Reverse Mortgages: Background and Issues

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Summary

Since the 1970s, parties have sought to create mortgage instruments that would enable elderly homeowners to obtain loans to convert their equity into income, while providing that no repayments would be due for a specified period or, ideally, for the lifetime of the borrower. These instruments have been referred to as reverse mortgages, reverse annuity mortgages, and home equity conversion loans.

Reverse mortgages are the opposite of traditional mortgages in the sense that the borrower receives payments from the lender instead of making such payments to the lender. Reverse mortgages are designed to enable elderly homeowners to remain in their homes while using the equity in their homes as a form of income.

In general, reverse mortgages may take one of two forms: term or tenure. Under a term reverse mortgage, the borrower is provided with income for a specified period. Under a tenure reverse mortgage, the borrower is provided with income for as long as he or she continues to occupy the property.

For borrowers, the most risky reverse mortgage is the term reverse mortgage. Borrowers have been reluctant to enter such mortgages because at the end of the loan term the borrower would likely have to sell the home and move.

For lenders, the most risky reverse mortgage is the tenure reverse mortgage. Lenders have been reluctant to originate such mortgages because the borrower is guaranteed lifetime income and lifetime occupancy of the home. This is risky because the mortgage debt grows over time, and the debt could exceed the value of the home if the borrower lives longer than his or her life expectancy. The use of tenure reverse mortgages has grown in recent years due to the availability of an FHA-insured reverse mortgage. Under the FHA program, the risk of the borrower living too long is shifted to the federal government.

Under prior law, FHA-insured reverse mortgages were subject to the FHA mortgage limit for the area in which a property is located. The Housing and Economic Recovery Act of 2008, P.L. 110-289, establishes a mortgage limit equal to the conforming loan limit for Freddie Mac.

Present law limits the aggregate number of FHA-insured reverse mortgages to 275,000 loans, and that limit has been exceeded. Notwithstanding the limit in present law, the 2009 Continuing Appropriations Resolution, P.L. 110-329, provides that FHA may continue to insure reverse mortgages through March 6, 2009. Unless Congress amends the law, FHA may not insure reverse mortgages after March 6, 2009.

This report will be updated as deemed necessary in response to changes in law or regulation.

Contents

Introduction 1
The Evolution of Reverse Mortgages 2
  Sale-Leaseback Transactions 2
  Reverse Annuity Mortgage 3
  Reverse Mortgage 5
Current Reverse Mortgage Plans 6
  The Home Equity Conversion Mortgage Program (HECM) 7
  The Home Keeper Mortgage 8
  The Cash Account Plan 9
  Senior Equity Reverse Mortgage 10
Choosing Among the Plans 10
Using Reverse Mortgages for Long-Term Care 13
  Funding Long-Term Care Directly 13
  Funding Long-Term Care Insurance 14
Issues for the Elderly 14
  Downsizing 14
  Selling and Renting 15
  Finding Tenants 15
  Reverse Mortgage 15
Issues for Congress 16
  Potential Federal Liability 16
  HECM Loan Limit 18
  Long-Term Care Insurance 19
  Number of HECM Loans 19
  Aging in Place 20
References 20

Tables

Table 1. Comparison of Monthly Reverse Annuity Mortgage Benefits 3
Table 2. Payment Options Under a $100,000 Term Reverse Mortgage 6
Table 3. Payment Options Under Reverse Mortgage Programs by Age of Youngest Homeowner 11
Table 4. Comparison of Reverse Mortgage Benefits to a Homeowner in Albany, NY 11
Table 5. Comparison of Reverse Mortgage Benefits to a Homeowner in Glendale, CA 12
Table 6. HECM Loans by Fiscal Year 17
Table 7. Potential Federal Liability Under the HECM 18

Contacts

Author Contact Information 21

Introduction

According to the American Housing Survey (AHS), nearly 25 million American homeowners have no mortgage debt, and more than 12.5 million of them are elderly (age 65 or older).[1] For many of the elderly homeowners, the equity in their homes represents their largest asset. The AHS finds that the median value of these unmortgaged homes is $127,959.

Many elderly homeowners find that although inflation has increased the value of their homes, it has also eroded the purchasing power of their fixed incomes. They find it increasingly difficult to maintain their homes while also paying for needed food, medical, and other expenses. Because of their low incomes, many may be unable to qualify for loans to pay for unexpected expenses. "House rich and cash poor" is the phrase often used to describe their dilemma. One option is to sell the home and move to rental housing or purchase a lower-cost home. For a variety of reasons, however, many older Americans prefer to remain in the homes in which they may have spent most of their working years.

Since the 1970s, academics and housing advocates have sought to create mortgage instruments that would enable elderly homeowners to obtain loans to convert their equity into income, while providing that no repayments would be due for a specified period or, ideally, for the lifetime of the borrower. These instruments have been referred to as reverse mortgages, reverse annuity mortgages, and home equity conversion loans.

Generally, when a borrower obtains a mortgage, a lender advances a lump-sum payment to or on behalf of the borrower, and the borrower becomes committed to making a stream of monthly payments to repay the loan. With the reverse mortgage, the lender becomes committed to making a stream of payments to the borrower, and such payments are repaid to the lender in a lump sum at some future date. Thus, reverse mortgages are the opposite of traditional mortgages in that the borrower receives payments from the lender instead of making such payments to the lender. Reverse mortgages are designed to enable elderly homeowners to remain in their homes while using the equity in their homes as a form of income.

Although reverse mortgages are a small part of the total mortgage market, their use has increased substantially in recent years. This report discusses the evolution and history of reverse mortgages, compares reverse mortgage products currently available, discusses the potential use of reverse mortgages as a way to finance long-term care, and raises a number of issues for policymakers and the elderly (aged 65 or older).[2]

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[1] *American Housing Survey for the United States: 2005*, Current Housing Reports. H150/05. U.S. Department of Housing and Urban Development and U.S. Census Bureau. August 2006, p. 156.

[2] *American Housing Survey for the United States: 2005*, Current Housing Reports. H150/05. U.S. Department of Housing and Urban Development and U.S. Census Bureau. August 2006, p. 156.

The Evolution of Reverse Mortgages

Sale-Leaseback Transactions

Under a sale-leaseback transaction a property is sold to a buyer who simultaneously leases the property to the seller. Often, sale-leaseback transactions are used by businesses that seek to raise working capital by selling and leasing back some property that is used in the trade or business. The technique enables firms to raise capital and avoid high borrowing costs. Capital that was formerly frozen in real estate assets can be used to generate a higher rate of return in the business itself. If the business obtained a mortgage against the property, the mortgage would cover only 75 to 80% of the market value of the property. Through the sale-leaseback transaction, the business can obtain cash for 100% of the value of the property (less transaction costs) and still maintain use and possession of the property.

In the 1970s, some advocates suggested sale-leaseback transactions as a way for elderly homeowners to convert the equity in their homes into a source of income. Under this plan, the elderly homeowner would sell the home and lease it back from the new owner. The seller could retain the right of occupancy for life or for a fixed number of years. In either case, the seller would become a renter of the home that he or she formerly owned.

The burden of property taxes, home insurance, and repair and maintenance costs would rest with the new owner. It is argued that these costs make it difficult for elderly homeowners to remain in their homes or cause them to make trade-offs between making home repairs and taking care of necessities such as food and health care. Such trade-offs may result in the elderly having owner-occupied but substandard property. Under a sale-leaseback plan, the owner/investor would be paying the operating costs of the property and be eligible for the associated tax write-offs. Proponents hold that the elderly would remain in well-maintained homes without the financial burden of such maintenance.

The sale-leaseback plan is a complicated form of equity conversion because of the number of variables that must be negotiated between the buyer and seller. The parties must negotiate the sales price, downpayment, loan term, and lease agreement. The items are interrelated and may affect the net benefit of the transaction to the elderly homeowner.

A few programs were initiated. Under the so-called "Grannie Mae" program, a company would arrange for the children or grandchildren to purchase and leaseback the home of the elderly person.[3] Under another plan, the Fouratt Senior Citizen Equity Plan, the leaseback payments took two forms: a promissory note (mortgage) and a deferred annuity.[4] The promissory note would provide for monthly payments to the seller over a term equal to the greater of the seller's life expectancy or 10 years. When the payments from the promissory note ended, the annuity would make the same payments for the lifetime of the seller.

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[3] "Q and A on Grannie Mae," *Home Equity News*, National Center for Home Equity Conversion, No. 8, June 1984, p. 3

[4] Sloan, Katrinka Smith. "New Developments in Home Equity Conversion." *The Real Estate Finance Journal*, vol. 3, issue 4, March 1988, p 44.

Only three Grannie Mae loans were made. There was interest in the Fouratt program but no loans were ever made. Sale-leaseback transactions are still being suggested as an option for elderly homeowners. Data are not available on whether homeowners are choosing that option.

Reverse Annuity Mortgage

The reverse annuity mortgage is another concept that was suggested in the 1970s by advocates of reverse mortgages. Under a reverse annuity mortgage (RAM), equity in the home is used as security for a loan. An annuity is purchased with the loan proceeds and the borrower receives monthly annuity income, less mortgage interest. The borrower pays only interest on the loan—repayment of the principal is deferred until the death of the owner, the sale of the property, or some prescribed date.

Table 1 shows the net annuity that would be available under a RAM to a female homeowner for a range of ages and interest rates. The age shown is the borrower's age when the loan was taken. It is assumed that a borrower obtains a $200,000 interest-only mortgage on the property and uses the proceeds to purchase an annuity. That means that the loan balance will always be $200,000. Upon the death of the borrower, the sale of the property, or some prescribed date, the borrower or the borrower's heirs would owe the lender $200,000. For a 55-year-old borrower the annuity would be $1,062 monthly. If interest rates are 5%, the lender would deduct $833 from the annuity and forward the borrower a net annuity of $229. If interest rates are 12%, the interest payment would be greater than the annuity payments so the borrower would owe the lender $938 (a net annuity of $-938). This would defeat the purpose of entering into a RAM.

The table shows that rising interest rates are a risk for homeowners and that the interest rate risk is greater for younger borrowers. For 55 and 60-year-old borrowers, the net annuity would become negative when interest rates are at 7% or higher. The net annuity would become negative at 8% for 65-year-olds, 9% for 70-year-olds, 10% for 75-year-olds, and 12% for 80-year olds. But RAMs may become a bad financial choice long before the net annuity becomes negative. For example, the net annuity becomes negative at 9% for a 70-year old, but would it make economic sense for a 70-year-old to mortgage the home and only receive a net income of $380 monthly when interest rates are 6%?

Table 1. Comparison of Monthly Reverse Annuity Mortgage Benefits

	Age of Homeowner					
	55	**60**	**65**	**70**	**75**	**80**
Gross Annuity[a]	$1,062	$1,114	$1,243	$1,380	$1,611	$1,937
Less Interest:[b]						
at 5%	833	833	833	833	833	833
Net Annuity	*229*	*281*	*410*	*547*	*778*	*1,104*
at 6%	1,000	1,000	1,000	1,000	1,000	1,000
Net Annuity	*62*	*114*	*243*	*380*	*611*	*937*
at 7%	1,167	1,167	1,167	1,167	1,167	1,167
Net Annuity	*-105*	*-53*	*76*	*213*	*444*	*770*
at 8%	1,333	1,333	1,333	1,333	1,333	1,333

	Age of Homeowner					
Net Annuity	*-271*	*-219*	*-90*	*47*	*278*	*604*
at 9%	1,500	1,500	1,500	1,500	1,500	1,500
Net Annuity	*-438*	*-386*	*-257*	*-120*	*111*	*437*
at 10%	1,667	1,667	1,667	1,667	1,667	1,667
Net Annuity	*-605*	*-553*	*-424*	*-287*	*-56*	*270*
at 11%	1,833	1,833	1,833	1,833	1,833	1,833
Net Annuity	*-771*	*-719*	*-590*	*-453*	*-222*	*104*
at 12%	2,000	2,000	2,000	2,000	2,000	2,000
Net Annuity	*-938*	*-886*	*-757*	*-620*	*-389*	*-63*

Source: Calculations by CRS using annuities generated at http://www.immediateannuities.com.

a. Monthly payment to a female on a $200,000 immediate annuity.

b. Monthly interest due on a $200,000 interest-only mortgage.

For the homeowner, another risk of the RAM is that the borrower may die too soon. Suppose a 75-year old female obtained a RAM and died after receiving 12 payments. The estate would owe $200,000, even though the owner only received $19,332 in gross benefits. Of course the owner could have purchased an annuity with a 10 years certain option or cash refund option. The 10 years certain option provides that if the annuitant lives less than ten years after the plan is issued, the payments would continue to the beneficiary's estate until the 10-year period is completed. The cash refund option provides that if the total payments to the annuitant are less than the original premium (in this example, $200,000) the beneficiary would receive the balance in a lump sum. These options reduce the monthly annuity payments and thereby reduce the financial viability of the RAM.

Under RAMs, the risks for lenders are that the owner may live too long (mortality risk). The purchase of the annuity shifts the mortality risk to an insurance company.

Though the concept appeared promising, CRS is aware of only one program that offered RAMs, though they were not marketed as such. In the 1990s, Homefirst, a subsidiary of Transamerica Corporation, offered a reverse mortgage plan in many parts of the country. Under the so-called "Lifetime" plan the borrower would receive monthly loan advances for a specified number of years. A deferred annuity was purchased from Metropolitan Life Insurance Company on behalf of the borrower, and it would begin lifetime monthly annuity payments once the borrower received the last loan advance. The borrower would receive lifetime income regardless of whether they continued to occupy the property.

By the late 1990s, there were several complaints regarding the reverse mortgages from Homefirst. An extreme example is illustrated by the case of a New York woman. She took out a reverse mortgage and received loan advances until she died after receiving 32 monthly payments. When her home was sold a few months later, Financial Freedom (Homefirst) demanded more than

$765,000 as repayment under the terms of the reverse mortgage. The monthly payments she had received during the life of the loan totaled about $58,000.[5]

As a result of this case and similar cases, three class action lawsuits were filed against Transamerica HomeFirst, Inc., Transamerica Corporation, Metropolitan Life Insurance Company, and Financial Freedom Senior Funding Corporation. The cases were combined and settled before a single judge in the Superior Court of California in San Mateo County under Judicial Council Coordination Proceeding No. 4061.

The above example illustrates the risks to borrowers and lenders of reverse annuity mortgages. Financial Freedom no longer offers the "Lifetime Plan." Instead, it offers the "Cash Account Plan" as a proprietary reverse mortgage product, and that plan is discussed in a section below.

Reverse Mortgage

In general, reverse mortgages may take one of two forms—term or tenure. Under term reverse mortgages the borrower is provided with income for a specified period. Under tenure reverse mortgage the borrower is provided with income for as long as they continue to occupy the property.

From the lender's perspective, reverse mortgages are deferred-payment loans. The lender makes a stream of payments (or a lump-sum payment) to the homeowner and expects repayment at some future date. The repayment is predicated upon the sale of the home at some price which exceeds the debt that has accumulated against the home.

The largest risk the lender faces is the risk that over time the outstanding debt may grow to be greater than the property value. This may be referred to as collateral risk. Collateral risk is partly determined by the type of reverse mortgage. The least risky reverse mortgage is the term reverse mortgage under which payments stop after a specified number of years. Payments to the homeowner are calculated so that the loan reaches a target balance at the predetermined period. That target balance is less than 100% of the property value when the loan was originated. As long as the property has not depreciated during the period, the lender is assured that sale of the property will provide sufficient funds to repay the loan.

For lenders, the most risky reverse mortgage is the tenure reverse mortgage because the borrower is guaranteed lifetime income and lifetime occupancy of the home. In this case, the collateral risk may be significant if the age of entry is too low, if property appreciation rates are overestimated, or if occupant survival rates are underestimated.

In general, prior to the 1990s lenders were only willing to make term reverse mortgages. The payment options under these term reverse mortgages are relatively easy to calculate—all that is needed is the interest rate, the term of the loan, and the end-of-term loan balance. With these factors it is a simple matter to calculate the monthly payment that would cause the loan balance to grow to the specified amount over the specified term. As shown in **Table 2** for example, the

[5] Kenneth R. Harney, "Settlement Shows How Costly Reverse Mortgages Can Be," *Washington Post*, February , 2003, p. H3.

monthly payment to a homeowner seeking a $100,000 reverse mortgage at a 6.5% interest rate would be $594 for a 10-year term, $943 for a seven-year term, $1,415 for a five-year term, and $2,523 for a three-year term. **Table 2** also shows the maximum cash advance that will grow to a loan balance of $100,000 over the given terms.

The age of the homeowner is not a factor in term reverse mortgages, homeowners would receive the same income regardless of age. If the owner lives longer than the loan term, the home would have to be sold to pay off the debt.

This feature, however, made term reverse mortgages unattractive to homeowners who faced the prospect of having to sell their homes at a specified date, and to lenders who faced the prospect of risking their reputations by forcing such sales. For these reasons there have been few takers for term reverse mortgages.

Table 2. Payment Options Under a $100,000 Term Reverse Mortgage

Loan Term	Monthly Payments ($)	Cash Advance ($)
10 years	594	52,296
7 years	943	63,523
5 years	1,415	72,316
3 years	2,523	82,327

Source: Calculations by CRS.

Note: This example assumes that the interest rate is fixed at 6.5% and that there are no transaction costs.

Current Reverse Mortgage Plans

Over time three major reverse mortgage products have become available to consumers in the U.S. They are the Home Equity Conversion Mortgage Program (HECM), the Home Keeper reverse mortgage, and the Cash Account Plan. At present, a relatively new reverse mortgage, the "Senior Equity Reverse Mortgage," is only available in Arizona, California, Delaware, the District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Texas, and Virginia.

All of the plans provide the borrower with lifetime occupancy of the home—"tenure" reverse mortgages. The availability of tenure reverse mortgages is likely the cause of the dramatic growth of reverse mortgages in the past few years.

These tenure reverse mortgages also provide the borrower with flexibility on how the income from the mortgage is received. A borrower may receive monthly payments as long as the property is occupied by the borrower. The borrower may receive a line of credit which grows at some specified annual rate and upon which the borrower may make draws as needed. The borrower may choose to receive a large up-front cash advance. Or the borrower may choose any combination of the above, such as a smaller cash advance, a line of credit, and monthly income.

The following sections discuss and compare these existing reverse mortgage products.

The Home Equity Conversion Mortgage Program (HECM)

The Housing and Community Development Act of 1987 (P.L. 100-242) authorized the Home Equity Conversion Mortgage Program (HECM) in the Department of Housing and Urban Development (HUD) as a demonstration program. It was the first nationwide reverse mortgage program which offered the possibility of lifetime occupancy to elderly homeowners.[6] As noted above, such mortgages are referred to as tenure reverse mortgages. The borrowers must be elderly homeowners who own and occupy their homes.[7] The interest rate on the loan may be fixed or adjustable.[8] The homeowner and the lender may agree to share in any future appreciation in the value of the property.[9] The program has been made permanent and the law was amended to permit its use for one-to four-family residences if the owner occupies one of the units. [10]

The borrower can choose from five payment plans:

- Tenure—equal monthly payments as long as at least one borrower lives and continues to occupy the property as a principal residence.
- Term—equal monthly payments for a fixed period of months selected by the borrower.
- Line of Credit—installments at times and in amount of borrower's choosing until the line of credit is exhausted.
- Modified Tenure—combination of line of credit with monthly payments for as long as the borrower remains in the home.
- Modified Term—combination of line of credit with monthly payments for a fixed period of months selected by the borrower.

Prior law provided that the HECM loan may not exceed the Federal Housing Administration (FHA) mortgage limit for the area in which the property is located. The Housing and Economic Recovery Act of 2008, P.L. 110-289, establishes a HECM limit equal to the conforming loan limit for the Federal Home Loan Mortgage Corporation (Freddie Mac). The mortgage must be a first mortgage, which, in essence, implies that any previous mortgage must be fully repaid either prior to the HECM or from the initial proceeds of the HECM. Prior to obtaining a loan, borrowers must be provided with counseling by third parties who will explain the financial implications of entering into home equity conversion mortgages as well as explain the options, other than home equity conversion mortgages, that may be available to elderly homeowners. To prevent displacement of the elderly homeowners, HECMs must include terms that give the homeowner the option of deferring repayment of the loan until the death of the homeowner, the voluntary sale

[6] The mortgages were not initially available in Texas because state law prohibited reverse mortgages. Texas law has been subsequently amended to permit reverse mortgages.

[7] If the property has multiple owners, the youngest owner must be at least 62 years of age.

[8] Virtually all of the HECM loans are sold to the Federal National Mortgage Association (Fannie Mae). Since lenders generally make HECM loans with the intention of selling them to Fannie Mae, and since Fannie Mae only buys HECM loans that have adjustable rates, all HECM loans are made with adjustable interest rates.

[9] Fannie Mae will not buy HECM loans that feature equity sharing, so none are made with this feature.

[10] Section 593 of P.L.105-276.

of the home, or the occurrence of some other events as prescribed by HUD regulations. The borrowers may prepay the loans without penalty.

Borrowers are required to purchase insurance from FHA. The insurance serves two purposes: (1) it protects lenders from suffering losses if the final loan balance exceeds the proceeds from the sale of a home, and (2) it continues monthly payments to the homeowner if the lender defaults on the loan. At loan origination borrowers are required to pay an up-front mortgage insurance premium (MIP) of 2% of the maximum mortgage amount. In addition, borrowers pay an annual insurance premium of 0.5% of the loan balance. Borrowers do not directly pay the insurance premiums. Instead, lenders make the payments to FHA on behalf of the borrowers and the cost of the insurance is added to the borrower's loan balance.

A lender may choose either the assignment option or the coinsurance option when originating the loan. Under the assignment option, HUD will collect all the MIP and the lender may assign the loan to HUD at the point that the loan balance equals the maximum HUD claim amount for the area. Under the coinsurance option, the lender may keep part of the MIP and forfeit the right to assign the case to HUD.

To date, data indicate that all lenders have chosen the assignment option. By choosing this option, effectively, lenders are shifting the collateral risk to HUD.

The American Homeownership and Economic Opportunity Act of 2000 (P.L. 106-569) amended the National Housing Act (12 USC 1715z-20) to waive the up-front insurance premium provided that the HECM proceeds are used to pay for long-term care insurance. The regulations to implement this change have never been finalized. This provision was eliminated by Section 2122 of P.L. 110-289.

When the home is eventually sold, HUD will pay the lender the difference between the loan balance and sales price if the sales price is the lesser of the two. The claim paid to the lender may not exceed the lesser of (1) the appraised value of the property when the loan was originated, or (2) the maximum HUD-insured loan for the area.

The Federal National Mortgage Association (Fannie Mae) has been purchasing the home equity conversion mortgages originated under the program.

The Home Keeper Mortgage

Since November 1996, Fannie Mae has also been offering its own reverse mortgage product: the "Home Keeper Mortgage." This is the only conventional reverse mortgage that is available on a nationwide basis. Private lenders have developed proprietary reverse mortgage products but they are generally only available in a few states.

An eligible borrower must (1) be at least age 62, (2) own the home free and clear or be able to pay off the existing debt from the proceeds of the reverse mortgage or other funds, (3) remain in the home as a primary residence, and (4) attend a counseling course approved by Fannie Mae. The interest rate on the loan adjusts monthly according to changes in the one month certificate of deposit index published by the Federal Reserve. Over the life of the loan the rate may not change by more than 12 percentage points. The loan becomes due and payable when the borrower dies, moves, sells the property, or otherwise transfers title. The borrowers have the option of receiving monthly payments, a line of credit, or a combination of the two.

The Home Keeper plan may also be used for home purchase. Elderly homeowners may use the Home Keeper reverse mortgage to purchase homes that better fit their needs. The homeowners would make a downpayment and fund the rest of the purchase price with a reverse mortgage. It would mean no monthly mortgage payments.

Under both programs, the homeowner must keep applicable property taxes and hazard insurance current, and maintain the homes in good repair. The loan would become due and payable if the homeowner fails to do either of the above.

The Cash Account Plan

Financial Freedom Senior Funding Corp., of Irvine, CA, offers the "Cash Account Plan" as a proprietary reverse mortgage product. The Cash Account Plan is available to seniors 62 years or older who own homes with a minimum value of $75,000. It differs from the two products above in that it does not offer the borrowers an option of getting monthly payments. It provides an open-end line of credit that is available for as long as the borrower occupies the home. The borrower can draw on the line of credit in full or part at any time; the minimum draw is $500. The unused portion of the line of credit grows by 5% annually.[11] Eligible home types include owner-occupied single-family detached, manufactured, condominium, Planned Unit Development units, or one-to four-unit residences if one unit is owner-occupied. Borrowers are required to obtain counseling from an independent counselor prior to obtaining the loans.

A monthly servicing fee is automatically added to the loan.[12] The interest rate charged to the borrower is equal to the current six-month London Interbank Offered Rate (LIBOR) plus 5 percentage points. The rate is adjusted semi-annually, but the interest rate may never rise more than 6 percentage points above the initial rate.

The Cash Account Plan is available in two forms: the Standard Option and the Zero Point Option. Under the Standard Option, a borrower pays a loan origination fee that is equal to 2% on the first $500,000 of loan balance, 1.5% on the next $500,000, and 1% on the balance in excess of $1 million.

Under the Zero Point Option, the borrower pays no loan origination fee. Closing costs, including third party costs and excluding state and local taxes, will not exceed $3,500. At closing the borrower is required to take a draw on the line of credit, and the minimum draw at closing is 75% of the line of credit. Subsequent draws have a minimum of $500. Full prepayment is permitted and, while there are no prepayment penalties, partial prepayment on the initial draw is not permitted for the first 5 years. The Zero Point Option is generally marketed to elderly homeowners with homes valued at $450,000 or more.

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[11] For example, if a borrower had a $150,000 line of credit and had not drawn on it during the year, the next year the line of credit would be $157,500.

[12] No servicing fee is permitted in Illinois and Maryland.

On June 18, 2008, Financial Freedom announced that it was suspending the Cash Account Plan.[13] This action was taken largely because of liquidity problems of IndyMac, the parent company of Financial Freedom.

The Cash Account Plan was available in the District of Columbia and 24 states: Arizona, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Illinois, Indiana, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New York, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, and Wyoming.

Senior Equity Reverse Mortgage

In late 2006, Reverse Mortgage of America, a subsidiary of Seattle Mortgage, introduced "The Lifestyle Plan." It was the first new reverse mortgage product to be introduced in nearly a decade. In 2007, Bank of America purchased the reverse mortgage products of Seattle Mortgage. The mortgages are being marketed as the "Senior Equity Reverse Mortgage," and at present are only available in Arizona, California, Delaware, the District of Columbia, Georgia, Maryland, North Carolina, South Carolina, Texas, and Virginia.

Like the Cash Account Plan, the Senior Equity Reverse Mortgage allows homeowners age 62 and older to use some of the equity in their homes while continuing to live there. It is designed for owners of high-value homes. Borrowers may choose to receive their funds in a single lump sum, in regular monthly installments, as a line of credit, or any combination of these options. So, unlike the Cash Account Plan, the Senior Equity Reverse Mortgage offers a monthly payment to borrowers.

The interest rate on the Senior Equity Reverse Mortgage is the six-month LIBOR Index, plus 2.95 percentage points. The interest rate may vary, but may not exceed 18%. Borrowers pay a loan origination fee of 1% of the home value but not more than $10,000. Borrowers also pay a monthly servicing fee of $25.

The proceeds from a Senior Equity Reverse Mortgage may be used to purchase a primary residence or a second home. The borrower would be responsible for a down payment equal to the difference between the value of the new home and the amount of funds received from the Senior Equity Reverse Mortgage.

Choosing Among the Plans

Table 3 compares the income that may be received under the three major plans for the same valued home. The table shows the monthly income that would be available if the borrower chose only to receive monthly payments, and the largest line of credit that would be available at loan origination if the borrower chose to only have a line of credit. The HECM plan pays the largest monthly payments and has the largest available lines of credit.

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[13] For details, see http://reversemortgagedaily.com/2008/06/18/financial-freedom-cash-account-discontinued/.

Table 3. Payment Options Under Reverse Mortgage Programs by Age of Youngest Homeowner

	HECM		Home Keeper		Cash Account[a]	
Age	Monthly Income	Line of Credit	Monthly Income	Line of Credit	Monthly Income	Line of Credit
62	$ 602	$ 108,092	$ 204	$ 24,244	N/A	$ 54,650
65	644	113,033	254	32,336	N/A	60,478
70	727	121,331	417	57,675	N/A	71,570
75	839	130,334	633	73,171	N/A	83,602
80	999	139,679	801	90,035	N/A	88,678
85	1,254	149,015	1,053	108,145	N/A	93,378
90	1,749	158,070	1,202	119,864	N/A	98,078

Source: Calculated by CRS using the Reverse Mortgage Calculator on Financial Freedom's website.

Note: Estimates are based on a $200,000 home in Denver, CO. It is assumed that the homeowner had no outstanding loans against the property.

a. These estimates were run before Financial Freedom suspended the program on June 18, 2008.

Table 4 compares the benefits available under the reverse mortgage programs for a 70-year-old homeowner in Albany, NY. Only when an Albany homeowner has a home valued in excess of $400,000 does the cash available from the Cash Account plan exceed the cash available from the HECM. And only when an Albany homeowner has a home valued at $400,000 or more does the monthly income from the Home Keeper plan exceed the monthly income from the HECM.

Note that in **Table 4** the benefits under a HECM do not increase as the home value increases above $250,000. That is because HECM loans are limited to the FHA loan limit for a particular area, and that limit is $237,405 for Albany, NY.

Table 4. Comparison of Reverse Mortgage Benefits to a Homeowner in Albany, NY

	HECM		Home Keeper		Cash Account	
Home Value	Monthly Income[a]	Line of Credit[a]	Monthly Income[b]	Line of Credit[b]	Monthly Income	Line of Credit[c]
$200,000	$721	$120,320	$413	$57,089	N/A	$75,965
250,000	865	144,433	528	73,082	N/A	96,281
300,000	865	144,433	648	89,074	N/A	116,597
350,000	865	144,433	760	105,066	N/A	136,550
400,000	865	144,433	875	121,059	N/A	156,457
450,000	865	144,433	915	126,491	N/A	176,364
500,000	865	144,433	915	126,491	N/A	196,121
550,000	816	144,096	915	126,491	N/A	216,023

Source: Calculated by CRS using Reverse Mortgage Calculator on Financial Freedom's website.

Note: Estimates are based on a loan to a 70-year old in Albany, NY. It is assumed that the homeowner had no outstanding loans against the property.

a. The HECM mortgage limit was $237,405 for Albany when these estimates were run, and that determined the maximum payments available under a HECM in the area.

b. The Home Keeper loan limit was $417,000 when these estimates were run, and that determined the maximum payments available under the Home Keeper program.

c. These estimates were run before Financial Freedom suspended the program on June 18, 2008.

Table 5 has been prepared using the Los Angeles area as a base. The table shows that the Home Keeper plan never offers higher cash benefits to 70-year old homeowners than the HECM.

Only when home values approach $550,000 or more does the Cash Account plan offer higher lines of credit than the HECM. That is by design. The Cash Account was not created to compete with the HECM, but to offer reverse mortgages to borrowers with homes valued above the HECM and Home Keeper limits.

Thus, it is not surprising that reverse mortgages made under HECM account for about 90% of the reverse mortgages made nationwide. The HECM offers better value to most borrowers.

Table 5. Comparison of Reverse Mortgage Benefits to a Homeowner in Glendale, CA

	HECM		Home Keeper		Cash Account	
Home Value	Monthly Income[a]	Line of Credit[a]	Monthly Income[b]	Line of Credit[b]	Monthly Income	Line of Credit[c]
$200,000	$ 727	$121,354	$417	$ 57,629	N/A	$ 71,478
250,000	921	153,711	533	73,686	N/A	90,608
300,000	1,115	186,068	649	89,742	N/A	109,738
350,000	1,309	218,445	765	105,799	N/A	128,696
400,000	1,358	226,727	881	121,856	N/A	147,462
450,000	1,358	226,727	920	127,310	N/A	166,227
500,000	1,358	226,727	920	127,310	N/A	184,992
550,000	1,358	226,727	920	127,310	N/A	203,752

Source: Calculated by CRS using the Reverse Mortgage Calculator on Financial Freedom's website.

Note: Estimates are based on a loan to a 70-year old in Glendale, CA. It is assumed that the homeowner had no outstanding loans against the property.

a. The HECM limit was $362,790 when these estimates were run, and that determined the maximum payments available under a HECM.

b. The Home Keeper loan limit was $417,000 when these estimates were run, and that determined the maximum payments available under the Home Keeper program.

c. These estimates were run before Financial Freedom suspended the program on June 18, 2008.

One financial writer, Jane Bryant Quinn, suggests that elderly homeowners should choose the Cash Account plan if the homeowners only plan to be borrowing for 3 or 4 years.[14] The Cash

[14] Jane Bryant Quinn. "Mortgage Smarts," *Newsweek*, October 23, 2006.

Account Plan has higher interest rates than the HECM but the HECM has higher up-front costs.[15] The lower up-front costs make the Cash Account Plan cheaper for short term loans. Quinn suggests that borrowers choose the HECM if they expect to keep the loan for many years. If borrowers choose a loan with a credit line, HECM will provide them with more long-term borrowing power.

Using Reverse Mortgages for Long-Term Care

As indicated previously, the AHS estimates that more than 12.5 million homeowners age 65 older, have homes that are free of mortgage debt. With the growth in the public cost of long-term care for the elderly, there has been research and discussion of ways that elderly homeowners may use reverse mortgages to tap this home equity and fund their own long-term care.

Funding Long-Term Care Directly

One option is for the homeowners to use reverse mortgages to fund long-term care directly. Primarily this would involve paying for home modifications and in-home care that would permit them to "age-in-place." Under its "Use Your Home to Stay at Home" initiative, the National Council for the Aging (NCOA) is encouraging the use of reverse mortgages to fund long-term care. Of the nearly 28 million American households age 62 and older, NCOA has found that about 13.2 million (48%) are good candidates for a reverse mortgage. According to NCOA, an estimated $953 billion could be available from reverse mortgages for immediate long-term care needs and to promote aging in place.[16]

That $953 billion figure, however, appears to have been calculated by assuming that the homeowners would, on average, be eligible for about $72,200 in reverse mortgage loans and then multiplying by the 13.2 million potential reverse mortgage candidates. In effect, that is assuming a 100% participation rate. The 2005 American Housing Survey estimates that of the 17.8 million homes owned by the elderly, only 64,000, or 0.4%, have reverse mortgages.[17]

By using reverse mortgages, some of the elderly would be able to fund their long-term care expenses for a number of years, and thereby delay potential entry into the Medicaid program. It is debatable, however, whether and how much savings this approach would provide for the Medicaid program.

The Medicaid program has the ultimate claim on the home equity of program participants. If participants fund their care through reverse mortgages, they may use up most or all of their equity, so there may be little or none left to be claimed by Medicaid. There may be cases where the net cost to the Medicaid program would be less if the participants had entered the Medicaid program earlier instead of consuming their equity through reverse mortgages.

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[15] But the Cash Account plan is not available in all states, so this may not be an option for some homeowners.

[16] Stucki, Barbara R. *Use Your Home to Stay at Home: Expanding the Use of Reverse Mortgages for Long-Term Care: A Blueprint for Action,* The National Council on the Aging, January 2005, p 9.

[17] Op. cit. *American Housing Survey for the United States: 2005*, Table 7-15, p. 460.

Funding Long-Term Care Insurance

Using the proceeds from reverse mortgages to pay for long-term care insurance (LTCI) is another option for elderly homeowners.

The demographics of reverse mortgages and long-term care insurance do not match for either consumers or the industry. Long-term care insurers want young consumers. Reverse mortgage lenders want old consumers. For consumers, LTCI is best taken at an older age when the benefits are greater, but the premiums are more expensive. For insurers, the major risk is that the purchasers will get sick too soon and need long-term care before they have paid enough premiums into the insurance fund. For reverse mortgage lenders, the major risk is that the borrower will live too long and accumulate debt against the property which exceeds the property value. The different risks result in different outcomes for consumers with the same profile. For example, insurers are reluctant to provide insurance to borrowers with certain health problems, because of the likelihood that the borrowers may need to use the insurance. Lenders, however, will make reverse mortgages to such borrowers, because there is less likelihood that the borrowers will occupy the property too long.

The cost of the insurance is another issue. In recent years, insurers have raised the insurance premiums on current customers. This suggests that a homeowner who used a reverse mortgage to purchase long-term care insurance could face the risk that the cost of the policy could increase at some later date. That would not be a problem if the homeowner could afford the increased cost. But if the increase were unaffordable, the borrower would have to drop the insurance. If this occurred, it might be possible that the borrower would still have some paid-up benefits, but the level of coverage would be less than the borrower had planned when initially purchasing the policy.

Issues for the Elderly

Though there has been growth in use of reverse mortgages in recent years, it is still a relatively little used option for elderly homeowners. Many elderly homeowners do not understand the program and are reluctant to participate. After spending many years paying for their homes, elderly owners may not want to mortgage the property again. There are several options to be considered.[18]

Downsizing

One option is to sell the home and purchase something smaller. Present law permits a seller to exclude from taxation up to $250,000 ($500,000 for a married couple) of the gain from sale of a home. The home must have been used as the principal residence for two out of five years before the sale. Funds not used for the new purchase could be used for investment and as a source of cash to meet future needs.

[18] This list is illustrative rather than exhaustive.

Selling and Renting

Instead of purchasing another property the homeowner could consider renting an apartment, perhaps in a complex designated for those 55 and older. The proceeds from the sale of the home could be saved and invested and used for income when needed.

Finding Tenants

Rather than sell the home, the homeowner could consider renting part of the home to students, young couples, other retirees. The rental income would help with ongoing expenses. In addition to the economic benefit, a rental might also provide some companionship to the owner.

Reverse Mortgage

The homeowner might consider a reverse mortgage. As mentioned above, a reverse mortgage enables an elderly homeowner to use the equity in the home to receive monthly income, a line of credit, or some combination of the two. Repayments are delayed until the home is no longer occupied as a principal residence. Then the borrower or the heirs must repay the loan. If the home is sold and the sales price exceeds the loan balance, the borrower or the heirs keep any proceeds that remain.[19] If the sales price is less than the loan balance, then the lender suffers the loss. The funds received from the reverse mortgage are tax free because the funds are considered as loan proceeds instead of income. The payments from reverse mortgages do not affect the income or eligibility from Social Security or Medicare. But homeowners who receive Supplemental Security Income (SSI) or Medicaid[20] might have these benefits reduced if the recipients do not spend their entire sum received under the reverse mortgage each month.

When considering a reverse mortgage, several questions should be addressed:

- Participants may be provided with lifetime occupancy, but will borrowers generate sufficient income to meet future health care needs?
- Will they obtain equity conversion loans when they are too "young" and, as a result, have limited resources from which to draw when they are older and more frail and sick? **Table 7** shows that the younger elderly will accumulate significant debt against the homes if they live too long.
- Will the "young" elderly spend the extra income on travel and luxury consumer items?
- Should home equity conversion mechanisms be limited as last resort options for elderly homeowners?
- Will some of the home equity be conserved?

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[19] Selling the home is not a requirement. The borrower or the heirs have the option of keeping the home and obtaining a loan or using other funds to repay the reverse mortgage debt.

[20] Medi-Cal in California.

- How would an equity conversion loan affect the homeowner's estate planning?
- Does the homeowner have other assets? How large is the home equity relative to the other assets?
- Will the homeowner have any survivors?
- What is the financial position of the heirs apparent?
- Are the children of the elderly homeowner relatively well-off and with no need to inherit the "family home" or the funds that would result from the sale of that home?
- Alternatively, would the ultimate sale of the home result in significant improvement in the financial position of the heirs?
- How healthy is the homeowner? What has been the individual's health history?
- Are large medical expenses pending? At any given age, a healthy borrower will have a longer life expectancy than a borrower in poor health.
- What has been the history of property appreciation in the area?

The above questions are interrelated. Their answers should help determine whether an individual should consider a reverse mortgage, what type of loan to consider, and at what age a reverse mortgage should be considered.

Issues for Congress

Potential Federal Liability

As revealed in **Table 6**, there has been dramatic growth in the use of HECMs over the past few years. More than 107,500 loans were made in FY2007 compared to little more than 157 in 1990. What does this mean for HUD, since the department has potential liability for these loans?

As noted previously, one of the greatest risks for lenders is that the borrower will live too long and that the loan balance will exceed the home value—collateral risk. Under the HECM program this risk falls to HUD because the lender can assign the loan to HUD in those cases. The collateral risk then becomes a potential liability for the FHA insurance fund.

When HUD accepts the assignment of HECM loans, HUD becomes responsible for future borrower advances or fixed payments until termination of the loan due to the death of the homeowner, the refinancing of the loan, or the sale of the home. At the end of FY2007, the value of HECM loans assigned to HUD exceeded $550 million, and the value is expected to grow to over $1 billion in FY2008.[21]

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[21] *FHA Annual Management Report Fiscal Year 2007*, U.S. Department of Housing and Urban Development, p. 96.

Table 6. HECM Loans by Fiscal Year

Fiscal Year	Number of HECM Loans	Percent Change (%)
1990	157	
1991	389	148
1992	1,019	162
1993	1,964	93
1994	3,365	71
1995	4,165	24
1996	3,596	-14
1997	5,208	45
1998	7,896	52
1999	7,982	1
2000	6,640[a]	-17
2001	7,781	17
2002	13,049	68
2003	18,097[b]	39
2004	37,829	109
2005	43,131	14
2006	76,351	77
2007	107,558	41

Source: Data from HUD. Year-to-year percentage change calculated by CRS.

a. HECMs could not be made for part of FY2000 (July to early October 2000) because FHA insurance authority had been exhausted temporarily.

b. HUD ran out of insurance authority and could not insure HECMs during the last two weeks of September 2003.

Table 7 presents the potential FHA liability for different scenarios. The life expectancy is the average number of years a person is expected to live, given that they have reached a specific age. Column 1 is the monthly income to a borrower of various ages obtaining a HECM in Denver on a home valued at $200,000. Column 4 is the loan balance that would accumulate at that life expectancy. Column 5 show what loan balance would be accumulated if the borrower defies the life tables and lives and occupies the home until age 95. Column 6 shows the potential liability to HUD if the borrower survives to age 95.

Column 5 of **Table 7** may also be interpreted as the sales price (and home value) that must be obtained at the sale of the house in order for the lender to break even (assuming no transaction costs). If a borrower obtains a HECM at age 62, the originally $200,000 home must be worth about $313,000 at the borrower's life expectancy, and nearly $833,000 if the borrower lives and occupies the property to age 95. The table suggests that at the expected life of the borrower there is little collateral risk for HUD when making HECMs to homeowners age 70 and above. Loans to younger borrowers are more risky. If borrowers lived to age 95 there would be significant collateral risk for homeowners younger than 80 years old when obtaining a HECM.

The calculations in **Table 7** assume that interest rates were 6.5% and stayed that way throughout the period. That is an unreasonable assumption given the history of interest rates over the past 30 years. Rising rates would increase the potential liability for HUD. Falling rates would decrease the potential liability of HUD.

Table 7. Potential Federal Liability Under the HECM

Age of Borrower	Life Expectancy[a]	Monthly Payment[b]	Loan Balance at Life[c]	Loan Balance at Age 95	Potential Liability[d]
(1)	(2)	(3)	(4)	(5)	(6)
62	20.7	$ 602	$313,180	$832,731	$519,551
65	18.4	644	271,311	712,379	441,068
70	14.9	727	216,863	544,404	327,541
75	11.8	839	176,870	411,463	234,593
80	9.0	999	146,099	303,241	154,142
85	6.8	1,254	127,082	211,178	84,096
90	5.0	1,749	123,609	123,609	N/A

Source: Life expectancies are from the National Center for Health Statistics. Calculations by CRS.

a. The average number of years a person (all races, male and female) is expected live once they have reached a specific age.

b. Monthly payment for a HECM on a $200,000 home in Denver, CO.

c. The loan balance at the life expectancy of the borrower, assuming a 6.5% interest rate.

d. The amount by which the loan balance exceeds the initial home value ($200,000), assuming a 6.5% interest rate

In any case, the table suggests that, given the interest rates, the potential liability the government faces under the HECM program will depend on the extent to which the program is used by borrowers age 70 and older, and the extent to which those borrowers meet or exceed their life expectancies. HECM loans to 62 and 65-year old homeowners could be quite risky for HUD. As noted above, at the end of FY2007, the value of HECM loans assigned to HUD exceeded $550 million, and the value is expected to grow to over $1 billion in FY2008.[22] These are loans on which HUD has the responsibility for all future monthly payments or cash advances.

HECM Loan Limit

Some proponents of the HECM program have long suggested that the law should be amended to provide a national HECM mortgage limit instead of having the limit be subject to the area FHA limit. The Housing and Economic Recovery Act of 2008, P.L. 110-289, establishes a HECM mortgage limit equal to the conforming loan limit for Freddie Mac. The Freddie Mac limit is currently $417,000, but it has been temporarily increased 150% (to $625,500) through December

[22] *FHA Annual Management Report Fiscal Year 2007*, U.S. Department of Housing and Urban Development, p. 96.

31, 2008. On January 1, 2009, Freddie Mac will have a general limit and a high-cost limit. The general limit is $417,000. In areas where 115% of median home price exceeds $417,000, the Freddie Mac limit will be the lesser of (1) 115% of the median home price or (2) 150% of the general limit (150% of $417,000 = $625,500). The general limit may be changed on January 1 of each year on the basis of changes in a home price index maintained by the newly created Federal Housing Finance Agency.

As revised by P.L. 110-289, HECMs have a national mortgage limit of $417,000.[23] Under HUD's interpretation of the law, the temporary increase in Freddie Mac's loan limit does not apply to HECMs.

Long-Term Care Insurance

As noted above, prior law provided that a borrower could waive the up-front insurance premium for HECMs, provided that the HECM proceeds were used to pay for long-term care insurance.[24]

The law was very restrictive in that it requires that all the proceeds of the HECM (after paying off any existing debt on the property) must be used exclusively for long-term care insurance. In exchange for savings on the insurance premium (which would be $4,000 on a $200,000 home), the homeowner would be giving up the option of using future HECM funds to pay for future home repairs, unexpected health costs, or increases in daily living expenses.

This feature made the proposal risky and unattractive to elderly homeowners. This provision has been removed from the law by P.L. 110-289.

Number of HECM Loans

The HECM program was begun as a demonstration program which authorized only 2,500 loans to be made under the program (50 per state).[25] The program has been made permanent and the limit on the aggregate number of HECMs that may be insured has been amended several times. It was raised to 150,000 by P.L. 106-569, to 250,000 by P.L. 109-13, and to 275,000 by P.L. 109-289.

The number of HECM loans now exceeds the 275,000 limit, and technically FHA can no longer insure such loans. Notwithstanding the limit in present law, however, the 2009 Continuing Appropriations Resolution, P.L. 110-329, provides that FHA may continue to insure HECMs through March 6, 2009. Unless Congress amends the law, HECMs may no longer be insured after March 6, 2009.

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[23] Mortgagee Letter 2008-35, U.S. Department of Housing and Urban Development, November, 6, 2008.

[24] 12 U.S.C. 1715z-20(l)

[25] 12 U.S.C. 1715z-20(g)

Aging in Place

Stephen Golant, a University of Florida professor and former consultant to the Commission on Affordable Housing and Health Facility Needs for Seniors in the 21st Century, suggests that the explosive growth of reverse mortgages may backfire for both elderly homeowners and the nation's cities.[26] He suggests that society should not romanticize the notion of older people aging in place in their homes and be blind to the downside.

According to Golant, the downside is that reverse mortgages encourage the elderly to remain in older housing that may be unsafe because of physical deficiencies. Holders of reverse mortgages are disproportionately poor, they often are in their 70s and 80s, and more likely to live alone. More than half occupy dwellings that are at least 40 years old, which means they are more likely to live in houses with physical deficiencies. They often do not make improvements in their homes that could help them avoid accidents. Golant suggests that we are doing a disservice to elderly homeowners by encouraging them to remain in such homes. Instead, the homes could be sold to younger home buyers who are more likely to make improvements to the homes which would contribute to revitalization of neighborhoods. Golant suggests that, although the elderly may prefer to remain in their own homes, many would be better off in places appropriate for their frailties and close to the support services they may need.

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