tax deduction (check with your tax advisor on tax matters) which can maximize their retirement income and they can continue to “age-in-place” and all the comforts that can provide. The donors are exposed to a charity’s default risk, especially if that default results in unpaid property taxes and home insurance. This type of charity credit risk eliminates those elderly donors, who, close to the end of their lives, wish to use the equity in their home to make a charitable contribution and enjoy the personal gratification such a donation can offer. Such property transfers can also put the charity at risk where the charity must advance its own funds for an indeterminate period, forgo the earnings on those funds, and take the risk the property has fallen in value in the interim period before they take unencumbered title.

Gift Annuity of Investment Assets or Cash

Most gift annuities are funded with cash or publicly-traded securities with one or two donors and beneficiaries. However, with dividend returns as low as 2% on the S+P index, and the IRS Discount at 1.8% (as at November 2016) a significant amount of principal is being included in the annuity return, reducing the amount available for the charity and making the charitable deduction smaller for the donor. Additionally, the small returns for both the donor and the charity require significant risk management be exercised, or if possible, the shifting of risk away from the charity in exchange for more control provided to the donor.

The use of a Federally-insured Home Equity Conversion Mortgage (or “HECM”) can greatly expand the market for individuals with the requisite net worth wishing to donate their primary residence and for charities willing to structure deals to facilitate this transaction.

The proceeds of a HECM are generally tax free and may be used for any purpose. The HECM also permits the deferral of any mortgage interest accrued on the loan until actual repayment.

HECM is a solution that can eliminate the risks to the charity, provide better security and control to the donor, and virtually eliminate any loss of principal to the charity or borrower.

The following table shows how HECMs compare very favorable in areas of charity and donor risk, tax deductibility and disbursement flexibility with traditional Gift Annuities and Gift of a Remainder Interest for a Gift Annuity.

	Risks	Gift of a Remainder Interest or Gift Annuity	Home Equity Conversion Mortgage
Charity Risk	*Rate Risk*	Charity may pay too generous rates	None - No payout
	Mortality Risk	Charity gift annuity cohorts may live longer than expected	None - Transferred to HECM Program
	Investment Risk	Market may not provide sufficient returns to fund obligations	None - No gift annuity obligation
	Asset Depreciation Risk	Asset may fall in value before sold	Same risk, but not a short-term volatile risk
	Overall Management Risk	Significant	Small administration when home is sold
Donor Risk	*Irrevocable*	Cannot be undone if resources required	Can be Revocable or Irrevocable [1]
	Inflation Risk (Gift Annuity)	Payout is fixed	No fixed payment received and home collateral value increases can be left to Charity or additional remainder interest
	Efficient Charitable Tax Deduction	Large donations can mismatch tax deductibility with 50% and 30% limitations and 5-year carryforward	Disbursements to charity can be controlled and made in concert with known income. Tax deduction can be claimed (subject to limitations) on actual cash payments made
	Lose home to foreclosure if property taxes and insurance unpaid	Risk transferred to Charity. Should only be a large charity with substantial resources. Smaller charities can default and loss of income can lead to non-payment of property charges	Unless Donors have at least $100,000 of annual income or in place of income, have savings or other liquid assets that spread over the remaining life of youngest borrower provide cash flow of $100,000 per year, we recommend a voluntary Life Expectancy Set-Aside (LESA) of all future property charges set-aside out of the HECM proceeds to minimize the risk of default [2]
	Misunderstand or not fully aware of the HECM/CGA program's obligations	No independent counseling on Gift Annuities or their possible impacts on future financial condition of donors	Every borrower on a HECM must go through an independent counseling with one of HUD's approved counsellors before we can start to process a loan [3]

[1] The trust must be valid and enforceable, and the lender must receive a complete copy of the agreement with all amendments. The trust may be revocable or irrevocable; however, irrevocable trusts come with additional considerations that must be reviewed, such as ensuring the borrower has unrestrained access to HECM proceeds, the proceeds are distributed in accordance with trust requirements, and the trust allows for the borrower's debts to be repaid. Contingent beneficiaries who receive benefits of the trust only after the primary beneficiary is deceased do not have to be qualified HECM borrowers.

[2] Because HECMs are primarily to permit home owners to cash out their home equity over time (or refinance a traditional forward mortgage and eliminate the monthly payment) and use this resource to fund retirement, the required income level is modest and generally less than a traditional mortgage. However, as originators (and not required by the HECM program) we prefer that charitable donors can demonstrate $100,000 of annual sustainable income, preferably after payment of other financial obligations, or savings or other investments or unused HECM proceeds that spread over the remaining life of the youngest borrower, would provide an annual cash flow of 100,000.

[3] HECMs are insured by the Federal Housing Administration (FHA), a government department, and the program is intended for people 62 years and older. The FHA requires applicants to complete a counseling session with an independent third-party counselor. Reverse mortgages are one of the few financial products that require independent counseling.

CONTACT ME

If you would like to discuss the HECM product and how it could help you, please call or email me, or visit www.jmcapitalreverse.com for more information.

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