BRONFENBRENNER

Life Course Center

ISSUE BRIEF

Volume 1

Number 2

College of Human Ecology • 259 Martha Van Rensselaer Hall • Cornell University • Ithaca, NY 14853

Reverse Mortgages—A Solution to Poverty in Old Age?

The United States is rapidly aging. The number of Americans over 50 will rise from 65 million to 97 million over the next 20 years. The number of people over 65 is at an all-time high and will continue to increase. The number of very old—those over 85—is also growing faster than ever before.

As Americans live longer, the issue of adequate, long-term financial resources becomes increasingly critical. For some elderly persons, savings, pensions, and other wealth, supplemented by social security, guarantee financial security for the balance of their lifetimes. For many others, however, old age is accompanied by rapidly diminishing financial resources and the risk of poverty.

Because they own homes but may have minimal savings and little or no income from earnings, pensions, or investments, many of the elderly poor can be characterized as "cash poor and house rich." Reverse mortgages are a strategy that allows them to tap into the cash value of their homes while continuing to live in them.

This practice results in improving not only the economic well-being of elderly persons, it improves the quality of their life as well. Studies have shown that the vast majority of elderly persons prefer to "age in place" and not have to leave their homes. Reverse mortgages allow them to stay in their homes as long as they wish.

Many of the elderly poor can be characterized as “cash poor and house rich.”

POVERTY RATES AMONG THE ELDERLY, INCLUDING AND EXCLUDING ASSETS

Professor Michael Rendall of Cornell's Department of Consumer Economics and Housing studies poverty among the elderly. He says that despite dramatic reductions in elderly poverty in the United States in recent decades, the numbers of "near-poor" elderly are still cause for concern. Compared to non-elderly persons, the elderly are considerably more likely to fall within the "near-poor" category. Many hover just above the poverty level and are at high risk of becoming poor.

Who Is At-Risk?

The elderly groups most commonly identified as vulnerable to poverty are:

- older women
- never-married and widowed women
- disabled persons
- Blacks
- Hispanics

However, the standard "income-only" method used to assess economic well-being and poverty ignores assets. Rendall and Alden Speare, Jr., of Brown University have constructed an alternative measure that includes that part of the value of total assets that may be spent as an "annuity" each year until death.

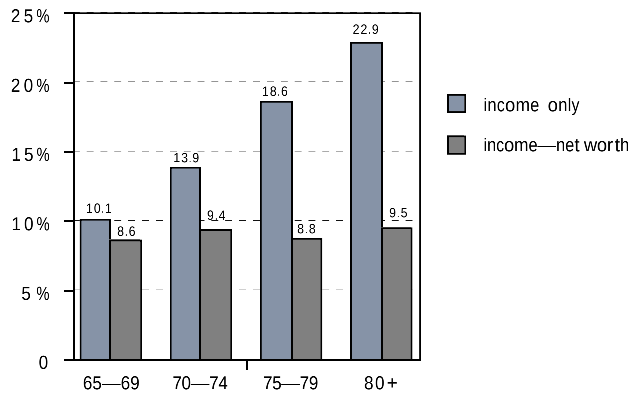
In summary:

- The "income-only" measure considers only a person's income—money from social security, pensions, investments, etc.—in evaluating economic well-being.

- The "income-net worth" measure considers assets (such as a home) as well as inocme and assumes these assets can be liquidated over time to maintain economic well-being. This measure reduces poverty rates and is preferred is assessing the economic well-being of elderly persons at risk of poverty.

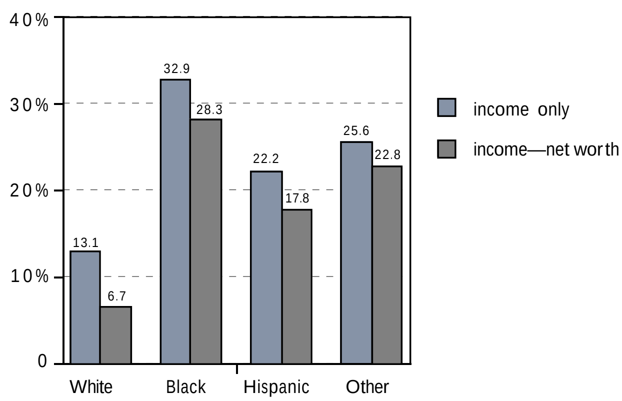
Rendall and Speare find some important differences in who and how many among the elderly are identified when the income–net worth measure is used. The following charts compare "income-only" and "income–net worth" measures to illustrate elderly poverty rates by age group, race, sex, and marital status.

Poverty rate by age group



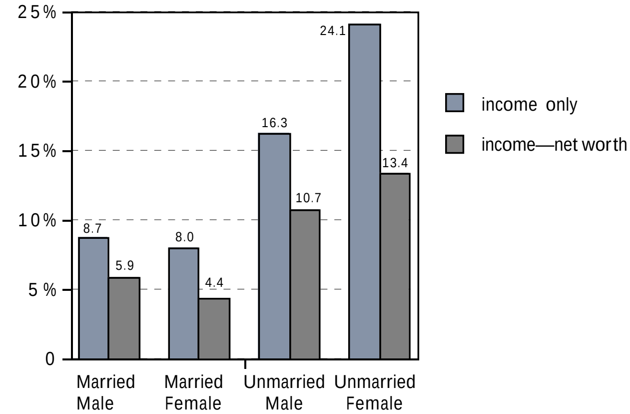
Because older persons have a shorter remaining life expectancy, their assets are worth more on a per-year annuity basis. The increasing poverty with age found under the income-only measure disappears under the income–net worth measure.

Poverty rate by race



Black elderly have lower asset holdings and thus their poverty rate is lowered proportionately much less.

Poverty rate by sex and marital status



The poverty rates of unmarried people are decreased substantially when assets are annuitized.

THE PROMISE OF REVERSE MORTGAGES

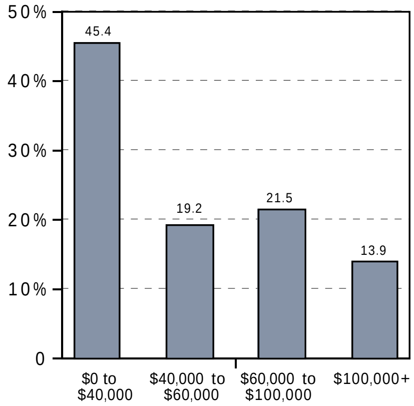
For elderly persons who own their own homes, reverse mortgages are emerging as a strategy to convert part of the value of their assets into income and potentially alleviate poverty. Professor Nandinee Kutty, also of Cornell's Department of Consumer Economics and Housing, studies reverse mortgages and their potential to improve the financial well-being of the elderly poor. She estimates that more than 620,000 income-poor elderly home-owners could raise their incomes above the poverty line by obtaining a reverse mortgage. These households constitute 29 percent of all poor elderly homeowners and 18 percent of all elderly households in poverty. Kutty's study of poor elderly homeowners in 1991 found that reverse mortgages would have reduced the elderly poverty rate from 12.4 percent to 10 percent.

Homeownership Among the Elderly Poor

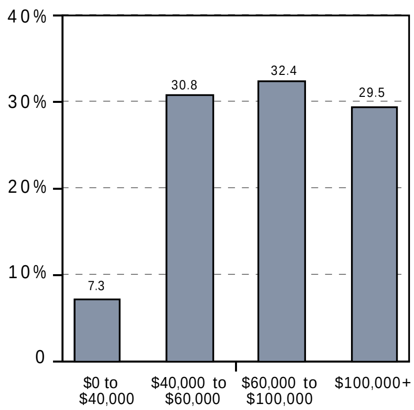
Homeownership among the elderly poor is quite high. Kutty has found that in 1991

- there were 2.1 million housing units owned and occupied by the elderly poor;
- 87 percent of homes owned by the elderly poor were owned free and clear;
- of the elderly who carried mortgage debt, the majority owed less than 20 percent of the value of their homes;
- the ratio of home value to current income was more than five to one for a majority of poor elderly homeowners;
- the median home value was $49,000 for elderly poor homeowners;
- and the value of all homes owned by the elderly poor was approximately $135 billion.

Value of homes owned by the elderly poor



Distribution of poor households that can be raised above poverty by home value.



How Reverse Mortgages Work

A reverse mortgage allows a homeowner to borrow against the equity in his or her home while continuing to live in the home. The home can be owned outright or may carry a small mortgage balance. If a mortgage balance exists, it must be paid off with the reverse mortgage loan. Unlike a conventional home equity loan, however, the borrower does not make monthly repayments against the loan. Rather, the loan becomes due and is paid back when the person either moves out of the home, sells the home, or dies. If the loan is not repaid, the lender can take possession of the home when the loan becomes due.

The borrower can receive cash in several ways.

- A lump-sum payment
- Monthly payments for a fixed period of time (Term Plan)
- Monthly payments over the remaining lifetime of the borrower, as long as the borrower continues to reside in the home (Tenure Plan)
- A credit line that can be borrowed against at various times
- A combination of lump-sum payment, monthly payments, and a credit line

Advantages of Reverse Mortgages

- They allow the borrower to remain in the home for as long as he or she desires.
- Payments to the borrower are tax free.
- Payments do not affect a borrower's eligibility for benefits under means-tested public programs if the money is spent within a short period of time.
- The borrower does not need a regular income to qualify for the loan. The lender only requires proof of the borrower's equity in the home.
- The borrower's other assets are not attached to the loan.
- The lender cannot take possession of the house as long as the borrower uses it as his or her principal residence.

Disadvantages of Reverse Mortgages

- The cash payments are usually less than the income from an annuity purchased with the proceeds of the sale of the home.
- Because Blacks (18 percent) and Hispanics (4 percent) are underrepresented among homeowners in poverty, few are able to take advantage of the strategy. Still, more than one in five Black or Hispanic homeowners can be raised above poverty through reverse mortgages.
- Because the value of the homes of Blacks and Hispanics is less than those of whites, cash payments to them are correspondingly lower.
- As interest rates increase, fewer homeowners are able to use reverse mortgages to rise above the poverty threshold.

Who Issues Reverse Mortgages?

Approximately half the reverse mortgages that are issued are insured by the Federal Housing Administration (FHA). The major sellers of non–FHA insured mortgages have been Transamerica, Union Labor Life, Providential, Capital Holding, and American Homestead. Fannie Mae has recently launched its own reverse mortgage program.

Since 1987, the FHA has insured reverse mortgages under the Home Equity Conversion Mortgage (HECM) Insurance Demonstration issued by FHA-approved lenders. This program, sponsored by the U.S. Department of Housing and Urban Development (HUD), insures loans in 48 states, the District of Columbia, and Puerto Rico. They currently are unavailable in Texas and South Dakota.

Use of Reverse Mortgages

Despite their advantages in helping elderly persons maintain economic well-being, reverse mortgages have not been widely used. This may be due to the fact that many elderly persons are reluctant to assume new debt after paying off their mortgages. Many also want to conserve their home equity for any large medical expenses they might face. The National Center for Home Equity Conversion estimates that approximately 26,000 reverse mortgages have been issued since 1981.

However, the use of reverse mortgages does seem to be slowly increasing. The number of loans closed under the HECM program more than tripled between 1992 and 1994. Kutty feels that as people who are used to novel financial products such as adjustable rate mortgages enter the ranks of the elderly, and as better reverse mortgage products enter the market, the use of reverse mortgages will grow even faster.

IMPLICATIONS

Kutty's research has found that reverse mortgages are an effective strategy to supplement the incomes of the elderly poor and raise them above the poverty line. There are several public policy benefits.

- If private sector resources are adequate to meet the demand for reverse mortgages, this strategy does not require any substantial government expenditure.
- If government involvement does become necessary, the financial outlay for reverse mortgages is still quite modest relative to alternative means of alleviating poverty, such as entitlement programs.

To encourage increased use of reverse mortgages by the elderly poor, she recommends

- the development and underwriting of reverse mortgage products better suited to household needs;
- the development of reverse mortgage products that address health care concerns of the elderly;
- the development of legislation to protect borrowers and lenders;
- outreach and education for eligible homeowners;
- and FHA-concentration on the elderly poor, who represent a segment of the market that is not traditionally catered to by private sector lenders.

Additional Resources

"The Scope for Poverty Alleviation Among Elderly Homeowners Through Reverse Mortgages" by Nandinee Kutty. Bronfenbrenner Life Course Center Working Paper No. 95-03.

"Comparing Economic Well-being Among Elderly Americans" by Michael Rendall, in *Review of Income and Wealth*, Series 39, Number 1, 1993.

For more information, contact

Dr. Nandinee Kutty
Cornell University
105 Martha Van Rensselaer Hall
Ithaca, NY 14853
607-255-8031
nkk2@cornell.edu

Dr. Michael Rendall
Cornell University
120 Martha Van Rensselaer Hall
Ithaca, NY 14853
607-255-7010
msr5@cornell.edu

Bronfenbrenner Life Course Center Issue Briefs are intended to provide policy makers, academic scholars, practitioners, educators, and community leaders with timely information about major policy-relevant issues and potential solutions relating to the changing life course of individuals and families. The Issue Brief Series examines our aging society, transformations in gender roles, changes in the family, and the restructuring of the work force.

CORNELL
UNIVERSITY
Bronfenbrenner Life Course Center
College of Human Ecology
259 Martha Van Rensselaer Hall
Ithaca, NY 14853

5/96 1M MS MS50552

Produced by Media Services at Cornell University
♲ Printed on recycled paper