

RESEARCH SUMMARY

Retire on the House: The Possible Use of Reverse Mortgages to Enhance Retirement Security

The fear that Americans are inadequately prepared for retirement has led to many policy ideas and some new financial products to improve retirement security for current and future retirees. In “[Retire on the House: The Possible Use of Reverse Mortgages to Enhance Retirement Security](#),” Mercatus Senior Research Fellow Mark J. Warshawsky provides an in-depth analysis of one of these products: the reverse mortgage. A reverse mortgage is suitable for only about one in seven retired households, but a reduction in costs could expand the potential market to almost a quarter of retired households.

THE REVERSE MORTGAGE

A reverse mortgage (also known as a HECM, or home equity conversion mortgage) is a product guaranteed and regulated by federal government. It allows homeowners above age 62 to access some of the equity in their home as periodic payments or a line of credit. This mortgage is repaid, with interest, in one payment when the borrower either dies or moves out of the home. It is a nonrecourse loan, which means the borrowers will never owe more than the loan balance or the value of the property, whichever is less. Therefore, it is risky to the guarantor, the federal government, which has to charge a high insurance premium to cover that risk. This also makes a HECM more expensive for the borrower.

Currently, less than 2 percent of retired households use reverse mortgages. Although there are several payment plans available, and the “line of credit” option is the most popular, this paper focuses on the “tenure” option, where continual periodic payouts are made for as long as the borrower lives in the home.

THE COSTS OF HECMS

Mortgage insurance issued by the Federal Housing Administration is a mandatory part of the HECM product. The premium on this mortgage insurance pays for the federal guarantee that the lender is protected against credit risk; it is part of the product design that the borrower will never owe more than the value of the home. Additionally,

- HECM closing costs include an origination fee to the lender that can run as high as the greater of (1) \$2,500 or (2) 2 percent of the first \$200,000 of the home’s value plus 1 percent of the amount over \$200,000, capped at \$6,000.
- Third-party fees include appraisal, title search and insurance, surveys and inspections, recording fees, mortgage taxes and credit checks, and—if less than 60 percent of the available funds are accessed in the first year of the HECM—the upfront mortgage insurance premium, equal to 0.50 percent of the home value.
- Fees that accrue over the life of the loan include interest expense, a monthly servicing fee of up to \$35, and a mortgage insurance premium equal to 1.25 percent of the outstanding loan balance.

- Because some of these fees are fixed amounts rather than percentages, they can render loans on relatively low-value homes, worth less than \$100,000, prohibitively expensive.

REDUCING HECM COSTS TO INCREASE RETIREMENT WELFARE

Only 2 percent of retired households currently use the reverse mortgage product, while over 80 percent of US households own a home. A decrease in the cost of HECMs would increase the current size of the reverse mortgage market and would significantly improve the retirement welfare of retired households.

Policymakers can achieve these goals by making the following changes:

- Reducing the initial and ongoing costs of the HECM by half, particularly origination fees and the government insurance premium.
- Lowering the principal loan limit to allow for the elimination of government backing for the product because of the reduced default risk to lenders.
- Tightening Medicaid eligibility rules and administering the program more effectively to encourage the purchase of private long-term-care insurance. This policy would also free up the value of the home, currently held by many households to pay for eventual long-term-care costs, for increasing retirement income from reverse mortgages.