Requirements to Make the Housing Asset a Viable Retirement Asset

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Comments on Andrews

The Andrews paper examines the potential for increasing the loan-to-value (LTV) ratios of reverse mortgages in order to make them more attractive as an income supplement for retirees. As the paper argues, the goal of increasing the amounts that older homeowners can borrow largely hinges on the ability to get the costs down. Andrews argues that a combination of government insurance for the longevity and real estate risks and the right investor, which he identifies as pension funds, will allow for LTV ratios closer to 100 percent. Several assumptions in this paper require further examination in light of more recent data about the experiences of reverse mortgage programs. My comments will focus mostly on the U.S. Home Equity Conversion Mortgage (HECM) insurance program, which is the largest and with which I am most familiar.

The first issue that needs to be examined is the goal of receiving closer to 100 percent of the home value, rather than the 40 percent that Andrews says is characteristic of the HECM program. To begin with, the LTV for the HECM program tend to be higher—more like 60 percent for someone in their 60s and increasing according to the age of the borrower. Getting anywhere close to 100 percent is, however, not an achievable goal with an entirely collateral loan. In other words, unlike a regular forward mortgage, which is secured primarily by the borrower's income and ability to repay the loan and secondarily by the collateral of the home, reverse mortgages require no repayment until the home is sold or the homeowner dies or leaves the home permanently. This feature allows older homeowners who are "house-rich, but cash-poor" to receive loans without the underwriting that accompanies regular forward mortgages—but it also means that the initial LTV ratio cannot approach 100 percent even under optimal circumstances. The total loan may eventually approach or exceed 100 percent, but the initial loan limit must allow for the accrual of compounding interest and ongoing fees. Andrews may want to estimate the degree to which the LTV can be improved under optimal pricing rather than establishing the unachievable benchmark of 100 percent.

A second issue is that reverse mortgage borrowers in the United States have not used the loans as a direct income supplement, though many have used them to retire regular mortgages and other consumer debt in order to free up discretionary income.[i] Many older homeowners look to home equity, not to supplement income, but to deal with large unanticipated costs, such as for major health or long-term care costs or to make major home repairs.

Third, regarding the match between the reverse mortgage characteristics and the institutional needs of investors, it may well be the case that pension funds have the kind of patient capital that works well for investing in reverse mortgages. That said, it is not clear why that match up would allow for substantially lower costs to consumers. Pension funds like other investors will look for competitive returns that match their appetites for risk and their needs for cash flow over time. Andrews may also want to reexamine the match between insurers and reverse mortgages. Over the past couple of years, two major long-term care insurers—Genworth and MetLife—have purchased reverse mortgage lending companies with the goal of offering a full range of products related to financial security in retirement years.

Finally, getting the costs of reverse mortgages down will require product innovation and more competitive markets that drive efficiencies and more competitive pricing. In the short run, the way to get costs down may not be to increase the LTV but to decrease it. Many borrowers would like to borrow substantially less than the maximum for which they qualify. Nonetheless they must pay the full mortgage insurance premium, even though their lower loan amounts represent much less risk. The next market innovations may involve a reverse mortgage lite product with low LTV ratios but also with much lower costs.

[i] Redfoot, D., K. Scholen, and S. Brown, *Reverse Mortgages: Niche Product or Mainstream Solution?,* AARP Public Policy Institute, 2007 – can be found at www.aarp.org/reversemortgage.