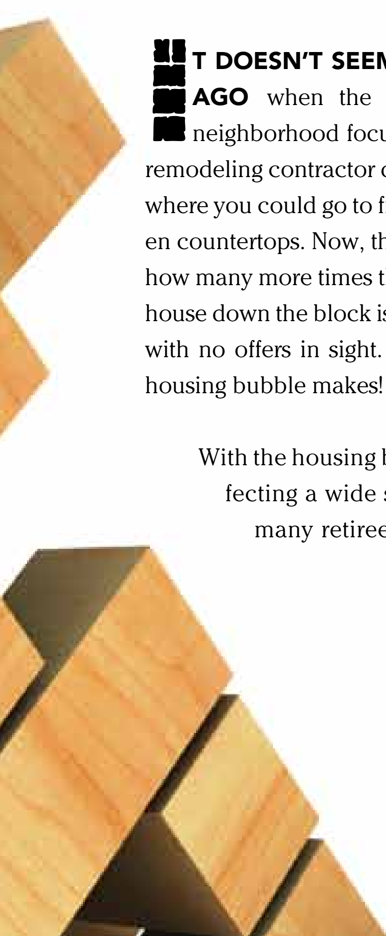
The Actuary

April/May 2011 – Volume 8 Issue 2

HOUSING WEALTH AND RETIREMENT

BY STEVE SIEGEL

WHAT ARE THE MOST SIGNIFICANT HOUSING ISSUES affecting retirees? Is paying off a mortgage still important? These questions and more are what recently led a roundtable panel to address housing in retirement issues.



IT DOESN'T SEEM ALL THAT LONG AGO when the conversation in my neighborhood focused on whose home remodeling contractor did the best work and where you could go to find the latest in kitchen countertops. Now, the talk on the street is how many more times the sales price on that house down the block is going to be reduced with no offers in sight. What a difference a housing bubble makes!

With the housing bubble negatively affecting a wide swath of Americans, many retirees have certainly felt its impact. Sensing the importance of housing to current or near-term retirees, the Society of Actuaries Committee on Post-Retirement Needs and Risks completed a call for papers on housing in retirement. The resulting papers appear in a monograph that provides varied perspectives on housing and retirement issues of concern to financial professionals, policymakers and homeowners, among others. The papers in the monograph explore issues including the role of housing wealth in financing retirement and recent trends in the use of housing wealth. The monograph can be found on the SOA website at: *http://www.soa.org/housingwealth*.

The Committee's focus on housing is motivated by the fact that non-financial assets, primarily housing, are about 70 percent of the assets of middle-income Americans age 55 to 64, excluding the value of Social Security and defined benefit plan pensions, and furthermore that housing is typically the largest overall item of expense for retirees.

To supplement the papers and further explore this topic, several of the paper authors and discussants were invited to participate in a round table discussion held by conference call. The roundtable discussion was intended to result in a lively exchange of ideas and thoughts on these issues. And, I'm happy to report, we were not disappointed!

ROUNDTABLE PARTICIPANTS

The round table included the following participants:

Steve Cooperstein, FSA—an independent actuary focused on creating new products and services for the financial services industry.

Chuck Epstein—an independent financial writer.

Tom Herzog, ASA, MAAA—chief actuary of the Federal Housing Administration at the time of the roundtable and currently with the National Association of Insurance Commissioners.

Anna Rappaport, FSA, EA, MAAA—chair of the Committee on Post-Retirement Needs and Risks and an actuary. She served as moderator of the discussion.

Don Redfoot—a senior policy advisor with the AARP's Public Policy Institute.

Joe Tomlinson, FSA, MAAA—an actuary and financial planner.

Sheila Zedlewski—director of the Income and Benefits Policy Center at the Urban Institute.

Zenaida Samaniego, FSA, MAAA—chief actuary of the U.S. Department of Labor, participated in an online discussion that preceded the conference call.

THE DISCUSSION BEGINS

The following is a synopsis of the questions that were posed in the roundtable and the resulting discussion.

Q: What are the most important housing issues affecting retirees?

A: Overall, panelists suggested the heterogeneity of retirees drives many of the housing issues that are faced, and the importance of a particular issue to an individual retiree will vary based on this differentiation. In other words, a retiree at an early stage of retirement will have a different set of issues to deal with than someone who has been retired for a significant amount of time. This heterogeneity also surfaces whether a retiree wants to stay put or move housing locations, and on the level of financial resources. Rappaport noted that the location of housing has a direct impact on quality of life as it dictates access to activities, families, support systems and transportation among other considerations. Following up on this, Redfoot suggested that for those who want to stay put, much of their quality of life may be dependent on housing choices that were made decades ago.

Besides the importance of the connection between housing and location, Tomlinson noted that, going forward, an issue becoming more relevant is the need to tap into home equity for income. As retirees spend more years in retirement, the use of home equity will most likely become more prevalent. Epstein noted that there is an opportunity to develop new products that will help to meet these needs for guaranteed lifetime income. In developing such products, industry professionals will have to contend with a behavioral factor that Cooperstein noted—people love to have control of their money and are hesitant to give it up.

Q: Is paying off a mortgage still an important financial strategy for retirees?

A: Reiterating the theme of heterogeneity, panelists felt that one size does not fit for all retirees in terms of paying off a mortgage. Zedlewski noted that according to the Health and Retirement Survey (HRS), fewer than half own their homes without a mortgage above age 55. She was concerned about advice suggesting not to retire until a home is owned outright, when having a mortgage and financing that cost in retirement was a legitimate part of a retirement plan. Cooperstein also felt that a mortgage payment could be a realistic part of a retiree's budget. Other participants agreed that it depends on individual situations, but in an ideal world, a mortgage would be paid off. Capping off the discussion, Herzog noted the desirability of paying off a mortgage before retirement which alleviates the potential risk of being subject to fraud from unscrupulous lend-

CONTINUED ON PAGE 22

Recent Developments in Reverse Mortgages

BY DON REDFOOT

IN 2007, NEARLY 80 PERCENT OF PEOPLE age 65 and older owned their homes—almost two-thirds (64.5 percent) of whom had no mortgage debt. Collectively, older homeowners have been estimated to have approximately $4 trillion in home equity, which for most homeowners substantially exceeds their financial assets.

Reverse mortgages have received considerable attention in recent years as a way to tap this home equity to meet various financial needs in retirement. A reverse mortgage is a loan secured by the home owner that requires no repayment until the last borrower moves permanently, sells the home, or dies. Such loans are generally non-recourse loans where neither the borrower nor their heirs will owe more than the home is worth.

Loans insured by the Federal Housing Administration's (FHA) Home Equity Conversion Mortgage (HECM) program constitute over 90 percent of all reverse mortgages that have been made. Since the program began insuring loans in 1989, over 660,000 loans have been made—roughly 500,000 of which are still in force. Since, until recently, Fannie Mae purchased the vast majority of loans and held them in its portfolio, it set interest rate margins and established the terms of the loans—all of which were adjustable rate loans that were iterations of a line of credit.

Because of the collapse of mortgage markets in the past two years, a number of changes have radically affected the reverse mortgage market:

- The small number of non-HECM loans geared to the jumbo market have disappeared.
- Fannie Mae's share of HECM purchases has precipitously declined until they announced recently that they would no longer purchase such loans.
- In the absence of Fannie Mae funding, Ginnie Mae mortgage-backed securities have become the sole means of funding HECM loans.
- In marked contrast to Fannie Mae loans, over 70 percent of Ginnie Mae HECM loans have been fixed-rate loans where the borrower must take out the full principal limit at closing.
- FHA has increased the ongoing mortgage insurance premiums by 150 percent and reduced loan limits by 11- to 15-percent over the past two years.
- The loan limit reduction has been offset to some degree by a reduction in the assumed minimum interest rate from 5.5 percent to 5.0 percent.
- FHA has also announced a new "HECM Saver" loan, which essentially eliminates the hefty upfront mortgage insurance premium of 2 percent of the home value in exchange for loan limits that are 10- to 18-percent lower than standard HECM loans.

HUD is hoping the new Saver loan option will reverse the sharp decline (40 percent) in loan volume over the past year and reduce the risk to the FHA mortgage insurance fund without the need for further reductions in loan limits or an unlikely credit subsidy from Congress. The coming year will be critical in determining if reverse mortgages remain a viable financial tool for older homeowners. A

Don Redfoot is a senior policy advisor with the AARP's Public Policy Institute. He can be contacted at *DRedfoot@aarp.org*.

ers. The decision to pay off a mortgage can be viewed as an investment decision, but it is also linked to the need for steady long-term income. It should also be noted that many of the mortgage products today may require increasing payments in the future, balloon payments, or rollover to new mortgages and these products could be troublesome for retirees.

Q: What options are available for using housing equity in retirement and how effective are they?

A: Panelists discussed some of the traditional options for using home equity via home equity loans and lines of credit without leaving the home. These two options could be used to obtain home equity for a variety of purposes and to help support retirement needs. Although these vehicles were effective in the past, one aftermath of the housing bubble is that they are much more difficult to secure now. As a result, Zedlewski thought that more home owners may be driven to try to obtain reverse mortgages to tap home equity without moving.

Another option for securing home equity is to sell the house outright. Tomlinson mentioned that many of his clients downsize and move to a smaller house to use their home equity. Redfoot also noted that selling the house may be a way of financing assisted living or skilled nursing care with home equity applied in this way. However, planning to sell the house at a time of future need is quite risky in a world when home values go up and down and where it can take a long time to sell a house. And if the house is not well maintained, that will cause the value to go down.

Finally, Zedlewski mentioned that some will go on Medicaid to obtain long-term care services in retirement. Depending on the state, home equity might be recovered by the state after you pass away. In terms of reverse mortgage use, Redfoot said the whole issue of Medicaid and long-term care is very complicated—loan proceeds do not count as income, but they may count against the asset test if they are not spent immediately.

Q: Are reverse mortgages a viable product for the future—why or why not? How can they be improved?

A: Epstein opened the discussion with the opinion that reverse mortgages are viable, in theory, for the future, although more products and competition are needed. Redfoot agreed that better product development and competition would help to bring the cost down from the current situation today and increase viability. Furthermore, he mentioned that having the credit markets return to a normalized state will be important. Overall, he felt that until costs come down on reverse mortgages and there is some product innovation, it will remain a niche market. (See sidebar on pg. 21 for more information.)

Q: What is the impact of fraud and improper loans on retirees?

A: Herzog opened the discussion on fraud by noting that much of this is driven by the public's lack of financial knowledge. In addition, the elderly may be particularly ripe for predatory loans, especially if they have not paid off their mortgage in retirement. Redfoot further noted that retirees are particularly targets of fraudulent activity because they have typically built up substantial home equity, often with a combination of high home values and low income. Because of the low income, they do not qualify for regular loans, but rather are driven to predatory-type loans which can set into motion a downward spiral of equity stripping.

Tomlinson mentioned another aspect of fraud or misunderstanding may be the myriad of product variations for mortgages that are made available. By offering more choice, opportunities for fraud are opened because of the lack of standardization and uniformity. Cooperstein capped off the fraud discussion by further emphasizing the vulnerability of retirees in the face of fraud. With retirees typically unable to replenish assets lost through fraud because of limited earnings potential, the impact of fraud can be particularly devastating.

Q: Based on the recent events, what are the most important implications for policymakers, practitioners and related financial professionals?

A: In closing, Epstein led off with the observation that housing in retirement is indicative of a broader issue that stakeholders should concern themselves with—the future of retirement, in general. Related to this, Redfoot noted an important policy question concerning retirement is whether there would be further shifting of risk to individuals as public programs are cut. In terms of housing, Zedlewski raised the possibility of potentially major tax reform in the near future. The policy questions here include how home ownership would be treated by the tax code as well as retirement savings at different income levels. This led Rappaport to raise a related issue of whether home ownership should continue to be encouraged at the possible expense of other types of savings. She pointed to the need for people to balance how much money they put in their homes versus their retirement funds, and for the need for tools to help people evaluate the trade-off. In this regard, Herzog pointed out the danger of concentrating too much savings into housing—it's possible to lose a great deal as the housing bubble proved. A lesson that, unfortunately, too many retirees and others have learned the hard way.

AN ACTUARIAL PERSPECTIVE ON NEXT STEPS

It is clear from the discussion that there are a number of challenges to making housing decisions in retirement. Given the issues surrounding housing in retirement, how might the actuarial profession become involved and assist in decision making? Possibilities that may tap actuarial talent include:

- New planning tools to help evaluate the pros and cons of saving more or less for retirement and putting more or less savings into a house.
- Innovative products to optimize use of home equity.
- Information to help evaluate the pros and cons of paying off a mortgage early, and on choosing different types of mortgages.
- Educational material to evaluate the appropriate use of reverse mortgages and their impact on long-term financial security in retirement.

FOR FURTHER INFORMATION

The Committee on Post-Retirement Needs and Risks is grateful to the participants for their insightful comments and thought-provoking discussion. Interested readers are encouraged to read the full transcript from the roundtable available at: *http://www.soa.org/housingresearch.*

Steve Siegel, ASA, is a research actuary for the Society of Actuaries. He can be contacted at *ssiegel@soa.org*