Home Equity and At-Need Annuities – A Dynamic Long-Term-Care Funding Duo

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Comments on Cooperstein

Home equity clearly is a major source of private funding for long-term care needs, primarily through selling the home when disabilities in late life require moving to a care facility and using the equity to pay for the services. The Cooperstein paper explores the potential of using home equity to purchase at-need annuities to address these long-term care needs. From an actuarial perspective (though I am not an actuary), an at-need product has several characteristics that may make it an attractive option under certain circumstances:

- As in the viatical products cited at the outset of the paper, an at-need approach moves from underwriting based on the age-based risks of the general population to individual underwriting based on the risks associated with the diagnosed condition that now requires long-term care funding.

- Once individuals have a diagnosed need, their life expectancies become shorter and more predictable, enabling higher benefits from an annuity.

- Once individuals have a diagnosed need, their lifetime costs of care—though often substantial—also become more predictable.

These features should allow for constructing an at-need annuity that maximizes the amounts that consumers can draw on to address their long-term care needs. Essentially, consumers are accepting the investment risk associated with accumulating enough assets through their home equity and then are purchasing protection against longevity risk and exhausting their resources through the annuity. Such a product would be most useful to consumers who are prepared to sell their homes to pay for the annuity and who have predictable constant needs that they want to manage themselves with specific monthly payments—as in the example that Cooperstein uses of his mother's experience. For consumers who relocate to a nursing home or assisted living and have fairly predictable monthly costs, this approach might be useful.

These same features could be applied to two other financial products—long-term care insurance and reverse mortgages—that may address other types of needs. With respect to long-term care insurance, one could imagine an at-need, lump sum purchase of long-term care coverage. Such a product may appeal to those who want to purchase the management of their long-term care needs as they progress, especially when the monthly costs may fluctuate or increase over time in ways that the consumer cannot easily predict and may not want to manage. Such a product could be funded through the sale of the home for those relocating for care or through a reverse mortgage—though the double transaction costs of the latter make it an expensive way to fund services.

The third way that could potentially benefit from the features noted above would be a specialized reverse mortgage product. Since a reverse mortgage must incorporate longevity risk calculations, one could imagine an at-need reverse mortgage product with individual underwriting based on the individual's truncated life expectancy. Such a product would have the advantage of allowing the person to remain in her home and receive services, which is the preferred option for most older people with disabilities. Through individual underwriting, the

loan amounts that the individual could access would be increased and/or the mortgage insurance premium to protect against longevity and market risk could be reduced or eliminated.

Finally, the same at-need features that could be included in private sector annuity, long-term care insurance, and reverse mortgage products could be incorporated into public policies that promote the use of home equity to meet long-term needs. For example, the Federal Housing Administration (FHA) insures over 90 percent of the reverse mortgages made. The upfront premium (2 percent of the home's value up to the maximum value of $625,000) could be reduced or forgiven for older homeowners who meet certain disability or diagnostic criteria based on their lower risk of longevity. Individual underwriting might allow for incorporating higher loan amounts.

More radically, the Medicaid program could be modified to incorporate some of these principles. As Cooperstein notes, Medicaid long-term care beneficiaries accept a lien on their properties in exchange for the benefits they receive—though he exaggerates state government willingness and ability to actually collect the debts owed. In essence, one could look at the Medicaid lien and estate recovery program as a poorly run public reverse mortgage program. The terms are great—no origination fees, no mortgage insurance premiums, no interest payments, and state governments are not very good at even collecting the debt. But the eligibility criteria and use restrictions of the Medicaid reverse mortgage are draconian—consumers can get only the types and amounts of services allowed by state Medicaid programs, and then only after they impoverish themselves. It's time for some creative thinking about how Medicaid or some other public program might offer incentives that expand eligibility and give consumers more control over how their home equity is spent in exchange for modest fees for older homeowners.

In short, as Cooperstein notes, home equity is the primary asset for most older people, especially for those whose modest levels of incomes and financial assets may put them at risk of requiring Medicaid assistance in the event of a long-term care need. Since most older people do not have long-term care insurance, using the "at-need" features discussed in this paper should stimulate more thinking about private sector insurance or financial products and public sector programs and how they could best serve older homeowners with disabilities.