Reverse Mortgages: What Homeowners (Don't) Know and How it Matters

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Reverse Mortgages: A New Puzzle?

- Take up of reverse mortgage products is very low:

  (1) There are good reasons for low demand

  (2) Individuals take the wrong decision

  – This paper: information barriers
- Déjà vu
  => Knowledge of reverse mortgages is very specific, BUT
  – This is also true for other financial products (stocks, annuities etc)
  – Would be nice to have a better connection to these
  – How does the paper differ to similar studies, such as Fornero, Rossi & Urzi: underdemand by cash-poor, but asset rich, female (correlated with low financial literacy)

The birth (and hopefully death) of a puzzle

- Absolutely convincing economic reasoning that financial product is welfare improving (stock, annuity, RM)
- Small problem: Nobody wants it – well, almost nobody
- Way out 1: no puzzle because some rational explanations have been overlooked (annuities: means-tested benefits)
- Way out 2: Still a puzzle, no rational explanations
  - The puzzle is worse than you think
  - The puzzle is not as bad as you think
- In case of 2: There must be something else
  - Informational barriers, product knowledge, misunderstandings
  - Behavioral factors: peers, framing, defaults (implicit, explicit)
  - Back to square 1: the product is not as convincing as we thought

Reverse Mortgages: Informational Barriers

- What would you consider "adequate knowledge"?
  Many OK economic decisions with very limited knowledge
- Knowledge index: what do we gain from aggregating? Are certain issues more related to non-take up than others?
- Use of survey monkey:
  - offers several different survey methods, which one is chosen?
  - sample size seems low, especially for analysis on information transfer
  - respondents are higher educated and have higher wealth than SCF – scores for financial literacy and reverse mortgage knowledge etc. might be higher than population average
- "The effect of risk aversion... is opposite to theoretical predictions ... may be driven by misconception of the product" (p.17): can be tested with the survey questions

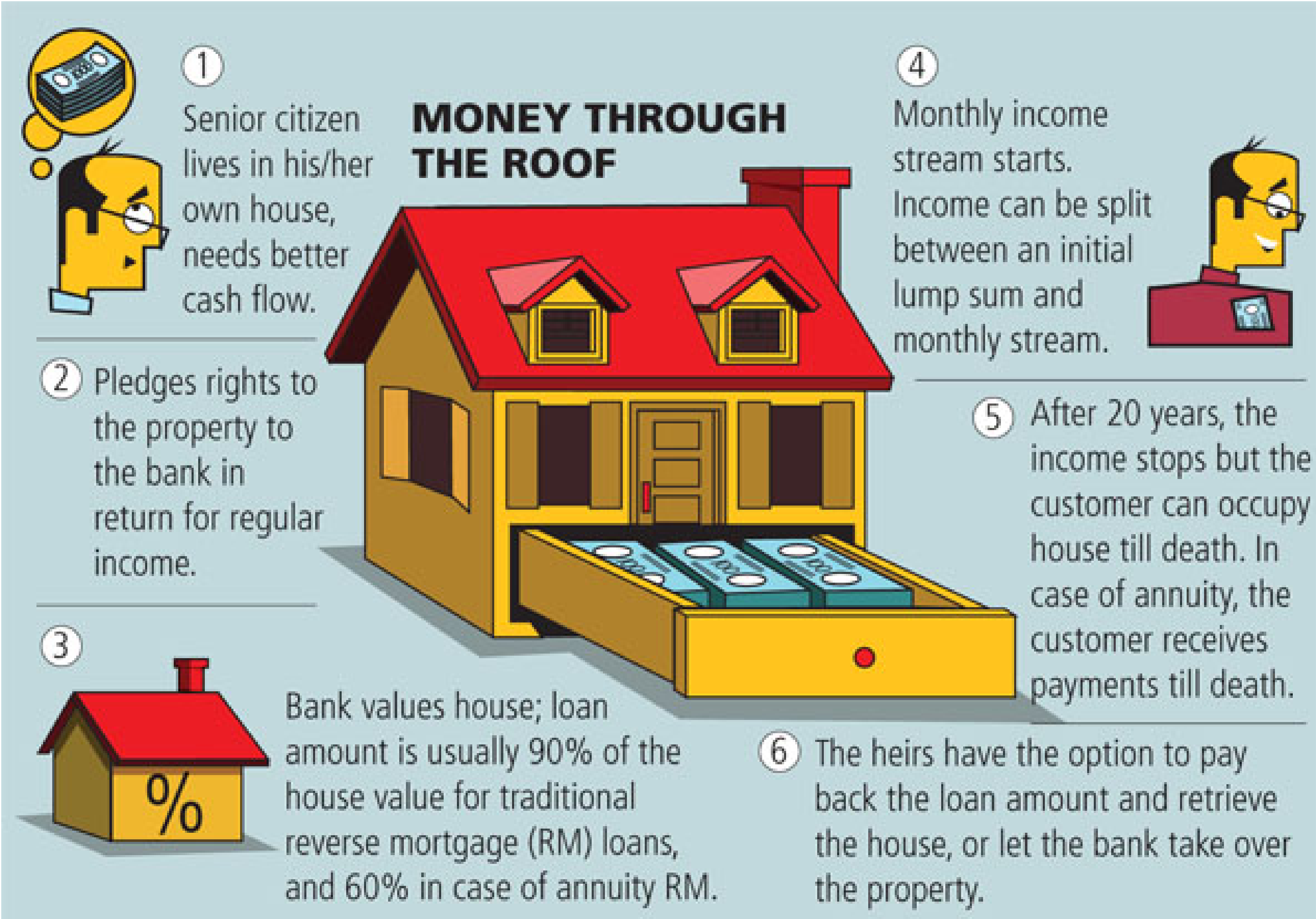
Please read the following information carefully.

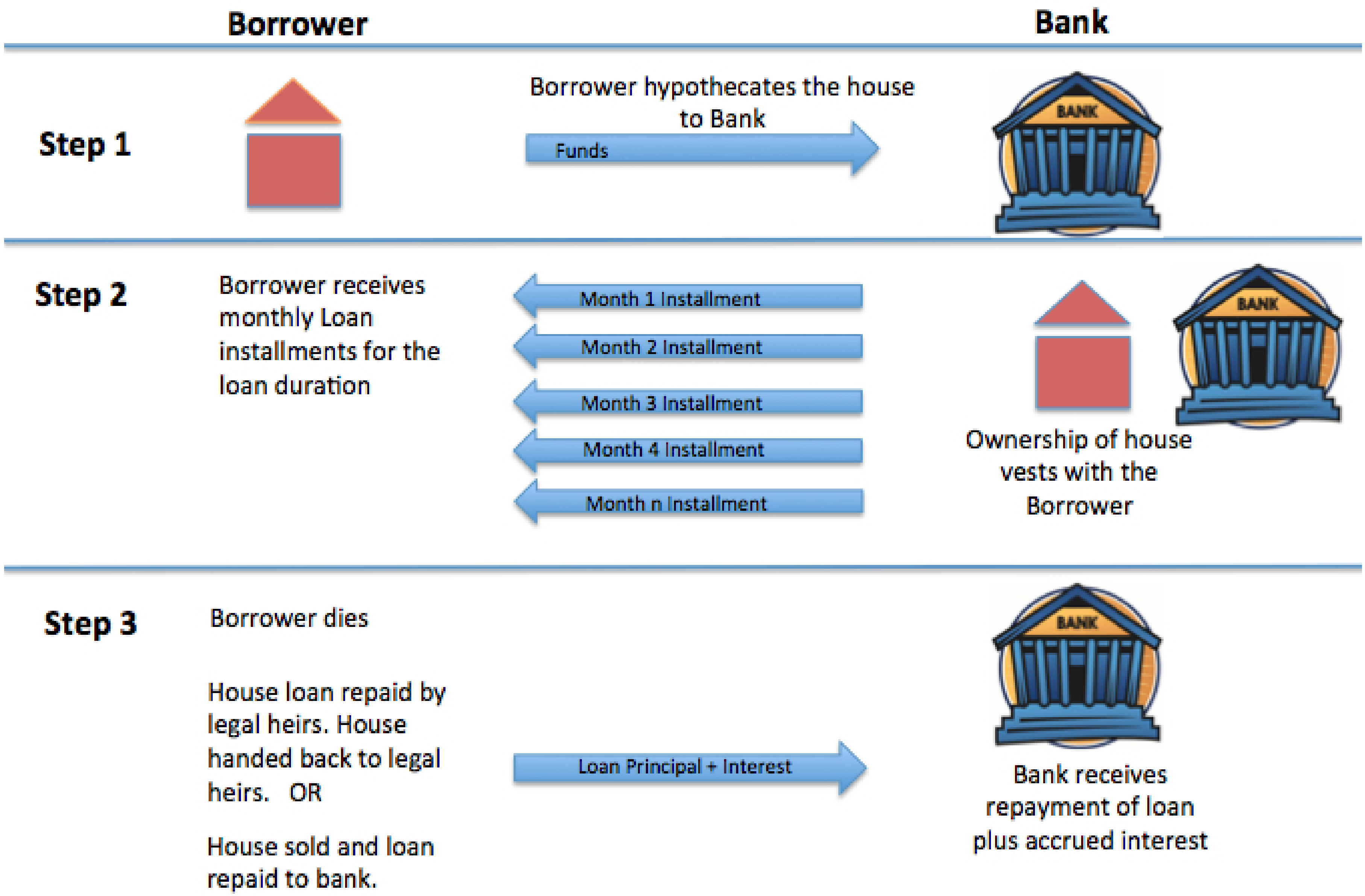
If you have finished, please click 'next'. A Home Equity Conversion Mortgage (HECM) allows seniors to access their home equity without any requirement to meet income or credit qualifications. Similar to a “conventional” mortgage, it is a loan which uses the house as a security. The homeowner, who borrows money against his home, has the choice between a onetime payment (lump sum), a line of credit, which can be used any time, a supplement to monthly retirement income (annuity), or any combination of these. Over time, interest charges are added to the loan amount, thus the loan amount rises. Repayment of the loan is required if the homeowner sells the home, moves out, or dies. When those events occur, the home can be sold to pay back the loan. HECM borrowers are protected against the possibility that their home may fall in value. If the home is worth less than the loan amount due, the borrower is not obliged to pay the bank more than the value of the home to satisfy the loan. As long as the loan is in place, the borrower remains the owner of the house, including all duties that come along with homeownership, such as obligation to pay property taxes and insurances. If the homeowner still repays an existing mortgage, a reverse mortgage can only be taken if the funds received from it are used to repay the existing mortgage.

Reverse Mortgages: Information Transfer

- Important issue, BUT
- “relatively simple description of a complex product” requires level of education of grade 10/11.
  => is Flesch-Kincaid grade related to text only or also imbedded knowledge?
- 3 minutes and 20 seconds hardly enough to understand the product.
- Why not show them really simple descriptions/pictures (=> my ad hoc search on the internet)


REVERSE
MORTGAGE


MONEY THROUGH THE ROOF
1 Senior citizen lives in his/her own house, needs better cash flow.
2 Pledges rights to the property to the bank in return for regular income.
3 Bank values house; loan amount is usually 90% of the house value for traditional reverse mortgage (RM) loans, and 60% in case of annuity RM.
%
4 Monthly income stream starts. Income can be split between an initial lump sum and monthly stream.
5 After 20 years, the income stops but the customer can occupy house till death. In case of annuity, the customer receives payments till death.
6 The heirs have the option to pay back the loan amount and retrieve the house, or let the bank take over the property.


Borrower
Bank
Step 1
Borrower hypothecates the house to Bank
Funds
BANK
Step 2
Borrower receives monthly Loan installments for the loan duration
Month 1 Installment
Month 2 Installment
Month 3 Installment
Month 4 Installment
Month n Installment
BANK
Ownership of house vests with the Borrower
Step 3
Borrower dies
House loan repaid by legal heirs. House handed back to legal heirs. OR
House sold and loan repaid to bank.
Loan Principal + Interest
BANK
Bank receives repayment of loan plus accrued interest

What on Earth is a Reverse Mortgage?

Potential Advantages

- Recieve tax-free money each and every month
- You do not make a mortgage payment; it pays you
- Will not end up owing more than the house is worth
- No minimum credit or income requirements
- You keep your home; it can even stop foreclosure

How We Can Help

- Mortgage-Reverse.org is a 100% FREE Senior Help Community
- We are the fastest growing online Community for Seniors, and have tons of professionals and other seniors that login daily to answer your questions!
- Join us or link to us at: http://mortgage-reverse.org

How Does it Work?

The first part of the ***Reverse Mortgage Process*** *is* ***education, counseling****, and* ***learning,*** *so just by reading this infographic you're ahead of the learning curve!*

1 DECISION *to* GET REVERSE MORTGAGE

2 BECOMING QUALIFIED

The amount you may be able to recieve is based primarily on **two main factors**, taking into account the current interest rate and a loan limit of $625,500.

Home Value
A higher home value means more available money!

Your Age
The older you are, the more money you get!

3 DECIDE *how* YOU RECEIVE PAYMENTS

Determine the amount of money you would like as well as how much you would like upfront, in fixed monthly disbursements or **any combination** thereof.

Lump Sum

Credit Line

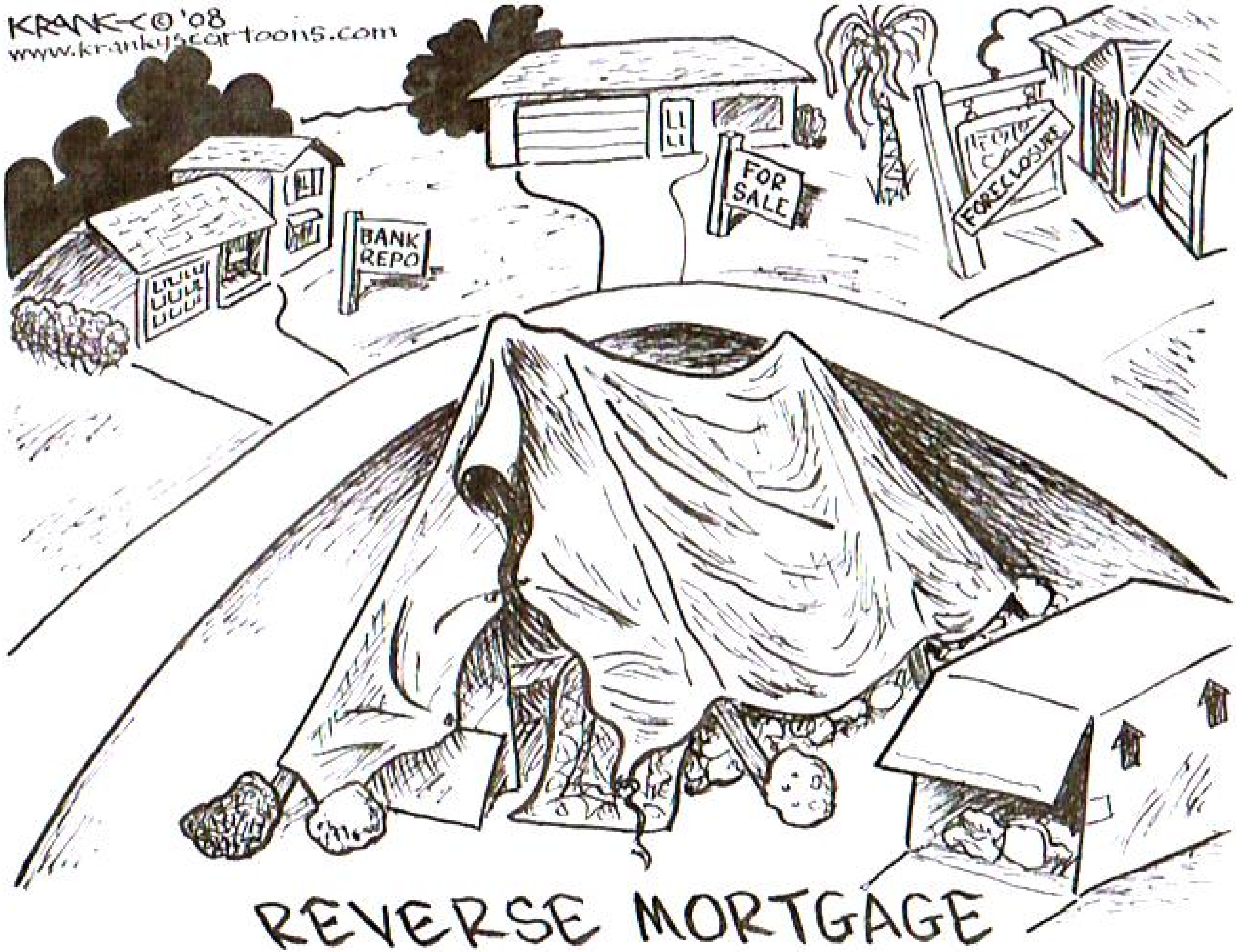
Monthly Payments

4 CLOSING OUT *the* MORTGAGE

The Borrower(s) or their heirs may pay off the loan and keep the home, or sell it and pay off the loan.

Reverse Mortgages: Back to Square 1?

- Even if the respondents did understand the description, why should they trust the banks? (Financial crisis)
- How reversible are reverse mortgages?
- What are the costs associated with the guarantee?
  If I do not need the insurance, why should I demand RM?
  => market likely to be plagued by adverse selection.
- Would be interesting: international comparison in mortgage patterns before and after retirement (=> taxes, institutions)
  - Italy: Large down-payments, low housing debt
  - Switzerland: Huge mortgage, tax advantage not to pay back
- We should not rule out that for many individuals reverse mortgages are not as beneficial as we think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