



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

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In a nutshell

- Reverse mortgages help elderly homeowners to...
 - Consume their home equity
 - While continuing to live and age in place in their “beloved” home
- Theory: great product
- Reality: only 2% of eligible U.S. households use it
- We show:
 - RM knowledge fairly limited
 - Most homeowners misunderstand the product
 - And shy away from it

Reverse mortgage

- Non-recourse loan
- Home as collateral
- Growing loan balance
- Interest accrues
- Life-long living right (rent free)

- Different forms of payout
- Fixed vs. Variable rate

HECM

= Home Equity Conversion Mortgage

- Governmentally backed reverse mortgage program
- NNEG insurance by FHA
- Since 1987

- Minimum age: 62
- Counseling

How it works

- Age: 65



How it works

- Age: 75



How it works

- Age: 85



How it works

- Age: 85
- Sell home
- Owner moves/dies



Cash for borrower/heirs

How it works

- Age: 95



Loan balance > home value

How it works

- Age: 95
- Owner moves/dies
- Sell home



Loan balance > home value
Covered by NNEG

HECM market

- Theory:
 - demand: 9-11 million U.S. households
(Mayer and Simons, 1994; Rasmussen et al., 1995)
- Reality:
 - 0.5 million HECM loans (90% market share)
(CFPB, 2012)

→ Why?
RM knowledge?

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Why RM Knowledge?

- Complex financial products
- Anecdotic evidence: Misunderstanding (Leviton, 2002; Reed et al., 2009; CFPB, 2012; Stark et al., 2014)
- Complex financial decisions:
 - General financial literacy vs. Specific knowledge
 - Debt literacy (Lusardi and Tufano, 2009)
 - Stock market (van Rooij et al., 2011)
- Low product-specific literacy \Rightarrow low demand?

Why RM Knowledge?

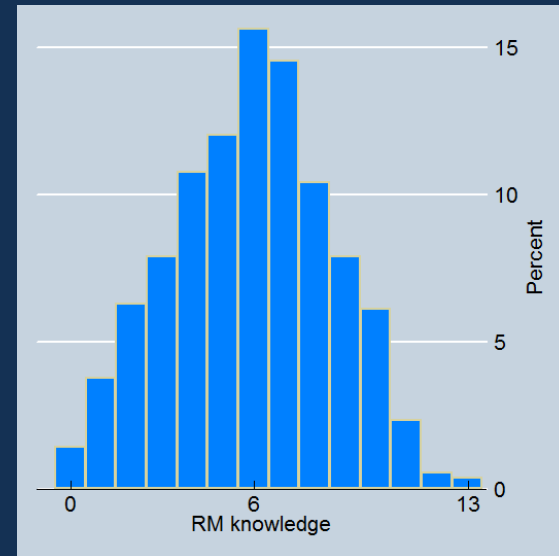
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What do people know?

- Representative U.S. survey (N=557)
- Matched on ZIP code with ACS & HUD data
- 97% have heard of RMs
- 2% have RM
- Knowledge: 13 items
- \emptyset knowledge score: 5.9



Explaining RM knowledge

| | RM knowledge (1) | RM knowledge (2) |
|--------------------------------|---------------------|----------------------|
| Age | 0.038* (0.021) | 0.028 (0.021) |
| Gender | 0.706*** (0.216) | 0.642*** (0.220) |
| White | 0.933** (0.399) | 0.916** (0.397) |
| Household income (in \$ '000) | 0.001 (0.006) | 0.006 (0.006) |
| Household savings (in \$ '000) | 0.002 (0.002) | 0.001 (0.002) |
| Ln(homevalue) | 0.033 (0.194) | 0.007 (0.197) |
| Children | 0.191 (0.261) | 0.352 (0.262) |
| Financial literacy | 0.772*** (0.163) | 0.780*** (0.161) |
| Planning skill | 0.303*** (0.082) | 0.306*** (0.084) |
| Conv. mortgage | 0.052 (0.225) | 0.080 (0.225) |
| RM experience | 1.979** (0.808) | 2.113*** (0.799) |
| Others known w. RM | 0.573** (0.271) | 0.518* (0.272) |
| | ⋮ | ⋮ |
| HECM penetration | | 5.707 (5.091) |
| Broker trust | | -0.209*** (0.071) |
| Constant | -2.089 (1.411) | 0.142 (1.726) |
| Observations | 557 | 557 |
| Adj. R ² | 0.172 | 0.196 |

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Willingness to accept a RM

| | WTA (1) | WTA (3) |
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| RM knowledge | 0.070*** (0.021) | 0.070*** (0.022) |
| Age | -0.001 (0.010) | 0.000 (0.011) |
| Gender | 0.110 (0.108) | 0.032 (0.112) |
| White | -0.091 (0.198) | -0.086 (0.199) |
| Household income (in \$ '000) | -0.008*** (0.003) | -0.008** (0.003) |
| Household savings (in \$ '000) | -0.001 (0.001) | 0.000 (0.001) |
| Ln(homevalue) | -0.054 (0.096) | -0.044 (0.101) |
| Children | -0.249* (0.129) | -0.191 (0.136) |
| Financial literacy | -0.128 (0.082) | -0.188** (0.083) |
| Planning skill | -0.043 (0.041) | -0.038 (0.043) |
| Conv. mortgage | 0.287*** (0.111) | 0.278** (0.115) |
| Others known w. RM | 0.698*** (0.131) | 0.651*** (0.134) |
| | ⋮ | ⋮ |
| HECM penetration | | -0.035 (2.565) |
| Bequest motive | | -0.066** (0.028) |
| Constant | 2.378*** (0.699) | 2.883*** (1.030) |
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Summary

- RM knowledge fairly limited
 - ➔ Esp. protective features (house price risk, living right,...)
confusion with regular mortgages
- (Little) knowledge = strong predictor of (low) demand
- Main target group (“cash-poor, house-rich“)...
 - ...has higher WTA...
 - ...but poor knowledge
 - ➔ Informed decision-making?