Understanding the Views of Older Homeowners to Help Us Chart Strategy

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Improving the lives of 10 million older adults by 2020

NCOA Background in home equity

- NCOA has strong experience in home equity space
- One puzzle yet to solve- juxtaposition of needs later in life, and lack of knowledge or interest in using available home equity

Why did NCOA conduct this research?

- For a majority of older home owners it is not a question of “if” but “when and how” they will tap home equity.
- We wanted to better understand older homeowners’ retirement concerns, and levels of understanding around two primary home equity release products.
- We wanted data to help us shape our home equity education and advocacy strategy.

Primary Research Objectives

- Assess interest of older homeowners in using home equity to meet their retirement needs and concerns.

- Assess how well older homeowners understand home equity release products.

- Assess if older home owners are receptive to education and information on these products and on other ways to use their home to help achieve income security.

Overview

- Sponsored by National Council on Aging (NCOA)
- Funded by generous grant from Reverse Mortgage Funding LLC
- Quantitative with Consumers and Financial Advisors, and Qualitative Methods with Consumers
  - <u>Quantitative</u>
    - Survey Logistics
      - 20-minute online survey, April 2016, geographically representative sample of 1,002 homeowners age 62+ who do not currently have a home equity loan product
      - Survey of 254 financial advisors
  - <u>Qualitative</u>
    - Series of 13 focus groups, Fall 2016, in three nationally representative cities- 112 participants
      - Rochester, NY, Minneapolis, MN and Denver, CO
      - 112 participants ages 60 to 75
      - Groups segmented by net worth and by those with and without prior or current HELOC ownership

Why Online quantitative? Why qualitative research after - not before - quantitative?

- NCOA has a strong competency in bringing digital education to scale to millions of older adults, and we are interested in how this sector could benefit from a similar approach. Digital permits micro targeting of segments and messages.

- We wanted to know if we could engage with people and provide education- are they open to learning? Are they open to acknowledging what they don't know?

Research Report Now Available for Download

www.ncoa.org/wp-content/uploads/2017-Home-Equity-and-Enhanced-Retirement-Security.pdf

Quantitative: Sample and Selection Criteria

- N = 1,002
- Home owner 62+
- Geographically representative
- Do not currently have RM/RLOC, home equity loan, HELOC

(Also surveyed 254 financial advisors)

Some demographics

Average age	67
Female	51%
Married or living with partner	77%
Caucasian	91%
Some college	58%
Income LT $50,000 and home equity GT 50% of net worth	39%
Mortgage fully paid	56%

Some housing in retirement concerns by home equity as % of Net Worth

Concern	Home equity as % of net worth	
	GT 50%	LT 50%
Maintaining home due to your own financial limitations	41%	20%***
Your neighborhood becoming less desirable	14%	22%**
Safety concerns when living on your own	35%	26%*
Needing to renovate house but not having funds to do so	38%	19%***
Loneliness or lack of available activities	21%	20%

*P<.05, **P<.01, ***P<.001

Select attitudes toward home & home equity

Attitude	%
Want to leave inheritance from equity in home	39%
Important that family inherit my house	13%
Would prefer home care if I need care	66%
Plan to move to senior community in the future	16%
Would like to move into home easier to maintain	29%
Definitely not purchase RM	**50%**
Definitely not purchase home equity product of any kind	**28%**

Product name experiment

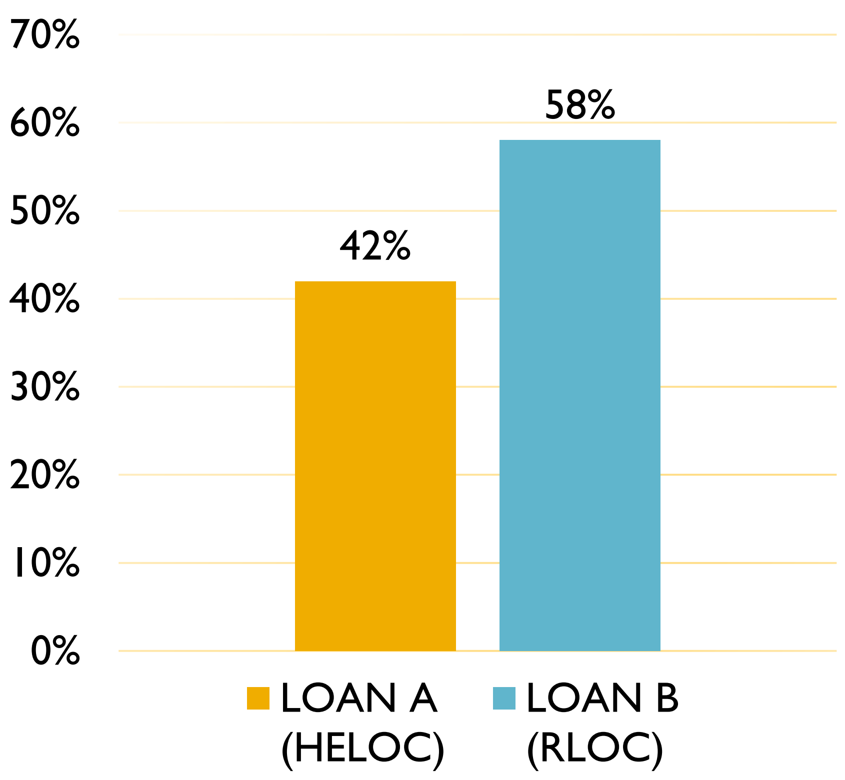
Key Product Features

*Please assume that the total costs and fees for both products are about the same. Both A and B are line-of-credit products for accessing a homeowner's home equity to meet expenses.

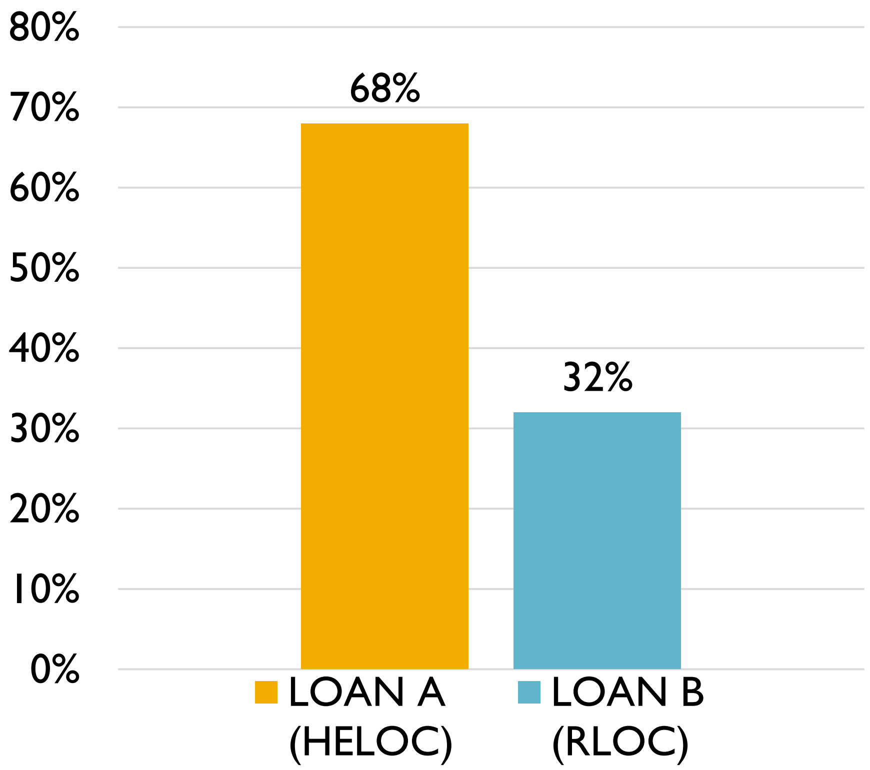
Loan Type A	Loan Type B
• Borrower has access to line for 10 years	• No mandatory 10 year draw
• Must make minimum monthly payments	• No minimum payments required
• Lender can freeze or reduce loan amount	• Lender cannot freeze/reduce loan amount
• Home subject to foreclosure if minimum payments, taxes or insurance not paid	• Home subject to foreclosure if taxes or insurance not paid
• Loan balance must be paid back in full, even if borrower owes more than home is worth	• Borrowers or heirs never pay back more than the home's fair market value when sold

Consumer name experiment results

Not Named (N=500)



Named (N=500)



Focus Groups

- Series of 13 focus groups, Fall 2016, in three nationally representative cities-

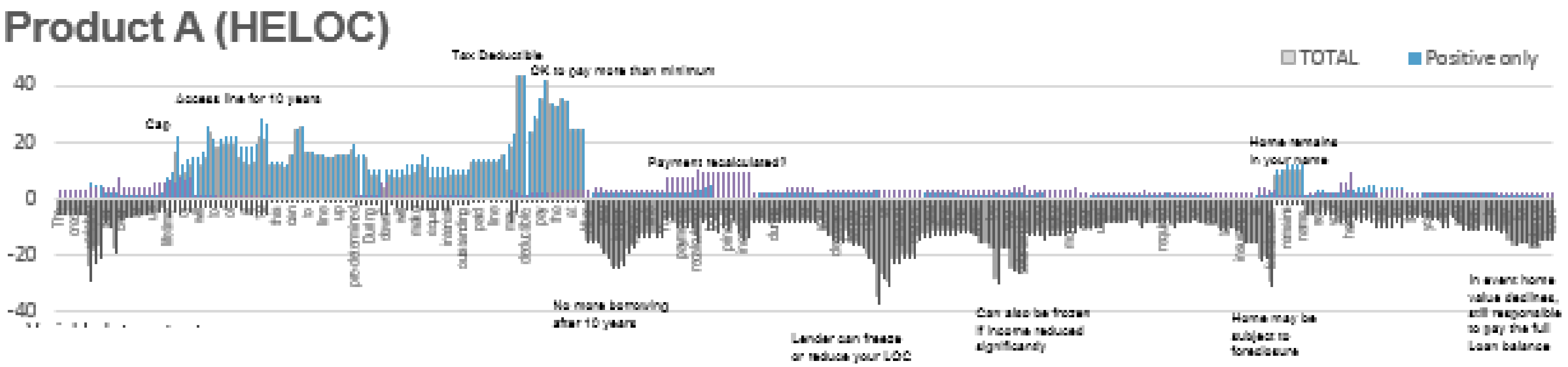
  Rochester, NY, Minneapolis, MN and Denver, CO

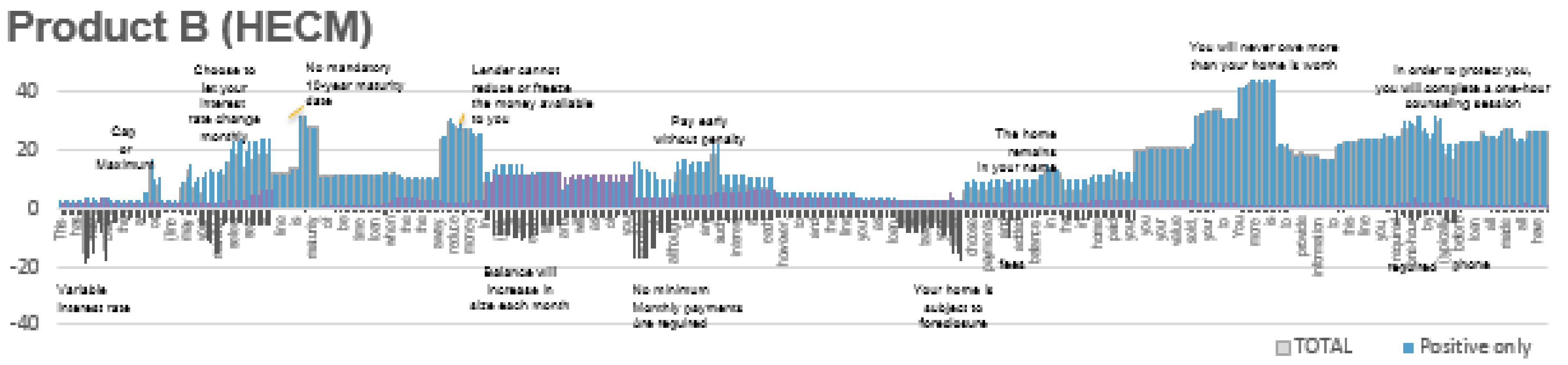
- 112 participants ages 60 to 75

- Groups segmented by net worth and by those with and without prior or current HELOC ownership

- Extensive use of sentiment graphs

Sentiment graphs (N=112)





Focus Group Analysis: Reasons why consumers preferred reverse mortgage over HELOC

- No mandatory 10-year maturity date
- Less risky – lender cannot freeze or reduce loan amount
- Option to make payments or not
- Never owe more than the home is worth
- Heirs not at risk for repayment over the value of the home
- Counseling component

How much are these features worth and to whom?

Key findings from the focus groups

- General discomfort with, and misunderstanding around, the notion of using home equity
- Open to learning
- Acknowledged limited understanding and misperceptions about RLOC and HELOC – even those that had HELOC's
- Consumers open to independent, objective information about home equity options and welcome web-based learning
- Transparency and trust critical
- Would welcome "Good Housekeeping seal of approval" if substantive

Consumers cite critical concerns about retirement, yet overlook or do not understand how to tap existing home equity to address those concerns

Results helped shape our home equity goals & strategy

Our Goal: Over the next 3 years educate at least 1.2 M older home owners about their options for using their most important asset – their home

Our Strategy: collaborate with businesses, research organizations, advocacy groups and policy makers to provide thought leadership (insights and strategies), to deliver online consumer education and decision-support, and to identify and advocate for policy changes and product innovations – with a special focus on helping low-to-moderate income older adult homeowners to improve their financial well-being and health.

Possible insights for your product and marketing teams

www.ncoa.org/wp-content/uploads/2017-Home-Equity-and-Enhanced-Retirement-Security.pdf

Elderly Household Finances and The Role of Home Equity in Retirement

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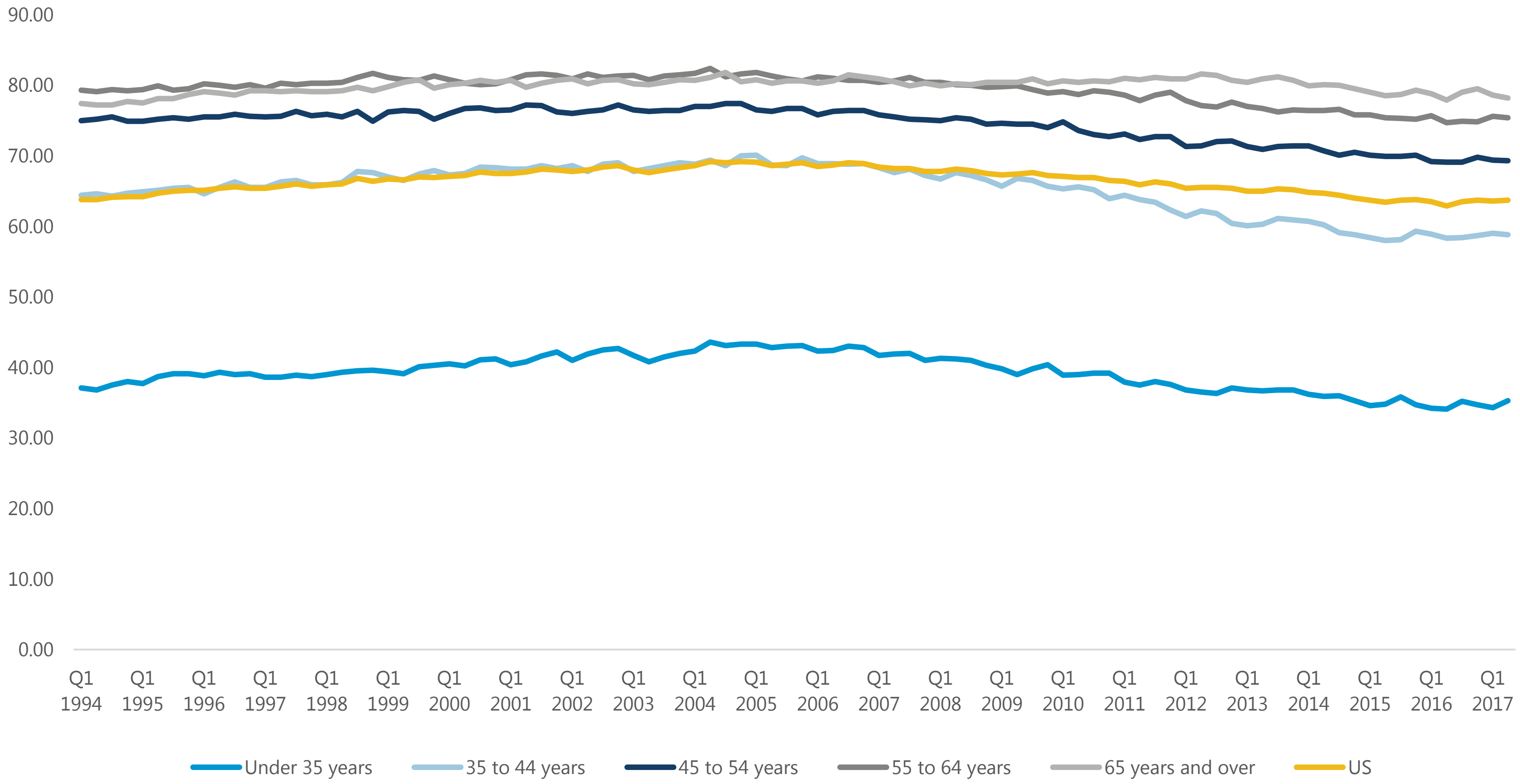
NRMLA Annual Meeting & Expo
San Francisco, CA
November 13 – 15th, 2017

Introduction

- Research based on 2016 Survey of Consumer Finances released by the Federal Reserve Board in September 2017; once every three years.
- Most recent data available
- Provides detailed and most up to date snapshot of elderly household finances using different measures of financial well being
- Allows us to estimate the number of elderly homeowners who may be financially burdened, but possess substantial home equity wealth
- Ultimately helps size the potential market for home equity lending for the elderly

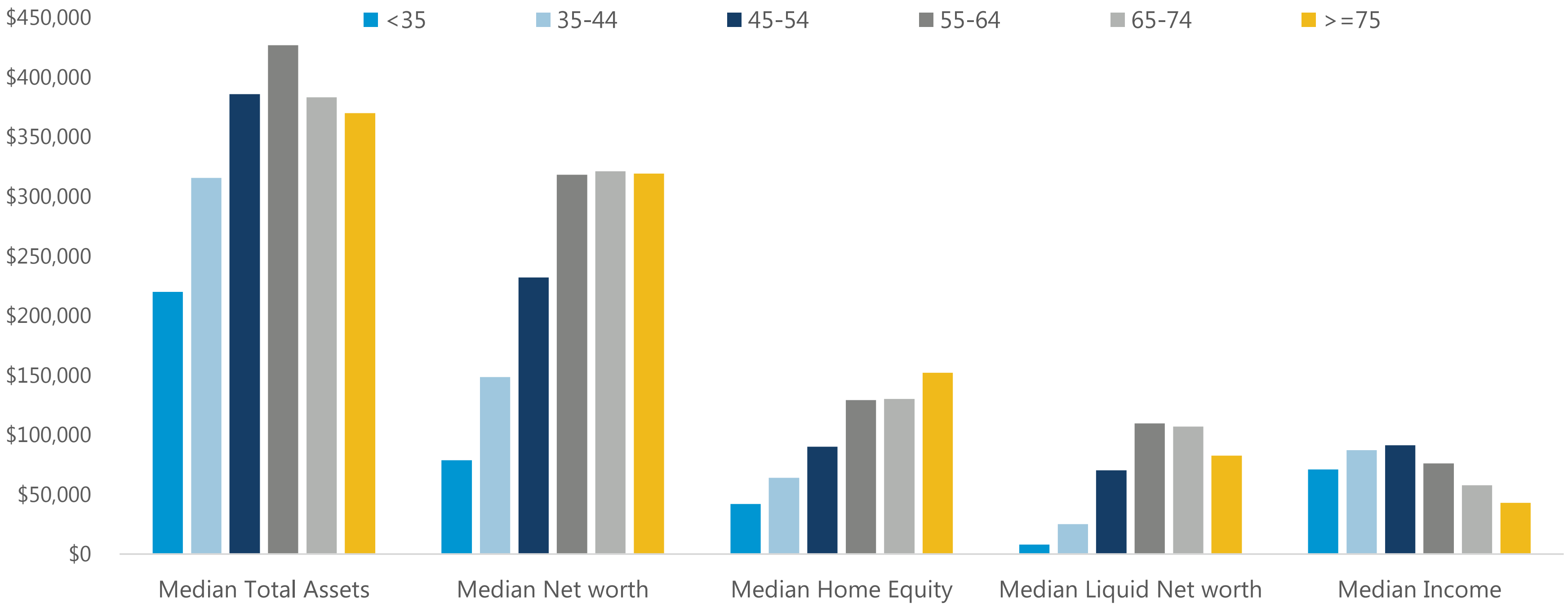
The elderly have higher homeownership rates than the general population



Source: US Census Bureau

Elderly homeowners tend to have more wealth than younger homeowners

2016 Wealth measures for US Homeowners by age

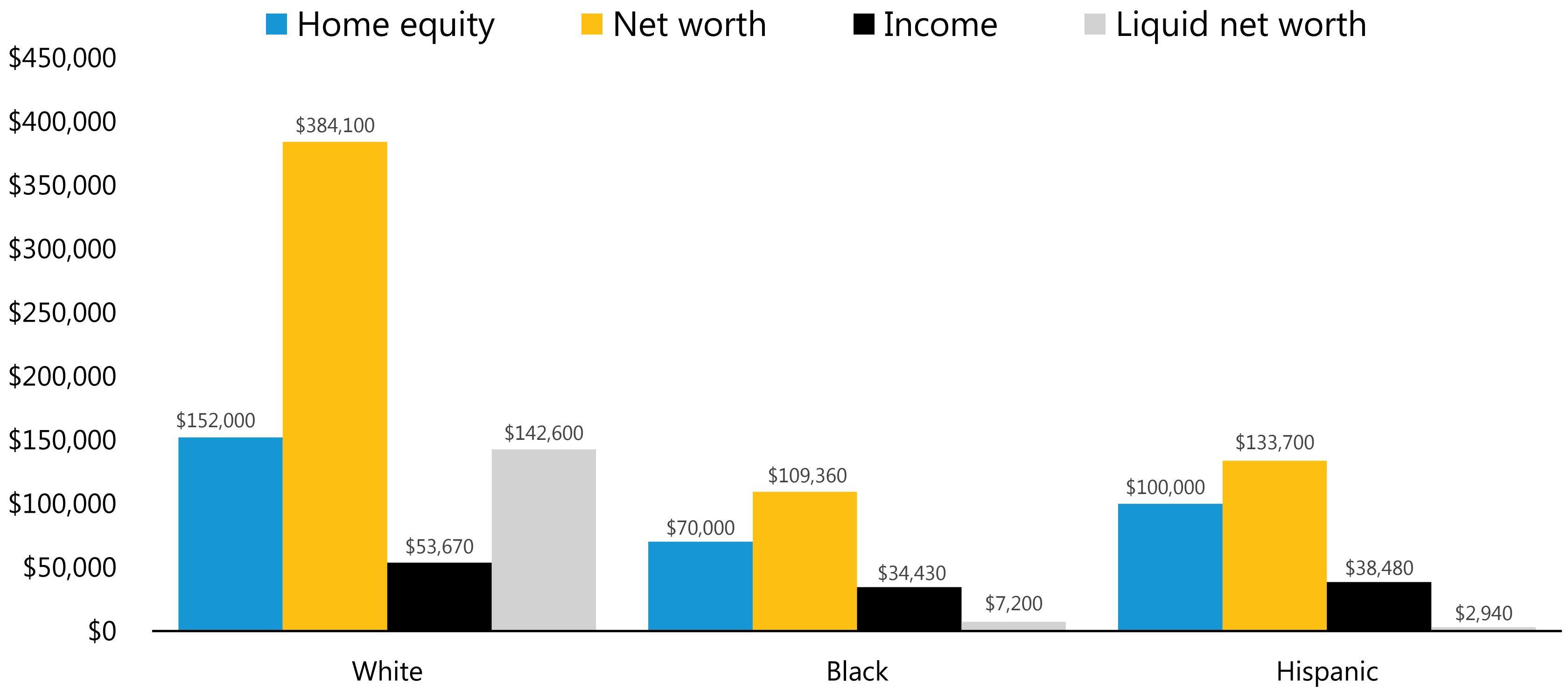


Source: Survey of Consumer Finances, 2016

Net worth = Total assets – Total debt
Home equity = Home value – housing debt
Liquid net worth = Financial assets – loans (student loans, personal loans, credit card debt); a measure of on hand net cash or cash equivalents

Wealth measures by race, age 65+ homeowners

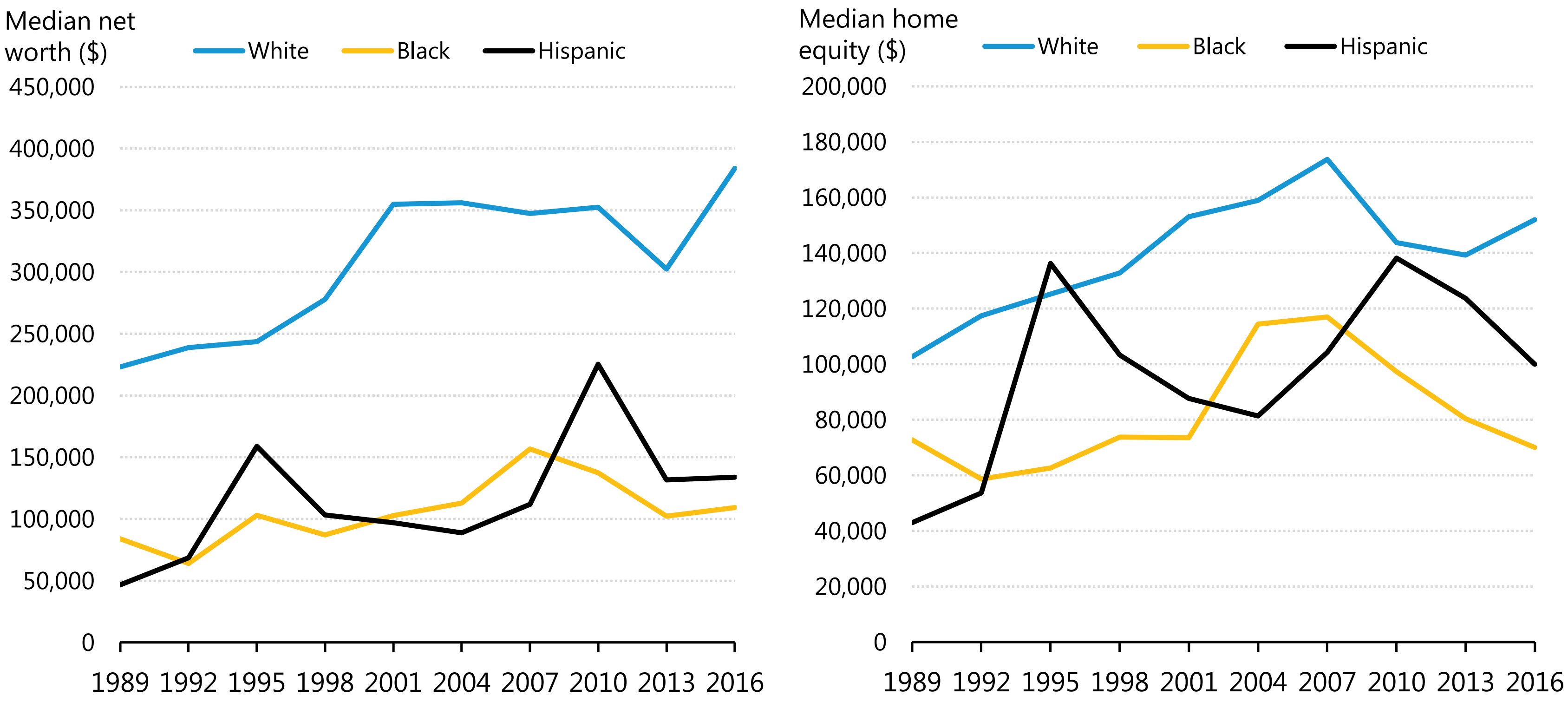
- Blacks and Hispanics lag whites along all wealth measures, especially liquid net worth
- Hispanics have slightly higher wealth measures than blacks



Source: Survey of Consumer Finances, 2016

Wealth measures for 65+ homeowners over time

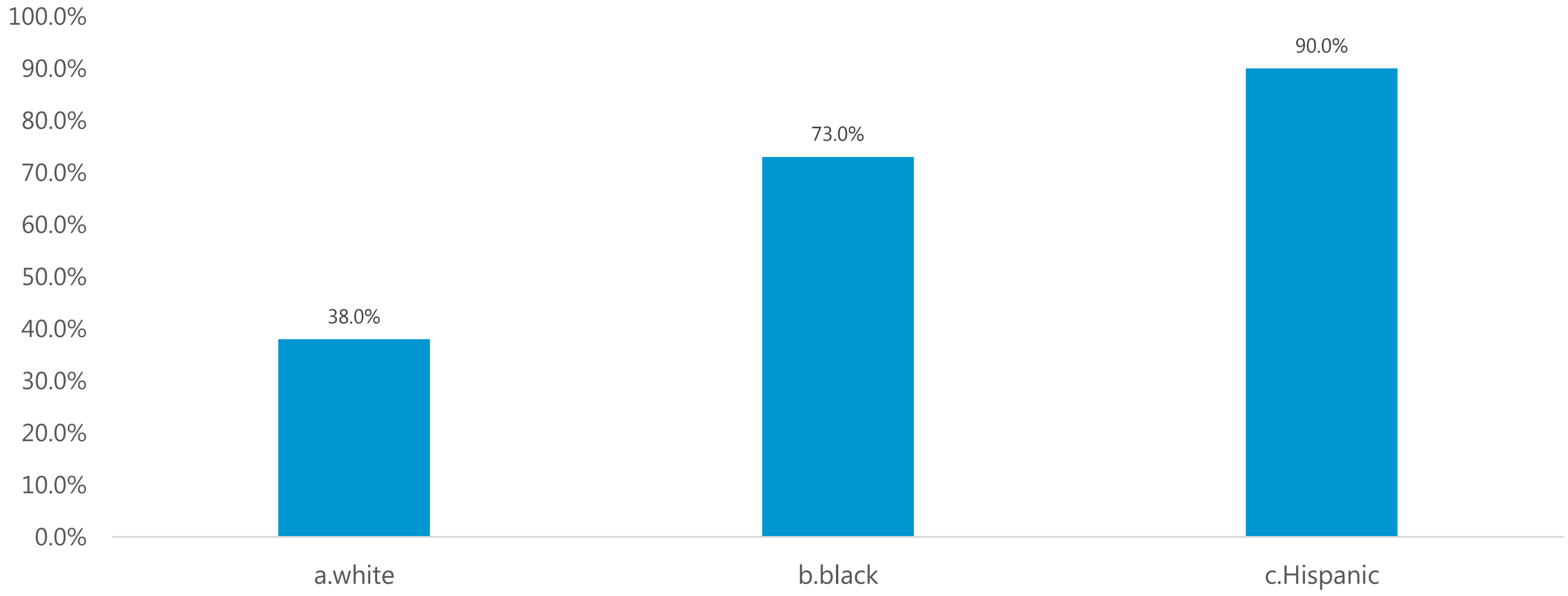
Despite racial differences, wealth measures have improved in recent decades



Source: Survey of Consumer Finances

Share of net worth attributable to home equity

Home equity comprises a much larger share of net worth for Black and Hispanic homeowners than for White homeowners (ages 65 and older)



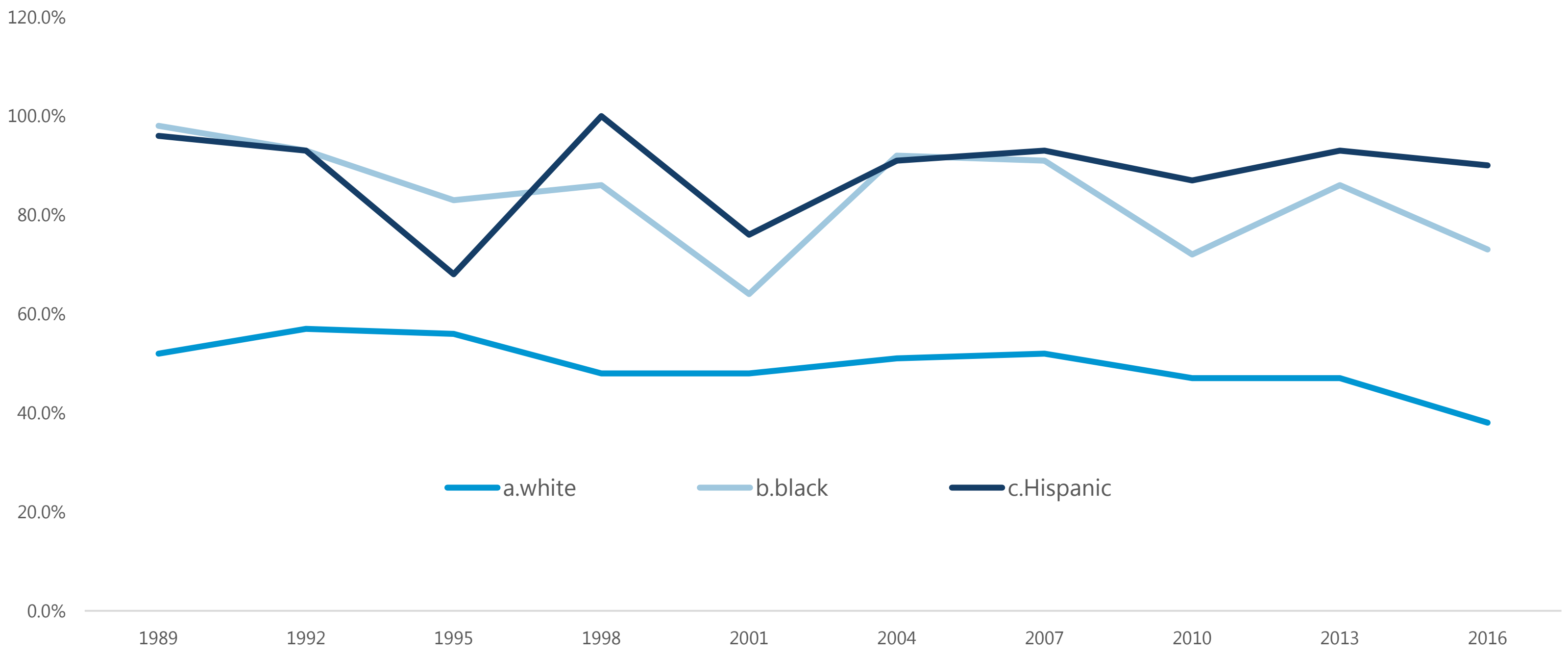
Source: Survey of Consumer Finances, 2016

- Most of their wealth is tied up in their homes
- Minorities have very low liquid net worth
- More likely to have the need to tap home equity

Share of net worth attributable to home equity, over time

- Historically, the vast majority of net worth for black and Hispanic homeowners has come from home equity

Median Ratio of Home Equity to Net Worth, ages 65+ by Race



Source: Survey of Consumer Finances

Sizing senior home equity borrowing needs

- Numerous studies have shown that Americans own staggering amounts of home equity, in the trillions of dollars
- Of course, not everyone will need or want to use it; But many will.
- How many elderly homeowners (age 65+) might need to tap home equity?
- The ones most likely are those with low incomes and savings, but significant home equity wealth
- Two basic assumptions:
  - Liquid net worth less than $50,000
  - Home equity above $100K
  - Annual income up to $20K, up to $40K, up to $60K

Sizing senior home equity borrowing needs

Number of households

Income	Home Equity		
	>$100,000	>$50,000	>$25,000
≤$20,000	920K	1.9M	2.4M
≤$40,000	2.5 M	4.5M	6M
≤$60,000	3.3M	5.7M	7.5M

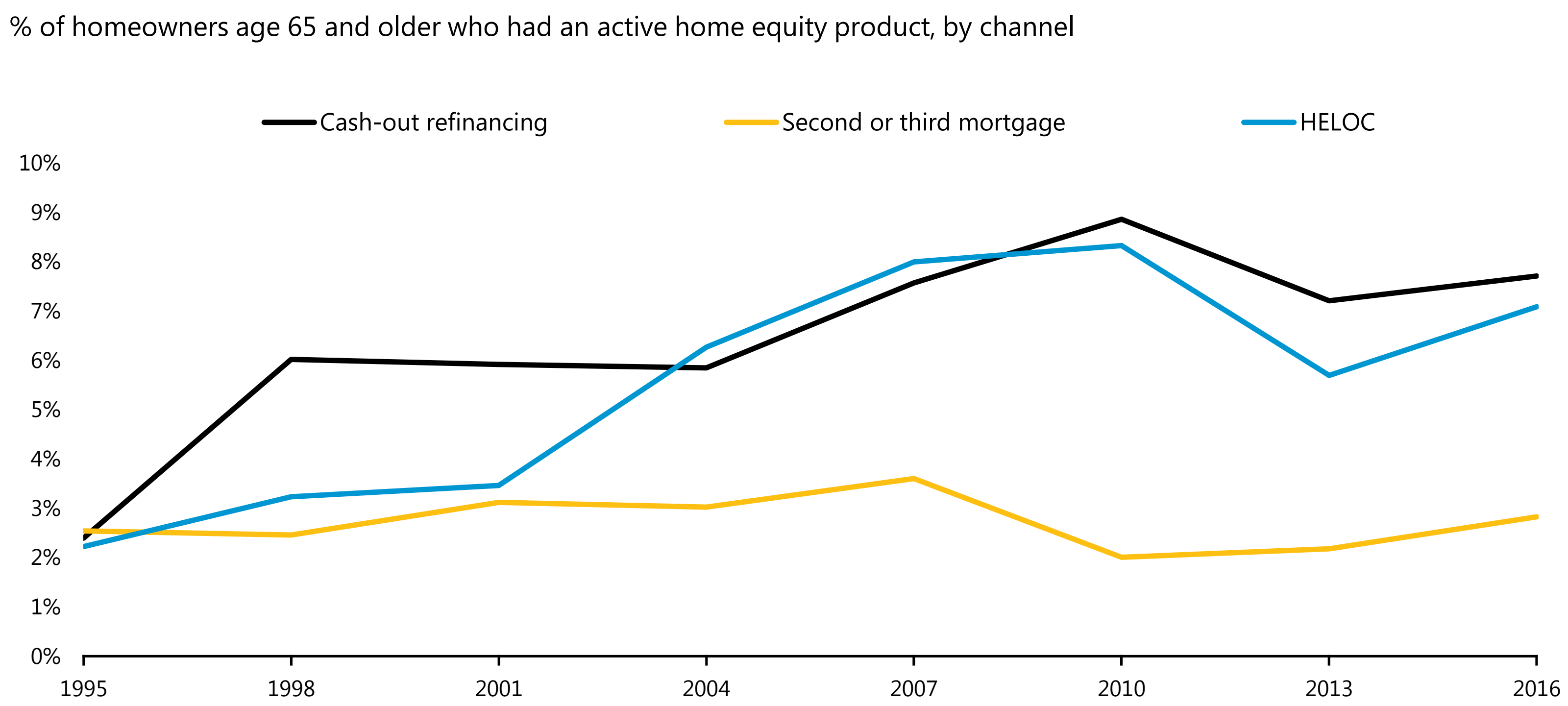
Source: Survey of Consumer Finances, 2016

Aggregate Home equity wealth owned ($)

Income	Home Equity		
	>$100,000	>$50,000	>$25,000
≤$20,000	$208B	$283B	$303B
≤$40,000	$562B	$724B	$781B
≤$60,000	$773B	$964B	$1Tr

- For all three income buckets, a total of 3.3 million households might need to access equity in their homes (conservative estimate)
- The aggregate home equity owned by these households is $773 billion
- Obviously, not all of this equity will be extracted due to lack of desire, or for other reasons
- But even if a small portion were tapped, that would give lending volumes a major boost . For example, 10% of 3.3 million = 330,000 loans (6 times current HECM volume)

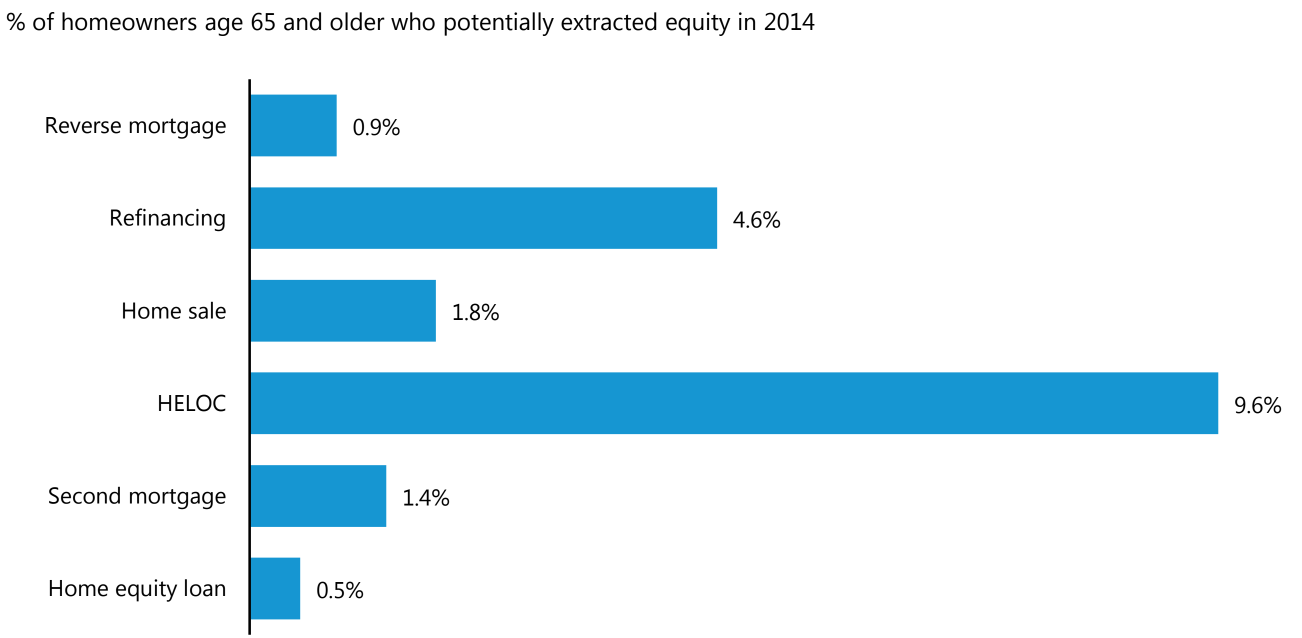
Lots of equity, but very low extraction rates



Source: Survey of Consumer Finances

- Despite substantial housing wealth and the need to improve retirement security, most seniors aren't tapping home equity
- Although extraction rates have increased during the last 20 years – mainly due to increased HELOC and cash-out usage

Home equity extraction rates are very low



- Less than 1 percent of seniors tapped equity via a reverse mortgage in 2014
- Total 17 percent of seniors age 65 and older potentially extracted equity in 2014
- HELOC by far the most popular vehicle, followed by refinance
- Actual numbers likely even lower because having approved HELOC doesn't mean equity was extracted

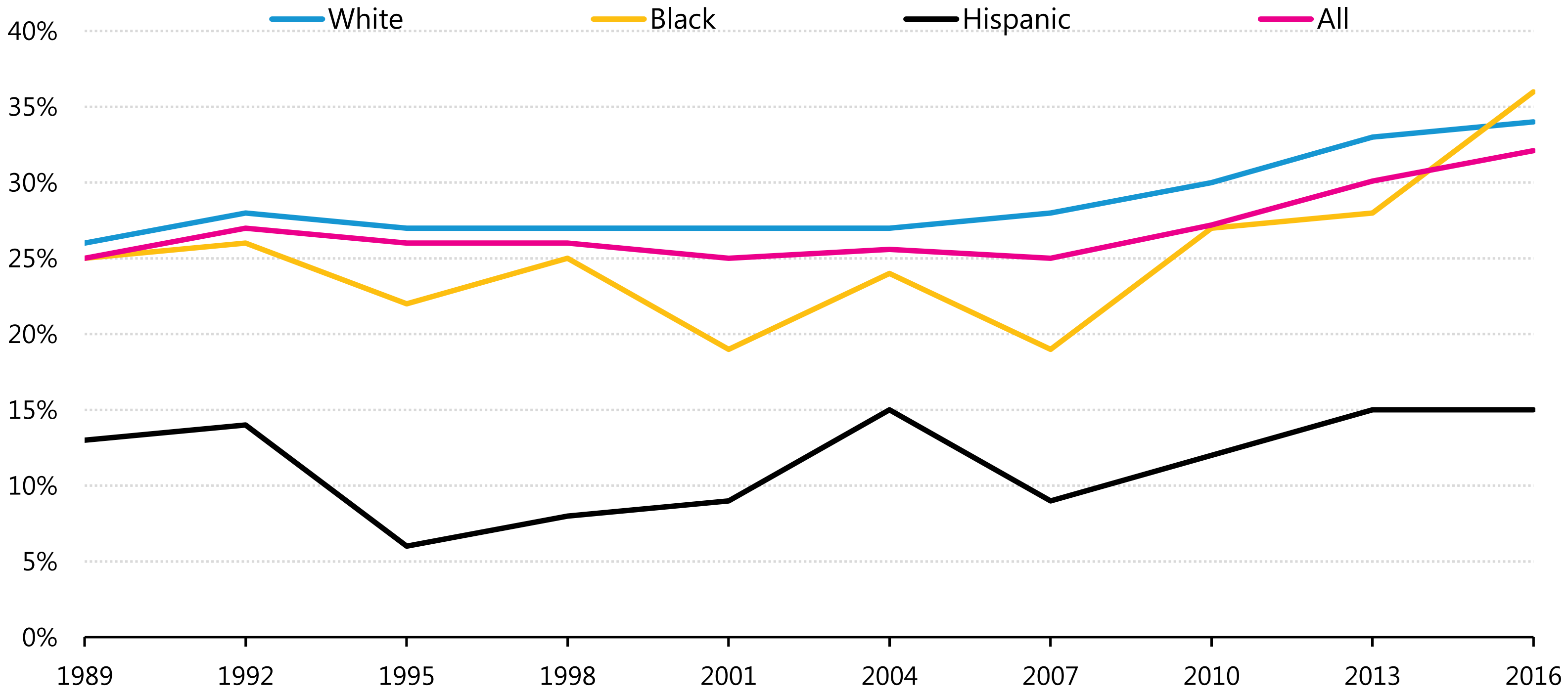
Source: 2014 Health and Retirement Study
Note: For home equity, HELOCs and seconds, the above percentages of respondents reported having one of these three products active at the time of survey; For cash-out, home sale and reverse mortgages, the period of coverage was prior 2 years

Still, need for equity extraction could grow over time

- Three structural reasons:
    - Growing senior population
    - Elderly indebtedness on the rise
    - Recent and expected gains in home equity

Elderly share of the population is rising

Share of US Homeowners ages 65 and Older, by Race

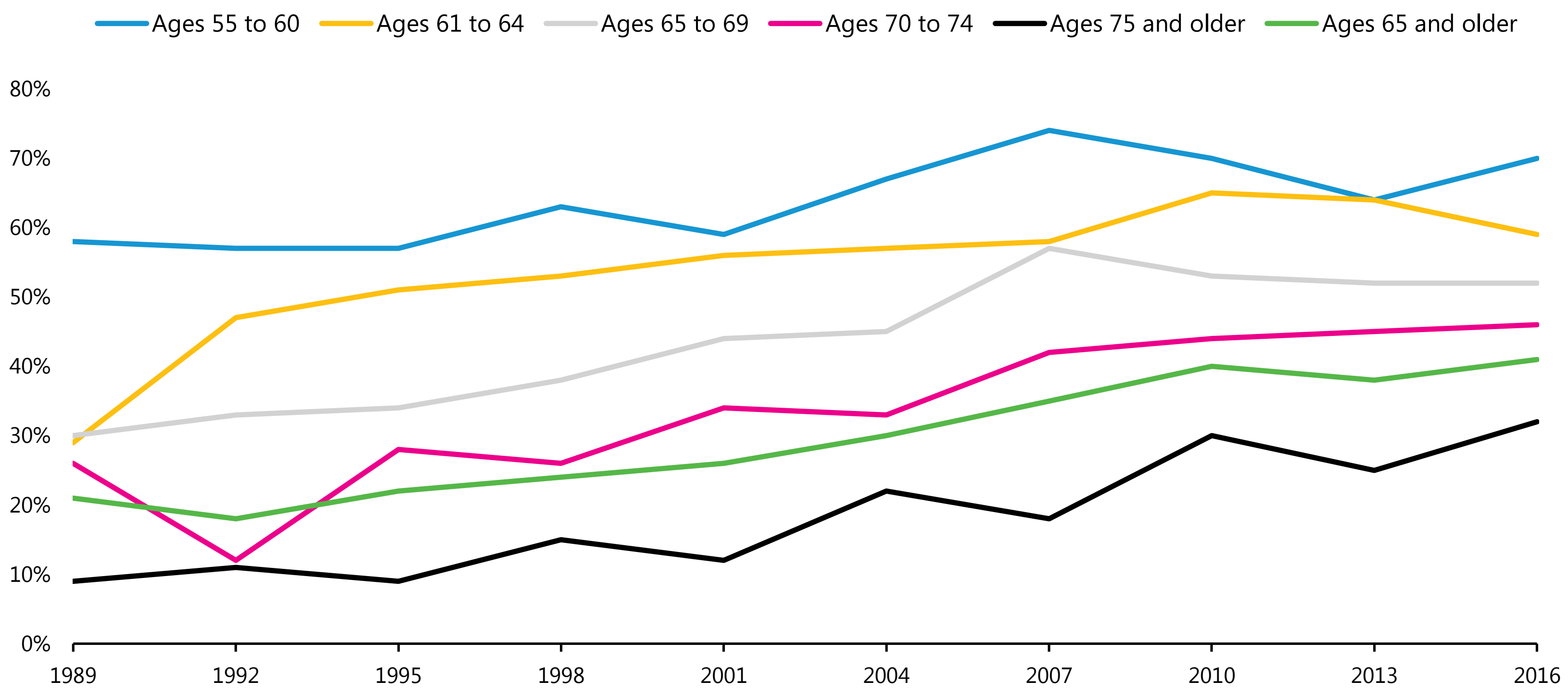


- In 2016, age 65 and older homeowners represented 32 percent of all homeowners, up from 25 percent in 2007. Expect growth to continue
- Demand for senior equity lending should grow even if extraction rates stay at present levels

Source: Survey of Consumer Finances

Share of elderly with a mortgage is up significantly

Share of Elderly Homeowners with a Mortgage

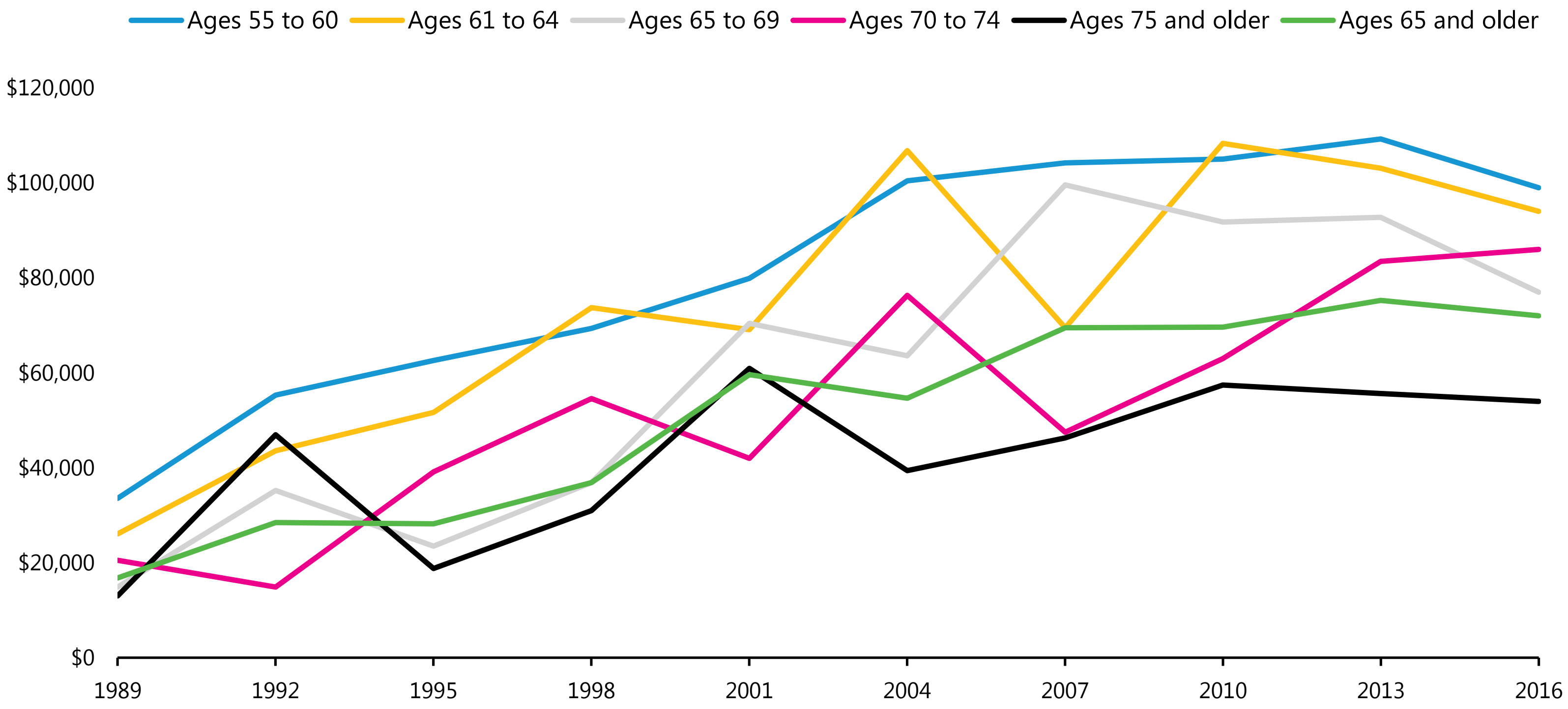


Source: Survey of Consumer Finances

- Among homeowners ages 65 and older, the percentage with a mortgage has nearly doubled since 1989 (21 percent to 41 percent)

Elderly are carrying higher mortgage debt

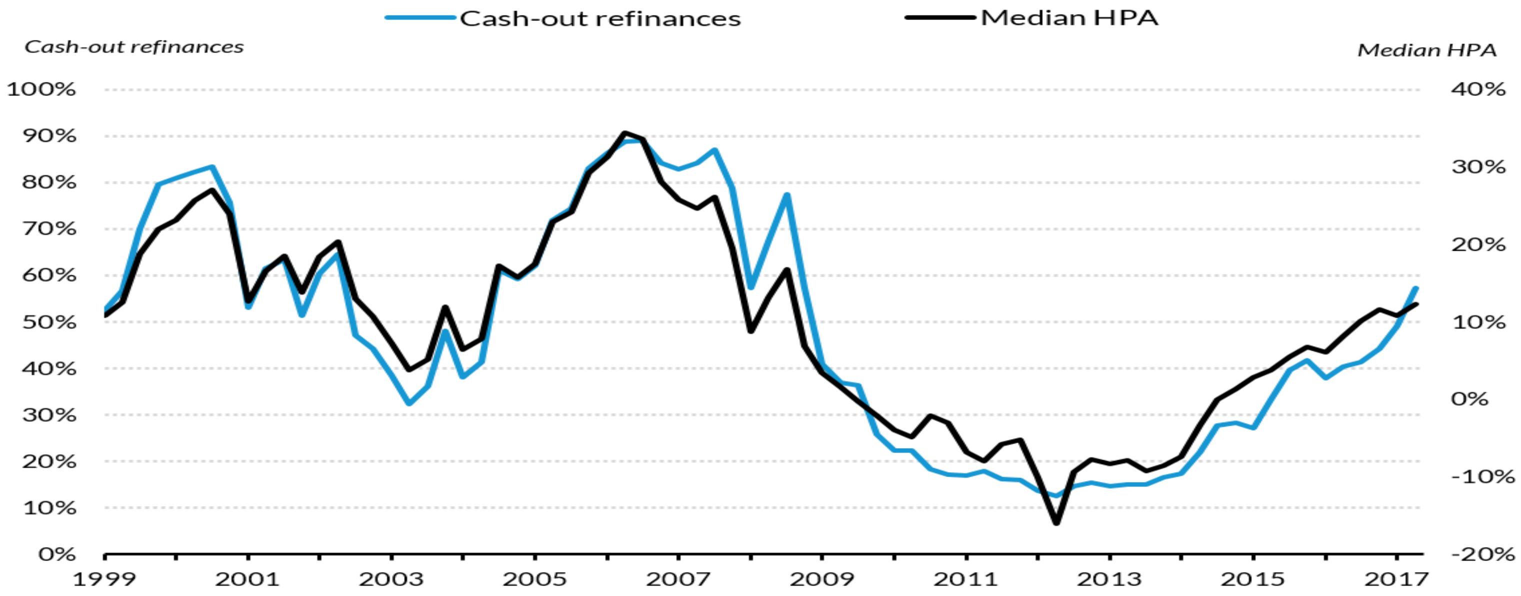
Median Mortgage Amount for Elderly Homeowners with a Primary Mortgage



Source: Survey of Consumer Finances, 2016 dollars

- For homeowners ages 65 and older, mortgage debt load has more quadrupled since 1989, adjusted for inflation ($17,000 to $72,000)

Cash-Out Dominates when House Price Growth is Strong



Source: Freddie Mac Quarterly Refinance Statistics

- House price appreciation is often associated with an increase in equity extraction
- Cash-out refi share has increased –up from 12 percent in 2012 to 57% in Q2 '17
- House price growth is expected to remain strong because of a shortage of housing supply
- Continued house price growth = more equity accumulation for existing homeowners

Future of senior home equity lending

- The latest study reaffirms what we know:
  - Staggering amount of home equity wealth
  - Significant numbers of financially constrained households
  - But very low extraction
- Despite low usage, senior home equity lending market could grow over time:
  - More people retiring every day
  - Today’s elderly are more indebted than previous generations
  - Stronger financial incentive to tap home equity
- Unique features of reverse mortgages can make it an ideal product for many, especially for low- and moderate-income households

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Using Housing Wealth to Improve Financial Outcomes in Retirement

Securities Portfolios Used for Retirement Income

A Major Concern of Retirees:

Outliving their financial resources

(a.k.a.: “Running out of money”)

typically occurs when they are most vulnerable.

So our focus is on Cash Flow Survival

Securities Portfolios Used for Retirement Income (cont'd)

Sequence of Returns Risk

Academic and scholarly research has demonstrated that negative or weak investment returns,

*-in the **early years** of retirement,*

-in a portfolio that is being drawn upon,

leads to a substantially increased probability of premature portfolio exhaustion, long before the end of a 25 or 30-year retirement.

Securities Portfolios Used for Retirement Income (cont'd)

Effect of Drawing on a Securities Portfolio

A Very Simple Example (to illustrate the effect of negative returns):

Consider a portfolio starting with a value of $100 (or add a few zeros):
Suppose that in the first year, the portfolio loses 20%, so, at the end of that year, it is worth $80. If **no draw is taken**, it will require a **25%** gain in the next year to return to its original value of $100.

If, on the other hand, a $5 **draw is taken** at the end of the first year (after the 20% loss), leaving a year-end value of $75, it will require a **33%** gain in the next year to return to it's original value of $100.

Securities Portfolios Used for Retirement Income (cont'd)

Maximum "safe" withdrawal rate

THE FAMOUS 4% "SAFEMAX" RULE :

- In the first year of retirement, draw 4% of the portfolio value.
- In each subsequent year of retirement, draw the same **dollar** amount, adjusted **only** for inflation (constant purchasing power).

In general, following this rule has a greater than 90% probability of enabling the portfolio to provide inflation-adjusted cash flow for 30 years.

Securities Portfolios Used for Retirement Income (cont'd)

Taking the unsafe approach

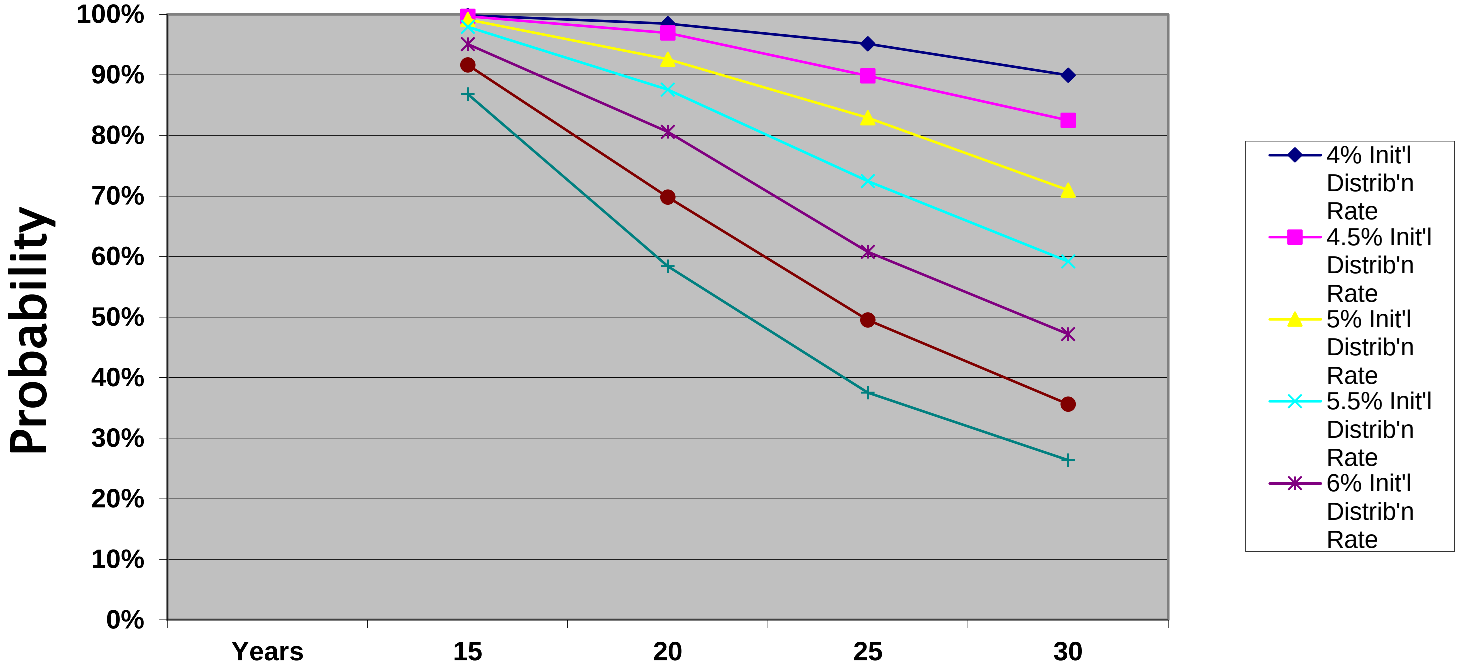
Drawing more than the "safemax" amount greatly increases the risk of running out of money.

For example, increasing the initial withdrawal rate from 4% to 5% increases the probability of **cash flow exhaustion** in less than 30 years, from 10% to 30%.

See the graph on the next slide.

Securities Portfolios Used for Retirement Income (cont'd)

Cash flow survival probability (withdrawals from account only)



Securities Portfolios Used for Retirement Income (cont'd)

The *conventional* wisdom for dealing with the risk of cash flow exhaustion:

If and when the portfolio is exhausted:

Use home equity, a reverse mortgage, as a *last resort*.

A "*Wait and See*" approach, a passive approach.

Securities Portfolios Used for Retirement Income (cont'd)

Effect of Drawing on a Securities Portfolio

A Very Simple Example (once again, for emphasis):

Consider a portfolio starting with a value of $100: (or add a few zeros) Suppose that in the first year, the portfolio loses 20%, so, at the end of that year, it is worth $80. If **no draw is taken**, it will require a **25%** gain in the next year to return to its original value of $100.

If, on the other hand, a $5 **draw is taken** at the end of the first year (after the 20% loss), leaving a year-end value of $75, it will require a **33%** gain in the next year to return to it's original value of $100.

Securities Portfolios Used for Retirement Income (cont'd)

Now that we know a major cause of portfolio exhaustion, can we invent a better strategy to reduce the risk?

- A better strategy is an **active** strategy that enables the retiree to **avoid drawing on the portfolio** when it has **negative or weak investment performance** in **the early years of retirement.**

- One way to accomplish that result is to draw, instead, on a reverse mortgage **credit line** whenever the portfolio's **investment performance was negative or weak.**

Securities Portfolios Used for Retirement Income (cont'd)

Let's think about this idea:

Questions: How do we know if the new strategy really works? And if it does work, how well does it work?

Answer: Test and compare the strategies!
(Compare the results of using Active Strategy with the results of using the Passive Strategy.)

Securities Portfolios Used for Retirement Income (cont'd)

- Question: How do we test and compare the strategies?

- Answer: Using a Monte Carlo technique to simulate the portfolio's investment performance, and inflation, over a 30-year period, we run two spread sheets simultaneously. They are identical in every respect except the timing of the draw on the portfolio or the HECM credit line.

Securities Portfolios Used for Retirement Income (cont'd)

Testing and comparing the strategies:

The retiree for this example:

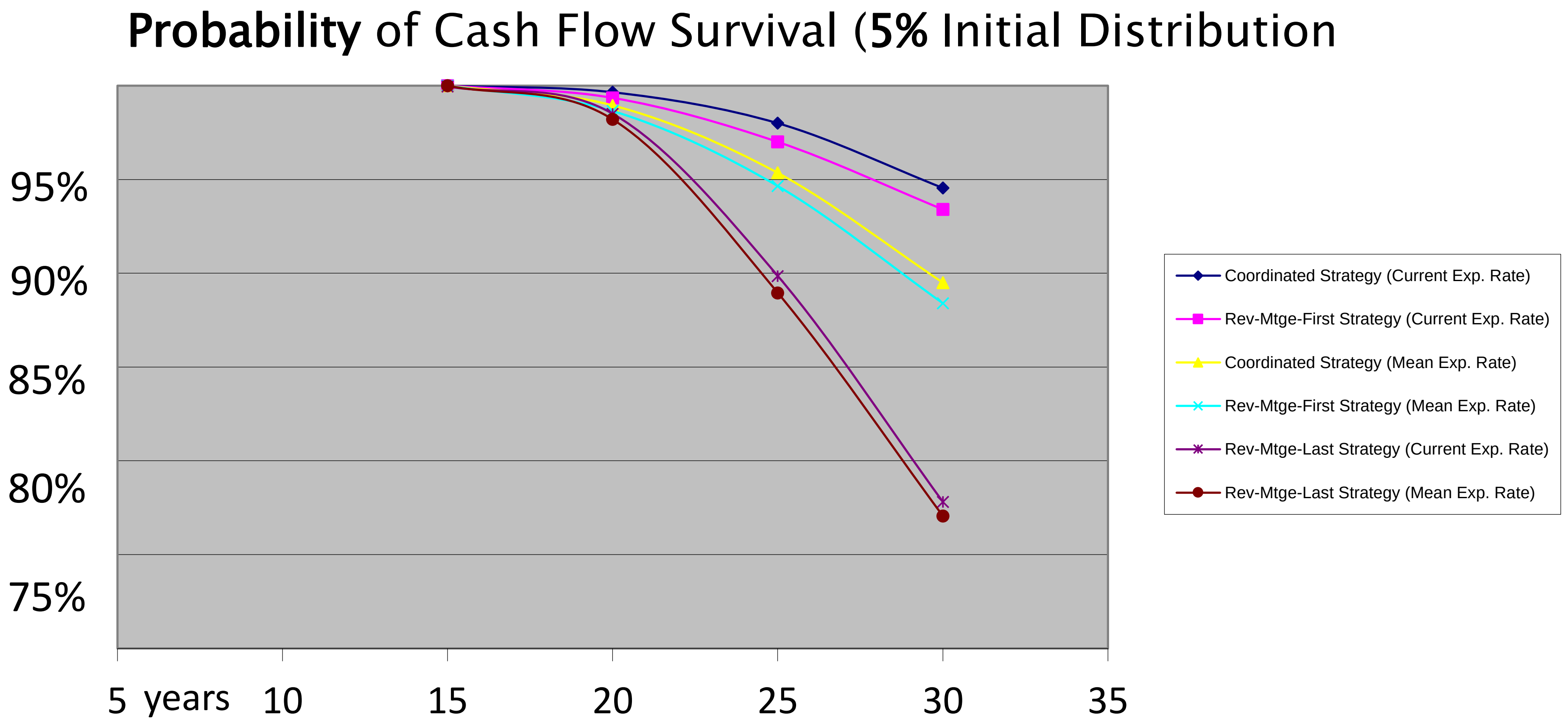
The Classic "Mass Affluent" Retiree

Input parameters for this example (NOTICE the RATIO):

- ✓ Initial account value: $ 800,000
- ✓ Initial home value: $ 417,000
- ✓ Account composition: 60% stocks and 40% bonds

(a) Securities Portfolios Used for Retirement Income (cont'd)

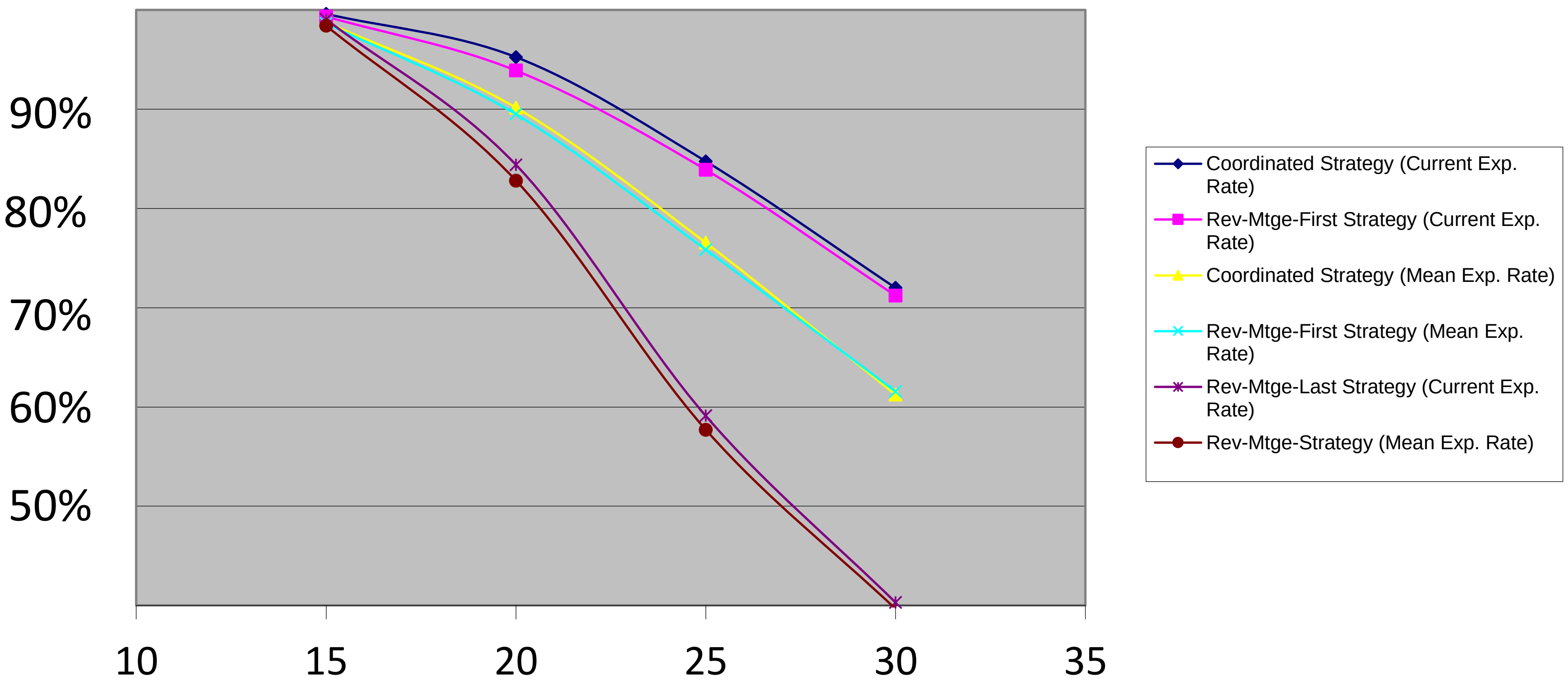
Some results of the tests…



Securities Portfolios Used for Retirement Income (cont'd)

Some results of the tests…(cont'd)

Probability of Cash Flow Survival (**6.5%** Initial Distribution



Securities Portfolios Used for Retirement Income (cont')

- Some comments about the Ratio of Home Value to Initial Portfolio Value in previous studies:

All the studies before 2017 used, in their examples, a ratio of .5 to 1 (equivalent of 1:2)

- (a) Sacks and Sacks (2012) [$400k/$800k]
- (b) Salter et al (2012, 2013) [$250k/$500k]
- (c) Wagner (2013) [$450k/$800k]
- (d) Pfau (2016) [$500k/$1 million]

Securities Portfolios Used for Retirement Income (cont'd)

- Some comments about the real world (and the future market):

- 1. Aggregate value of homes owned by Americans age 65 and over is almost twice the total value of their retirement savings. (Ratio is 2:1)

- 2. Although data is sparse, it appears that for a very large portion of the American population of seniors, the individuals' ratios are in a range generally greater than .5:1, closer to the range of 1:1 to 2:1.

Securities Portfolios Used for Retirement Income

A Very Recent Finding

A very recent finding (just published last month) is the following:

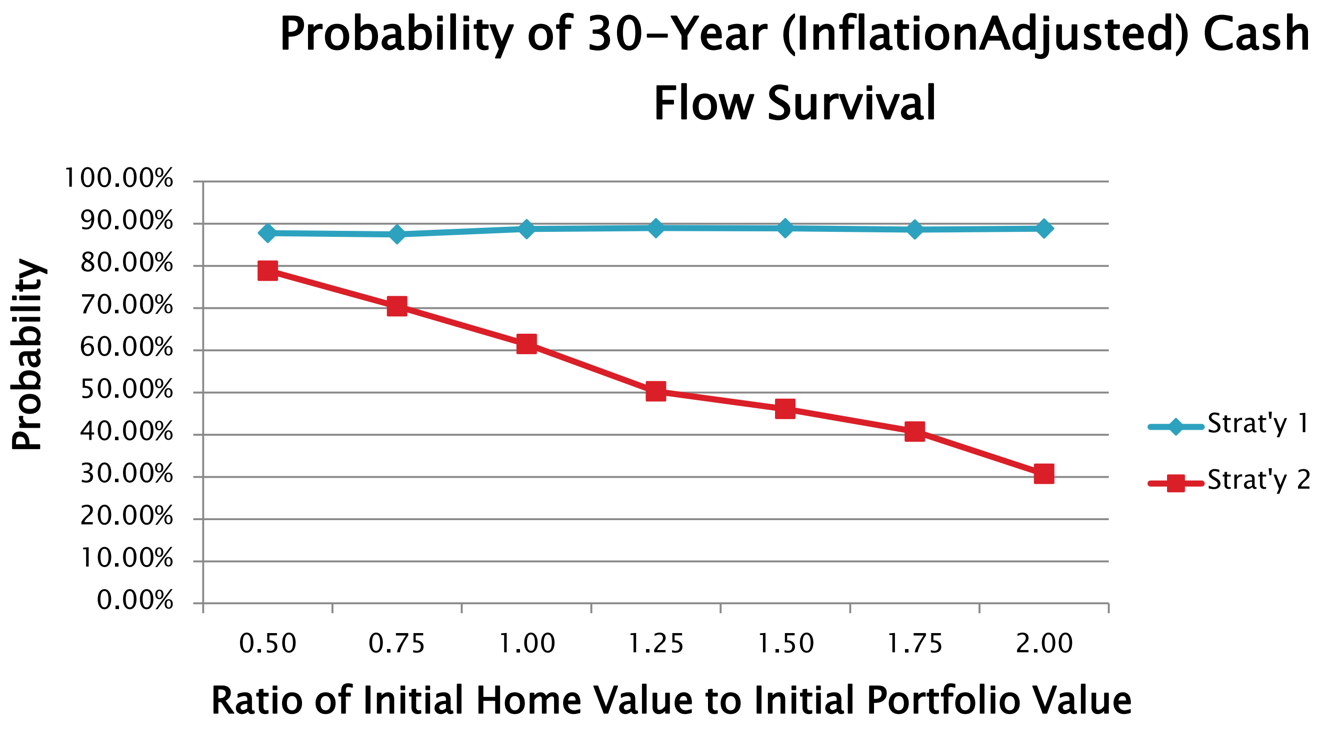
For any **Total** of home value plus investment portfolio, the **dollar amount of initial distribution** that results in approximately a 90% probability of 30-year (inflation-adjusted) cash flow survival is the **same** for a **wide range** of **ratios of initial home value to initial portfolio value.** This is true when the “Coordinated Strategy” (“Strategy 1”) is used, but **not** when the “Last Resort Strategy” (“Strategy 2”) is used.

Securities Portfolios Used for Retirement Income (cont'd)

The chart in the next slide shows the results determined with a total of $450,000. Using investment return projections of a few years ago, the dollar amount of the initial distribution was $15,000. This was 1/30 of the total of $450,000, leading to naming the algorithm "the Rule of 30." Similar results have been found for totals of $600,000, $750,000, $900,000 and $1,200,000. (Also, similar results, with different fractions, have been found when other investment return projections are used.)

Securities Portfolios Used for Retirement Income (cont'd)

A Very Recent Finding



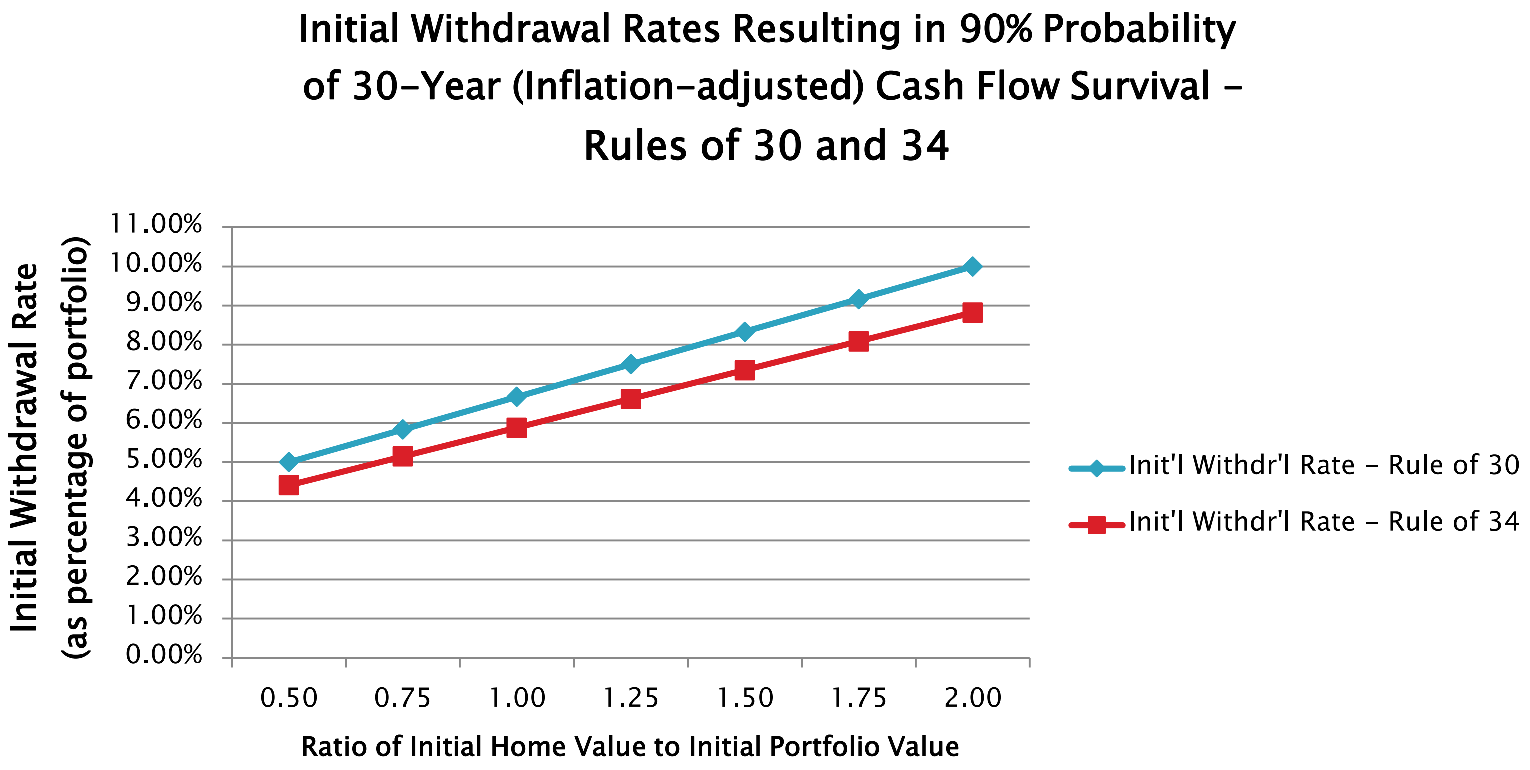
Securities Portfolios Used for Retirement Income (cont'd)

Another Way to View the Effect of the Coordinated Strategy:

Another way to view the effect of the Coordinated Strategy: The greater the ratio of Initial Home Value to Initial Portfolio Value, the greater the "boost" to the cash flow survival that comes from the home value, when the Coordinated Strategy is used. And hence the greater the percentage of the portfolio's initial value that can be used to determine the initial withdrawal amount. The two lines reflect two different sets of investment return projections: The "Rule of 30" line reflects earlier (more optimistic) projections and the "Rule of 34" line reflects current (more conservative) projections.

Securities Portfolios Used for Retirement Income (cont'd) A Very Recent Finding

The chart below presents a different way of showing the findings that are shown on the previous slide.



CONCLUSIONS:

1. The use of a reverse mortgage credit line, in the Coordinated Strategy (“Strategy No. 1), is applicable, i.e., likely to provide a significantly enhanced cash flow survival during retirement, to a much larger group of retirees than previously recognized. (10 to 20 million members of the baby boomer generation.)

2. This conclusion is entirely consistent with the observations and recommendations of academics and scholars who advocate for the use of home equity to help stem the baby boomer retirement crisis. See, e.g., Robert Merton (MIT), Jack Guttentag (U. Penn.) and Alicia Munnell (Boston College Center for Retirement Research).