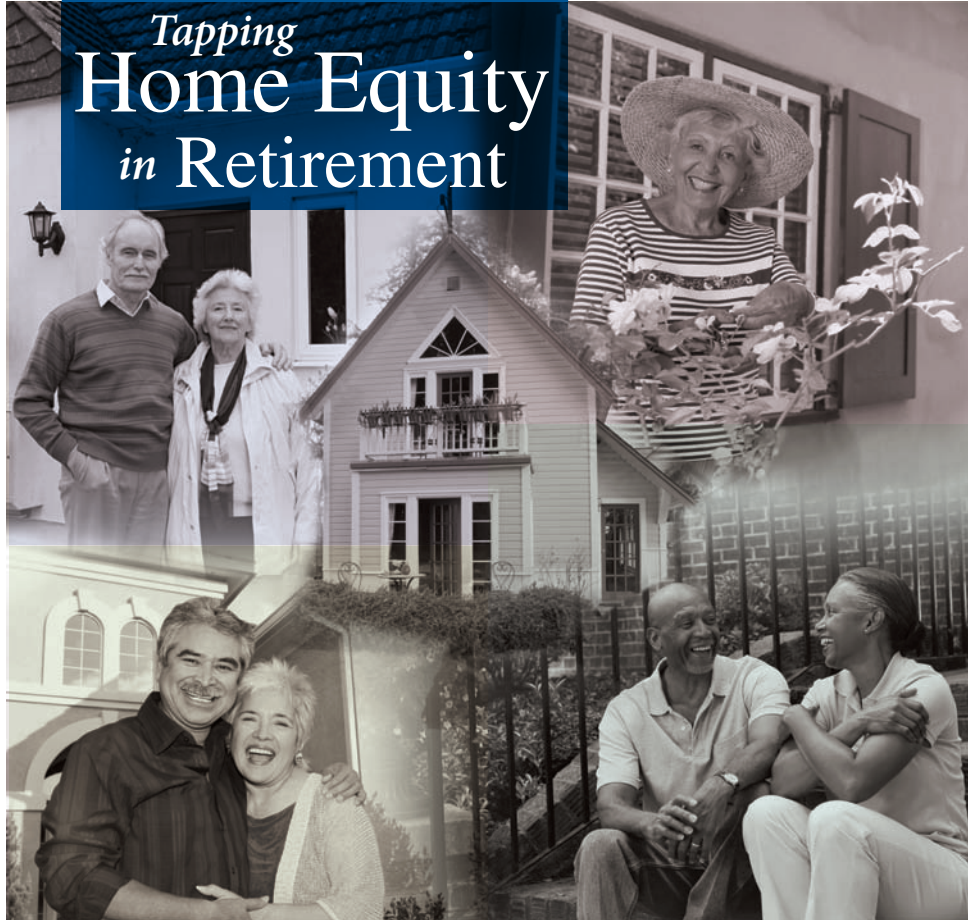


STUDY

Tapping
Home Equity
in Retirement



**The MetLife Study on the Changing Role of Home Equity
and Reverse Mortgages**

JUNE 2009

NCOA
NATIONAL COUNCIL
ON AGING

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Executive Summary

Maintaining financial security as an older adult in America has always been difficult and a challenge. Today's issues of living longer, rising costs, fewer defined benefit pension programs, and diminished investment values have put extraordinary pressure on finding new sources of income and creative ways to stretch out accumulated savings. To supplement their budgets, older homeowners are starting to tap their housing wealth by taking out home-equity loans or reverse mortgages. But with little guidance, they are often unsure about how to use this asset as an integral part of their financial strategy, rather than as a last-resort financial resource. Older adults with lower to moderate incomes face the biggest challenges, since the bulk of their non-pension wealth is usually tied up in their homes.

The purpose of this study is to examine different options for using home equity to respond to these new retirement realities. The



study approaches the issue from a consumer perspective, since older Americans whose incomes are under duress are on the front line of change. The analysis reviews national demographic data to provide a snapshot of how households age 62 and older use this asset to cope with financial shortfalls. It examines recent surveys of the changing attitudes of older adults and Baby Boomers to provide a glimpse into the problems which may lie ahead and the need for new solutions. The study also includes existing economic and housing research that evaluates the capacity of housing wealth to sustain consumption in retirement.

The aim of this effort is to encourage the development of a more robust and holistic approach to managing financial risk in retirement through the use of home equity. It reflects a growing awareness that narrow visions and simple strategies will not be enough to allow Americans to grow old with dignity and security. The diverse data presented here also offers a foundation to begin discussion about new ways to view reverse mortgages as part of a financial strategy to increase income security, enhance financial resilience, and improve debt management.

The research indicates that a small but growing number of older people use housing wealth earlier in retirement to maintain financial independence, rather than saving this asset as a last resort. Some are beginning to tap this asset to ensure that they will have enough income to meet basic expenses. With limited savings, other older homeowners are using a portion of their home equity as a financial buffer to cope with unexpected health and household expenses. For many older adults, these decisions are driven by growing consumer debt.

The findings of this study suggest that home equity will not offer a simple solution to the growing financial problems of aging Americans. The choices that these older homeowners make, and the problems they face, also highlight the difficulty of shifting from a financial planning strategy that aims to preserve housing wealth to one that uses this asset as a retirement resource. As millions of Baby Boomers begin to enter retirement, it appears that many indicate interest in using this asset to maintain their lifestyle throughout retirement, if necessary. The findings suggest that the financial services industry, policymakers, and advocates for older adults cannot ignore home equity in their efforts to promote retirement security.

The diverse needs and expectations of older homeowners indicate that it will be important to strengthen retirement planning strategies beyond simple models of asset accumulation and decumulation. The study identifies four key principles that should guide the development of a more comprehensive approach to ensuring financial security in later life:

- › **Use a holistic, person-centered framework**—Strategies need to shift from product-focused solutions to comprehensive financial plans that include home equity as an integral part of retirement security.
- › **Promote flexibility**—Older homeowners need multiple, affordable products that can meet both their long- and short-term financial goals in retirement.
- › **Address changes over the life course**—Financial, health, family needs, and risks change as people grow older and need to be considered when home equity is included in financial planning.

- › **Offer solutions that strengthen financial security**—A house is more than a financial asset; it is also a home. Older homeowners across the economic spectrum are looking for cost-effective options that give them peace of mind through additional sources of retirement income.

These guiding principles provide a foundation upon which to develop home-equity products and public policy that can better serve aging homeowners. They also highlight the importance of greater mutual understanding and cooperation to accelerate learning and spur the development of affordable solutions and effective public policy to better serve older homeowners. Financial professionals can work with consumer advocates to strengthen financial literacy programs for homeowners of all ages. Organizations that offer reverse mortgage counseling, debt management, and benefits counseling need to work together to make sure that older Americans use home equity wisely. By working together, the financial services industry, U.S. Department of Housing and Urban Development (HUD), and aging organizations may be able to speed up the development and testing of lower-fee reverse mortgages and other financial products that can meet the needs of homeowners with modest housing wealth.

Recent trends show a small but increasing use of home equity among older homeowners when considering the size of the eligible population. However, they serve to remind us that people are not complacent about their growing retirement risks. Americans are proud of their resourcefulness. Growing numbers of older homeowners will benefit from additional support and guidance, since the decisions that homeowners make about this valuable asset will have long-term ramifications for the well-being of older Americans and for our nation.

Introduction

This study examines different options for using home equity to cope with financial shortfalls in later life. The study incorporates a wide array of consumer data to highlight the decisions that today's older adults make about this asset, and the need for new solutions as the oldest Baby Boomers begin to enter retirement. The 2007 *American Housing Survey* and the 2007 *Survey of Consumer Finances* provide a snapshot of the prevalence of home loans among older homeowners. Other consumer surveys cited highlight the changing attitudes of older adults and Baby Boomers toward the house as a source of cash. This data provides a glimpse into the opportunities and issues which may lie ahead and the potential for new solutions to an evolving challenge.



The concerns of homeowners in or nearing retirement put a human face on a complex economic issue. The choices that they make, and the problems they face, also highlight the difficulty of shifting from a financial planning strategy that aims to preserve housing wealth to one that uses this asset as a retirement resource. Most older adults have limited amounts of home equity, and face difficult decisions and trade-offs:

- Should they tap housing wealth early in retirement to sustain income security?
- Should they wait and use this asset as a financial buffer to cope with an increasingly uncertain future?
- How will the need to manage growing amounts of consumer debt influence these decisions?

It is not just older Americans who worry about using home equity wisely. Policymakers are concerned that older adults who tap this asset to pay for everyday expenses will have fewer resources to deal with declining health in later life. Many states already struggle to pay for public programs, such as Medicaid, that assist older adults with low incomes and those who are impoverished by health expenses. Financial shortfalls among middle income older adults that accelerate the need for public assistance could make these fiscal pressures even greater. Some financial professionals are also questioning the value of retirement planning models based on steady asset accumulation and decumulation in our uncertain economic climate.¹ It is unclear whether such traditional financial advice will help older homeowners use

home equity effectively to manage retirement risks. To provide a more comprehensive perspective, the study includes existing economic and housing research that evaluates the capacity of housing wealth to sustain consumption in retirement.

The aim of this study is to encourage the development of a more robust and holistic approach to managing financial risk in retirement through the use of home equity. This effort reflects a growing awareness that narrow visions and simplistic strategies will not be enough to allow Americans to grow

old with dignity and security. An important objective of this study is to use the experiences of older homeowners, along with existing research, to outline specific principles that can guide the design of new solutions. The diverse data presented here also offers a foundation to promote discussion among the financial services industry, government policymakers, and aging organizations. Greater mutual understanding and cooperation can accelerate learning and spur the development of affordable solutions and effective public policy to better serve older Americans.



Home Equity as a Resource

As a starting point for examining home equity as a retirement resource, it is important to consider two questions. After the collapse of the real estate market, how much money is left in the house to pay for retirement expenses? Second, how willing are older homeowners to use this asset as more than a last resort to maintain their well-being?

The need to use the house as a source of cash is influenced by the availability of other financial resources. Some homeowners with lower to middle incomes also find that the choices available to tap this asset are limited because they do not qualify financially for certain home loans. Many wonder whether the equity they have left in their homes can offer any solutions to enhance retirement security.

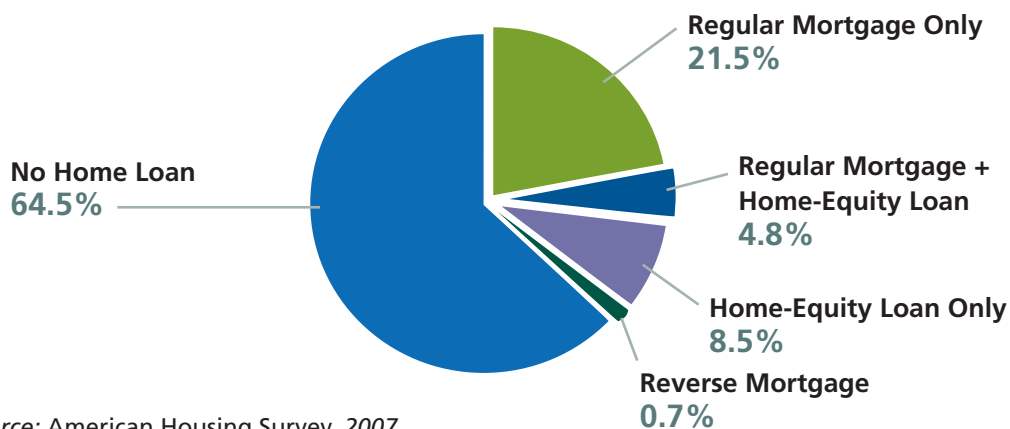
How Much Equity Is Left?

Economists estimate that homeowners in the United States lost a total of \$3.3 trillion in property value in 2008.² The magnitude of these price declines varies across housing markets in different parts of the country. In communities

where houses appreciated dramatically, such as Los Angeles, single-family home values dropped on average by over 31%, from \$594,000 to \$402,000 between 2007 and 2008.³ Price declines were smaller in the South (7.5%) and Midwest (10.6%), where home values have remained at more modest levels. These figures may underestimate true home values, since many properties that are sold today are foreclosures offered at deeply discounted prices.

Real estate declines reduce the overall wealth of all homeowners, especially older ones. The declines are especially problematic for people who have to sell their homes in a declining market. However, homeowners who can weather the storm may see home values rise again in the future. This is an option for many older Americans, who prefer to stay in their homes for as long as possible, and have realized relative gains from their original home purchase price. In 2007, almost 80% of older households owned a home, including almost 78% of those age 75 and older.⁴

Figure 1: Mortgage Status Among Homeowner Households Age 62 and Older



Source: American Housing Survey, 2007.

Among today's older adults, the decision to liquidate home equity is often influenced by deeply held values. As a consequence, some economists and policymakers have questioned whether home equity should be viewed as a retirement asset. Older homeowners tend to see the house as a place to live rather than a source of cash. Many are oriented to leaving the family home as a bequest to their children. In 2007, almost 65% of the 21.7 million homeowner households headed by someone age 62 and older owned their homes free and clear of any mortgage (see *Figure 1*).

Although older adults want to preserve home equity, many are finding it harder to achieve this goal in the face of rising economic challenges. The proportion of households age 65 and older that have a home loan has grown significantly in recent years, from 24% in 1999 to 32% in 2007.⁵ There are two explanations for this trend. One reason is that more homeowners are entering retirement without having paid off their regular mortgage. In 2007, about one in five homeowner households age 62 and older still had a regular mortgage (see *Figure 1*). Due to historically low interest rates at the early part of this decade, many (some older workers and retirees) may have been able to refinance their mortgage and reduce their monthly payments to levels they feel they can handle in retirement.

Some older homeowners are also cashing-out a portion of their housing wealth. Over 13% of homeowner households had a home equity lump sum payment or line of credit in 2007. A significant proportion of these borrowers are making monthly payments on both an existing mortgage as well as a home-equity loan. In addition, about 1% of older households have taken out a reverse mortgage. Although the number of these borrowers is small,

the rapidly growing interest in and knowledge of reverse mortgages is often seen as a signal that older homeowners are becoming more willing to use home equity as a retirement resource. The popularity of these loans may also reflect the fact that, unlike conventional loans, lenders do not consider a borrower's income or credit history to determine eligibility for a reverse mortgage. However, the maximum amount that can be borrowed is limited by the value of the home, the homeowner's age, and an overall limit set by the Federal Housing Administration (FHA).

Diverse Needs

The resources that people can accumulate during their working years have a major impact on their financial well-being as they grow older. Periods of economic boom and recession also affect how people born at different times experience retirement, and the challenges they face. To gain insights into these diverse experiences, and the need to tap home equity, homeowners' households were divided into four groups. These groups reflect differences in annual income and home values, and include:

- › **House-poor and cash-poor**—Low incomes (under \$20,000) and home equity under \$125,000.⁶
- › **House-rich and cash-poor**—Low incomes and homes worth at least \$250,000.⁷
- › **Moderate wealth**—This group included two types of households: a) those with low incomes and homes worth \$125,000 to under \$250,000, and b) those with moderate incomes between \$20,000 and \$40,000 and homes worth less than \$250,000.
- › **House-rich or cash-rich**—This group included two types of households: a) the cash-rich—those with incomes above

Home Equity as a Resource

\$40,000 and homes worth less than \$250,000, and b) the house-rich—those with moderate incomes between \$20,000 and \$40,000 and homes worth at least \$250,000.

- **House-rich and cash-rich**—Households with incomes of at least \$40,000 and homes worth at least \$250,000.

One in five older households is cash-poor (see *Table 1*). They are typically among the oldest homeowners, with a median age of 76. For these older adults, whose lives were likely touched by the Great Depression, the current economic slump is nothing new. Many have learned over many years how to cope with financial shortfalls. Their life experiences may also have limited their ability to get a good start in life, which may account for their lower education levels. With very modest incomes, and an aversion to debt, most of these older adults do

not have a mortgage. Encouraging them to take out a home loan could be risky, since their limited financial literacy often makes them targets for financial fraud and abuse. The HUD HECM (Home Equity Conversion Mortgage) reverse mortgage program was originally designed to help house-rich and cash-poor older adults use their substantial housing wealth to improve their financial well-being.

About 30% of older homeowner households fall into the moderate wealth group. While these older adults are not poor, they may still fall short of economic security due to their modest incomes and housing wealth. As a result, they may be interested in using home equity as a buffer against unexpected health expenses or home repairs. At the higher end of the middle-income group, house-rich or cash-rich older homeowners have a more substantial financial cushion to sustain them in retirement. Most

Table 1: Attributes of Homeowner Households Age 62 and Older, by Wealth Status

| | AFFLUENT | MIDDLE INCOME | | | POOR |
|---------------------------------------|--------------------------|-------------------------|-----------------|--------------------------|--------------------------|
| | House-rich and cash-rich | House-rich or cash-rich | Moderate wealth | House-rich and cash-poor | House-poor and cash-poor |
| Median Household Values | | | | | |
| Age of householder | 69 | 70 | 73 | 76 | 76 |
| Home value | \$409,000 | \$175,000 | \$125,000 | \$350,000 | \$65,000 |
| Household income | \$81,900 | \$49,800 | \$25,324 | \$12,468 | \$12,000 |
| Other Household Demographics | | | | | |
| Married | 75.9% | 64.9% | 48.0% | 27.3% | 22.7% |
| Has a college education | 55.2% | 34.1% | 15.6% | 20.7% | 8.3% |
| Householder worked last week | 32.6% | 24.8% | 12.5% | 5.7% | 5.5% |
| No mortgage | 48.1% | 59.7% | 71.6% | 70.8% | 79.3% |
| Total | | | | | |
| Homeowner households age 62+ | 4,353,625 | 6,449,825 | 6,562,602 | 1,037,121 | 3,348,454 |
| % of total households (21.75 million) | 20.0% | 29.7% | 30.2% | 4.8% | 15.4% |

Source: National Council on Aging (NCOA) calculations based on data from the American Housing Survey, 2007.

homeowner households in this group are married (64.9%) and one-quarter (24.8%) are still working. However, fewer have paid off their mortgage (59.7%), which can be an additional stress on the monthly budget.

Affluent older homeowners are relatively young (median age 69) and are predominantly married couples. These households have sizable financial resources, which may reflect the fact that one-third (32.6%) are still in the labor force. Over half (51.9%) are also still making monthly mortgage payments. A challenge for many of these homeowners will be whether they can afford to retire. They may be interested in exploring new options to incorporate housing wealth in their asset allocation strategies.

Issues and Challenges

Despite their limited retirement resources, only 14% of homeowners age 62 and older have decided to use a home-equity loan or reverse mortgage to get cash from their houses. Traditional attitudes toward the house may explain why some older Americans are reluctant to tap home equity. The fact that older adults still overwhelmingly select home loans that require monthly payments may also be a factor in this decision. Borrowers are vulnerable to financial stress or foreclosure when faced with rising expenses or declining income (i.e., reduction in Social Security benefits or loss of spouse's pension).

Reverse mortgages generally do not affect Social Security and Medicare benefits. However, needs-based benefits, such as Medicaid and Supplemental Security Income (SSI), may be impacted. Most reverse mortgages, in addition to interest charges, have an origination fee, closing costs, a mortgage insurance premium, and a monthly service fee. These amounts can be paid by the reverse mortgage itself, so there is no immediate burden to the borrower. The costs are added to the principal and paid with interest when the loan becomes due.

Unlike a home-equity loan or traditional mortgage, with a reverse mortgage there are no monthly payments. The loan becomes due when the borrower sells the home, permanently moves out, vacates for a period of 12 months, or when all the homeowners are deceased. At that time, the loan principal, interest charges, and any fees must be paid in full.

The need to tap home equity depends on the availability of both financial and social resources. These factors vary significantly among the four different housing groups. As a result, older homeowners may decide to tap home equity for many different reasons, such as a source of additional monthly income or to manage debt. Older adults' financial situations also affect the loan options that they can use to liquidate a portion of their housing wealth.

Affluent older adults can select from a wide range of conventional loans. Older homeowners who do not qualify financially for a regular mortgage may end up with a subprime loan which carries a higher interest rate and the risk of financial exploitation. These findings suggest that one-size-fits-all solutions will not be adequate to ensure retirement security for homeowners across the economic spectrum.

Although the numbers are small, it appears that older Americans increasingly see their homes not just as secure places to live, but also as collateral for a loan. It will be important to monitor this evolving trend to understand how homeowners who are in or nearing retirement use this asset to solve financial problems. Researchers should also track changes in mortgage lending to older adults. One challenge is that federal sources of data on lending practices, such as the Home Mortgage Disclosure Act (HMDA) database, do not collect information on the age of borrowers.

Strategy #1—Increase Income Security

The foundation for retirement security has traditionally likened to a three-legged stool consisting of savings, pensions, and Social Security. Recent financial trends suggest that this conventional approach is becoming less effective. The savings rate among Americans has declined significantly since the 1980s—reaching its lowest level in 2004 since the Great Depression—although it recently turned upward (see *Figure 2*). Compounding these cash shortfalls is the decline of defined benefit plans, which leaves many Americans facing a future with less guaranteed retirement income.

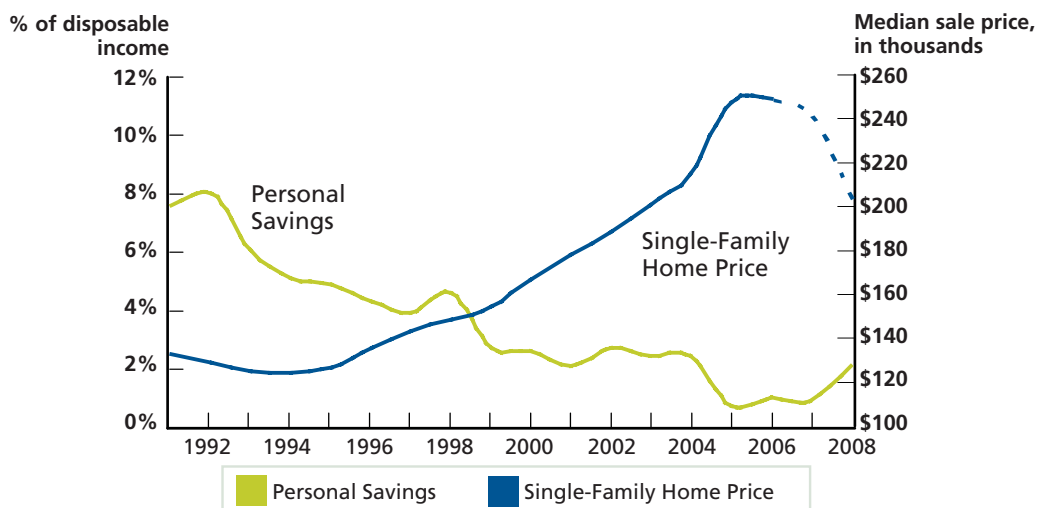
To maintain their standard of living, some older homeowners are starting to convert home equity to monthly income. This approach is a relatively new concept that has gained momentum with the development of reverse mortgages. Financial professionals are also beginning to explore different options for using home equity to increase annuitized income.

Sustain Cash Flow

As the cost of living continues to rise, many older Americans find it hard to make ends meet. Researchers estimate that nearly 78% of all older adult households do not have sufficient resources to sustain them through their retirement years.⁸ Baby Boomers are also concerned about being able to maintain their standard of living as they grow older. Older workers who expect inadequate retirement income, or a less reliable source of income, such as a defined benefit plan, are more likely to plan to use home equity to pay for retirement expenses.⁹

Cash-poor older households often find it difficult to pay the bills each month. High monthly expenses can be especially problematic for households who are house-rich and cash-poor. A high proportion of these homeowners are elderly widows who may have seen their income drop significantly when their husbands

Figure 2: Shifts in Family Resources



Source: Bureau of Economic Analysis National Economic Accounts; Prices for homes with conventional single-family non-farm loans, Federal Housing Bureau Historical Summary, Table 36.

Table 2: Financial Challenges of Homeowner Households Age 62 and Older, by Wealth Status

| | AFFLUENT | MIDDLE INCOME | | | POOR |
|--------------------------------------|--------------------------|-------------------------|-----------------|--------------------------|--------------------------|
| | House-rich and cash-rich | House-rich or cash-rich | Moderate wealth | House-rich and cash-poor | House-poor and cash-poor |
| Housing Attributes | | | | | |
| Year bought the home | 1988 | 1984 | 1982 | 1979 | 1980 |
| Home built after 1975 | 37.3% | 28.8% | 25.3% | 25.3% | 20.9% |
| Electricity bill more than \$100/mo. | 59.0% | 49.0% | 38.0% | 36.3% | 31.8% |
| Real estate taxes \$3,000 or more | 48.1% | 19.8% | 8.5% | 29.9% | 3.7% |
| Other Household Demographics | | | | | |
| Single women householders | 15.4% | 24.1% | 39.1% | 57.6% | 60.8% |
| Lives in central city or suburb | 63.4% | 55.3% | 48.1% | 70.9% | 38.0% |

Source: NCOA calculations based on data from the American Housing Survey, 2007.

died (see Table 2). Almost 71% live in central cities and suburbs where the cost of living and property taxes tend to be high. They also have a substantial amount of housing wealth (median value \$350,000; see Table 1). By selecting a tenure payment plan, a 75-year-old reverse mortgage borrower with a home worth \$350,000 could receive almost \$1,500 each month tax free for as long as they live in their home. This amount would more than double their monthly income.

Older homeowners who are house-poor and cash-poor may be less likely to benefit from a reverse mortgage. Most of these older adults live in smaller communities and rural areas where home values are relatively low (median value \$65,000; see Table 1). They also tend to live in older homes that may need additional repairs in order to qualify for a reverse mortgage. As a result, most of these homeowners would receive very little

additional income each month by “annuitizing” their housing wealth.

Most middle-income older adults also have limited amounts of housing wealth that they could use to supplement their incomes. For example, a 75-year-old borrower with a home worth \$125,000 could receive about \$500 each month from a reverse mortgage. This amount might not significantly increase their standard of living. These funds could increase retirement security for households with moderate wealth by filling gaps between the cost of living and available income. As they feel the pinch, 70% of Americans age 60 and older are already cutting back on essentials such as transportation or food.¹⁰ Others are economizing by lowering the heat or turning off lights, which can significantly increase the chances of a serious accident or illness. One in three older adults fall each year, most commonly in their homes, resulting in almost 1.7 million injuries annually.¹¹

Strategy #1—Increase Income Security

Increase Annuitized Income

While some aging homeowners must deal with immediate cash shortfalls, others look ahead and worry that they may come up short. At age 65, American men can expect to live an additional 17 years, and women 20 years, on average.¹² With increasing longevity, there is some chance that they may outlive their retirement resources. Maintaining financial security over many years will be especially challenging for many Baby Boomers who cannot rely on guaranteed retirement income from an employer-sponsored defined benefit pension plan.

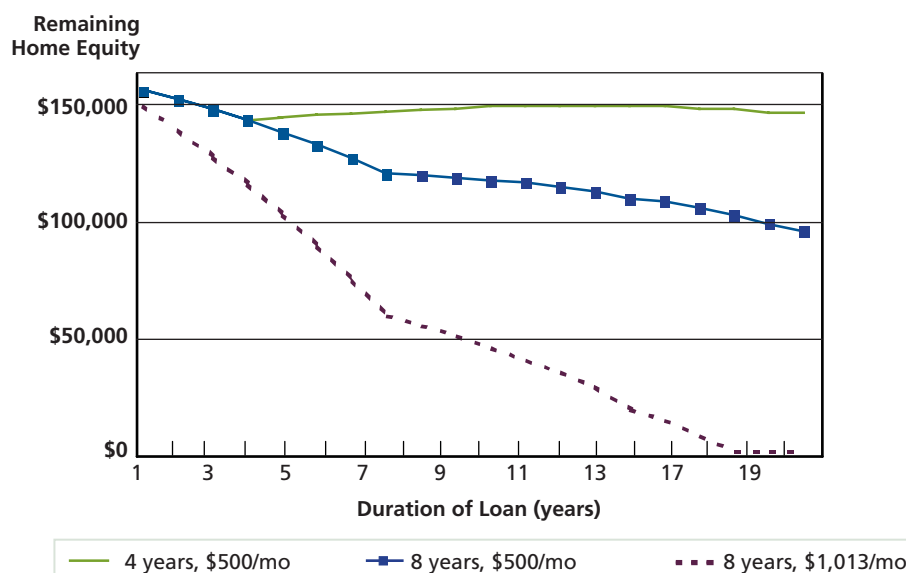
One option to increase monthly annuitized retirement income is to defer Social Security payments. Retirees receive a reduced monthly benefit at age 62 and progressively larger benefits for each month they postpone benefits up to age 70. Elderly widows could see the greatest benefit, since deferral would increase the expected value of their monthly survivor benefits.¹³ To maximize their monthly payments, as well as that of their spouses and other dependents, people near retirement

could continue working. However, this option may be difficult for workers in physically demanding occupations, and those who are limited by health problems. To help workers who anticipate a long life, and who must retire before age 70, some financial professionals are recommending a term home-equity loan or reverse mortgage to help pay for everyday expenses for a few years until they are eligible for maximum Social Security benefits.

Figure 3 highlights how this strategy could work for a middle-income woman age 62 with a home worth \$150,000 and with an annual salary of \$50,000. If she chose to retire at age 62, her monthly Social Security payment would be \$1,013. If she waited until age 70, she would receive \$1,953 per month. To maximize her benefit:

- She would need to get an additional \$1,013 per month from a reverse mortgage for eight years (total \$97,248) if she stopped working at age 62, but deferred her Social Security benefits until age 70. This approach would rapidly deplete home equity.

Figure 3: Equity Draw-Down with a Reverse Mortgage to Defer Social Security



Source: NCOA calculations using the Reverse Mortgage Analyzer—HECM monthly CTM 200 loan; appreciation rate 2%, expected interest rate 4.91%.

- If she switched to part-time work at age 62, and drew \$500 per month from a reverse mortgage to supplement her income until age 70, she could lock in an additional \$940 per month in Social Security benefits starting at age 70, and still retain a significant amount of home equity.
- If she worked full-time until age 66, then switched to part-time work and drew \$500 per month from a reverse mortgage for four years, the potential impact on her home equity might be minimal, at current interest rates and with modest (2%) home appreciation per year.

The net benefit of this approach would depend on how long a person (and spouse) lived after age 70, changes in interest rates, and the duration of the loan. Borrowers who moved soon after reaching age 70, and paid off their reverse mortgages, would pay less in total interest on their loans than those who continued to live in the same house for many years. Given the complexity of this financing option, older workers would need to carefully evaluate the potential long-term ramifications of this approach.

Financial professionals are also exploring the possibility of using home equity to supplement income when the financial market conditions are depressed. In 2008, workers with 401(k) plans worth over \$200,000 saw their account balances decline by over 25%.¹⁴ Tapping home equity would reduce the need for retirees to spend money from a recovering retirement account or to liquidate income-generating assets to support consumption.

Another option for older homeowners to ensure retirement income would be to buy a “longevity” annuity with their savings, and tap small amounts of home equity to fill financial gaps until they start to receive their annuity

payments. Longevity annuities require a smaller investment than an immediate annuity because they usually do not begin payouts until after age 80 or 85. This approach could be attractive to older Americans who worry that purchasing an immediate annuity will leave them little cash to pay for unexpected expenses or to leave a bequest. Consumers should carefully examine the fees associated with longevity annuities, since they can be expensive.

Issues and Challenges

A fundamental component of retirement security is having enough income to meet basic expenses. Conventional wisdom encourages people to save as much as possible during their working years so they can maintain their standard of living in retirement. But with sizable losses to retirement savings plans in recent years, along with the growing cost of basic necessities, it is harder for many people to accumulate enough funds to ensure a comfortable retirement. As Americans enter their retirement years, they may need to reevaluate their financial situation and convert some of their housing wealth to income to supplement the family budget.

Researchers generally agree that using a reverse mortgage to supplement income can be an important option for house-rich and cash-poor older homeowners who may otherwise live in poverty.¹⁵ However, as shown in *Table 1*, low-income older adults with sizable housing wealth are relatively rare, and represent less than 5% of all older households. Without additional support, the majority of poor older homeowners are unlikely to benefit from liquidating housing wealth through a home loan. Combining public benefits with modest amounts of home equity could be another option to enable some older homeowners with modest means to continue to live at home with greater dignity and security.

Strategy #1—Increase Income Security

There is less consensus about the value of annuitizing home equity to support income security among middle-income households. A recent study estimated that the median increase in income for these older adults may be able to increase their income by less than 28% through a reverse mortgage.¹⁶ Many feel that such modest amounts of extra cash will not guarantee retirement security for many older homeowners.¹⁷

A major barrier to annuitizing housing wealth is consumer receptivity to this approach. Taking out a loan to support everyday consumption, rather than to make home improvements or otherwise increase wealth, goes against conventional wisdom. Many older homeowners feel that this strategy is only appropriate for financially desperate older adults. When asked, 36% of homeowners age 65 and older can think of no benefit for older adults to use home equity to stay at home.¹⁸ Older Americans are usually reluctant to annuitize their retirement wealth. This attitude may reflect the fact that many



older adults today already have a sizable portion of their income annuitized through defined benefit pension plans and Social Security.

Baby Boomers who tap home equity during their working years will have less housing wealth left in retirement. These homeowners may be interested in targeted, short-term home loans that can help them defer Social Security payments or delay the liquidation of depressed equity. Such strategies highlight the new ways in which financial professionals are beginning to incorporate home equity as a retirement resource. Older homeowners need to scrutinize these financing options carefully, to ensure that short-term solutions do not grow into long-term problems. Younger borrowers should also weigh the benefits of taking out a reverse mortgage early in retirement, since the amount that a borrower can receive from these loans increases substantially with age. Mandatory reverse mortgage counseling by HUD-approved agencies is an important source of independent information about these loans.

Consumer advocates and the financial services industry have raised concerns about cross-selling annuities and other financial products with reverse mortgages. The Housing and Economic Recovery Act of 2008 strengthens consumer protections by forbidding lenders from requiring borrowers to buy other financial products (such as annuities or insurance) as a condition for taking out a reverse mortgage. Also, the Financial Industry Regulatory Authority (FINRA) has an investor notice strongly cautioning investors against using home equity to purchase investments. FINRA has also put financial service firms on notice that recommending the use of home equity to purchase investments is not a suitable recommendation. Homeowners who are considering these options will need additional financial education to make wise decisions.

Strategy #2—Enhance Financial Resilience

Retirement has always been a time of financial uncertainty. Not knowing how long they will live, or the extent of their health needs, makes it difficult for older people to decide when to spend their financial resources. With increasing economic uncertainty, they face even greater challenges. As an alternative to using home equity for regular consumption, older adults may want to improve their retirement security by preserving this asset as a cushion against unexpected events.

Older Americans who own their homes free and clear of any mortgage often value the house as a type of “insurance.” The challenge for homeowners who opt for this traditional use of home equity is knowing how long to wait, especially if they face increasing financial hardship. They also need to decide how to tap this asset when that “rainy day” arrives.

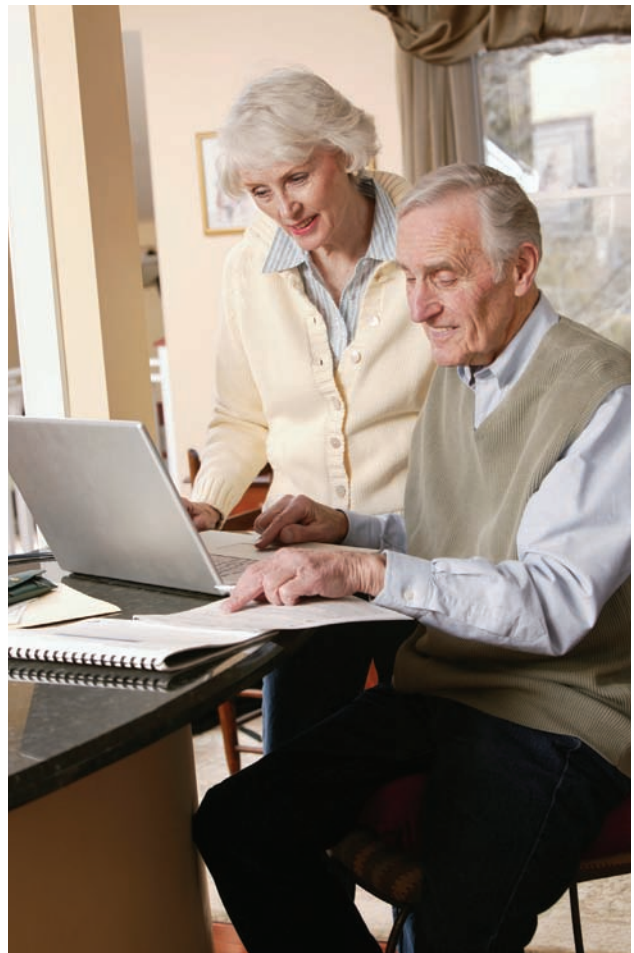
Self-Insurance

Most Americans want to continue to stay at home for as long as possible. They worry about large and unexpected out-of-pocket costs that can disrupt their ability to sustain themselves financially. One of the biggest uncertainties is out-of-pocket costs due to declining health and ability. Medical and long-term care expenses often lead to considerable wealth depletion among older adults who live in the community.¹⁹ Married couples may also want to keep their assets until late in life, to cover the substantial end-of-life medical and funeral costs that can leave widows impoverished.²⁰

Consumer surveys find that older homeowners today typically preserve home equity to protect themselves financially against potentially catastrophic expenses.

Those who see home equity as a “last resort” typically wait to liquidate home equity until they face a major life change, such as widowhood or the nursing home needs of a spouse.²¹ At this point in life, homeowners usually decide to sell their homes.

A small proportion of older homeowners are beginning to use home-equity loans to pay for health and long-term care needs. A 2007 survey by the Commonwealth Fund found that 8% of older adults with medical bills or medical debt problems took out a mortgage or loan to pay for these costs.²² About 28% of reverse mortgage



Strategy #2—Enhance Financial Resilience

borrowers take out this loan due to concerns about out-of-pocket health and disability-related expenses.²³ Only about 5% of these borrowers use their loan funds for immediate health needs, suggesting that they may be planning ahead for these financial risks.

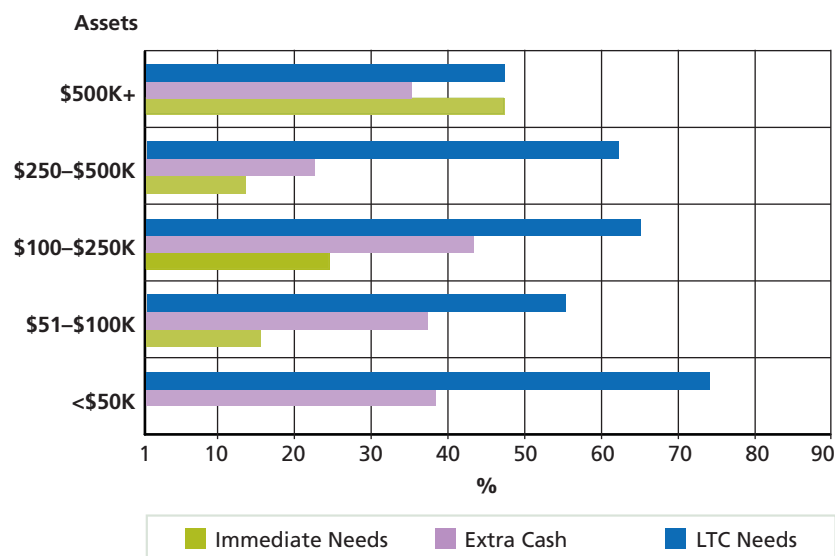
The possibility of receiving help at home, rather than in an institution, may also encourage younger homeowners to tap home equity before they face a health crisis in retirement. A recent survey found that a high proportion of Boomers turning age 62 see long-term care as an important reason to consider a reverse mortgage (see *Figure 4*).²⁴ Over 70% of those with very modest retirement assets (household net worth of less than \$50,000) may be planning to use home equity to pay these expenses as they grow older.

Older Americans often rely on housing wealth because they did not purchase long-term care insurance. Those who wait until their

retirement years may also find that they do not qualify for coverage due to an existing health condition or find they can no longer afford it. Policymakers, advocates, and insurance companies have raised serious concerns about using home equity to purchase long-term care insurance.

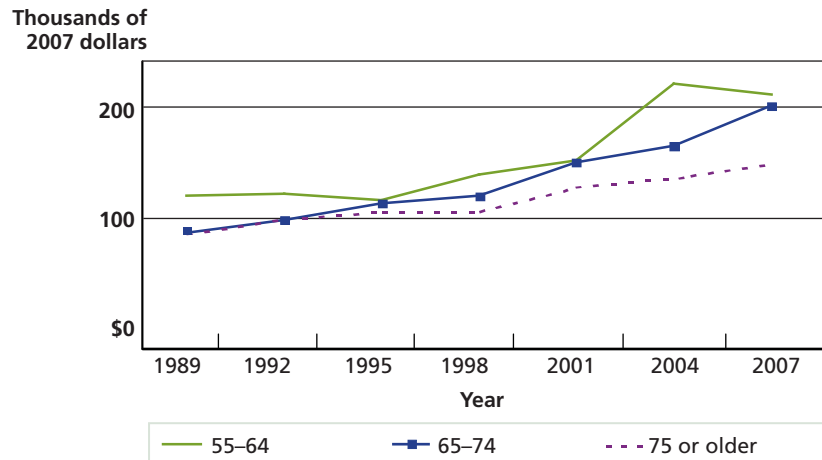
However, home equity may play a different role to support Baby Boomers who buy long-term care insurance. A recent survey found that 84% of Americans who purchased a policy in 2008 were under age 65.²⁵ To save costs, 76% of these buyers opted for coverage that would pay for a claim lasting five years or less. As they grow older and start to need help, policyholders may want to save their limited insurance coverage to pay for serious disabilities. They could tap home equity to pay for low-cost services that make it easier to stay at home. Small amounts of home equity could also pay for early interventions that can reduce health problems.

Figure 4: Reasons Boomers at Age 62 Might Consider a Reverse Mortgage



Source: MetLife Mature Market Institute, *Boomers: Ready to Launch*, 2007.

Figure 5: Rising Home Values, by Age



Median value of primary residence.

Source: Survey of Consumer Finances Chartbook, 2007.

Financial Buffer

One of the greatest fears of older Americans is ending up in a nursing home. Due to improvements in health and growing options for community living, however, the risk of needing institutional care has declined significantly. As a result, a greater challenge for many retirees will be to maintain financial stability as their needs change over time. Older adults often require assistance with transportation, grocery shopping, or other household chores to cope with declining health. For many people, these added expenses are a real burden.

The homes of older adults are also getting older and may erode in value if homeowners do not keep up with repairs and improvements. Researchers have found that appreciation rates for similar homes are considerably smaller when the household head is over 75 years old.²⁶ This can be a serious financial drain for older adults who already own modest value homes (see *Figure 5*).

With limited amounts of home equity, older homeowners may benefit from using these funds sparingly as a financial buffer to manage

the unexpected. The most common approach today is to take out a home equity line of credit (HELOC). Homeowners often use a HELOC to pay for home renovations. Many reverse mortgage borrowers also select a line of credit payment option to address a wide array of basic necessities. This financing strategy can be cost-effective, since borrowers only pay interest on the amount that they use from the loan.

The popularity of HELOCs, and increasingly reverse mortgages with line of credit payment plans, suggests that an important reason why older Americans already tap home equity is to enhance their financial resilience. In fact, 93% of reverse mortgage borrowers reported that these loans have had a positive effect on their lives.²⁷ Having a cushion of readily accessible funds can encourage older homeowners to act sooner, to keep small problems from becoming a costly crisis. For example, carbon monoxide fumes from faulty furnaces, gas water heaters, and ranges can have a serious effect on people with heart disease.²⁸ Replacing a leaky roof or faulty furnace before they cause structural damage or a serious illness reduces the chances that a person will exhaust their retirement savings.

Strategy #2—Enhance Financial Resilience

Issues and Challenges

While many older Americans worry about outliving their savings, an equally important risk may be under-spending that can compromise an older person's health and home environment. The ability to live at home is a dynamic process, where the situation can change rapidly. To make sure that they can stay in control, older adults and family caregivers need to be able to implement effective solutions quickly. A growing challenge will be to help older adults find a balance between using home equity to address immediate needs and preserving this asset to help ensure retirement security.

Saving home equity as a last resort may seem to be the safest way to protect this valuable asset, but during periods of economic volatility, such conventional wisdom may no longer serve older adults well. Those who plan to tap this asset only when they have an urgent need may not know how much home equity will be available when they need it, due to fluctuating interest rates and changing home values. It may also be difficult to get a home loan quickly to deal with a crisis situation. The recent crash of the real estate market further highlights the difficulties that older adults can face when they need to sell their home in a hurry.

Homeowners who are looking for shorter-term solutions need to be careful about the type of loan they select. Borrowers who opt for a HELOC must have sufficient funds available to pay the loan at the end of the term. They may also want to have an emergency cash fund to ensure that they can continue to make monthly loan payments. As non-recourse loans, reverse mortgages provide important protections against foreclosure. However, using these loans to access small amounts of funds may not be worth the high transaction costs. More research is needed to evaluate the trade offs between the costs versus protections of different home loans.

The suitability of using home equity as a financial buffer will also be influenced by the ability of older homeowners to continue to live in their homes. While most older adults want to stay at home for as long as possible, HUD has found that over half of reverse mortgages are terminated within six years after origination.²⁹ Without additional support for community living, it may be more appropriate for an older homeowner to sell the house rather than incur substantial transaction costs to liquidate home equity through a home loan.³⁰ These findings also highlight the growing need to strengthen partnerships between aging organizations and the lending community to ensure that older borrowers can meet their life goals.



Strategy #3—Improve Debt Management

A common characteristic of today's older adults, especially those whose lives were touched by the Great Depression, is their aversion to debt. These attitudes may also reflect the fact that there were few opportunities to cash out home equity before the 1980s. Since then, Congress has enacted several laws that have liberalized lending standards and promoted the development of new loan products, including home-equity loans and subprime loans. As retiree incomes are being squeezed, older Americans have been taking advantage of easier access to credit.

Several studies show that consumer spending tends to increase as home values rise.³¹ Having this extra financial cushion may give homeowners more confidence to spend rather than save for a rainy day. But for some people, their expenditures have been growing faster than their incomes. Younger retirees and Baby Boomers are finding it especially hard to follow the traditional advice of “work hard, save

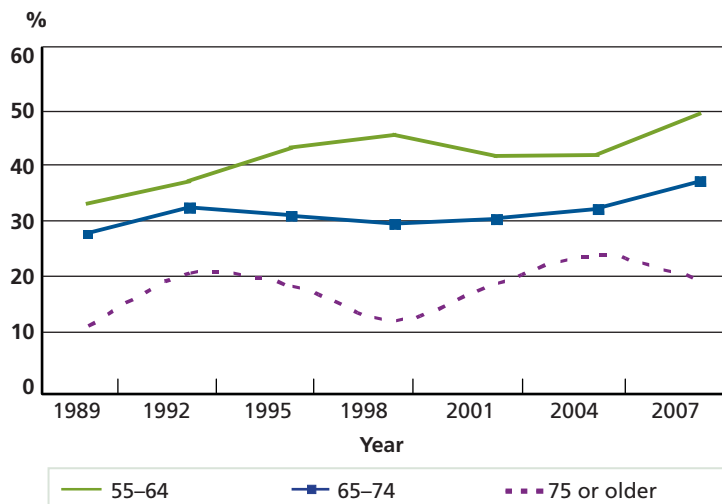
money, and stay out of debt.” A recent study found that 40% of people age 62 to 75 already have, or expect to have, mortgage debt in retirement.³² These financial difficulties increase the need for debt management among older homeowners.

Transfer Debt

It is difficult to maintain financial stability in the face of rising household expenses. For older adults living on a fixed income, the most readily available solution may be their credit cards. The proportion of older families who use this financing option is growing. Since 1998, self-reported credit card use among families headed by someone age 75 and older has almost doubled to 19% (see *Figure 6*). Among families age 55 to 64, about half carry credit card debt.

Even though more older people use credit cards, their balance amounts are not excessive. Families age 65 to 74 typically owed about \$3,000 in 2007, while those age 75 and older

Figure 6: Families with Credit Card Balances, by Age



Source: *Survey of Consumer Finances Chartbook, 2007*.

Strategy #3—Improve Debt Management

had a balance of \$800 on average.³³ The challenge for these families is that banks have recently begun increasing interest rates sharply and reducing credit card limits. As a result, many borrowers find they have to make higher credit card payments each month. They often face substantial fees and other penalties when they are late on their payments. Borrowers on fixed incomes may have little left after paying their credit cards to also make monthly mortgage payments.

One consequence of ready access to credit has been the growing proportion of people age 55 and older who face bankruptcy. Between 1991 and 2007, the bankruptcy rate among people age 55 to 64 grew from about 6% to over 15%.³⁴ The proportion of people age 75 and older who face bankruptcy, while small, grew substantially from 0.3% to 2% during this period. The additional pressures that credit card borrowers now face will likely push more older homeowners into bankruptcy or foreclosure.

Debt consolidation is a common option to deal with this financial challenge. Under this approach, older adults shift their unsecured consumer and credit card debt to a home loan such as a HELOC or reverse mortgage. When used wisely, this strategy can lower monthly expenses since interest rates for home-secured debt are much lower than those for credit cards today. Older homeowners who use a reverse mortgage for this purpose may increase their available monthly income because they are deferring all payments on their bills until they move out of their homes.

Using home equity to avoid bankruptcy can be an important safety net for cash-strapped older adults. However, this approach also presents some challenges. Homeowners need to maintain financial discipline to avoid the risk of going further in debt if they keep using

their credit cards. This can be difficult for low-income families who struggle to meet everyday expenses each month.

Defer Mortgage Payments

The type of loan that homeowners select to resolve their financial problems can have a big impact on their financial well-being in retirement. One in five older households that are house-poor and cash-poor still has a mortgage (see *Table 3*). They may face sizable monthly payments, especially if they did not qualify for a regular mortgage, and opted instead for a subprime loan with higher interest rates.

Of the 7.7 million older households with housing debt, almost 58% are middle-income families in the moderate wealth or house-rich or cash-rich groups. Although they may not be struggling, additional mortgage payments can increase their financial vulnerability. Based on the Elder Economic Security Standard Index, single homeowners with a mortgage typically need about \$19,000 per year in basic income to live in a moderate-cost city such as Minneapolis.³⁵ They require over \$33,000 per year to maintain a basic standard of living in higher cost areas such as Los Angeles.³⁶

Over half (51.9%) of affluent older homeowner households have some type of home loan (see *Table 3*). Of households with home loans, they are also most likely to have multiple loans (21.6%). Sizable housing debt can make it hard for affluent homeowners, many of whom still work, to retire and enjoy the balance of their lives. These households are also most likely to be pulling cash out of their houses with home-equity loans. About 45% use this financing option, often in combination with a regular mortgage. Since these borrowers are relatively young (median age 66), they run the risk of spending a large portion of their housing wealth early in retirement.

Table 3: Type of Home Loans Used by Homeowner Households, Age 62 and Older with Housing Debt, by Wealth Status

| Type of Loan | AFFLUENT | MIDDLE INCOME | | | POOR |
|--------------------------------------|--------------------------|-------------------------|-----------------|--------------------------|--------------------------|
| | House-rich and cash-rich | House-rich or cash-rich | Moderate wealth | House-rich and cash-poor | House-poor and cash-poor |
| Regular mortgage only | 54.4% | 60.6% | 63.0% | 64.0% | 71.6% |
| Regular mortgage & home-equity loan | 21.6% | 12.3% | 8.5% | 12.2% | 5.3% |
| Home-equity loan only | 23.2% | 24.7% | 25.8% | 18.1% | 21.5% |
| Reverse mortgage | 0.8% | 2.3% | 2.7% | 5.8% | 1.6% |
| Total with a Home Loan | | | | | |
| Homeowner households age 62+ | 2,260,049 | 2,597,712 | 1,865,671 | 302,601 | 694,258 |
| Percent of total households in group | 51.9% | 40.3% | 28.4% | 29.2% | 20.7% |

Source: NCOA calculations based on data from the American Housing Survey, 2007.

Borrowers who must continue to make regular mortgage payments in retirement, and those who get cash through a conventional home-equity loan, are placing their houses at risk.

As they age, people face a growing possibility that a costly health problem could disrupt their family budgets. When they cannot make their monthly loan payments, they may lose their houses. A recent study found that by the end of 2007, more than 684,000 homeowners age 50 and older were delinquent in mortgage payments or in foreclosure.³⁷

A reverse mortgage allows older homeowners to defer monthly mortgage payments on a conventional home loan. Borrowers (or their heirs) do not have to repay the loan until the last borrower dies, permanently moves out, or vacates for a period of 12 months. About 46% of reverse mortgage borrowers surveyed by AARP have paid off their regular mortgage in this way.³⁸ Some are transferring their existing housing debt to meet the requirement that a reverse mortgage be in primary lien position.

Anecdotal evidence suggests that growing numbers of older homeowners are taking out this type of loan specifically to avoid the need to make monthly mortgage payments.

Issues and Challenges

Using home equity to manage debt became popular after the Tax Reform Act of 1986 phased out the deduction for interest on credit cards, auto loans, and most other types of consumer debt while preserving tax deductions for certain home loans. Since then, borrowers have shifted from installment plans to tax-advantaged mortgages and home-equity loans to pay for major purchases such as cars and appliances. Easy access to credit also provided lower-income households with greater liquidity to purchase the goods and services that they need to continue to live at home.

Using housing wealth to manage consumer debt can enhance a person's standard of living. But if this resource is not used wisely, it can also be a source of financial insecurity. Older homeowners often take on sizable debt without

Strategy #3—Improve Debt Management

considering the potential impact of these loans on their long-term retirement security. Shifting debt from credit cards to a home loan can extend payments over many years. Even at low interest rates, this decision will reduce an elder's hard-earned home equity. For homeowners who only qualify for a subprime mortgage, stretching payments over many years can end up costing more than twice as much as with a credit card.³⁹ These additional expenses can significantly deplete the already limited retirement resources of older adults with modest means.

Using a reverse mortgage to defer debt payments can also be risky. Borrowers who use loan funds early in their retirement may have little home equity later in life. Borrowers continue to accumulate interest payments on the loan balance as long as they stay in their homes. Those who continue to live in their homes for many years may find that they have

little or no home equity left after they repay the loan. This could be problematic for older adults who need to move to an assisted living facility or other supportive setting as they become frail and in need of care. Without sufficient funds, some may need to turn to Medicaid to pay for long-term care. When the reverse mortgage becomes due, borrowers or their heirs must pay the amount borrowed plus interest charges and any service fees (see page 14 of *The Essentials: Reverse Mortgages*).⁴¹ If the borrowers or heirs want to maintain ownership of the home, they must repay all amounts due, even if those amounts are more than the value of the house.

The current economic crisis heightens the risk that older homeowners with modest or fixed incomes will be unable to make monthly payments on their conventional home loans. They may be better off with a reverse mortgage, since the risk of foreclosure is much lower with these loans. However, the high transaction costs of reverse mortgages often deter older adults from selecting this loan. Costs at closing (origination fee, upfront mortgage insurance premium, appraisal, and other closing costs) are rarely folded into the interest rate, so they can be sizable, ranging from about \$6,000 for a \$100,000 home to over \$16,000 for a \$400,000 home. Among older adults who received counseling and decided not to take out a reverse mortgage, 63% were discouraged by up-front loan costs.⁴¹

Four states have developed programs that offer reverse mortgages at reduced cost. Montana and Connecticut have state-run and state-financed reverse mortgage programs that target older adults with modest incomes. New Jersey and Rhode Island offer reduced origination fees to borrowers who get a reverse mortgage. Policymakers should consider these and other incentives to make this option more affordable to lower- to middle-income families.



Implications

The proportion of older homeowners who use home equity as a retirement resource is still small. As a consequence, it is easy to overlook this emerging trend. Although the indicators are faint, they are important because they serve to remind us that people are not complacent about rising retirement risks. Americans are proud of their resourcefulness. Growing numbers already use this asset to meet a wide array of unmet financial needs. These include maintaining a steady flow of income, providing a financial buffer to cope with health and homeowner expenses, and managing monthly credit card and other consumer debt. As Baby Boomers enter retirement, millions of aging Americans may soon turn to their homes as part of their financial plans.

These findings suggest that the financial services industry, policymakers, and consumer advocates cannot ignore home equity in their efforts to promote retirement security. The home is still the most important retirement asset for many older homeowners, especially families with lower to middle incomes. Before the housing bubble burst, people age 65 and older owned in total over \$4 trillion in housing wealth.⁴² It will be useful to develop more affordable solutions and effective public policy for older homeowners, since the decisions that they make about this valuable asset will have long-term ramifications for their well-being, and for our nation.

Need for Financial Flexibility

Americans in or nearing retirement are concerned about economic fluctuations that can affect their well-being as they grow older. As a result, homeowners are looking for new strategies to increase their flexibility to respond to changing financial needs. The findings of this



study indicate that older adults rarely tap home equity to support basic consumption. Instead, they tend to use this asset to enhance their ability to fill cash shortfalls and provide a buffer against cash flow shortages that may disrupt the family budget. Home equity can play an important role to strengthen the capacity of older homeowners to cope with financial uncertainties in later life. Small infusions of cash can also help older homeowners to remain flexible and adaptive, and to respond to problems while they are still manageable.

The idea of using home equity to increase financial resilience is a concept that is only beginning to receive attention from the financial services industry. Financial professionals who focus on asset accumulation still encourage older homeowners to preserve housing wealth. However, for those who are unable to save enough to ensure a secure retirement, they may need to use home equity

Implications

as more than just a last resort. In this changing retirement landscape, financial professionals should re-examine the role of housing wealth as an integral part of financial risk management.

Homeowners who tap home equity earlier in retirement will likely face new and potentially unanticipated risks. Additional research will be required to assess the changing needs and vulnerabilities of older homeowners, and the suitability of different financial solutions. To support these efforts, and to monitor lending trends to older adults, the Federal Reserve Board should expand Home Mortgage Disclosure Act (HMDA) reporting requirements by adding variables on the age of the borrower and co-borrower. Such timely data can also help to ensure that consumer protections for older homeowners keep pace with the evolving home mortgage marketplace.

Guiding Principles

The findings of this study suggest that home equity will not offer a simple solution to the growing financial problems of aging Americans. The diverse needs and expectations of older homeowners also highlight the need to strengthen retirement planning strategies beyond simple models of asset accumulation and decumulation. The following principles offer guidelines that can aid the development of a more comprehensive approach to financial security in later life:

- › **Use a holistic, person-centered framework**—Strategies need to shift from product-focused approaches to comprehensive financial plans that include home equity as an integral part of retirement security.
- › **Promote flexibility**—Older homeowners need multiple, affordable products that can meet both long- and short-term financial goals in retirement.

- › **Address changes over the life course**—Advice and solutions that include home equity need to take into consideration how financial, health, and family needs and risks change as people grow older.
- › **Offer solutions that strengthen financial security**—A house is more than a financial asset; it is also a home. Older homeowners across the economic spectrum are looking for cost-effective options that can give them peace of mind.

These guiding principles provide a foundation upon which to develop loan products and public policy that can better serve aging homeowners. Greater focus on these issues can also serve as a framework for strengthening ties between experts from many different disciplines that seek to improve the quality of life for older homeowners.

Partnering to Promote Innovation

As Americans increasingly rely on home equity to manage cash flow in retirement, they will be looking for additional advice and effective tools. Meeting this challenge opens the door to a wide array of collaborative efforts. The financial services industry professionals can work with consumer advocates to strengthen financial literacy programs for homeowners at all ages. As the number and complexity of the options grow, older workers and retirees will need more sophisticated decision-support tools. Additional advice will be important for lower- and middle-income families who have not traditionally used financial planning services.

Organizations that offer debt management, reverse mortgage counseling, and benefits counseling should work together to help older Americans understand their options. As trusted community resources, Area Agencies on Aging and Aging and Disability Resource Centers can

help older homeowners combine home equity with assistance from public programs to help them stay home longer. These agencies can also facilitate the transition from the home to other living arrangements. To support these efforts, it will be important that mandatory reverse mortgage counseling programs keep pace with the growing interest in these loans.

For many Americans, out-of-pocket health and long-term care expenses represent their greatest uncovered financial risk in retirement. Organizations that serve older adults need to work together with the financial services industry to promote the development of cost-effective loan products and innovative programs that can help impaired older homeowners meet this growing challenge. It will also be important to conduct demonstration projects that test different models for using home equity. In our aging society, it is still too early to say which solutions may work best to enhance financial security for different segments of the older adult population. Americans should also consider at an earlier age how they will pay for potential long-term care expenses.

As part of this effort, federal and state policymakers will want to consider the needs and resources of older homeowners as they develop new programs and public policy to finance long-term care. Home equity can be an important new source of funds to pay for early interventions that can reduce the need for costly nursing home care. To supplement tax deductions for mortgage payments, policymakers might consider offering government incentives to lower the cost of reverse mortgages to help financially vulnerable older adults continue to live at home. Married couples may need additional protections to make sure that one spouse does not become impoverished if they tap home equity to pay for the health or long-term care needs of the other.

When they face a financial shortfall today, aging Americans turn to familiar solutions such as credit cards or conventional loans that offer few consumer protections. These findings suggest a growing need for more flexible and affordable home loans. Before the crash of the housing market, lenders were developing many new proprietary reverse mortgage products for affluent homeowners. By working together, the financial services industry, HUD, and aging organizations may be able to accelerate the development and testing of reverse mortgages and other financial products that are designed to meet the needs of homeowners with modest housing wealth.

Solving everyday financial problems is becoming increasingly complex and difficult in later life. Although there are still many unanswered questions, the financial services industry, policymakers, and consumer advocates cannot be complacent about the potential benefits and risks of using this asset to address the challenges facing older Americans.



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