



Use Your Home to Stay at Home™

Expanding the Use of Reverse Mortgages for Long-Term Care: A Blueprint for Action

WITH SUPPORT FROM:

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A Blueprint for Action

by

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The National Council on the Aging

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EXECUTIVE SUMMARY

One of the paradoxes of our current long-term care system is that impaired, older Americans are struggling to live at home at a time when they own more than \$2 trillion in untapped housing wealth. The majority of older Americans are homeowners. Many have accumulated substantial amounts of home equity, including families whose other retirement resources may be very modest. Over half the net worth of seniors is currently illiquid in their homes and other real estate. With so much wealth tied up in the home, the decisions that today's older homeowners make about this financial asset can significantly impact our nation's ability to better balance public and private funding for long-term care and to respond more rapidly to consumer preferences for "aging in place."

Reverse mortgages are specialized loans that enable seniors to tap their home equity while they continue to live in the home. With an estimated amount of over \$72,000 available on average to older households from these loans, reverse mortgages can help impaired elders pay for several years of daily home care visits, over a decade of out-of-pocket expenses and respite for family caregivers, or substantial home modifications. Despite the promise of this financing option, older Americans have not been encouraged to tap into their substantial housing assets.

The purpose of this project is to outline the rationale for increasing the use of reverse mortgages for long-term care and to identify areas where government interventions may be able to stimulate the market. The analysis examined the unique ways that seniors treat home equity that may make this asset both useful and difficult to fund in-home services and supports. The report identifies limitations with the current products, along with the need for additional consumer protections to ensure that this product will be used appropriately by impaired, older homeowners. It includes options for administrative action, regulatory changes, and demonstration programs that policy makers could consider to help to change the dynamics and momentum of this financing strategy.

Methodology

The Blueprint was developed to serve as a guide for policymakers as they explore the opportunities and limitations of tapping home equity to pay for long-term care at home. The study utilized both quantitative and qualitative research methods to identify barriers and formulate policy recommendations. Research on reverse mortgages has often relied on national estimates of home equity. But these numbers likely overestimate the true potential of the market. Working with mortgage industry experts, we estimated the actual amount of funds that could be available from reverse mortgages for individual households and the nation as a whole. This analysis was based on data from the 2000 Health and Retirement Study. We assessed the potential of this financing option for different segments of the older homeowner population, including economically vulnerable seniors, affluent elders, and those in between. The results of this analysis provide a sense of the magnitude of financial resources that could be infused into the long-term care system through greater use of home equity. In addition, microsimulation modeling using the Long-Term Care Financing Model developed by the Lewin Group provided estimates of the potential cost savings to Medicaid should the use of reverse mortgages for long-term care become more widespread.

Consumer surveys and discussions with experts offered new insights into the challenges of expanding the reverse mortgage market. Telephone interviews with senior homeowners and adult

children of older homeowners helped us evaluate generational differences in attitudes toward this financing option. As part of the project's Expert Panel, 45 individuals from organizations with expertise in long-term care, mortgage lending, economics, public policy, housing, and insurance provided insights and suggestions on this issue. These individuals contributed to the study through informal interviews, group discussions, and with feedback to specific questions.

Using Reverse Mortgages to Fund Long-Term Care at Home

In the United States, reverse mortgages are the principal financial instruments available to seniors who want to convert some of their home equity into cash. The Blueprint provides new estimates on loan amounts that extend our understanding of the potential market for reverse mortgages. Based on the analysis conducted for this study, the amount of funds that could become available by liquidating home equity is substantial:

- Reverse mortgages hold the potential to increase private sector funding for in-home services and supports in total by an estimated \$953 billion.
- Homeowners who receive Medicaid benefits, or who are at financial risk of needing Medicaid should they become impaired, could potentially obtain \$308 billion in total from reverse mortgages.

Almost half of older homeowners are candidates for using a reverse mortgage to pay for long-term care at home (defined as being able to receive a minimum of \$20,000 from this loan):

- Among the 27.5 households with at least one resident age 62 and older, 13.2 million (48 percent) are candidates to use a reverse mortgage if they needed to pay for in-home services and supports.
- Candidate households could receive \$72,128 on average from a reverse mortgage.

By liquidating a portion of their housing wealth through a reverse mortgage, impaired older homeowners could access a significant amount of cash to pay for immediate assistance and to help prevent premature institutionalization.

- Most (74%) of candidate households (9.8 million) are dealing with impairments that can make it hard to live at home: about 1.8 million need help with ADLs or IADLs, almost 2 million have difficulty only with ADLs or IADLs, and 6 million have functional limitations only.
- Through reverse mortgages, \$695 billion in total could become available to candidate homeowners with some level of impairment.
- The 1.8 million candidate homeowners with an immediate need for help with ADLs or IADLs could access about \$121 billion in total from these loans.

Reverse mortgages can provide additional funds for a broad range of older homeowners:

- 0.4 million Medicaid beneficiary households could be candidates for using a reverse mortgage to pay for long-term care at home. On average, these homeowners could receive a Home Equity Conversion Mortgage (HECM) loan potentially worth \$51,229. These funds could pay for living expenses, along with services and supports, not covered by Medicaid.

- 1.4 million poor homeowners who do not receive Medicaid would be a candidate to use a reverse mortgage. They could access a lump sum or line of credit worth on average \$55,085 from a HECM loan to pay for in-home services and supports.
- 3.3 million households at financial risk for “spending-down” could use a reverse mortgage to help them pay for help at home. On average, these homeowners could receive \$62,800 from a reverse mortgage to pay for immediate care needs and for early interventions such as home modifications.
- About eight million affluent homeowners are candidates for using a reverse mortgage and could potentially receive \$80,130 on average from this type of loan. This group might consider using these funds to purchase long-term care insurance.

Reverse mortgages hold considerable promise to help impaired, older homeowners pay for the services they need to continue to live at home. Using home equity to pay for long-term care insurance is more problematic. Based on our analysis, this approach will likely be an option for only a very small number of older homeowners. It can be very costly for borrowers since they would be paying both insurance premiums and interest on the loan for many years. In addition, borrowers who use the proceeds of their loan to pay their premiums face the risk of their coverage lapsing if they run out of loan funds before they need care. They may also have difficulty keeping their policy in force if insurance premiums increase substantially. Using reverse mortgages to pay for in-home services and supports is likely to be a better choice for more seniors. However, it is important to note that long term care insurance is likely to better meet the needs of Boomers and younger seniors in financing their long-term care than are reverse mortgages.

Major Barriers

The success of any public initiative that incorporates reverse mortgages depends largely on the willingness of older homeowners to draw down their housing wealth during retirement. Use of home equity is still limited, and there are many barriers that are likely to slow future expansion of this market. This study examined how loan features, consumer attitudes, and government policy can impede greater use of reverse mortgages as a funding source for in-home services and supports.

Product features: Many seniors are taken aback by the high upfront costs of reverse mortgages. Limits on the size of HECM loans and misperceptions about loan features can also deter prospective borrowers from taking out a reverse mortgage. Using general life expectancy tables to determine reverse mortgage loan amounts may be inappropriate for severely impaired seniors whose life expectancy is shortened due to a chronic illness or impairment.

Consumer attitudes: Most older homeowners do not have a strong interest in liquidating housing wealth to help them “age in place.” Many are concerned about preserving these funds to meet a variety of needs, including making a bequest, ensuring a comfortable place to live, and protecting themselves against potential nursing home expenses. Americans often regard reverse mortgages as an option for financially desperate elders.

Government policy: Home equity plays an important but not always straightforward role in the means-tested Medicaid program. Under our current financing system, the desire of seniors to protect housing wealth is often at odds with the objectives of public programs to be a payer of

last resort and to serve as a safety net for the truly needy. Government regulations regarding eligibility for long-term care under Medicaid, along with program requirements and restrictions, may present obstacles for impaired elders to “use their home to stay at home.”

Potential Role of Incentives

Greater focus on home equity could add an important new element to the long-term care financing debate. Areas where the appropriate mix of government incentives for reverse mortgages have the potential to make an important difference include:

- Reverse mortgages could enhance government efforts to rebalance our country’s long-term care system toward increased home and community services. Additional cash from reverse mortgages offers greater flexibility and choice for impaired elders. This financing option should appeal to a greater number of older Americans and can encourage increased personal responsibility.
- Innovative public-private partnerships that incorporate reverse mortgages could help address consumer fears about impoverishment due to long-term care. This could make it more attractive for consumers to voluntarily use home equity to pay for early interventions that can reduce the need for costly nursing home care.
- Many of the consumer concerns that motivate the use of Medicaid estate planning, such as loss of control of assets and a desire to leave a bequest, can be addressed through reverse mortgages. By providing cash, these loans enable impaired seniors to control the type and amount of services they receive. Since a reverse mortgage only taps a portion of home equity, it is possible that there will be funds left for heirs after the loan is paid. Government incentives for reverse mortgages may encourage impaired seniors to access home equity sooner and reduce the need to recoup public long-term care expenses through estate recovery.
- Payments from a reverse mortgage can help reduce dependence on Medicaid by lowering the likelihood for spend-down. Increased use of this financial option for long-term care could result in savings to Medicaid ranging from about \$3.3 to almost \$5 billion annually in 2010, depending on market penetration rates increasing from 4 percent to 25 percent of older homeowners.

Offering incentives to increase the use of home equity could open new avenues for public and private resources to complement one another in meeting the changing needs of impaired seniors who live at home. The complexity of these issues and the diversity of older homeowners also highlight the need to carefully consider the potential ramifications of tapping the largest financial asset of most older Americans. Policymakers will be challenged to find appropriate ways to ensure that impaired borrowers who benefit from public incentives for reverse mortgages use these funds to pay for in-home services and supports.

Options for Action

The study identified a wide array of options that could promote the appropriate use of reverse mortgages for long-term care. There are five key areas that could serve as starting points for further policy debate and the development of consensus for future action. These are:

- Examining Medicaid policy and public incentives for reverse mortgages.

- o States could consider using state funds to pay some or all of the closing costs impaired homeowners on or at risk of needing Medicaid.
- o The Center for Medicare and Medicaid Services (CMS) could enable Medicaid beneficiaries to use funds from a reverse mortgage to purchase non-covered home- and community-based services. Other alternatives include developing Medicaid buy-in programs with home equity or enabling states to target older homeowners at risk for Medicaid.
- o The Department of Health and Human Services (HHS) could develop a demonstration program for a public-private partnership program for reverse mortgages.
- Strengthening consumer protections for borrowers who use reverse mortgages to pay for in-home services and supports. Potential options include:
 - o Develop standards for appropriate marketing of reverse mortgages to homeowners who need long-term care.
 - o Provide additional consumer information and decision support on the use of home equity for long-term care through organizations serving seniors, including the Aging and Disability Resource Centers.
 - o Incorporate long-term care as part of mandatory counseling on reverse mortgages.
- Increasing awareness and acceptance of reverse mortgages for long-term care. Government and industry could work together to:
 - o Develop educational campaigns targeting consumers, service providers in the community, and senior advisors.
 - o Encourage community groups to inform seniors and their families about reverse mortgages for in-home services and supports.
- Promoting innovations that reduce the cost of tapping home equity while providing strong value over time. Options could include:
 - o The mortgage industry could develop new loan products and features (such as shorter-term loans or medical underwriting) that provide higher payouts to impaired elders with limited life expectancy.
 - o The Department of Housing and Urban Development (HUD) could waive the upfront mortgage insurance premium for severely impaired borrowers.
 - o Use reverse mortgages to help fund a coordinated service delivery network for older homeowners in “naturally occurring retirement communities” (open NORCs).
- Additional research on ways to increase the use of home equity for long-term care.
 - o Evaluate the potential of using reverse mortgages for in-home services and supports in each state.
 - o Assess the unique needs of impaired, rural, and minority homeowners.
 - o Examine the role of reverse mortgages to help Medicaid nursing home residents’ transition into the community.

Conclusions

As the population ages and the pressure on state Medicaid budgets rises, it becomes increasingly important to find effective ways to improve our long-term care financing system. Funding the growing demand for long-term care is a major national challenge that will require increased spending by both the public and private sectors. This study provides compelling evidence that reverse mortgages have the potential to significantly increase the funds available to pay for home and community-based long-term care. By liquidating a portion of their housing wealth, older homeowners could access a substantial amount of cash. With appropriate incentives, careful protections, and innovative products, greater use of reverse mortgages may offer additional options for seniors to manage assets to pay for long-term care at home.

A wide array of barriers needs to be addressed, however, to create a substantial “win-win” for government and consumers in the near future. These challenges can best be met through ongoing discussions and collaborative actions by government, industry, and the private nonprofit sectors. NCOA will continue its efforts to advance this long-term care financing mechanism by working with members of the Expert Panel from this study and other interested organizations as part of the Use Your Home to Stay at Home Coalition. The goal will be to encourage debate and build consensus on the best options to pursue as next steps. These efforts will lay the foundation for alliances that can foster the appropriate use of reverse mortgages in the mix of long-term care financing strategies.

PART I: BACKGROUND

Impetus for the study

There is a growing sense of frustration in the way we finance long-term care in the United States. After decades of effort to increase the availability of home and community-based services, the bulk of Medicaid long-term care spending still goes to institutional care. Though much of the recent financing debate has focused on rebalancing our current system in anticipation of the future needs of aging baby boomers, the current state of financing for long-term care also presents many challenges. States are already cutting back Medicaid services and restricting eligibility to public long-term care programs in response to rising demand and fiscal constraints (Smith et al. 2004). As a result, the need for services and supports often goes unmet among today's seniors with a chronic condition who want to continue to live at home (Bethell et al 2001).

One of the paradoxes of our long-term care system is that impaired, older Americans are struggling to live at home at a time when they own more than \$2 trillion in untapped housing wealth (Schafer 2000, Neighborhood Reinvestment Corporation 2002, MetLife Mature Market Institute and National Alliance for Caregiving 2004a). The vast majority of Americans age 65 and older in 2004 (82 percent) are homeowners (Callis and Cavanaugh 2004). Over half the net worth of seniors is currently illiquid in their homes and other real estate (Orzechowski and Sepielli 2003). The majority of these older households have accumulated substantial amounts of home equity, including families whose other retirement resources may be very modest. With so much money tied up in the house, this financial asset has the potential to dramatically increase the ability of today's seniors to pay for long-term care at home.

Older Americans have not been encouraged to tap into their substantial housing assets. Policy discussions on long-term care financing have also largely ignored home equity as a potential source of private financing for in-home services and supports. Government policies on long-term care recognize the value of the home but largely favor the preservation of this asset. This situation arose, in part, because older homeowners have had few options to liquidate housing wealth. The development of reverse mortgages in the last 15 years, however, offers a new way for seniors to "use their home to stay at home" by tapping a portion of their home equity.

The possibility of a substantial new source of private funding raises an intriguing challenge for policymakers. Can changes in current policy and products improve the functioning of the reverse mortgage market and accelerate innovation in the field of long-term care financing? Use of home equity is still limited, and there are many barriers that are likely to slow future expansion of this market. Nonetheless, reverse mortgages increasingly are being seen as an attractive option that should have a greater role in the long-term care policy debate.

Using home equity to pay for long-term care services and insurance is an idea that has been considered for many years. Firman (1983, 1985) proposed the use of home equity conversion as a new strategy to fund home care. Jacobs and Weissert (1987) found that a significant number of seniors, including those with lower incomes, could pay for home care or private insurance with home equity. The potential of this approach was also examined in other early publications (Benejam 1987, Gibbs 1992). It is interesting to note that most of these papers were written before the Home Equity Conversion Mortgage (HECM) program or comprehensive long-term care insurance had been developed. More recent studies have emphasized the role of reverse

mortgages as an asset management tool (Rasmussen et al. 1997) and as a way to pay for services and supports that support “aging in place” (Redfoot 1993, NRMLA 2002).

In recent years, there has been renewed interest in the use of reverse mortgages to pay for in-home services and supports. There has been a growing amount of activity at the state level to promote this financing option:

- Montana offers a state reverse mortgage program to help seniors “age in place.” Housing Authorities in Rhode Island and New Jersey charge lower origination fees for these loans.
- At least twelve states—California, Indiana, Michigan, Montana, Nebraska, New Jersey, New York, North Carolina, Ohio, Rhode Island, Texas and Washington—currently promote reverse mortgages as an option to finance long-term care (National Governor’s Association 2004).
- The American Legislative Exchange Council has developed model legislation for states called the “Reverse Mortgage Enabling Act” that would allow citizens to access the equity in their homes for the purpose of paying for long-term care.

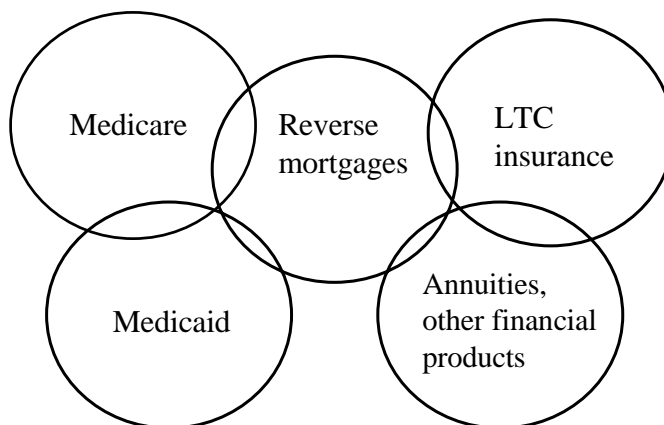
With so much interest in reverse mortgages, there is an urgent need for guidance to inform policymakers on the benefits and limitations of unlocking housing wealth to pay for long-term care. What are the needs and concerns of older homeowners? What is the appropriate role of federal and state government in promoting this financial tool to seniors? Where can states realize savings to public expenditures that would warrant state support of reverse mortgages? Policymakers need to learn more about this product and the experiences of states.

The possibility of incentivizing the use of reverse mortgages to pay for long-term care was recently reinforced by the American Homeownership and Economic Opportunity Act of 2000. Under this new law, the Department of Housing and Urban Development (HUD) is authorized to waive the upfront mortgage insurance premium for borrowers who take out a Home Equity Conversion Mortgage (HECM) and use all the proceeds of this loan to purchase a tax-qualified long-term care insurance policy.

The provisions of this law raise many questions about the value of using home equity to pre-fund long-term care through insurance. How much money can older homeowners obtain from a reverse mortgage? Will the proceeds of this loan be sufficient to pay insurance premiums and to enable seniors to purchase an adequate level of coverage? Should government incentives for reverse mortgages target insurance products or encourage the direct purchase of in-home services and supports? There is considerable uncertainty whether an insurance-based approach to home equity offers meaningful benefits for consumers and government.

Much of the recent interest in reverse mortgages stems from a desire to infuse more money into the long-term care system. Reverse mortgages could play a central role in financing a wide array of long-term care products and programs (Figure 1.1). Incentivizing greater use of home equity could open new avenues for public and private resources to complement one another in meeting the changing needs of impaired seniors who live at home.

Figure 1.1 Potential central role of reverse mortgages in financing long-term care



However, there is also a growing sense among policymakers that money by itself will not be enough to reform the way our nation pays for long-term care. A strong desire among seniors to live at home (Bayer and Harper 2000), combined with consumer demands for greater choice and control over long-term care services, highlights the need to examine the potential role of reverse mortgages within a broader policy perspective. Government efforts, such as the New Freedom Initiative, are underway to encourage states to increase the availability of community options and reduce reliance on institutional care. The Olmstead Supreme Court decision, which requires that individuals receive care in settings most appropriate to their needs, further pushes policymakers to more effectively meet the needs of impaired elders who want to live at home.

Policy leaders in the field of senior housing and health are recognizing the importance of reverse mortgages as part of the solution to help seniors continue to live at home. Recent initiatives include:

- As part of the expansion of its American Dream Commitment, Fannie Mae will collaborate with AARP to develop strategies that include supporting aging in place through reverse mortgages (Fannie Mae 2004a).
- In their 2002 report to Congress, the Commission on Affordable Housing and Health Facility Needs for Seniors in the 21st Century stressed that reverse mortgages may be an important way to assist homeowners in paying for health care costs.
- In 2002, more than 130 representatives from state and local government agencies, disability and aging organizations, local home modification programs, consumers, and researchers participated in a summit to create “A California Blueprint for Action on Home Modification.” One of the recommendations coming out of this conference was the need to explore alternative funding sources such as reverse mortgages (National Resource Center on Supportive Housing and Home Modifications 2003).

As they seek to expand the use of reverse mortgages, policymakers need to consider a wide array of policy alternatives. Is it better to provide broad incentives to improve the functioning of the reverse mortgage market, or should efforts target specific policy issues or populations? These choices will present significantly different policy implications in terms of costs, the immediacy of the results, and the scope and magnitude of the potential outcomes.

State Medicaid programs may elect to offer incentives to homeowners who qualify for public programs or focus on those who are deemed “at risk” of needing government assistance. How large are these different groups of senior homeowners? Many consumer advocates are concerned about the financial security of low-income couples who own a home jointly. How will a shift in public incentives for home equity impact the family? The current public system for long-term care offers strong spousal impoverishment protections that include the home.

Objectives of the study

Many basic questions remain unanswered regarding the possibility of “using the home to stay at home.” The Blueprint was developed to serve as a guide for policymakers as they explore the opportunities and challenges of this financing option. The purpose of the project was to outline the rationale for increasing the use of reverse mortgages and to identify areas where government may be able to stimulate the market and promote greater use of home equity for long-term care.

To help inform policymaking choices, the study used a two-pronged approach. The Blueprint brings together a wide range of research from the fields of housing, finance, and aging. This information provides a foundation to identify realistic policy options and meaningful incentives. Additional research was conducted to fill in gaps in our understanding of this new market for reverse mortgages. Specific objectives of the study included:

1. Assess the size of the potential reverse mortgage market and the possibilities of using this financing mechanism among different segments of the senior homeowner population.
2. Identify key barriers that currently hamper efforts to increase the use of reverse mortgages for long-term care and pinpoint the potential solutions for overcoming these barriers.
3. Delineate the most appropriate roles for government and the private sector in expanding the use of housing wealth for in-home services and supports.
4. Outline specific recommendations and options for public policy and product development that can serve as next steps for action.

Using research, consumer surveys, and discussions with experts, the Blueprint offers new insights into the potential reverse mortgage market along with recommendations for administrative action, regulatory changes, and demonstration programs. The results of this study are organized into five sections. Part II describes the basic features of reverse mortgage products, with special emphasis on the government-insured HECM program. This section summarizes our knowledge of the characteristics of reverse mortgage borrowers. It also presents the result of recent surveys that asked consumers about their concerns with this financial instrument. This section also identifies limitations with the current products, along with new innovations that could make reverse mortgages a more attractive option for impaired, older homeowners.

Part III examines the current size and future potential of the reverse mortgage market. Based on original research, these data provide a sense of the magnitude of financial resources that could be

infused into the long-term care system. This section examines the funds available to help older homeowners pay directly for services and supports, and for long-term care insurance. The discussions also include estimates of potential cost savings to Medicaid from increased use of home equity.

The next two sections examine the challenges of tapping home equity for in-home services and supports. The market for reverse mortgages is expanding, but progress has been slow due to consumer resistance. Part IV looks at attitudes of older Americans toward the home, independent living, and long-term care costs that may hinder implementation of this new approach to financing long-term care. These discussions help identify leverage points where government incentives may have the greatest effect to overcome barriers relating to consumer concerns.

Part V examines the role of government policy—both state and federal—in supporting and limiting the use of reverse mortgages. Since home equity plays an important role in Medicaid policy, this section looks closely at the treatment of the house as a financial asset under government rules for financial eligibility, asset transfers, and estate recovery. This section identifies the current availability of government incentives for reverse mortgages, the needs that these programs address, and gaps where there may be a need for additional public support.

To improve the functioning of the reverse mortgage market, policymakers, working with the mortgage industry and service providers, will need to find ways to encourage older homeowners to tap their home equity for long-term care. Part VI outlines a broad set of options for action that could make it more attractive for consumers to voluntarily “use their homes to stay at home.”

Methodology

The concept of linking reverse mortgages to long-term care involves a wide array of issues, from lending practices to consumer attitudes and government policy. This study therefore incorporated both quantitative and qualitative research approaches to identify barriers and formulate policy recommendations. Quantitative analyses were conducted for this study by several different researchers. Their efforts focused on three specific research activities:

1. Analysis of national datasets to determine the size of different market segments and the total funds available to individuals and the nation from reverse mortgages.
2. Telephone interviews with senior homeowners and adult children of older homeowners to evaluate generational differences in attitudes toward the use of reverse mortgages for in-home services and supports.
3. Microsimulation modeling to estimate the potential savings to Medicaid from increased use of reverse mortgages for long-term care.

Much of this effort was guided by the insights and suggestions of 45 individuals from organizations with expertise in long-term care, mortgage lending, economics, public policy, housing, and insurance. These representatives of governmental organizations, the mortgage industry, senior advocates, and long-term care providers participated as members of the Expert Panel for the study. (See the Appendix for a list of participants). Panel members helped identify various ongoing and historical research efforts as well as key barriers and potential solutions. They provided insights and suggestions on project findings and the feasibility of proposed recommendations. The report incorporates the group’s discussions as well as information gleaned through informal interviews.

Input from these experts was critical since the concept of using home equity to promote “aging in place” is not entirely new. Economists have been interested in the role of housing wealth as a means to alleviate poverty since the 1960s (Chen 1967, Guttentag 1975, Sholen and Chen 1980). Many federal agencies, advocacy groups, financial institutions, and other interested parties have been involved in the HECM program since the 1980s (US Department of Housing and Urban Development 1990). The Expert Panel included many of these early pioneers who were instrumental in creating the reverse mortgage market and the HECM program.

Estimate the size of the total market and potential market segments

The analysis of the reverse mortgage market for long-term care was done in conjunction with researchers from the Seniors Research Group of Market Strategies, Inc (SMG). Data from three national surveys were used to develop estimates of the numbers of older homeowners who would qualify for a reverse mortgage in each of the potential market segments and the amount of reverse mortgage funds potentially available to meet long-term care needs. These national surveys included: the 2001 American Housing Survey, proprietary industry data from Financial Freedom Closed Loan dataset, and the 2000 Health and Retirement Study (HRS 2000).

The 2001 American Housing Survey and Financial Freedom Closed Loan dataset were compared to highlight demographic differences between recent reverse mortgage borrowers and reverse mortgage eligible homeowners. The review of the characteristics of recent borrowers was based on data from the Financial Freedom Senior Funding Corporation, a leading reverse mortgage lender. The Financial Freedom Closed Loan Dataset represents customer data from 20,329 Home Equity Conversion Mortgage (HECM) borrowers who closed their loans between January 2001 and August 2003.

The American Housing Survey is conducted by the Bureau of the Census for the Department of Housing and Urban Development (HUD). This survey collects data on the nation’s housing, including apartments, single-family homes, mobile homes, vacant housing units, household characteristics, income, housing and neighborhood quality, housing costs, equipment and fuels, size of housing unit, and recent movers. National data are collected in odd-numbered years. The most recent complete data available were from 2001 and have been used in this analysis. We focused on a subset of the total population, including only those 8,468 respondents who are age 62+ and who own their homes.

The primary source of data for the analysis of the reverse mortgage market was the 2000 Health and Retirement Study (HRS 2000), which is funded by the National Institute on Aging with supplemental support from the Social Security Administration. The HRS 2000 is a national longitudinal study representing all persons over 50 years of age in the United States. The HRS is a rich source of data on both the health status and the economic resources of older families. HRS researchers have also developed special methods to impute data on variables that can be subject to high rates of non-response, such as income, financial assets, housing equity, and medical expenditures (Cao 2001). Such data, however, is self-reported. Estimates of the size of the potential market for reverse mortgages presented here must therefore be viewed with some caution since respondents are often inaccurate in their estimates of home equity and other financial resources.

We calculated the amount of money available from reverse mortgages based on the formula used by the industry to determine the maximum loan limit, also called the principal limit. This

formula takes into account the age of the borrower(s), the mortgage interest rate, and the adjusted property value (the lesser of the appraised value of the property and the maximum FHA 203b lending limit for the borrower's area). These estimates also incorporate any debt owed on the house, including any first or second mortgage, as well as closing costs for the loan. The interest rate used in the analysis is based on the one-year, constant maturity Treasury security index for the week of February 2, 2004 (4.0 percent) plus a lender's margin of 1.5 points. The calculations included the maximum origination fee (2 percent of the value of the home or FHA 203b loan limit) and servicing fee (\$35 per month). Other closing costs were based on a national average used in the National Reverse Mortgage Lender's Association (NRMLA) reverse mortgage calculator. HUD pricing factors used in the calculations were obtained from Financial Freedom.

The 203b lending limit varies by county, but the HRS 2000 only identifies the geographic location of respondents by CMS Region. For this analysis the respondent's lending limit was calculated by taking the average of the 203b limit in all counties in the respondent's CMS Region, weighted by the total population per county in that region. FHA lending limits for one-family homes in 2004 were obtained from the HUD website. To check the accuracy of our reverse mortgage loan calculations, we sent 100 records to Financial Freedom for input into their loan calculation software. Researchers at Financial Freedom found that our estimates were within a few hundred dollars of their calculations.

The HRS contains a broad set of measures of functional ability, including activities of daily living (ADLs), Instrumental ADLs (managing money, using the telephone), and measures of higher level functioning such as the ability to climb stairs or carry groceries. Among married couples, these individual-level measures of impairment were aggregated to the household level by determining the most severe impairment experienced by either spouse.

Assess consumer attitudes toward using reverse mortgages for long-term care

Working with the National Council on the Aging (NCOA) staff, SMG conducted exploratory research designed to gain an understanding of current attitudes regarding the use of reverse mortgages for long-term care across generations. The objectives were to:

- Understand the differences and similarities in attitudes among seniors and adult children of seniors regarding reverse mortgages.
- Understand how the misperceptions and beliefs of seniors and adult children influence seniors' likelihood to use a reverse mortgage to fund long-term care.

This research study was conducted via a telephone interview of seniors and adult children of seniors. Because this research was exploratory in nature, nearly half of the interview questions were open-ended in order to capture all possible consumer attitudes, beliefs, and perceptions related to long-term care, home ownership, and tapping into home equity to pay for long-term care needs. Open-ended responses were coded to allow for succinct reporting of results and facilitate the comparison of seniors and adult children. The phone interviews were conducted between February 19 and March 6, 2004.

The sample was obtained from national purchased lists of adults age 62+ (seniors) and adults age 35-60 (adult children, these respondents were screened for having a parent age 62+). Since this phase of the research was more qualitative than quantitative, the sample was not intended to be representative of the entire U.S. population. Instead, the sample was focused as much as possible on senior homeowners with low (less than \$20,000) to moderate (\$20,000 - \$40,000) income.

Most seniors and adult children who reported their/their parents' income placed it in the low to moderate range (although about half of the adult children did not know their parents' income). The low to moderate income segment of the population was determined from the initial results of the Phase 1 analysis of secondary data to be a key target for reverse mortgages.

A total of 200 respondents participated in the study, 100 seniors and 100 adult children of seniors (the seniors and adult children were not related to each other). Both samples were screened to ensure that the senior/parent of the adult child was currently a homeowner, currently residing in that home and not currently a long-term care insurance policy holder.

Statistical significance was calculated for all responses at a 95 percent confidence interval—the margin for error for each sample of 100 is +/- 10 percent. Significant differences between the seniors and adult children are indicated with an asterisk.

Estimate potential savings to Medicaid from reverse mortgages

Potential savings to the Medicaid program were estimated by researchers at HCBS Strategies Inc. and the Lewin Group, using the Long-Term Care Financing Model (LTCFM). Their analysis focused on homeowners age 65 and older who would qualify for a reverse mortgage. Savings to Medicaid were estimated based on reductions in the rate of spend-down among older homeowners due to the increase of households' funds from reverse mortgages. In making these calculations, the LTCFM incorporated data on incidence and occurrence of disability and long-term care spending, home ownership and equity, income and other assets, probability of spend-down to Medicaid, and government expenditures for Medicaid.

The LTCMF measures disability in terms of impairment in activities of daily living (ADLs—bathing, dressing, eating, using the toilet, and transferring) and instrumental activities of daily living (IADLs—preparing meals, managing money, shopping/getting around outside the home, light housework, and using the telephone). Impairment means requiring hands-on or standby assistance from another human being in order to perform the activity, and the need must have lasted or be expected to last for at least three months. Age-specific disability rates are assumed to decline consistent with the rate of decline in mortality. This implicitly results in the period of disability remaining constant over time. It is consistent with a 0.6 percent annual rate of decline in disability rates.

Currently, less than one percent of older homeowners have taken out a reverse mortgage. In anticipation of greater market penetration in the future, the estimates of Medicaid savings incorporated take-up rates for reverse mortgages at three different levels (4 percent, 9 percent, and 25 percent). These rates were based on the results of our telephone interviews of senior homeowners and input from the mortgage industry, and reflect the likelihood that the respondents indicated of using a reverse mortgage for long-term care (very likely—4 percent, very likely to likely—9 percent, and at least moderately likely—25 percent).

Building a foundation for action

Promoting greater personal responsibility through reverse mortgages is likely to appeal to many policymakers across the political spectrum. The deeply held values that Americans have about their homes, however, suggest that this approach will not be a quick or easy solution to our nation's long-term care financing problem. Nor will reverse mortgages alone solve all the problems of our nation's long-term care financing system. Funding the growing demand for

long-term care is a major national challenge that will require an increased amount of funding coming from both the public and private sectors.

In developing a roadmap for the future, it will be important to ensure that the desire for government savings are *balanced* with the need to expand the ability of seniors to continue to live at home. One of the guiding principles underlying the Blueprint recommendations was to find ways to improve the functioning of the reverse mortgage market in such a way that both consumers and government benefit. Strengthening the links between reverse mortgages and public programs such as Medicaid opens new possibilities for a more coordinated financial approach that can reduce the risk of institutionalization and enhance quality of life for older Americans.

Although housing wealth has played a small role in the long-term care policy debate, there is a great deal that policymakers can learn from the extensive experiences of grassroots programs, HUD, and reverse mortgage lenders. The comments of Expert Panel members suggest that reverse mortgages are at a critical juncture in their development. There is now an urgent need for greater innovation and a plan of action that is based on practical approaches to help homeowners who need assistance pay for in-home services and supports. The options outlined in this study therefore focus on policy actions and specific strategies that could be accomplished in the next three to five years to help change the dynamics and momentum of this evolving market.

Greater focus on home equity adds an important new element to the long-term care financing debate. This sizable, but overlooked, resource has the potential to significantly expand the impact of the private sector on the structure and timing of in-home services and supports. By synthesizing current thinking on barriers and identifying promising approaches to implement this option, the Blueprint lays the groundwork for developing a shared vision of the appropriate role for reverse mortgages in the long-term care financing system.

PART II: REVERSE MORTGAGES AND LONG-TERM CARE

Most older Americans would prefer to “age in place” in their own homes (Bayer and Harper 2000). The high proportion of long-term care paid by government, however, suggests that few seniors can afford to pay these costs for very long (Congressional Budget Office 2004). Until recently, older homeowners had limited options for improving their financial situation: they could sell the house, or if they had adequate incomes, they could take out a first or second mortgage. A new solution is to tap the equity built up in the home.

In the United States, a reverse mortgage is the principal financial tool available to seniors who want to convert some of their home equity into cash. Reverse mortgages can give older homeowners the funds they need to pay for long-term care and other expenses, while allowing them to continue living in their own homes. For policymakers, reverse mortgages can be an important source of new funds to help strengthen efforts to increase personal responsibility for long-term care and promote home and community-based services.

This section examines the basic features of reverse mortgages and how they can be used to pay for long-term care. Included is a description of the characteristics of today’s borrowers, along with an overview of consumer awareness and attitudes toward reverse mortgages. The features of Home Equity Conversion Mortgages (HECMs) that may limit the use of this product to pay for long-term care are also discussed.

Basic features of reverse mortgages

A reverse mortgage is a special type of loan that allows homeowners age 62 and older to convert some of the equity in their homes into cash. These types of loans are called “reverse” mortgage because the lender makes payments to the homeowner. Since the loan is based on the equity in the home, lenders do not consider the borrower’s income, or credit and medical history in determining eligibility for a reverse mortgage.

In order to qualify for a reverse mortgage, a homeowner should own the home free and clear or have significant equity in the home. The reverse mortgage must be the primary debt against the home (“first” mortgage). Homeowners must first pay any outstanding amount owed on the home, either before applying for the reverse mortgage or by taking a lump sum advance from the loan.¹ The home must be the borrower’s primary residence. Eligible properties include owner-occupied one-to-four-family homes, manufactured homes, federally-approved condominiums or planned unit developments (PUD), and cooperative housing units.

Consumers usually obtain a reverse mortgage through a mortgage lender. Some credit unions and banks, along with state and local housing agencies, may also offer these loans. Before closing, loan applicants must have the house appraised to determine its value and to make sure that it meets FHA minimum property standards. In cases where the home needs repairs, homeowners can finance the cost of these repairs as part of the loan. Reverse mortgage borrowers continue to own the home and are responsible for paying property taxes, hazard insurance, and maintenance of the home.²

The amount that a homeowner can borrow is based primarily on the age of the youngest homeowner, the value of the home, and the current interest rate. Older owners (because of their limited life expectancy) and those with more expensive homes are able to get higher loan amounts.³ Borrowers can select to receive payments as a lump sum, line of credit, fixed monthly payment (for up to life), or a combination of payment options. Proceeds from a reverse mortgage are tax-free, and borrowers can use these funds for any purpose. Interest on a reverse mortgage is not deductible for tax purposes until it is actually paid at the end of the loan.

Unlike conventional mortgages, there are no income requirements for these loans. In addition, reverse mortgage borrowers do not need to make any payments for as long as they (or in the case of spouses, the last remaining borrower) continue to live in the home as their primary residence. When the last borrower permanently moves or dies, the loan becomes due.

Interest accrues at a compound rate on the outstanding loan balance. The amount of debt borrowers owe on a reverse mortgage equals all the cash they receive from the loan (including funds used to pay for closing costs, required home repairs, or to pay off existing debt), along with the interest that has accumulated on the loan balance. When the loan becomes due, borrowers or their heirs may elect to repay the loan and keep the house, or sell it and keep the balance remaining after paying off the reverse mortgage.

Types of reverse mortgages

The amount of money that borrowers can get depends on the reverse mortgage product they select. There are three types of reverse mortgages available in the market. These include:

- Home Equity Conversion Mortgage (HECM).
- Fannie Mae Home Keeper loan.
- Cash Account loans offered by Financial Freedom Senior Funding Corporation.

The HECM program is offered by the Department of Housing and Urban Development (HUD) and run by the Federal Housing Administration (FHA). The Federal National Mortgage Association (Fannie Mae) currently purchases all HECM loans originated by approved lenders. Borrowers can select to receive HECM payments as a lump sum, line of credit, fixed monthly payment (for up to life), or a combination of payment options. Borrowers can change payment options at any time for a small fee. Any unused funds in the HECM line of credit grow by a certain percentage per annum (equal to the interest rate on the loan).

In addition to the HECM, there are also proprietary reverse mortgages. The Fannie Mae Home Keeper loan is available to homeowners age 62 and older in all 50 states. Borrowers can receive more cash from these loans than with a HECM since the loan limit for this product in 2004 is \$333,700. The limit on Home Keeper loans is 50 percent higher for Alaska, Hawaii, and the U.S. Virgin Islands. Payment options include fixed monthly payments for life, a line of credit, or a combination of these payment options. The HomeKeeper only offers a flat creditline that does not increase.

Seniors age 62 and older can get a Cash Account reverse mortgage from Financial Freedom Senior Funding Corporation. The Cash Account is available to seniors who own homes that are worth at in excess of \$400,000 at the time of loan origination. These “jumbo” loans are especially beneficial to homeowners with expensive homes since there is virtually no maximum

home value or loan limit under this plan. Borrowers can select an open-end line of credit (i.e., the consumer can borrow, repay, and borrow again) that is available for as long as the borrower occupies the home. Unused funds in a line of credit grow at a fixed annual rate. Loans offered by Financial Freedom are not available in every state.

Consumer protections

There are many protections in place for people who decide to take out a reverse mortgage. Federal Truth-in-Lending law requires that reverse mortgage lenders disclose the projected average annual cost of the loan. Borrowers can cancel the loan for any reason within three business days after closing. They must notify the lender in writing to terminate the reverse mortgage.

Most lenders charge interest for a reverse mortgage at an adjustable rate on the loan balance.⁴ To protect borrowers, all reverse mortgage have limits on the rate at which interest costs for the loan can change within a year, as well as over the life of the loan. Changing interest rates do not affect the monthly payments that a borrower receives.

The costs that reverse mortgage borrowers pay are similar to those of a traditional home loan or to refinance an existing mortgage. These include an origination fee, appraisal fee, and third-party closing costs (fees for services such as an appraisal, title search and insurance, surveys, inspections, recording fees, etc.). Most of these upfront costs are regulated, and there are limits on the total fees that can be charged for a reverse mortgage. Since most of these costs can be financed as part of the loan, borrowers typically face few out-of-pocket costs for a reverse mortgage (typically the appraisal fee and credit check to make sure that the borrower is not delinquent on any other federally insured loans).

All reverse mortgages are non-recourse loans, which mean that the borrower or heirs never owe more than the value of the home at the time of sale or repayment of the loan. This important feature is especially critical to surviving spouses who might otherwise be impoverished due to the cost of the loan. To receive this protection, HECM borrowers pay a mortgage insurance premium. Mortgage insurance offers additional security to both borrowers and lenders. Borrowers are protected against default by lenders. Lenders avoid losses that arise when the HECM loan balance exceeds the value of the home at the time of sale (“crossover risk”). FHA insures reverse mortgages issued under the HECM program.

Borrowers who apply for any reverse mortgage must first receive independent counseling before they complete the loan application. This helps ensure that borrowers understand the advantages and limitations of this type of loan, and are aware of possible alternatives to reverse mortgages. Counselors must work for a HUD-approved agency and receive special training on reverse mortgages. Currently, there are about 800 approved HECM counseling agencies (Weicher 2004). Counselors offer this information in person or by telephone. The AARP Foundation has developed a national certification program for reverse mortgage counselors.

Consumer awareness of and attitudes toward reverse mortgages

Since reverse mortgages are relatively new, few seniors have direct experience with this financing option. Nonetheless, a significant number of older Americans are aware of this product. A national survey by AARP found that 51 percent of respondents age 45 and older had heard of a reverse mortgage (Bayer and Harper 2000). Awareness of these loans was particularly

high in the 65-74 age group (63 percent). About one in five (19 percent) respondents age 45 and older indicated that this is an idea they might consider in the future.

Results of the consumer survey conducted for the Blueprint also indicate that there is significant awareness of reverse mortgages. Based on our telephone interviews of senior homeowners and adult children of senior homeowners:

- About two-thirds of senior respondents (67 percent) had heard of a reverse mortgage, as had 53 percent of adult children respondents.
- Of those that were aware of reverse mortgages, only 28 percent of seniors and one-third of adult children (34 percent) indicated that they are familiar to very familiar with this product.

One of the research gaps addressed by this study was to evaluate consumer reactions to using home equity specifically for long-term care. When asked whether they would make use of a reverse mortgage to pay for the help they need to continue to live in their home, one in four seniors (25 percent) reported that they would be at least moderately likely to do so. About 9 percent reported that they would be likely to tap home equity to pay for assistance at home. Only 4 percent of senior respondents indicated that they regarded this as a very likely option.

To examine generational differences in attitudes toward reverse mortgages, the telephone interviews also included adult children of seniors who are homeowners. Family and friends are often the main source of financial advice and knowledge for households (Hilgert, Hogarth, and Beverly 2003). Children can have a significant impact on the decision to take out a reverse mortgage. Homeowners with children may be more concerned to preserve the home in order to leave a bequest. Adult children, however, may prefer to have their parents tap home equity so they can continue to live independently.

The telephone interviews found that only about one in four (22 percent) adult children is comfortable with the idea of using a reverse mortgage for long-term care. A smaller proportion (8 percent) feels it is likely/very likely that their parents will select this financing option. When it comes to making a decision to use home equity, 15 percent indicated that it is up to their parents to do what they want. Many senior respondents (41 percent) felt that their children would be likely/very likely to support their decision to use a reverse mortgage to stay in their home longer.

Part of the reason for the limited interest in reverse mortgages may stem from the fact that the benefits of using home equity to pay for care or modifications are not obvious to consumers. When asked, over one-third of seniors (36 percent) and 28 percent of adult children could think of no benefit for seniors (or in the case of adult children, their parents) if they make use of home equity to pay for the help to stay in their own home. The most often mentioned benefits to seniors include staying in the home (19 percent) and maintaining independence (11 percent). Adult children (11 percent) were more likely than senior respondents (1 percent) to mention the benefit that the senior would get the money they need.

Similarly, about four in ten (35 percent) of seniors and 41 percent of adult children see no benefits for children if a senior were to use their home equity to pay for in-home services and supports. The most often mentioned benefits to adult children included less responsibility (11 percent of seniors and 5 percent of adult children) and saving money (10 percent of seniors and 16 percent of adult children).

The findings also revealed that consumers see few clear drawbacks for using home equity to pay for in-home services and supports. About four in ten senior respondents (39 percent) and 36 percent of adult children saw no drawbacks for seniors to use home equity to pay for the help to stay in their own homes. Drawbacks cited by both seniors and adult children included difficulty repaying the loan, outliving the money, and losing the home. None of these issues were mentioned by more than about one-tenth of those interviewed. Most seniors and adult children also see no drawbacks for the children if the seniors used home equity to pay for help to stay at home. Adult children were considerably more likely (70 percent) than seniors (54 percent) to see no drawbacks for the children of older homeowners.

Another challenge to this financing strategy is that many people do not intend to take out a reverse mortgage because they do not think they will need it. About four in ten seniors and adult children believe it would not be necessary to use home equity to pay for care at home or home modifications because “it just won’t happen” or “it will not have to be done.” More than four in ten seniors (42 percent) and over half of adult children (52 percent) indicated that the family would take care of the senior once they need help. About one-quarter of seniors (27 percent) and 17 percent of adult children believe that the senior will be able to pay for help or home modifications so they can continue to live at home.

Over half of senior respondents (59 percent) believe that they are likely to extremely likely to stay in their own home once they need help with everyday activities. Despite this optimism, many senior respondents (43 percent) had not made any financial plans to cover the cost of help they would need to stay at home. Responses offered as “financial planning” ranged from insurance to government assistance to help from family members. About one-quarter (27 percent) of adult children did not know if their parents had made financial plans for long-term care.

Inadequate preparation for long-term care found in this survey is similar to findings from other consumer studies. One of the most prevalent perceptions among Americans is that they will never need long-term care. Although a recent survey found that 61 percent of people ages 40 to 70 believe that their chances of needing long-term care are greater than being in an auto accident, most people remain unaware of the challenges of meeting this need (Metlife Mature Market Institute 2004b).

Attitudes toward using reverse mortgages for long-term care insurance

Reverse mortgages offer another option to help elders pay for long-term care insurance. Using a portion of home equity to purchase a policy can significantly leverage housing wealth for long-term care. But this strategy can also be very costly because borrowers would be paying both insurance premiums and interest on the loan for many years. In addition, borrowers who use the proceeds of their loan to pay their premiums face the risk of their coverage lapsing if they run out of funds before they need care. They may also have difficulty keeping their policy in force if insurance premiums increase substantially.

In the telephone interviews conducted for this study, only 10 percent of seniors indicated that they would be at least moderately likely to use a reverse mortgage to buy a long-term care policy. Interestingly, 19 percent of adult children felt that this option would be something that their parents would be likely to consider. Limited interest in this financing option may reflect the

fact that long-term care insurance is typically sold as a way to protect financial assets. As such, it may seem almost counterintuitive to tap home equity to pay for a long-term care policy.

In a separate study conducted for CMS, researchers asked seniors age 62 and older about their attitudes toward using a HECM loan to purchase long-term care insurance. In general, the focus group participants were aware of the risks associated with long-term care but they were less familiar with reverse mortgages. Many were reluctant to take on more debt to pay for a long-term care policy, even if the upfront HECM mortgage insurance premium were eliminated. Most respondents saw reverse mortgages as a “last resort,” to be used only for an emergency or critical need. When asked about the new HUD law, participants were uncomfortable with the requirement that they use all the proceeds of the loan for insurance if they wanted to avoid paying the upfront mortgage insurance premium.

Borrower characteristics

Since the inception of the HECM program in 1989, only about 100,000 older homeowners have taken out this type of reverse mortgage (Weicher 2004). Most of the information on this population comes from loan application forms. Based on these data:

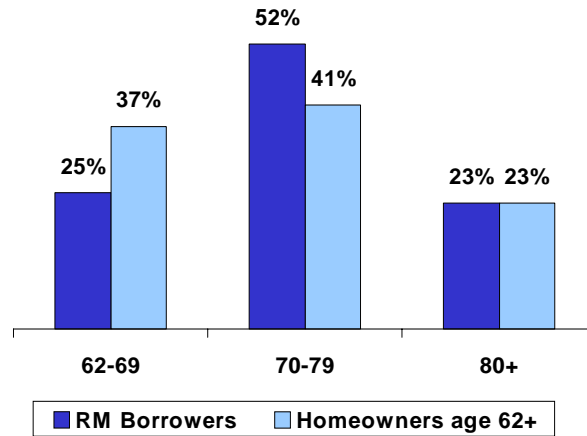
- The average age of borrowers is declining, from age 76 in 2000 to age 74 in 2004.
- About half (48 percent) of HECM borrowers in 2004 are single women. The proportion of single women who participate in this program has declined significantly from 2000, when this group represented 57 percent of reverse mortgage borrowers.
- Couples who took out a HECM loan increased from about 30 percent of borrowers in 2000 to 36 percent in 2004.

Anecdotal evidence also suggests that the market may be gradually shifting. Lenders are finding that a small but growing number of more affluent seniors are taking out a reverse mortgage to pay for a dream vacation or other leisure activities. Based on the latest data from HUD, average property values of HECM borrowers increased from \$142,000 in 2000 to \$214,000 in 2004 (Weicher 2004). Some financial planners are starting to recommend reverse mortgages as an asset management tool to help their clients free up housing wealth for other investments.

Additional information on the characteristics of reverse mortgage borrowers comes from an evaluation of the HECM program that was conducted in 2000 (Rodda et al. 2000). These researchers found that:

- Most (86 percent) HECM borrowers in 2000 were non-Hispanic whites. About 9 percent are non-Hispanic African Americans. Other racial/ethnic minorities represent the remaining 4 percent of borrowers. In general, the racial and ethnic composition of HECM borrowers is similar to the general population of older homeowners. Non-Hispanic African Americans participate in the HECM program at a higher rate (9.2 percent) than they are presented in the general population of older homeowners (7.8 percent).
- Based on focus groups of HECM participants and anecdotal evidence from lenders, it appears that a majority of HECM borrowers in 2000 had children.

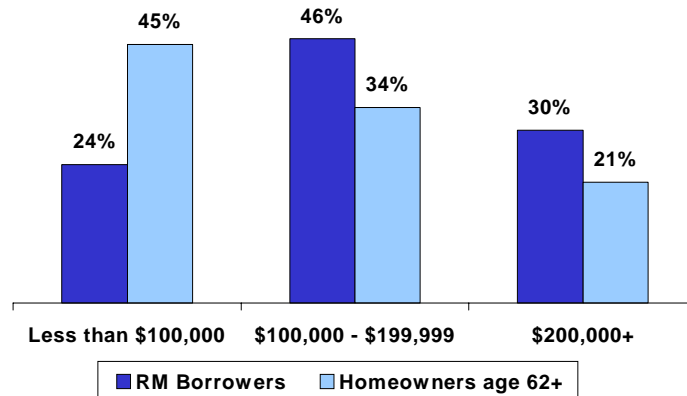
Figure 2.1. Age distribution of reverse mortgage borrowers compared to all homeowners age 62+



Source: NCOA analysis based on data from the 2003 American Housing Survey and industry data from Financial Freedom.

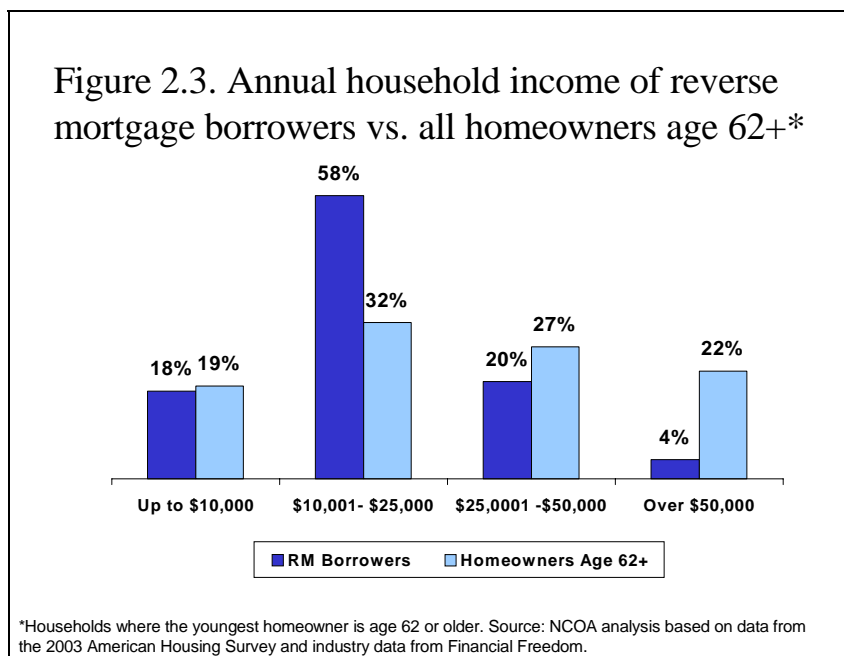
Industry data on loans originated between 2000-2003 shows that three-quarters of borrowers (75 percent) are age 70 or older at the time of application for the loan (Figure 2.1). The predominance of relatively older borrowers among the reverse mortgage population is not surprising. This is because the amount that borrowers can get from their home is greater at older ages. About half (52 percent) of borrowers are in the 70 to 79 age group—a higher proportion than among the general population of elderly homeowners (41 percent).

Figure 2.2. Home values of reverse mortgage borrowers versus all homeowners age 62+



Source: NCOA analysis based on data from the 2003 American Housing Survey and industry data from Financial Freedom.

On average, these reverse mortgage borrowers are more likely to be “house rich” than typical older homeowners (Figure 2.2). Close to half of reverse mortgage borrowers (46 percent) have homes worth \$100,000 to \$199,999, compared to only about one-third of general homeowners (34 percent). Elders who take out a reverse mortgage are also more likely than the general homeowner population to own expensive homes, worth \$200,000 or more.



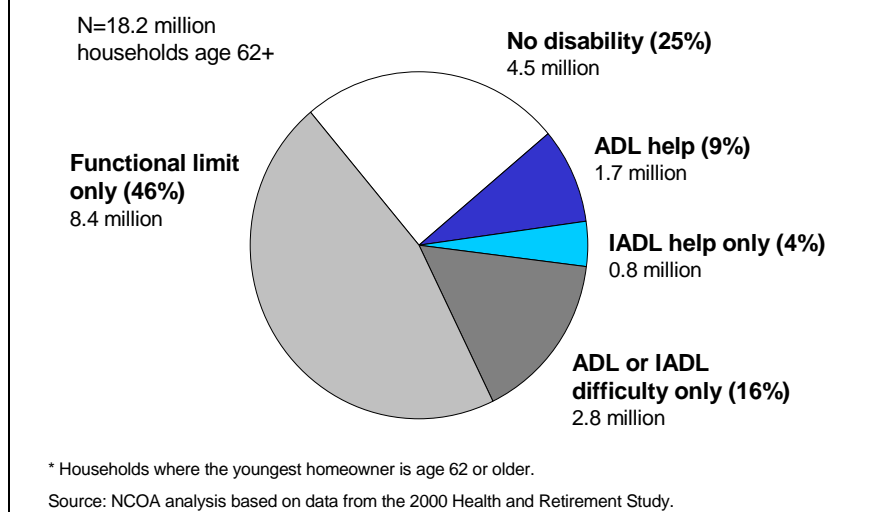
Most HECM borrowers have very limited financial resources other than their home. Among borrowers who took out a loan between 2000 and 2003, three quarters (76 percent) had incomes of \$25,000 or less (Figure 2.3). In 2004, the average income of borrowers was \$17,000 (Weicher 2004). This is relatively low when compared to the national household median income of \$25,634 among homeowners age 65 and older in 2003 (U.S. Census Bureau 2004).

Using reverse mortgages for long-term care

Reverse mortgages offer several benefits for impaired elders. These funds are quickly available to qualifying homeowners so that they can deal with long-term care needs as they arise. Funds can be used for any purpose, such as paying for family caregivers, home modifications, or a care coordinator. These loans give consumers considerable flexibility in managing their financial assets over time.

The potential need for financial assistance with in-home services and supports among older homeowners could be substantial. Among all households in 2000 where the youngest homeowner is at least age 62, 29 percent have difficulty or need help performing everyday activities. These include about 1.7 million homeowners (in the case of couples, at least one spouse) who require assistance with one or more ADLs, the most severe type of impairment associated with long-term care needs. (Figure 2.4).⁵ An additional 4 percent of these households only needed help with IADLs.

Figure 2.4. Level of impairment among households age 62+*

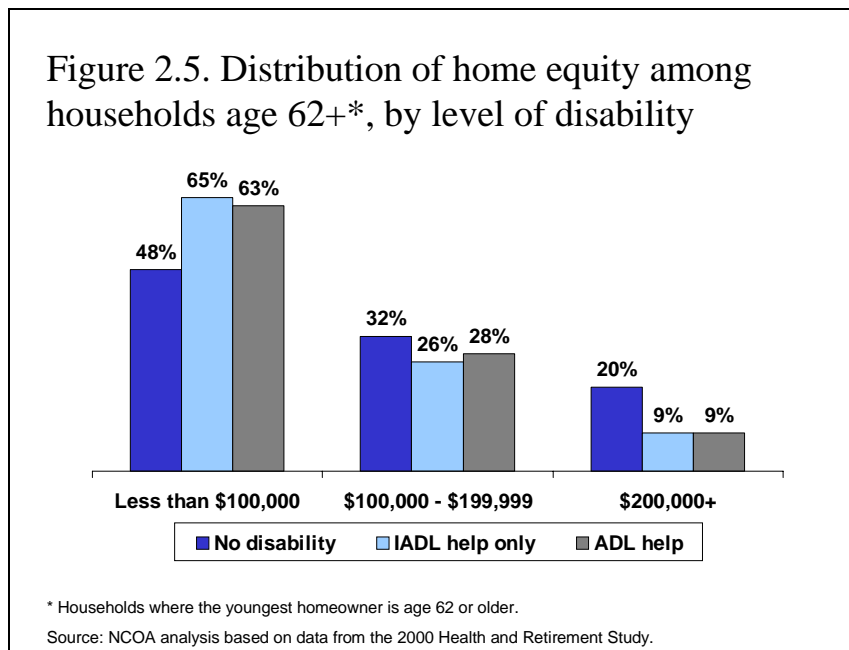


A high proportion (46 percent) of these older homeowners have a functional limitation, such as difficulty with climbing stairs or carrying groceries, that may make it hard for them to continue to live at home safely. While these impairments are modest, they can have serious consequences if they lead to bigger problems such as malnutrition or debilitating injuries. For example, arthritis can make it hard to cook and impossible to climb stairs. More than one-third of seniors fall each year, and of those who fall, up to 30 percent suffer serious injuries (such as hip fractures) that make it hard for them to continue to live at home (National Center for Injury Prevention and Control 2004). Elders over age 71 who fall are significantly more likely to need nursing home care (Tinetti and Williams 1997).

Encouraging greater use of reverse mortgages among elders who need long-term care will present many new challenges. A high level of impairment can make it difficult for older Americans to “age in place.” Homeowners who need help with ADLs will need considerably more financial resources to pay for in-home services and supports than elders who only have a functional limitation. In addition, the risk of ADL impairment increases with age, so severely impaired seniors who take out a reverse mortgage are likely to be older than the typical borrower today. About 18 percent of community-dwelling seniors age 85 and older need help from another person with one or more ADLs compared to only 4 percent of elders age 65 to 74 (Spillman 2003).

Households where homeowners are more severely impaired tend to have lower housing wealth than those with unimpaired homeowners. Among households where at least one of the homeowners is age 62 or older, 20 percent of non-disabled households hold home equity of \$200,000 or more, compared to only 9 percent of households where a homeowner needs help with ADLs or IADLs (Figure 2.5). “Impaired” households are more likely to have modest amounts of home equity. Almost two-thirds of households who need help with ADLs (63

percent) or who only need help with IADLs (65 percent) held home equity amounts less than \$100,000.



Having a physical or mental impairment can make it more difficult to accumulate financial assets or build up substantial home equity. Elders who had to retire early or pay significant out-of-pocket costs due to a chronic condition during their working years may have difficulty paying for mortgage payments (Tu 2004, May and Cunningham 2004). Similarly, elders with low incomes are at increased risk for experiencing a chronic health problem (Roland and Lyons 1996).

Product design barriers

A considerable amount of research has been done to identify barriers in product design that could limit the use of the HECM program for seniors (Rodda et al. 2000, Caplan 2002). These typically include:

- Upfront loan costs
- Limits on the size of the loan
- Misconceptions about loan features

Addressing these barriers would increase the appeal of reverse mortgages for all seniors, including those who need long-term care. Reverse mortgages may also present unique challenges to impaired homeowners who may not be able to remain at home for many years due to declining health.

Upfront loan costs

Many seniors are deterred by the high upfront costs of reverse mortgages. These costs can represent a significant share of the total amount that can be borrowed. Today, a 75-year-old

HECM borrower with a home valued at \$105,000 would have to pay about \$6,100 in closing costs on a loan worth \$63,000. When the servicing fee set-aside (about \$5,300) is added, the total amount available through the loan is reduced by \$11,400 for a home worth \$105,000. Closing costs represent a significant amount of the money that could be available to pay for long-term care.

Origination fees: The origination fee covers a lender's operating expenses. Under the HECM program, the maximum allowable origination fee is equal to the greater of \$2,000 or 2 percent of the value of the home (or for more expensive homes, the FHA loan limit). The origination fee would be \$2,100 for a home worth \$105,000. This amount can be financed as part of the loan.

Financial Freedom now offers several options that allow borrowers to get a reverse mortgage without having to pay upfront origination fees. Some lenders also suggest that increasing loan volumes might help to reduce these costs. Economies of scale in origination may lower the cost of management, training, and some back office operations that will remain relatively fixed as loan volumes grow.

Mortgage insurance: FHA charges fees for mortgage insurance in two parts: (1) an upfront premium of 2 percent of the maximum claim amount, and (2) a monthly premium of 1/12 of 0.5 percent of the outstanding principal balance. For a home worth \$105,000, the upfront mortgage insurance premium would be \$2,100.

The high cost of mortgage insurance is particularly unpalatable for homeowners who are very old or have a disability. Since these borrowers are unlikely to remain in their homes for a long period of time, they present less of a risk that the value of the loan will grow to exceed the value of the property.

Servicing fees: Federal regulations allow the loan servicer to charge a monthly fee up to a maximum of \$35. Servicing a loan includes maintaining data on monthly loan activity, providing borrowers with periodic loan statements, certifying occupancy and property maintenance, changing borrower payment plans, accepting mortgage repayments, and declaring the mortgage due and payable (Fannie Mae 2004b).

The servicing fee set-aside is the total amount of money deducted from the available loan limit at closing to cover the projected costs of servicing the borrower's reverse mortgage account. The amount of money set aside is primarily determined by the borrower's age and life expectancy.

The National Reverse Mortgage Lenders Association has found that one of the main concerns that consumers have about this loan is the servicing fees. In part, this reflects the fact that many homeowners are unaware of the costs associated with obtaining a mortgage. Servicing fees are essentially invisible in forward mortgages since they are built into the interest rate charged for the loan.

Limits on the size of the loan

Reverse mortgages must be the primary debt against the home. This makes it very difficult for a borrower to tap more of their home equity through any additional loans.⁶ For seniors who live in rural areas or who own expensive homes, the low amounts that can be borrowed through the HECM program may be a deterrent. HUD limits the amount that can be borrowed under the HECM program (termed the 203-b loan limit) based on average home values in each county. In 2004, the loan limit varies from a low of \$160,176 (typically for rural areas) to a high of \$290,319 (usually for high-cost metropolitan areas). Borrowers with expensive homes who live

in counties with the lowest loan limit could get up to 45 percent less from a HECM loan than they would for a house of the same value in areas with the highest loan limit.

Misconceptions about loan features

Seniors who are unfamiliar with reverse mortgages often are fearful about taking out this type of loan. A common concern is that they will lose the home. Others believe that this financial option is very risky and should only be used by someone who is facing dire financial circumstances. More education will help address these concerns. Many consumers do not understand that the mortgage insurance offers important protections to borrowers who continue to live at home for a long time.

In addition to a lack of knowledge about the way reverse mortgages work, there are also some lingering misconceptions about outdated product features. For instance, a small proportion of reverse mortgage loans made prior to 2000 involved equity sharing. The purpose of this feature was to provide additional upfront funds for borrowers (as much as 40-50 percent more) by using the growth in home equity to help repay the loan.

In recent years, many people have seen their homes appreciate dramatically. For borrowers who elected the equity sharing feature, paying off their reverse mortgage will have become very expensive. To avoid litigation and negative media coverage for reverse mortgages, in 2000 Fannie Mae decided to discontinue offering the equity share feature of the Home Keeper loan.

Special needs of impaired borrowers

Life expectancy is an important factor in evaluating the cost and benefits of a reverse mortgage. One reason is that HECMs have relatively high upfront closing costs. For borrowers who opt for monthly payments and then move out, sell the home, or die within a few years of taking out the loan, a reverse mortgage can be very expensive. For example, a severely impaired borrower who receives \$1,000 per month, but can only live at home for one year before needing a nursing home, could pay over \$6,500 in closing costs and servicing fees for a total of \$12,000 in loan payments during that year. The reverse mortgage becomes due if the last remaining borrower requires care in a nursing home or assisted living facility for more than a year.

Using general life expectancy tables to determine reverse mortgage loan amounts also may be inappropriate for severely impaired seniors whose life expectancy is shortened due to a chronic illness or impairment. Lubitz et al. (2003) estimate that the life expectancy of a 70 year old with no functional limitations is about 14 years. Such healthy elders can expect to be active (with no limitations) for almost nine of those remaining years. In contrast, people age 70 who report that they are in poor health can expect to live another 10 years, but only 2 years will likely be without some limitation that could make it difficult to continue to live at home.

Policy issues and concerns

Reverse mortgages have a number of positive features for impaired elders. By using a reverse mortgage to liquidate a portion of their housing wealth, seniors do not have to move or relinquish control over their most important asset. Since reverse mortgages only allow borrowers to tap a portion of their home equity, there may be funds left over after paying off the loan to support the spouse or cover assisted living or other facility care. Borrowers or their heirs can also benefit from any appreciation in the value of the home over time. Spouses are protected since they will never owe more than the value of their home.

Upfront costs of a reverse mortgage, already perceived to be high, become even more critical for impaired elders. These seniors are likely to be older and poorer than typical reverse mortgage borrowers. A variety of options could be considered to lower these costs for impaired borrowers, including reducing or eliminating the upfront mortgage insurance premium. In reducing loan costs, the challenge will be to find solutions that offer a better deal to consumers without jeopardizing the viability of the HECM program and reverse mortgage marketplace, or weakening consumer protections.

Innovative types of reverse mortgages may be especially helpful to impaired borrowers with lower life expectancy. These products may include features such as medical underwriting or less upfront loading of expenses that could make this loan more cost effective for people who are not likely to stay at home for many years. In developing these products, the industry will need to make sure that impaired elders receive meaningful benefits and are not subject to excessive fees.

The deeply held values that Americans have about their homes, however, suggest that this approach will not be a quick or easy solution to our nation's long-term care financing problem. Education will be critical to raise awareness of reverse mortgages among seniors who want to live at home. Few seniors are interested in using a reverse mortgage due to a reluctance to use their equity and a lack of understanding about how these loans work. Since adult children are open to the concept of using a reverse mortgage to pay for long-term care or home modifications, targeting the adult children of seniors should be an important part of building awareness of reverse mortgages and how they can help older homeowners stay at home. Community-based organizations, along with local aging networks, and Aging and Disability Resource Centers can play an important role to inform a broad audience about this financing option.

Borrowers who intend to take out a reverse mortgage for long-term care need additional information to ensure that this type of loan is appropriate for their needs. There will be many challenges in educating borrowers about long-term care and long-term care insurance. Professionals who advise seniors, including reverse mortgage lenders, counselors, and long-term care insurance agents, will need to be educated about the appropriate uses of home equity for long-term care financing.

As more seniors are encouraged to take out a reverse mortgage, the risk of predatory lending and fraud increases. This will be a particular concern for impaired homeowners who may be in crisis and are likely to be most vulnerable to scams. Strong protections, which could include national standards for appropriateness of loans, will be needed to help protect these vulnerable borrowers. Impaired elders may also need additional assistance to deal with the voluminous documents that are required for closing the loan. State departments of aging, HUD, and the mortgage industry could work together to develop specialized counseling programs for reverse mortgages that include government incentives for long-term care.

ENDNOTES

1. If a prior lender agrees to be repaid after payment of the reverse mortgage loan, the borrower may not need to pay off other debt against the home. Some state and local government programs that offer tax deferral or home repair loans to low-income elders are willing to be in second lien position.
2. Reverse mortgage lenders can require repayment at any time if borrowers do not meet these conditions. Other default conditions on most reverse mortgages include 1); 2) donation or abandonment of the home; 3) the borrower perpetrates fraud or misrepresentation; 4) a government agency needs the property for

public use; or 5) a government agency condemns the property. If a HECM or HomeKeeper borrower files for bankruptcy the reverse mortgage loan servicers will carefully monitor bankruptcy proceedings in accordance with standard Fannie Mae guidelines and contact appropriate legal counsel to file proofs of claim.

Changes that affect the security of the loan for the lender can also make reverse mortgages payable. These changes could include: 1) renting out part or all of the home; 2) adding a new owner to your home's title; 3) changing the home's zoning classification. Borrower may only take out additional debt against the home if the lender is willing to take a subordinate position to the reverse mortgage loan.

3. HECM loan limits are the same as those for FHA's forward mortgage program. The amount that can be borrowed is based on "adjusted property value," which is the appraised value of the house or the local FHA 203-b loan limit, whichever is less. In 2004, the 203-b loan limit ranged from a low of \$160,176 (typically for rural areas) to a high of \$290,319 (for high-cost metropolitan areas). FHA varies loan limits to reflect local median house values.

4. HUD requires that the interest rate lenders charge on adjustable-rate HECMs must be equal to the one-year, constant maturity Treasury security index plus a lender's margin. The lender's margin is set by Fannie Mae, which purchases virtually all HECMs in the secondary market.

5. Severity of disability is usually measured based on a person's ability to perform different types of everyday activities. Activities of Daily Living (ADL) measure the capacity for self-care, including bathing, dressing, toileting, transferring, or eating). Instrumental Activities of Daily Living (IADL) assess the ability to live independently, such as using the telephone, preparing meals, or taking medications without supervision.

6. To help borrowers take advantage of appreciating equity, in 2004 HUD released a new regulation that reduces the upfront mortgage insurance premium charged to seniors who refinance a HECM. Under the new rule, the premium will be paid on the difference between the home value at the time the original HECM was made and the newly appraised home value at the time of refinancing. This regulation has not yet been implemented. In addition, the mandatory counseling requirement is waived in a refinancing if the loan amount that the borrower is eligible to receive exceeds five times the total cost of the refinancing.

PART III: CURRENT SIZE AND FUTURE POTENTIAL OF THE REVERSE MORTGAGE MARKET

In creating a new financing tool that is based on home equity, mortgage lenders have faced a fundamental question: if they build it, will seniors come? Limited demand for reverse mortgages among consumers has made some people skeptical about the potential for significant growth in the reverse mortgage market.

A focus on poor, single homeowners as the target population for reverse mortgages may have contributed to this situation. This emphasis ignores several other, potentially important market niches for the product. Among them are middle-income elders with an impairment who need additional resources to pay for in-home services and supports. Another untapped market may be found among younger, more affluent homeowners who want to use the equity in their home to help finance long-term care insurance. How much more might the market grow if the use of reverse mortgages for long-term care became widespread?

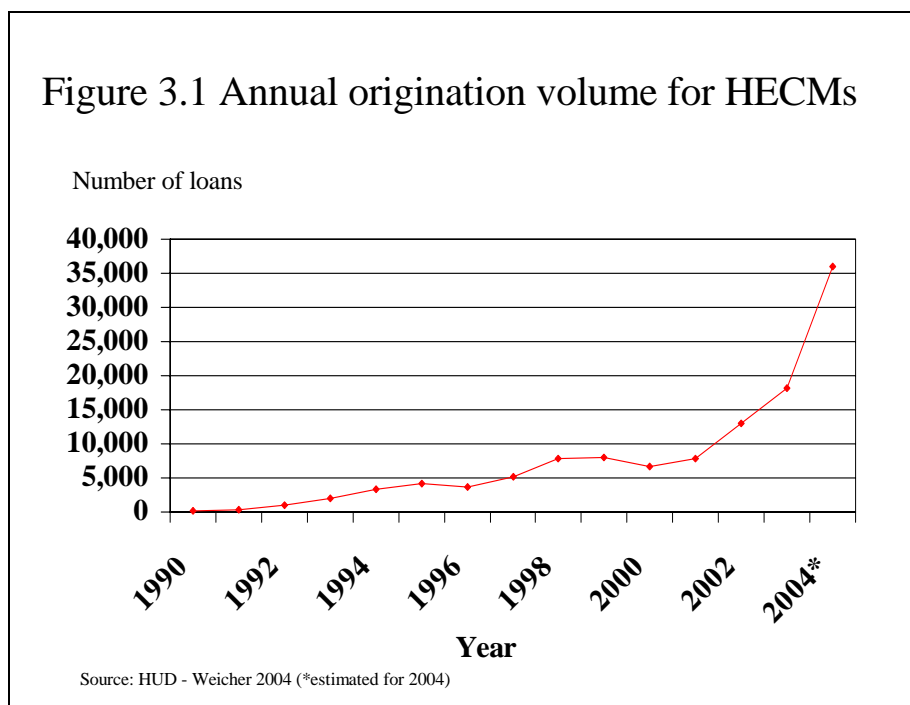
This chapter examines the current reverse mortgage market and the factors that have contributed to its recent growth. In looking at the future market potential, the analysis estimates the total number of older households that could qualify for a reverse mortgage and the aggregate funds that could be available to address our nation's long-term care financing needs. Market size and loan amounts were also estimated for three key segments of the older homeowner population: current Medicaid beneficiaries, households at financial risk of needing Medicaid, and more affluent elder households. In addition, the analysis looked at the extent to which these loans will pay for in-home services and long-term care insurance. The final section provides an estimate of cost savings to Medicaid under different levels of reverse mortgage market penetration.

Current market for reverse mortgages

The reverse mortgage industry started in the early 1960s, when a small number of lenders began offering proprietary reverse annuity products. In the succeeding decades, reverse mortgages gradually developed. The Home Equity Conversion Mortgage (HECM) began in 1989 as a HUD demonstration program. In 2000, Congress made the HECM program a permanent program under HUD.

Until recently, the market for reverse mortgages has been modest. Since 2001, however, lenders have seen a dramatic increase in the volume of HECMs made nationwide, reaching over 100,000 loans originated in total. Very low mortgage rates, combined with the fall of the stock market, have significantly increased the popularity of reverse mortgages. Within the last three years, FHA has seen the HECM program grow by 200 percent (Weicher 2004). By end of 2004, the HECM program is expected to double its previous year activity in both dollars and loan volume—to an estimated \$6 billion and 36,000 loans (Figure 3.1).

Figure 3.1 Annual origination volume for HECMs



The use of reverse mortgages is growing nationwide. The top markets for HECM loans are scattered in many regions around the country (NRMLA 2004):

- California (Los Angeles, Santa Ana, San Francisco, San Diego)
- New York (New York)
- Colorado (Denver)
- Michigan (Detroit)
- Massachusetts (Boston)
- Minnesota (Minneapolis-St. Paul)
- Florida (Coral Gables)

Several factors are likely to contribute to continued growth of the reverse mortgage market. The industry is maturing and these loans are becoming more widely available. Financial advisers and the media are increasing consumer awareness of this financial tool. A rapidly aging population can also increase demand for reverse mortgages in the coming years.

The HECM program is the oldest and most popular reverse mortgage product. Currently, HECMs represent about 90 percent of all the reverse mortgages in the market. In consideration of these facts, all the market analyses conducted for this Blueprint are based on the HECM product.

Expanding the market through long-term care

By helping seniors gradually liquidate housing wealth to augment their financial resources, reverse mortgages have shown that they can significantly reduce the number of elders in poverty (Morgan et al. 1996, Bronfenbrenner Life Course Center 1996, Kutty 1998). For “cash poor”

homeowners, even a small increase in monthly income can significantly improve the quality of their lives. Using reverse mortgages to pay for the long-term care need of older Americans will present different challenges.

One of the biggest risks to financial security in retirement is unanticipated long-term care expenses. The cost of in-home services can range from an average of \$200 per month in out-of-pocket expenses by family caregivers to \$2,160 on average per month for four-hour daily home care visits (National Alliance for Caregiving 2004, MetLife Mature Market Institute 2004c). Services for elders who need round-the-clock care at home can be more expensive than nursing home care. Without adequate financial support, the needs of impaired elders can overwhelm caregivers, impoverish older families, and lead to institutionalization.

To examine the practicability of using home equity to pay for these expenses, this study sought to answer four basic questions:

- How many older Americans could qualify for a reverse mortgage?
- Among these elders, how many are candidates for using a reverse mortgage to pay for help at home?
- How much money would be available to pay for in-home services and supports?
- How much long-term care will these funds buy?

The role that reverse mortgages will play in financing long-term care will be determined by the extent to which this product helps older homeowners “age in place.” If loan amounts are small or using reverse mortgages is only an option for a narrow group of elders, this financial tool is likely to play a relatively limited role in solving the problems of long-term care financing. Alternatively, if a wide array of homeowners can benefit from tapping home equity to pay for in-home services and supports, then enhancing the development of the reverse mortgage market through policy initiatives and incentives may be warranted.

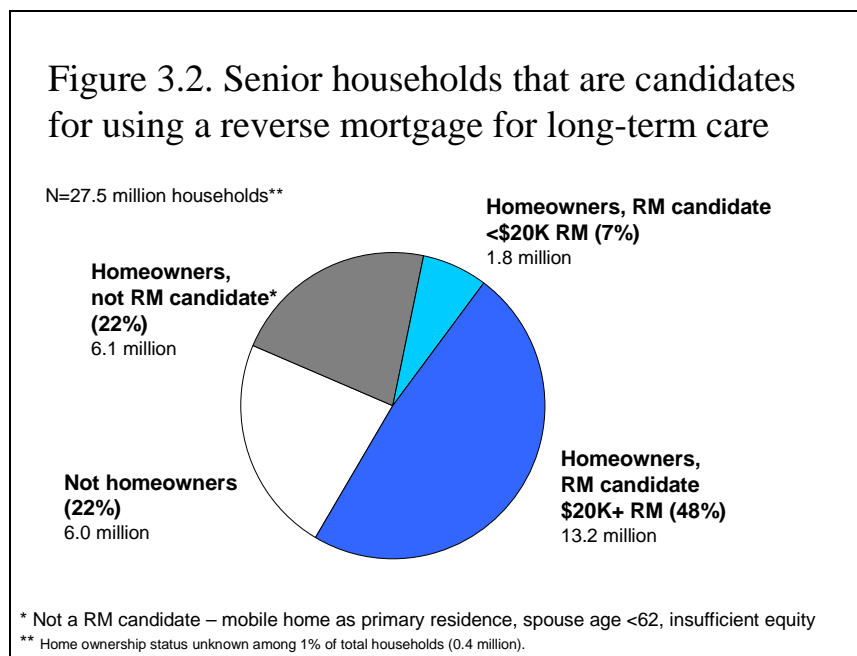
Size of the potential market

Based on the Health and Retirement Study, in 2000 there were 27.5 million elder households with at least one resident age 62 or older. A high proportion (21.1 million) of these households (78 percent) were homeowners (Figure 3.2). About 74 percent owned their homes free and clear of any mortgages. In aggregate, elder households have accumulated over \$2 trillion in home equity.

Such high levels of housing wealth underscore the promise of reverse mortgages. But these numbers likely overestimate the true market potential. Of the 21 million elder homeowner households, 15 million (71 percent) would likely meet the eligibility requirements for a HECM. Homeowners do not qualify for this loan for a variety of reasons. They may live in an ineligible structure such as a mobile home, or owe a sizable debt on the house (including first mortgage or home equity loans) that is too large to be paid off with the proceeds of the reverse mortgage. The requirement that both borrowers must be at least age 62 eliminates households with younger spouses. These homeowners could qualify for a reverse mortgage in the future.

The cost of home and community care can be substantial, so the candidate population in this analysis was further restricted to include only homeowners who would be able to receive a minimum of \$20,000 from a reverse mortgage. Since the study’s ultimate concern is to identify

ways to use reverse mortgages to promote “aging in place,” this limit reflects the relatively lower costs of in-home services and supports compared to institutional care. Seniors who need facility care could sell the house to pay for more intensive and costly services. In addition, a reverse mortgage loan becomes due when a borrower moves permanently into a nursing facility. It was also important to set the financial threshold low enough to include “house rich and cash poor” homeowners who are already inclined to use a reverse mortgage but might benefit from government subsidies.



Using this approach, a total of 13.2 million (48 percent of all elder households) are candidates for using a reverse mortgage to pay for long-term care. The average home equity per candidate household is \$144,000 (median is \$105,000). By liquidating their housing wealth through a reverse mortgage, qualifying elder homeowners would be able to access \$953 billion in total through HECM loans. The following sections examine the total candidate population more closely to identify older homeowners who are likely to consider this financing option, based on their financial risk of needing public assistance for long-term care, and their level of impairment.

Key market segments

Reverse mortgages could play an important role in reducing the likelihood that elderly households will deplete their financial resources paying for long-term care. For economically vulnerable households, access to these funds also has the potential to lower dependence on government subsidized care through the Medicaid program. Among the 13.2 million candidate households, about 5.2 million (39 percent) either receive Medicaid benefits or are at financial risk for needing government assistance (Table 3.1). Though Medicaid beneficiaries may be receiving home and community services, additional cash from reverse mortgages can help cover unmet needs while providing greater choice and control over services.

The potential market and size of reverse mortgage loans were estimated for three groups of older homeowners who face differing risks for impoverishment due to long-term care:

1. Current Medicaid beneficiaries.
2. Elder households at financial risk of needing Medicaid.
3. More affluent homeowners who are unlikely to qualify for government subsidized care.

Each of these groups presents different challenges to policymakers due to their distinct socio-economic characteristics. It is also likely that they will respond differently to incentives for reverse mortgages.

Medicaid beneficiaries (Group 1): This group consists of HRS 2000 respondents age 62 or older who live in the community and reported that they received full or partial Medicaid benefits in 2000. To qualify for home and community services through Medicaid, these households must have very low income and assets, or spend a high proportion of their financial resources to pay for health and long-term care expenses.¹

Based on our analysis, of the 2.54 million households containing at least one Medicaid beneficiary, about 17 percent could be candidates for using a reverse mortgage to pay for long-term care (Table 3.1). Relatively few of these homeowners are married (35 percent). The average age of the youngest homeowner in this group is 75.

Table 3.1. Distribution of home ownership by market segment

	Total households age 62+	Total owner households	% total households	Candidate households for using a RM for LTC	% total households	% owner households
Medicaid beneficiary	2,537,000	1,058,000	41.7%	437,000	17.2%	41.3%
High risk Medicaid	4,444,000	2,927,000	65.9%	1,403,000	31.6%	47.9%
Spend-down risk	7,331,000	5,449,000	74.3%	3,321,000	45.3%	60.9%
Low Medicaid risk	13,083,000	11,642,000	89.0%	8,034,000	61.4%	69.0%
Total	27,397,000	21,077,000		13,196,000		

Source: NCOA calculations based on data from the 2000 Health and Retirement Study.

Medicaid beneficiary households typically own \$95,000 in home equity (median value is \$75,000). As shown in Table 3.2, on average, these homeowners could receive a HECM loan worth \$51,229. At current interest rates, these funds would enable borrowers to make monthly withdrawals of \$1,465 from a HECM creditline for about three years.² To make the funds last five years, these borrowers would be able to make monthly withdrawals of about \$895.

Table 3.2. Amount of potential HECM funds, by Medicaid risk level

	Average potential cash or creditline from a HECM loan	Monthly withdrawals by estimated duration of funds		
		3 years	5 years	10 years
Medicaid beneficiary	\$51,229	\$1,465	\$895	\$470
High risk Medicaid	\$55,085	\$1,575	\$964	\$506
Spend-down risk	\$62,800	\$1,798	\$1,100	\$577
Low Medicaid risk	\$80,130	\$2,290	\$1,403	\$737
Total	\$72,128			

NCOA calculation using the AARP reverse mortgage calculator and a creditline interest rate of 4.09%.

Households at risk for Medicaid (Group 2): These elder households are important from a policy standpoint because their limited financial resources place them at greatest risk for turning to public programs should they need long-term care. Two distinct groups were examined to assess the potential of reverse mortgages:

- 1) High Medicaid risk households (Group 2a): These homeowners have limited income and assets that likely meet the financial eligibility requirements for receiving help at home from Medicaid.³ If they became severely disabled and needed to pay for long-term care, these elders would likely qualify immediately for government assistance. The average age of the youngest homeowner in this group is 74. Almost one in three (32 percent) of “high risk” households could consider using a reverse mortgage for long-term care (Table 3.1).

These financially vulnerable elders own a substantial amount of home equity, on average \$97,351 (median value is \$75,000). By liquidating their housing wealth, they could access a lump sum or line of credit worth on average \$55,085 from a HECM loan (Table 3.2). These funds could be very important to support family caregiving, since a high proportion (69 percent) of homeowners in this group is married.

- 2) Spend-down risk households (Group 2b). This group is primarily composed of “tweeners,” elders whose financial resources are sufficient to pay for everyday expenses but not to handle substantial out-of-pocket payments for services and supports at home.⁴ These elders may be able to qualify for Medicaid by depleting their income and assets to pay for long-term care (termed “spend-down”) in the community.

In this analysis, the risk of spend-down was determined based on the ability to pay for home care (about \$27,000 per year in 2000). Single elders in Group 2b were included if their financial resources would pay for less than two years of daily home care. Married couples included in this group have income and assets that would cover home care expenses for less than four years. The average age of the youngest homeowner in this group is 74. Most of these households (66 percent) consist of unmarried homeowners.

Close to half (45 percent) of households at financial risk for “spending-down” could use a reverse mortgage to help them pay for long-term care (Table 3.1). The mean amount of home equity owned by these households is \$111,466 (median value is \$90,000). On average, the households could expect to get \$62,800 from a reverse mortgage. At current interest rates, these borrowers could make monthly withdrawals of \$1,100 from a HECM creditline for about five years (Table 3.2).

Low Medicaid risk households (Group 3): This segment of the senior homeowner population consists of more affluent households. For this analysis, the group included households who can afford to pay for daily home care for at least two years (single households) or four years (married households).⁵ About half (53 percent) of these households consist of couples. This market segment is younger than the other groups, with an average age of 72 for the youngest homeowner.

A high proportion of more affluent elders (61 percent) are candidates for using a reverse mortgage for their long-term care needs (Table 3.1). The average home equity in this group is \$167,792 (median value is \$125,000), and the average reverse mortgage loan value is \$80,130 (Table 3.2). With greater access to liquid assets, more affluent elders might be reluctant to tap home equity to pay directly for in-home services and supports. Demand for reverse mortgages among this group may instead emerge from a desire to protect their wealth and leverage their resources through private long-term insurance. Only a small number of Americans (8.3 million) have purchased this type of coverage (Coronel 2003).

Long-term care needs among candidate households

Reverse mortgages can provide a substantial amount of additional funds for a broad range of older homeowners. However, most elders are likely to be reluctant to tap home equity until they need assistance. Of the 13.2 million candidate households, about 9.8 million (74 percent) are dealing with some level of impairment that affects their ability to live at home (Table 3.3). Of these, 1.75 million (13 percent) contain one or more elders who have an immediate need for long-term care. These elders need assistance to perform one or more ADLs or IADLs. Among these households, almost one million are on Medicaid or at financial risk for needing government assistance to pay for long-term care. An additional 1.96 million households (15 percent) would likely require assistance in the near future because they only have difficulty with ADLs or IADLs.

Nearly half of candidate households (6.1 million) are coping with functional limitations. These homeowners are an important target population for reverse mortgages because they are not well served by traditional sources of long-term care financing that target elders with a high level of impairment. Only the sickest seniors may be eligible to receive services through the Medicaid program. For example, beneficiaries receiving services under a Medicaid Home and Community Based Services Waiver (1915c) must be so severely impaired that they would otherwise require nursing home care before they can qualify for help at home. Similarly, long-term care insurance policyholders typically must need help with two or more ADLs to trigger their home care benefits. This makes it difficult for elders with limited financial resources and moderate levels of impairment to get timely help before they face a debilitating—and costly—crisis.

By liquidating their housing wealth through a reverse mortgage, the 9.8 million candidate households dealing with some level of impairment would be able to access \$695 billion in total through HECM loans. The 1.75 million candidate homeowners with an immediate need for help with ADLs or IADLs could access about \$121 billion in total from these loans. These financial resources could have a significant impact on the well-being of impaired elders and their families. By having money of their own to pay for long-term care, elders can maintain their dignity, as well as retain some independence and control over their lives. For spouses and other family caregivers, these supports can help reduce the financial, emotional, and physical strain that often comes with caring for an impaired elder (Family Caregiver Alliance 2003).

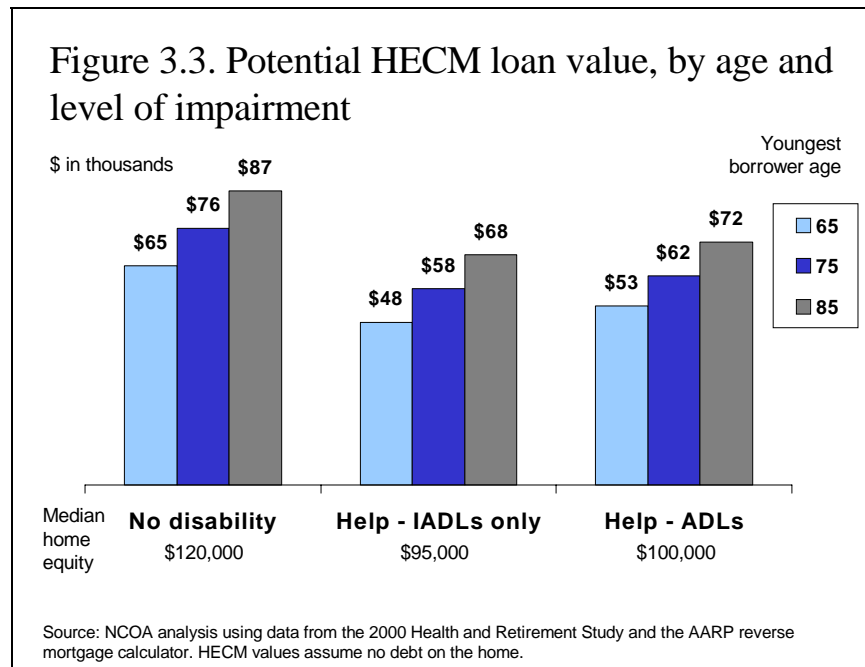
Table 3.3. Level of impairment among candidate households

	Total households	Need for immediate help		Potential future need		Functional limitation only		No disability	
		Needs help with 1+ ADL/IADL		Difficulty only with 1+ ADL/IADL					
		Number	%	Number	%	Number	%	Number	%
Medicaid beneficiary	437,000	152,000	34.7%	76,000	17.3%	138,000	31.4%	73,000	16.6%
High risk Medicaid	1,403,000	375,000	26.7%	228,000	16.2%	571,000	40.7%	229,000	16.3%
Spend-down risk	3,320,000	435,000	13.1%	557,000	16.7%	1,481,000	44.6%	847,000	25.5%
Low Medicaid risk	8,034,000	787,000	9.8%	1,103,000	13.8%	3,892,000	48.4%	2,252,000	25.8%
Total	13,196,000	1,749,000		1,964,000		6,082,000		3,401,000	

Source: NCOA calculations based on data from the 2000 Health and Retirement Study.

Direct payment of home and community services

Impaired elder homeowners could significantly increase their resources to pay for in-home services and supports through a reverse mortgage. The median amount of home equity is \$100,000 among candidate households that include an elder who needs help with ADLs (Figure 3.3). These homeowners could get a reverse mortgage loan ranging in value from about \$53,000 to \$72,000, depending on the age of the youngest borrower. One of the benefits of these loans is that borrowers can get a substantially higher loan amount at older ages, when they are more likely to be at risk of needing assistance.



A lump-sum payment can help more severely impaired borrowers pay for immediate needs. These can include making home modifications or paying for specially modified vans that can

