Comments on Zedlewski, Cushing-Daniels, and Lewis

Zedlewski, Cushing-Daniels, and Lewis offer a very useful analysis of the degree to which reverse mortgages could supplement income for older homeowners. It is particularly helpful in illustrating how the amount of supplementation is related to such characteristics as the age, ethnicity and income of the homeowners. On average, the oldest homeowners could realize the highest percentage increase in their incomes, whites and Hispanics could increase their incomes more than blacks, and homeowners in the lowest quartile could see the highest percentage increase in their incomes.

The authors note that the higher percentage increase among those with the lowest incomes is due to the fact that small returns from a reverse mortgage can make a bigger increase for lower incomes. The authors note that most older people in the lowest income quartile would not benefit from a reverse mortgage either because they do not own their homes or because the amounts of equity are too small to result in a net positive benefit. This observation is undoubtedly true, but perhaps looking at the half-full side of the equation, home equity likely represents the only significant asset for most of the 53 percent of older households in the lowest income quartile who own their homes. Though the amounts may be relatively small, the large percentage increases possible for homeowners with low incomes make reverse mortgages a potentially important financial tool for a segment of this population.

The paper notes the large increases in the volume of reverse mortgages in recent years, which corresponds to the large increases in home values between 2002 and 2006. The authors note that this run up in home equity can cushion the blow from decreasing home values over the past couple of years. However, the data upon which they are relying is a year old—which already seems a lifetime away in terms of deteriorating market conditions. Declining home values coupled with higher interest rates for reverse mortgages may dampen the demand for reverse mortgages. Indeed, increases in the numbers of federally insured reverse mortgages have seen relatively modest gains in the past two years after many years of double digit growth.

In their concluding section, the authors note the high costs of reverse mortgages and note that older homeowners need to be fully aware of the costs and long-term consequences. This theme deserves more discussion when raising the potential of reverse mortgages to supplement income in retirement. Several trends in the use of reverse mortgages raise concerns about the degree to which they promote or impede long-term financial security. For example, the average age of borrowers has declined by more than three years since 2000—from 76.0 to 72.8 years.[i] More troubling, however, are data on the long-term performance of HECM loans analyzed by the Department of Housing and Urban Development (HUD).[ii] These data indicate that loans to younger borrowers (age 64-66) lasted, on average, less than seven years—even though the life expectancy at that age is more like 18 years. Moreover, the data indicate that the average borrower takes out 58 percent of the creditline limit in the first year. Finally, anecdotal evidence from counselors and others indicates that more reverse mortgage borrowers may be taking out loans to deal with serious debt problems early in retirement.

In combination, these data and impressions raise concerns that growing numbers of reverse mortgage borrowers are exhausting substantial portions of their home equity early in retirement, then terminating their loans when they have, on average, another 12 years or more to live. We have no information about what these younger borrowers do after terminating their loans, presumably by selling and moving. How are they meeting their housing needs? How are they meeting their financial needs or needs to fund long-term care?

Before encouraging more people to take out reverse mortgages to supplement their incomes, we need more effective strategies to help consumers make wise decisions about the long-term consequences for financial security. Borrowing money early in retirement to fund consumption may not be a good long-term strategy to meet financial security needs over the remaining lifetime.

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[i] Department of Housing and Urban Development online data at http://www.hud.gov/offices/hsg/comp/rpts/hecm/hecm0409.xls.

[ii] Szymanoski E., J. Enriquez, and T. DiVenti, "Home Equity Conversion Mortgage Terminations: Information to Enhance the Developing Secondary Market," *Cityscape: A Journal of Policy Development and Research*, Volume 9, Number 1, 2007.