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The Housing Bubble Goes Bust: The Impact of Housing Values on the Demand for Reverse Mortgages

Eileen St. Pierre, Ph.D., CFA, Oklahoma State University[1]

With the aging of the baby boom generation, much attention has been focused in the consumer education community on how this generation will finance their retirement given their lack of personal savings, as compared to previous generations. One financial instrument increasingly being considered by individuals, financial planners, and public policy officials is the reverse mortgage. A reverse mortgage is a special type of home loan that allows a homeowner to convert a portion of his/her home equity into cash. There are several factors that determine how much money a homeowner can borrow: homeowner's age, current value of the home and its growth rate in the future, current interest rates, and the amount of equity in the home. Generally speaking, the older you are, the more valuable your home is, and the lower interest rates are, the more money you can access. Since the value of the home is such an important factor in determining the cash flow received by the homeowner from a reverse mortgage, it is important to understand how changes in home values have impacted the demand for reverse mortgages.

This study looks at how the surge in home values starting in late 2001 to mid 2006 (the housing bubble), and the precipitous drop in prices since then, affected the demand for FHA-sponsored home equity conversion mortgages (HECMs) in the United States. It will also assess whether this change in demand was influenced by the age, gender, and state/region of residence of the eligible homeowner(s). The HECM Single Family Portfolio Snap Shot contains monthly data on HECM loans from January 1990 to April 2009 and has been made publicly available by HUD. The data set is partitioned into three sub periods: (1) program initiation to the start of the housing bubble, (2) the 2001 to 2006 housing bubble, and (3) current housing crisis and resulting credit crunch. The number of HECM loans is assumed to be a proxy for the demand for reverse mortgages.

In all but four of the 50 states, the number of HECM loans has increased over time. The only exceptions were California, Colorado, Minnesota, and Nebraska; in Period 3, the numbers of loans were below those in Period 2. Given how many new loans are added to the database per month, it appears that the number of loans in these 4 states could soon exceed those in Period 2 by the end of the 2009 fiscal year. On a national basis, it does not appear that declining real estate values are affecting the demand for reverse mortgages. Alarmingly, the number of HECM lenders has skyrocketed since the collapse of the real estate market, particularly in Florida and California. This increase in competition may leave homeowners confused about which company to trust.

The Home Equity Conversion Mortgage Characteristics data set has also been made publicly available by HUD. It contains annual averages of variables from fiscal year 1990 to 2008 including age and gender percentage. Generally speaking, the average age of borrowers has been falling over time, with a steady decline beginning after the year 2000. This shows that seniors are relying more on reverse mortgages as an income source for longer periods of time in retirement, not just using this cash flow for emergencies or long-term care needs.

The percentage of single females taking out HECMs has followed the same pattern. The percentages of single male and dual applicants have increased since 2000, with the percentage of dual applicants falling slightly in 2007 and 2008. Past literature has theorized that single elderly women would be the primary users of reverse mortgages. They tend to live longer than men and could use reverse mortgages as their final financial buffer against adversity. However, if the percentage of dual applicants has risen, this could also indicate that reverse mortgages are being used as a more regular source of retirement income. In other words, couples are making this decision together earlier in retirement, not leaving this financing decision as a last resort for the surviving spouse.

It is imperative that seniors and those individuals who are nearing retirement fully understand reverse mortgages. The resulting collapse of the real estate market and its aftermath will continue to be felt in the U.S. and throughout the world for quite some time. Consumer educators need to make sure they counter ads from reverse mortgage lenders with a sound curriculum that provides unbiased and accurate information about the benefits and risks of reverse mortgages.

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[1] Assistant Professor and Personal Finance Extension Specialist, Department of Human Development and Family Science, Oklahoma State University, 233 Human Environmental Sciences, Stillwater, Oklahoma 74078-6122, Office: (405) 744-8072, Fax: (405) 744-2800, eileen.stpierre@okstate.edu