Use Your Home to Stay at Home™

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

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

by

Barbara R. Stucki, Ph.D.

The National Council on the Aging

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A study that explores the potential of using home equity to pay for in-home services and supports requires the thoughtful input and insights of many people and organizations. First and foremost, we want to express our appreciation to the 45 members of our Expert Panel who contributed their expertise to this effort (listed in the Appendix). These discussions, which brought together a diverse array of perspectives, were instrumental in developing a greater understanding of this new financing option linking housing and in-home services.

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TABLE OF CONTENTS

Illustrations

Tables

Figures

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-tem 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 then 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 pubic 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.

- States could consider using state funds to pay some or all of the closing costs impaired homeowners on or at risk of needing Medicaid.
- 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.
- The Department of Health and Human Services (HHS) could develop a demonstration program for a pubic-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:
  - Develop standards for appropriate marketing of reverse mortgages to homeowners who need long-term care.
  - 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.
  - 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:
  - Develop educational campaigns targeting consumers, service providers in the community, and senior advisors.
  - 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:
  - 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.
  - The Department of Housing and Urban Development (HUD) could waive the upfront mortgage insurance premium for severely impaired borrowers.
  - 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.
  - Evaluate the potential of using reverse mortgages for in-home services and supports in each state.
  - Assess the unique needs of impaired, rural, and minority homeowners.
  - 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.

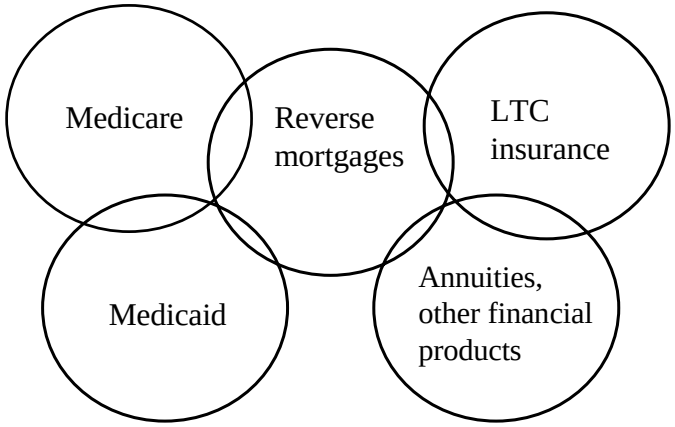
With so much interest in reverse mortgages, there is an urgent need for guidance to inform policymakers on the benefits and limitations of unlocking housing wealth to pay for long-term care. What are the needs and concerns of older homeowners? What is the appropriate role of federal and state government 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 that 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:

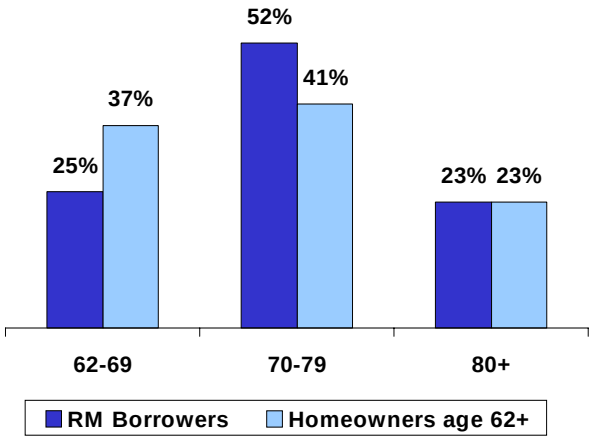
- The average age of borrowers is declining, from age 76 in 2000 to age 74 in 2004.
- About half (48 percent) of HECM borrowers in 2004 are single women. The proportion of single women who participate in this program has declined significantly from 2000, when this group represented 57 percent of reverse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

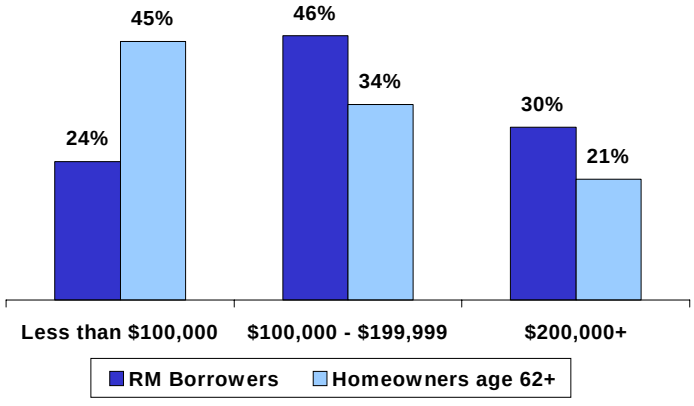
Figure 2.1. Age distribution of reverse mortgage borrowers compared to all homeowners age 62+



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).

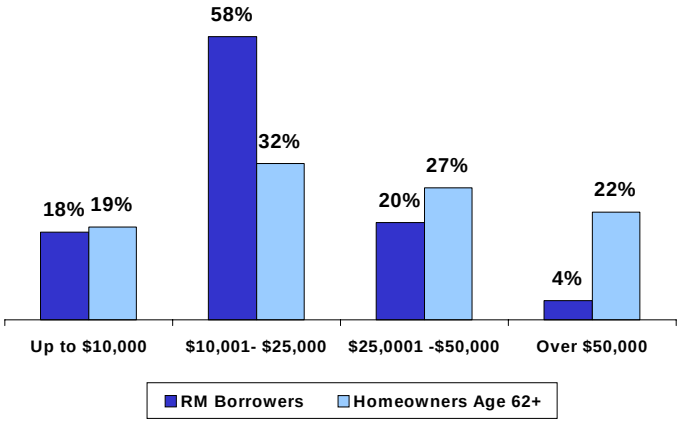
Figure 2.2. Home values of reverse mortgage borrowers versus all homeowners age 62+



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.

Figure 2.3. Annual household income of reverse mortgage borrowers vs. all homeowners age 62+*



*Households where the youngest homeowner is age 62 or older. Source: NCOA analysis based on data from the 2003 American Housing Survey and industry data from Financial Freedom.

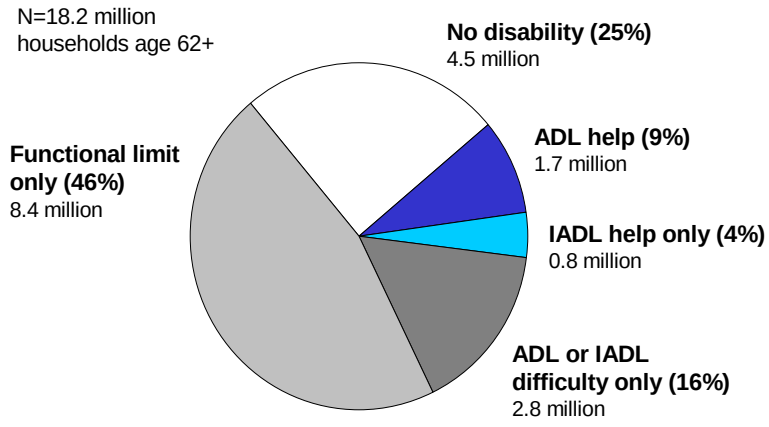
Most HECM borrowers have very limited financial resources other than their home. Among borrowers who took out a loan between 2000 and 2003, three quarters (76 percent) had incomes of $25,000 or less (Figure 2.3). In 2004, the average income of borrowers was $17,000 (Weicher 2004). This is relatively 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+*



* Households where the youngest homeowner is age 62 or older.

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

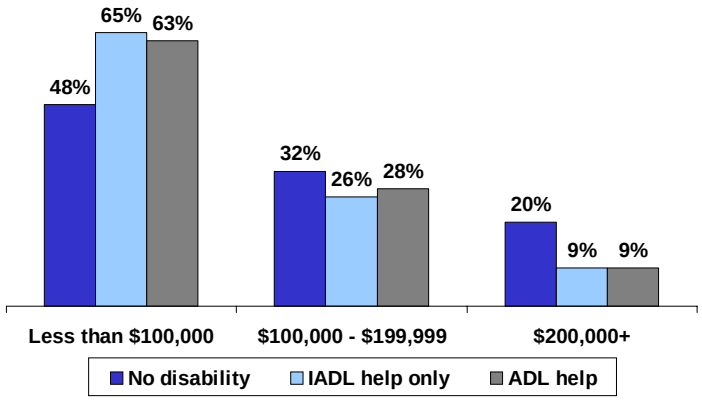
A high proportion (46 percent) of these older homeowners have a functional limitation, such as difficulty with climbing stairs or carrying groceries, that may make it hard for them to continue to live at home safely. While these impairments are modest, they can have serious consequences if they lead 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 that 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.

Figure 2.5. Distribution of home equity among households age 62+*, by level of disability



* Households where the youngest homeowner is age 62 or older.

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

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 many 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?

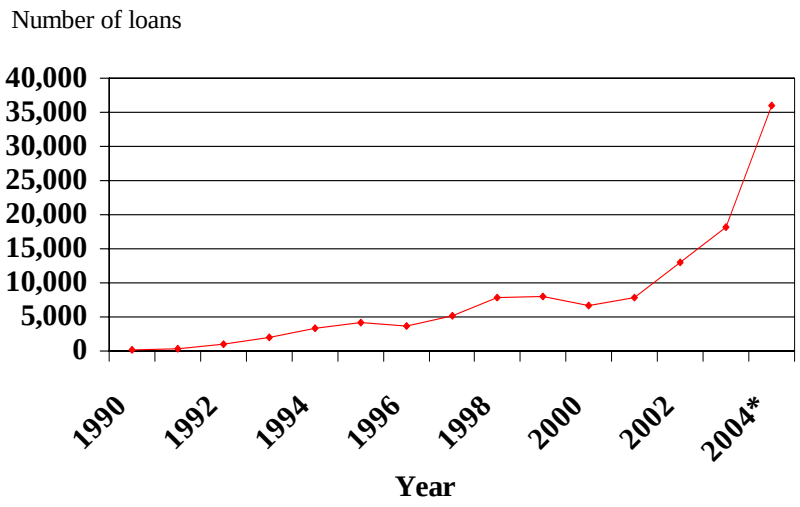
This chapter examines the current reverse mortgage market and the factors that have contributed to its recent growth. In looking at the future market potential, the analysis estimates the total number of older households that could qualify for a reverse mortgage and the aggregate funds that could be 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



Source: HUD - Weicher 2004 (*estimated for 2004)

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

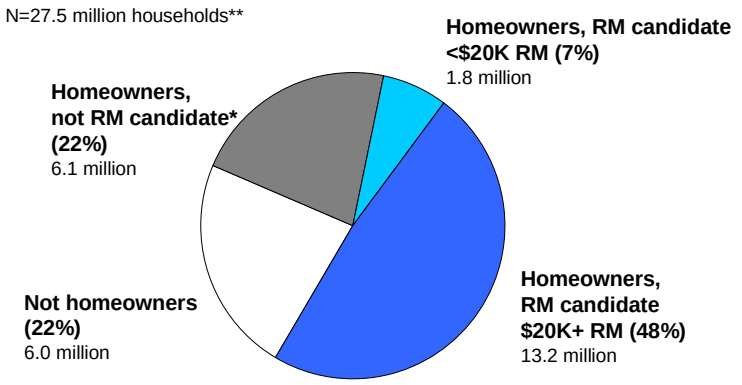
Based on the Health and Retirement Study, in 2000 there were 27.5 million elder households with at least one resident age 62 or older. A high proportion (21.1 million) of these households (78 percent) were homeowners (Figure 3.2). About 74 percent owned their homes free and clear of any mortgages. In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

Figure 3.2. Senior households that are candidates for using a reverse mortgage for long-term care



* Not a RM candidate – mobile home as primary residence, spouse age <62, insufficient equity

** Home ownership status unknown among 1% of total households (0.4 million).

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-tem 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-tem 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

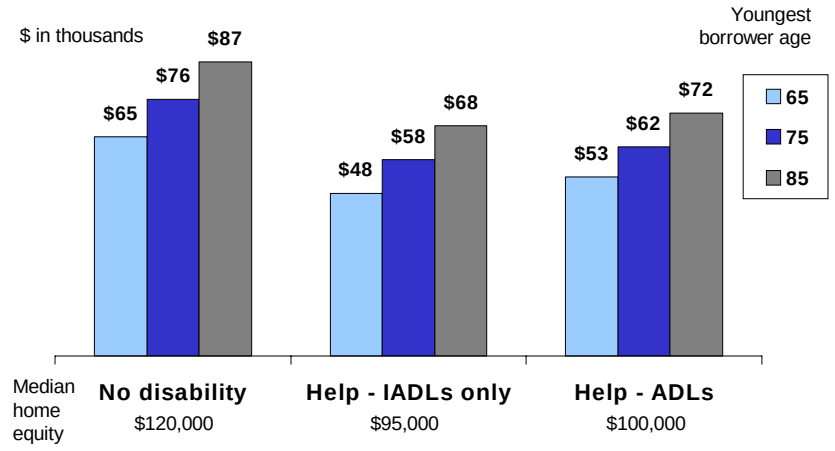
	Total households	Need for immediate help: Needs help with 1+ ADL/IADL		Potential future need: Difficulty only with 1+ ADL/IADL		Functional limitation only		No disability	
		Number	%	Number	%	Number	%	Number	%
Medicaid beneficiary	437,000	152,000	34.7%	76,000	17.3%	138,000	31.4%	73,000	16.6%
High risk 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.

Figure 3.3. Potential HECM loan value, by age and level of impairment



Source: NCOA analysis using data from the 2000 Health and Retirement Study and the AARP reverse mortgage calculator. HECM values assume no debt on the home.

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

increase their ability to live at home. For older people who find that the need for long-term care arises slowly, it may be more appropriate to receive payments from a reverse mortgage through a credit line or as fixed monthly payments (for up life in the home). Most HECM borrowers have typically elected to receive their payments through a line of credit, either alone (68 percent) or in combination with a tenure or term payment plan (20 percent, Rodda et al. 2000).

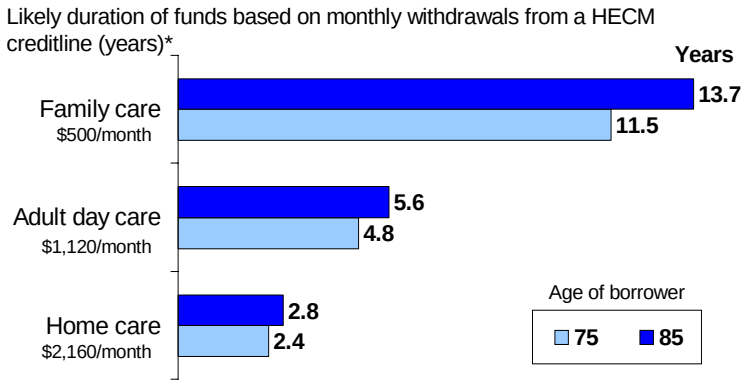
Table 3.5. Amount of potential HECM funds, by disability level

	Total candidate households	Median age youngest borrower	Median home equity	Median HECM cash or creditline	Monthly withdrawals by estimated duration of funds		
					3 years	5 years	10 years
Need help with ADLs	1,196,000	76	$100,000	$62,848	$1,800	$1,100	$569
Need help with IADLs only	559,000	77	$95,000	$60,208	$1,723	$1,055	$553
No disability	3,401,000	72	$120,000	$72,285	$2,070	$1,265	$665

Source: NCOA calculations based on data from the 2000 Health and Retirement Study and the AARP reverse mortgage calculator and a creditline interest rate of 4.35%.

Table 3.5 gives examples of the amount that the average impaired borrower could withdraw from an HECM line of credit each month. Since impaired elders who live at home may need help for a long time, these amounts were calculated so that the credit line funds could last for about three to 10 years. The amount that would be available monthly to households that are dealing with ADLs could vary from $569 to $1,800 depending on the expected duration of the funds.

Figure 3.4. Duration of funds to pay for home and community care from a HECM creditline



*Estimate based on HECM amount for a $100K home and an annual creditline interest rate of 4.35%.
Source: NCOA analysis using the AARP reverse mortgage calculator.

Reverse mortgages can help impaired seniors pay for in-home services and supports for many years. The average home health aide charges about $72 for a four-hour visit, which adds up to

$2,160 per month for daily home care (MetLife Mature Market Institute 2004c). Adult day care services cost on average about $56 per day, or $1,120 per month (NADSA 2004). At these rates, a 75-year-old borrower who has $100,000 in home equity would be able to use a reverse mortgage to cover the typical expenses of an adult day program for almost five years, or daily home care visits for about 2.4 years (Figure 3.4). At current interest rates, these funds could also support family caregivers by paying for their out-of-pocket costs ($200 per month) and respite care once per week ($300 per month) for more than 11 years. Since lenders offer higher loan amounts at older ages, an 85-year-old borrower would be able to pay for assistance for longer periods.

Table 3.6. Distribution of lifetime home care use

Estimated lifetime home care use	Percent of elderly turning 65	Total estimated lifetime home care expenses, 2004
Any use	71.8	
30 visits or fewer	14.7	$2,160 or less
31-60 visits	6.6	$2,232-$4,320
61-90 visits	10.6	$4,392-$6,480
91-182 visits	12.1	$6,552-$13,104
183-365 visits	11.2	$13,176-$26,280
366-730 visits	7.8	$26,352-$52,560
731 visits or more	8.8	$52,632 or more

Source: Lifetime likelihood of home care use estimate based on the Brookings-ICF Long-Term Care Financing Model, in HIAA (1997). Cost for a 4 hour home care visit in 2004 was $72, from MetLife Mature Market Institute (2004c).

Another way to evaluate the potential value of a reverse mortgage is to compare the size of the potential loan to expected lifetime home care expenses. It is difficult to determine how much in-home services and supports impaired elders may need after age 65. Elders with a strong informal support system may be able to rely exclusively on family help. In contrast, those who need substantial assistance, or who cannot depend on family for help, may require considerable paid care to stay at home. An analysis by the Lewin Group estimates that most seniors (71.8 percent) will need some paid home care services (Table 3.6). Most Americans who reached age 65 (91.2 percent) are likely to need less than 730 home care visits in their lifetime, at an average cost of less than $52,560. Among these older homeowners, a reverse mortgage would typically be able to cover out-of-pocket expenses for home care, plus other costs associated with a chronic illness or injury.

Reverse mortgages and long-term care insurance

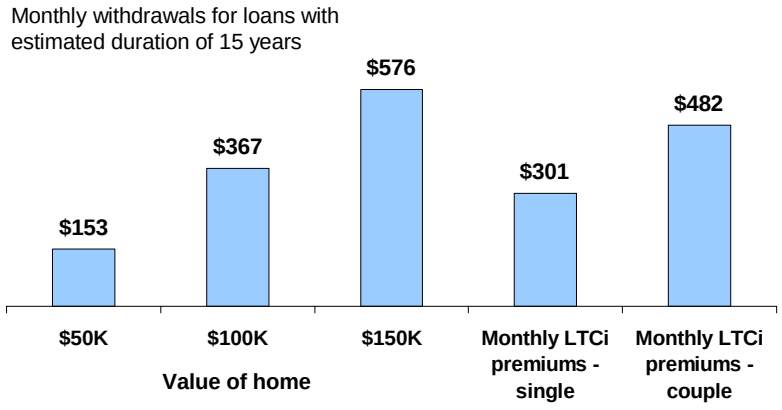
Private insurance can help spread the financial risk that seniors face due to long-term care. Today's policies offer comprehensive coverage in all care settings, including nursing homes, assisted living facilities and in the home. Long-term care insurance can pay for a wide range of services to help policyholders stay at home, including respite care, home health aides, home modifications, and even payments for family caregivers.

Affordability is a key barrier to purchasing long-term care coverage among seniors (Bankers Life and Casualty 2004). One study found that only 31 percent of Americans age 65 and older could afford comprehensive long-term care insurance, even if they were willing to spend up to 10 percent of their income on premiums (Mulvey and Stucki 1998). The cost of purchasing private insurance increases significantly with age. However, one in four (24 percent) of reverse mortgage borrowers are under age 70 (see Figure 2.2), suggesting that there may be a segment of borrowers for whom this approach might be an option.

Homeowners who are in good health could elect to liquidate a portion of their home equity to help pay for the cost of this coverage. To assess the viability of this option, we determined the amount of money that a 70 year-old borrower would need to pay premiums until age 85, when they are likely to need assistance with daily activities. In 2004, a three-year long-term care insurance policy with inflation protection and a 90-day elimination period, that pays $150 per day in benefits and includes home-care coverage, could cost on average about $301 per month for a single person. The cost of this coverage for couples at age 70 would be about $482 (using a 20 percent spousal discount, which is typical in the insurance industry, Glickman 2004).

Figure 3.5 shows the potential amount that borrowers could withdraw monthly from an HECM credit line, starting at age 70, to pay these long-term care insurance premiums. These estimates suggest that single elders would need homes worth at least $100,000 to be able to use the proceeds of a reverse mortgage to pay for a three-year policy for an estimated 15 years. For couples with such modest amounts of housing wealth, using reverse mortgages for long-term care insurance is not an option. They would need a home worth at least $130,000 to obtain a loan that would pay for this insurance.

Figure 3.5. Monthly HECM creditline withdrawals available for LTC insurance (LTCi) at age 70



*HECM estimate based on an annual creditline interest rate of 4.35%, assuming no debt on the home. Source: NCOA analysis using the AARP reverse mortgage calculator and a 3-year policy with a $150 daily benefit.

Using most or all of the proceeds from a reverse mortgage to pay for this coverage, however, could be risky for many households with such modest amounts of home equity. After paying for insurance premiums for 15 years, they would have little left in their HECM creditline to pay for expenses not covered by the $150 per day long-term care benefit. Since private insurance only pays when policyholders become severely impaired, these homeowners could also face a financial crunch if they needed to pay for assistance to stay at home prior to triggering their insurance benefits. Without additional resources, any premium increases would raise the risk that these borrowers could lapse their policy.

Recent studies also concluded that there is likely to be low demand to use HECMs to pay for private insurance, since they appears to be little overlap between the ages and incomes of the borrower population and people who purchase long-term care insurance (Rodda et al. 2003, Ahlstrom et al. 2004). From the industry perspective, the link between reverse mortgages and current long-term care insurance products also may not be a good fit. There are strict suitability standards for long-term care insurance that reverse mortgage borrowers, with incomes of $17,000 on average and often few assets other than the home, would be hard-pressed to meet. In addition, few insurance agents understand reverse mortgages, and they may be unwilling to deal with this product due to lack of commissions. The three to four weeks that it takes to close the loan would be an additional deterrent to completing a long-term care insurance sale.

An alternate approach would be to use the loan proceeds to increase the amount of long-term care that homeowners fund out-of-pocket. This could make private insurance more affordable because elders could buy less long-term care coverage. For example, homeowners could select a policy with a lengthy waiting period (such as one year) and use loan proceeds to cover expenses until the insurance starts paying benefits. Alternatively, they could purchase a limited amount of long-term care coverage (such as a two-year policy) and pay for any care they needed beyond this time period.

There are several benefits to this approach. When the purchase of long-term care insurance is not directly linked to the use of reverse mortgages, homeowners may be more inclined to buy a policy before age 62, when premiums are considerably less expensive. Any future premium increases also may be more manageable for elders who opt for less costly policies. Not having to wait until the homeowner (and in the case of married couples, both spouses) is at least age 62 offers other benefits. As people grow older, they are at greater risk for being uninsurable due to a pre-existing chronic health condition.

Potential savings to Medicaid

Demand for long-term care is growing in our rapidly aging society, placing an increasing burden on state Medicaid programs. As the second largest item in state budgets, Medicaid is already being targeted for cost control efforts. In this tight fiscal environment, home equity could play an important role in reducing government expenditures for long-term care.

Table 3.7. Projected Medicaid savings from reverse mortgages

	Projected Medicaid expenditures (in millions of 2002 dollars)							
	2010				2020			
Take up rate	Baseline	With reverse mortgage use	Savings	% of Medicaid Spending	Baseline	With reverse mortgage use	Savings	% of Medicaid Spending
4%	$56,220	$52,879	$3,342	5.94%	$78,014	$73,407	$4,606	5.90%
9%	$56,220	$52,630	$3,591	6.39%	$78,014	$72,795	$5,219	6.69%
25%	$56,220	$51,356	$4,864	8.65%	$78,014	$71,935	$6,079	7.79%

Source: Lewin Group projections based on the Long-Term Care Financing Model.

On the basis of projections made by the Lewin Group for this project, increased use of reverse mortgages for long-term care could result in savings to Medicaid ranging from about $3.3 to almost $5 billion annually in 2010, depending on the future take up rate for these loans. This represents 6 to 9 percent of the total projected annual Medicaid expenditures, including nursing home care. These reductions result from the additional income available to borrowers that would delay eligibility for Medicaid.

The potential impact of using housing wealth to offset public expenditures for long-term care depends in large part on future growth of the reverse mortgage market. Currently, very few older homeowners have taken out a reverse mortgage. Engaging more seniors through education and incentives could spur the growth of the market. Based on our telephone interviews, 4 percent of respondents indicated that they would be very likely to consider tapping home equity to pay for in-home services and supports in the future. If reverse mortgage take-up rates reached this level, by 2010 Medicaid could save over $3.3 billion annually. One in four older homeowners (25 percent) may be at least moderately likely to tap home equity for long-term care, based on interview responses. If these elders could be encouraged to do so, Medicaid savings from reverse mortgages could reach almost $4.9 billion annually in 2010 and $6 billion in 2020.

Policy issues and concerns

The analysis presented here suggests that reverse mortgages have the potential to significantly increase the funds available to pay for long-term care at home. Almost half of older homeowners could be candidates for using a reverse mortgage for long-term care. This number, however, represents only the broad potential of this financing option. Without strong incentives to overcome the reluctance of today's seniors to tapping home equity, the actual number of older homeowners who take out a loan is likely to be much smaller. Since the analysis is based on home equity data from 2000, the financial estimates presented in this section are likely to underestimate the true magnitude of the potential funds available from home equity.

The three market segments examined in this study suggest that older homeowners vary significantly in terms of their age, marital status, and financial resources. Finding appropriate ways to help this diverse group of elders use home equity for long-term care at home will be challenging. It is also likely that these groups will respond differently to incentives for reverse mortgages. Alterative strategies to promoting this financing option will present significantly different policy implications in terms of costs, the immediacy of the results, and the scope and magnitude of the potential outcomes.

One approach would be to use education and targeted incentives to encourage elders to tap home equity sooner to pay for assistance that can help them avoid or delay institutionalization. Finding resources to pay for help with daily chores or home modifications is difficult under the current fragmented financing system. Reverse mortgages can offer a flexible alternative to pay for early interventions, including geriatric assessments and assistive devices. This approach could interest several segments of the older homeowner population, including:

- Moderate-income seniors who need additional funds to pay for long-term care. Living at home with a disability can be difficult for all but the wealthiest seniors. Reverse mortgages could make in-home services and supports more readily available to impaired elders who do not qualify for government assistance.
- Elders who are facing the onset of a chronic health problem. These homeowners are likely to be interested in this type of loan because they are starting to have difficulty caring for themselves or are becoming concerned about their ability to live at home safely.
- Seniors with severe functional limitations who are able to remain at home because they can rely on informal (unpaid) care. For these elders, a reverse mortgage can be very helpful to supplement family caregiving with small amounts of privately paid care.

Our findings indicate that reverse mortgage loans can last for many years for those who only need modest sums each month to pay for help at home. Borrowers who spend their housing wealth at an early stage, however, will have fewer financial resources when they become more severely impaired. For many older Americans, the equity they have built up in their house is their main financial safety net. Uncertainty about future health and long-term care expenses can therefore make getting a reverse mortgage a risky proposition.

With so much as stake, these homeowners could benefit from some type of "insurance" mechanism that would protect them from impoverishment if they took out a reverse mortgage to pay for help at home. This could be achieved through innovative financial products that link to reverse mortgages or in partnership with Medicaid. One option would be to develop a program that allows borrowers less restrictive access to Medicaid should they exhaust their reverse mortgage loan paying for long-term care expenses. A similar approach has been developed to promote long-term care insurance though the Long-Term Care Private/Public Partnership programs. Under the LTC Partnerships, participating policyholders can protect a specified amount of assets from Medicaid estate recovery.

Another possibility would be to use reverse mortgages to fund a coordinated service delivery network for older residents who live in "naturally occurring retirement communities" (NORCs). Due to in-migration or aging in place, increasing numbers of neighborhoods now contain a high proportion of older homeowners. Such concentrated groups of seniors could offer economies of scale in the organization and delivery of supportive services. Most existing NORC service programs assist elders in multi-unit dwellings, so this effort would need to concentrate on "open" NORC programs that target seniors who live at home. "Open" NORCs may serve as a good test sites to develop affordable, private-pay services for "tweeners" who do not qualify for Medicaid until they face a crisis. This goal could be achieved by building partnerships among state and local agencies, the mortgage industry, and private nonprofit service providers.

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. Assessing the appropriate role of reverse mortgages for financially vulnerable seniors presents many challenges. With limited financial resources, these elders would quickly qualify for public assistance if they needed long-term care. Since the home is a protected asset under Medicaid eligibility rules, the motivation to access home equity among this group is likely to be small.

At the same time, reverse mortgages can offer low-income, impaired elders greater choice and control over the services they receive. Medicaid recipients (Group 1) who get help at home might be interested in purchasing additional services and supports with the proceeds of a reverse mortgage. One policy option would be to incentivize Medicaid beneficiaries to use reverse mortgages to help pay for living expenses, home modifications, and other types of assistance that the recipient's state Medicaid program does not cover.

Severely impaired elders with limited financial resources and social supports could be a key target for government incentives since many may find it difficult to continue to live at home. This group is likely to include elders at risk for "spend-down" in the community (Group 2b), because 66 percent of these homeowners are unmarried and may therefore have fewer caregivers. Our findings suggest that the equity that most elders have accumulated in their home, while substantial, is not likely to be sufficient to cover the entire long-term bill for people who must rely extensively on paid services. Without additional support from family or other in-home programs, reverse mortgages would not be appropriate for these older homeowners. The best option might be to sell the house and move into a supported environment such as an assisted living facility. However, these facilities may be prohibitively expensive for elders of modest means, and there are long waiting lists for subsidized housing. With nowhere else to go, the only option for these seniors may be the nursing home.

Providing incentives that help severely impaired elders stretch their limited resources can offer an alternative to institutionalization. One approach would be to allow homeowners who are at financial risk of needing Medicaid to take out a reverse mortgage in order to "buy into" the Medicaid system. Programs such as the Program of All Inclusive Care for the Elderly (PACE) or social HMOs (SHMO) offer comprehensive, high quality benefits (including primary, acute, and long-term care) to older Medicaid beneficiaries who live at home. Low-income seniors could use the funds from a reverse mortgage as a "bridge" between Medicaid eligibility and having to rely solely on private payments. States could assist these low-income, non-Medicaid homeowners by subsidizing some or all of the closing costs of a reverse mortgage to help make their funds last longer.

Incentive programs will need to take into consideration the marital status of the "at risk" segment of the senior homeowner population. Spousal protections will be particularly important to encourage the use of home equity in the high Medicaid risk population (Group 2a), 69 percent of whom are married. These "house rich and cash poor" elders are in a financially precarious position that is likely to make them very reluctant to tap their only financial asset to pay for the care needs of one spouse. Married homeowners are often motivated to use Medicaid estate planning in order to avoid total impoverishment due to nursing home care and to protect assets for the non-impaired spouse (Curry et al. 2001).

Homeowners with significant financial resources (Group 3) are unlikely to tap into home equity. In addition, these elders tend to be younger than other market segments and would therefore

receive lower amounts from a reverse mortgage. However, they may be interested in using a reverse mortgage to protect more liquid assets by purchasing long-term care insurance. More affluent homeowners may be encouraged to use reverse mortgages for this purpose by incentives such as lower loan costs or additional "back end" protection (through less restrictive access to Medicaid) should they face catastrophic long-term care expenses.

Consumers who are thinking about using housing wealth to finance in-home services and supports need additional information to evaluate the appropriateness of taking out a reverse mortgage. Since these loans can be used for any purpose, there are currently no formal standards used by the mortgage industry when marketing this product. To protect impaired, older homeowners, additional standards may be required for mortgage products and programs that specifically target borrowers who need long-term care. Such standards for the appropriate use of these loans may be particularly important for borrowers who will receive government incentives to tap their home equity for in-home services and supports.

ENDNOTES

1. For this study, Medicaid beneficiaries were defined as individuals who reported that they were currently receiving Medicaid benefits at the time of the HRS survey.

Income and asset limits for Medicaid home and community waiver programs for the elderly vary considerably by state. For this analysis, we used the 300% of SSI income standard ($18,432 for singles and $27,684 in 2000), since 37 states used this standard to determine financial eligibility for these waivers in 2001 (Bruen et al. 2003). Liquid assets were limited to $2,000 for single homeowners and less than $84,120 (the maximum institutional spousal protection limit in 2000) for couples. In 2001, 39 states applied nursing home spousal protection rules to their Medicaid home and community waiver programs for the elderly (Bruen et al. 2003).

Some of survey respondents classified as Medicaid beneficiaries reported assets higher that those allowed for full or partial Medicaid benefits. However, a portion of these beneficiaries also reported receiving SSI or welfare benefits which are limited to those with few financial resources. Due to the difficulty of obtaining accurate financial data from survey respondents, we chose not to further refine the Medicaid beneficiary population based on reported assets.

2. These calculations assumed a constant interest rate over the expected duration of the loan funds. The actual amount and duration of the creditline would vary to reflect changing interest rates. Reverse mortgages today are adjustable rate mortgages. Borrowers can choose a loan that either has a monthly or annually adjusted interest rate.

3. Households at high financial risk for Medicaid were defined to include those with incomes less than 300 percent of SSI. Liquid assets were limited to $2,000 for singles elders and less than $84,120 for couples.

4. The term "tweener" typically refers to elder households with between $50,000 and $150,000 in liquid assets in 2000 (Knickman and Snell 2002). This amount is higher that the asset limits used to define the "spend-down risk" group in this study. Limits on financial resources in this analysis were based on the ability to pay for daily home care visits. The National Association of Home Care reported that the average cost of a four-hour visit in 2000 was $75 ($27,375 per year).

For unmarried households in this group, income was therefore limited to $18,432-$45,807. Non-housing assets had to be less than $54,750 (the cost of two years of daily home care). The income of married couple households was limited to $27,684-$55,059. Non-housing assets had to be less than $109,500 (the cost of four years of daily home care). The "spend-down risk" group also included non-Medicaid households that had very low incomes and assets that exceeded the spousal protection limit.

5. Households at low risk of needing Medicaid included: 1) for singles, those with incomes above $45,807 or non-housing assets above $54,750; and 2) for couples, those with incomes above $55,059 or non-housing assets above $109,500.

PART IV: CONSUMER ATTITUDES TOWARD USING HOME EQUITY FOR LONG-TERM CARE FINANCING

Many households age 62 and older have substantial amounts of untapped housing wealth. With an estimated $953 billion in total that could be available through reverse mortgages, this financial asset has the potential to dramatically increase the ability of seniors to pay for long-term care at home. Older homeowners who qualify can get sizable amounts of money through a reverse mortgage—over $72,000 on average—to immediately pay for services, home modifications, and other supports.

If elders could improve their ability to "age in place" by liquidating home equity over time, why hasn't the market for reverse mortgages developed more rapidly? It has been difficult to convince consumers that taking out a reverse mortgage would be a good way to address their current and future long-term care needs. High transaction costs associated with reverse mortgages are often cited as a reason why elderly homeowners are unwilling to use home equity. However, in addressing these market challenges, there is an awareness that consumer attitudes will also play a key role in the development of this financing strategy for long-term care.

The purpose of this chapter is to examine the unique ways that seniors treat home equity that may make this retirement asset both useful and challenging to fund long-term care. The discussion focuses on the attitudes older Americans have toward their homes, independent living, and long-term care costs that can be barriers to liquidating home equity. Included is an assessment of consumer interest in different incentives for reverse mortgages.

Persistence of home ownership

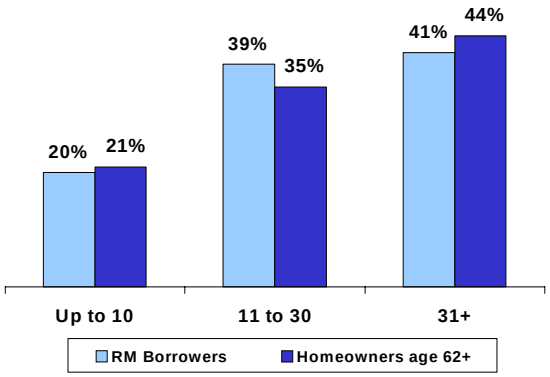
The success of any public initiative that incorporates reverse mortgages depends largely on the willingness of older homeowners to draw down their housing wealth during retirement. To understand consumer attitudes toward using home equity, it is therefore important to look at patterns of asset decumulation in retirement. Economic life-cycle models predict that individuals will accumulate assets while young and then systematically draw down these assets as they grow older. In reality, the decision to tap home equity in retirement is not so straightforward. Seniors take into account uncertainties regarding their income and investment returns, as well as the financial risks associated with changes in health and marital status.

The way in which seniors treat home equity has intrigued economists for many years. This is because, in contrast to other retirement assets, older homeowners typically do not liquidate housing wealth in order to pay for everyday expenses. Instead, home ownership levels are high, even at advanced ages, and these rates appear to be growing. In 2003, 82 percent of seniors age 65-74 were homeowners, compared to 80 percent in 1993 (Joint Center for Housing Studies 2004). Ownership among people age 75 and older increased from 74 percent to 78 percent within the same period.

These statistics reflect the desire, typical of over 92 percent of Americans age 65-74 and 95 percent of those age 75 and older, to remain in their homes as long as possible (Bayer and Harper 2000). This consumer survey also found that 73 percent of respondents age 55 and older believe that they will always live in their current residence. Figure 4.1 highlights the fact that a high proportion of elders have already stayed in their current home for over 30 years. This is true for

all homeowners age 62 and older (44 percent) and for those who take out a reverse mortgage (41 percent). Older minority homeowners are most likely to stay in the first homes they buy. Among people over the age of 65, almost two-thirds of non-Hispanic black homeowners (65 percent) and 55 percent of Hispanic homeowners still live in their first homes. In contrast, only 32 percent of older, non-Hispanic whites live in the home that they originally purchased. (Joint Center for Housing Studies 2003).

Figure 4.1. Years lived in the home among RM borrowers and homeowners age 62+

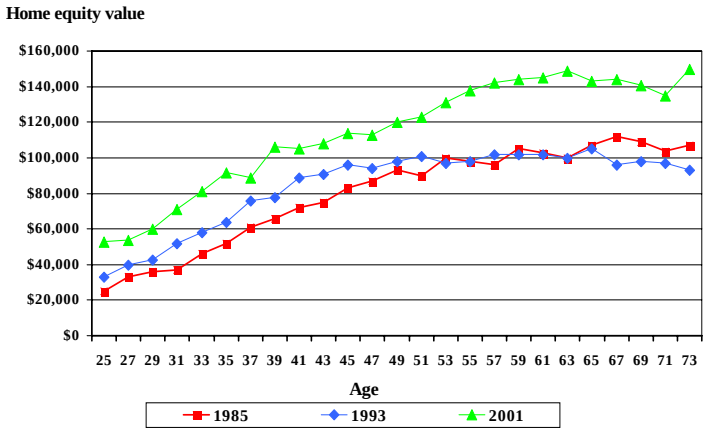


Source: NCOA analysis based on data from the 2003 American Housing Survey and industry data from Financial Freedom.

Homeownership is one of the most effective ways for households to accumulate wealth over time. By holding onto the home, seniors have built up significant amounts of equity in recent years. Figure 4.2 shows average home equity for homeowners in 1985, 1993 and 2001, grouped by the age of the head of the household. All three years show that home equity is higher at older ages. In addition, home equity gain over the last 15 years has been more pronounced for homeowners age 50 and older —from about $100,000 in 1993 to over $140,000 in 2003 (Nothaft and Chang 2004).

The equity seniors have accumulated in their homes, on average, now accounts for about 50 percent of the total wealth of older Americans (Orzechowski and Sepielli 2003). The importance of housing assets in overall household wealth continues to grow, as the proportion of income from savings and other non-housing assets has steadily declined among seniors in the last 10 years (Federal Interagency Forum 2000).[1] In 2001, more than one-third of older Americans depended on Social Security for over 90 percent of their income (Wu 2003). The dramatic fall of the stock market has exacerbated the problem, reducing personal wealth by an estimated $3.5 trillion between 2002 and 2003 (Ernst and Young 2003).

Figure 4.2. Average home equity by age, 1985-2001



Source: Nothaft and Chang (2004), based on data from the American Housing Survey. Home equity was calculated using home values and mortgage balances that were translated into 2001 dollars using the national Consumer Price Index (urban consumers).

Because most older Americans are homeowners, housing wealth is widely distributed among families from different economic strata. Researchers at Cornell University found that there were 2.1 million elderly homeowners in poverty in 1991 (Bronfenbrenner Life Course Center 1996). Most of these economically vulnerable seniors (87 percent) owned their homes free and clear of any mortgage. The estimated total value of all homes owned by the elderly poor is $135 billion. Home equity is also more equitably distributed across households than other, more liquid forms of financial wealth. A recent survey by the Administration on Aging (2003) found that only a small proportion of seniors own non-housing assets such as stock and mutual funds (29 percent), regular checking accounts (31 percent), and IRA and Keogh accounts (25 percent).

Assessing the risk

Awareness of long-term care as a retirement issue is growing in the United States. In 2001, 60 percent of Americans age 45 and older indicated that they were at least somewhat familiar with current long-term care services (RoperASW 2001). Close to half (45 percent) of seniors 65 and older worry that they will use all their money to pay for long-term care (National Council on the Aging 2002). In making a decision to use home equity for long-term care, homeowners face a difficult choice. Should they take out a reverse mortgage early to purchase in-home services and supports that can help them "age in place," or should they save their housing wealth to cover the high cost of nursing home care? The behavior of older homeowners reveals a great deal about the attitudinal barriers that policymakers will need to overcome in encouraging this private-sector approach to long-term care financing.

Long-term care risks

A growing number of services and supports are available to seniors who want to "age in place."[2] These options can enhance an elder's capacity to live independently and enable them to cope with changes in physical and mental abilities over time. Even severely impaired elders can now continue to live at home if they receive appropriate assistance. The cost of these services and

supports can vary from a few dollars for items such as levered door handles to $20,000 or more to retrofit a home or to pay the annual cost of help from a home care professional.

In general, it appears that families do not regard the cost of in-home services and supports as a substantial financial risk. Among family caregivers who assist severely impaired (Level 5) relatives and friends, two-thirds (66 percent) indicate that they do not feel any financial hardship as a result of providing care (National Association Caregivers 2004). Using several different measures, researchers found that that less than 11 percent of home care users had burdensome expenses for these services (Stum et al. 1998). Many family caregivers provide a substantial amount of unpaid assistance, and may be unaware of the substantial "hidden" costs of providing this help. For example, employees who limit their work activities in order to provide care may face a total lifetime loss of over $659,000 due to reduced wages, pensions, and Social Security payments (MetLife Mature Market Institute 1999).

In contrast to home care, the greatest fear of many seniors is that they will end their days impoverished and in an institution. The complex medical care provided in nursing homes is expensive, costing $70,080 per year on average in 2004 (MetLife Mature Market Institute 2004c). Among today's seniors, 43 percent will likely enter a nursing home at some time before they die (Kemper and Murtaugh 1991). Rising longevity is expected to increase this risk to 46 percent in the next 20 years (Spillman and Lubitz 2002).

It can be difficult for older homeowners to gauge the magnitude of the financial risks they may face due to institutional care. Of those who enter a nursing home, about half (51 percent) can expect to stay less than three months (Kemper and Murtaugh 1991). One in five seniors (21 percent), however, will likely need five or more years of care in a facility. The probability of nursing home use also varies considerably by age. About 17 percent of 65 to 74 year olds will need facility care compared to 60 percent of people age 85 to 94. Total expected acute and long-term expenditures for older households (from age 65 until death) therefore differs significantly by longevity. Potential costs can range from $31,181 on average for someone who dies age 65 to more than $200,000 for elders who die at age 90 (in 1996 dollars; Spillman and Lubitz 2000).[3]

Demographic shifts in the older population will present additional challenges to seniors who are trying to predict their household expenditures for long-term care. Rising longevity, particularly among men, may to be reducing demand for nursing home care as more surviving spouses are able to provide help at home (Redfoot and Pandya 2002). The growing ability for married seniors to continue to live independently may help households save on some long-term care expenses. However, elderly couples who live at home face additional financial strains. Many older families may find it difficult to further stretch their already limited retirement assets when both spouses need assistance due to chronic conditions.

Liquidating home equity for long-term care

Uncertainty about future health and long-term care expenses can make getting a reverse mortgage seem like a risky proposition. Borrowers who spend their equity at an earlier stage will have fewer financial resources when they become more severely impaired. If their housing equity has been depleted, impaired elders many not be able to raise enough funds from selling the home to move into an assisted living facility or other supported housing environment.

There are many complex factors that influence a desire to tap home equity among older Americans. Of these, changes in marital and health status appear to have the greatest impact on

moving out of the home. Researchers have found that most older households are likely to wait until a "trigger event," such as a long-term care shock or widowhood, before they make a decision to liquidate housing wealth (Venti and Wise 2001, Megbolugbe et al. 1997, Heiss et al. 2003, Walker 2004). The proportion of older Americans who are homeowners generally begins to decline after age 70, at a rate of about 2 percent per year between age 70 and 85 (Hurd 2003).

For many seniors, deteriorating health precipitates a move. At that point, home equity is usually released by selling the home. A recent study found that, in the period from 1995 to 2000, a long nursing home stay (over 100 days) increased the probability that an older person would sell the home (Walker 2004). The impact of nursing home expenditures on homeownership appears to vary by gender and family composition:

- At least one long stay in a nursing home resulted in about an 18 percent reduction in homeownership. This effect was found both among single and married homeowners. About 6 percent of single households with no lengthy nursing home stays sold their home during this period compared to 23 percent of long stayers. Among married households, homeownership declined by 3 percent where there was no long nursing home stay and 21 percent when this care was needed.
- Among married households, when a husband had a long nursing home stay, the probability of selling the home increased by 11 percent. When the wife needed extended facility care, the likelihood of a home sale increased by 20 percent.

During this period, the likelihood of selling the house was 5 percent lower among homeowners who were eligible for Medicaid and had substantial medical expenses. This lower probability likely reflects the fact that Medicaid excludes the value of the house when counting assets for eligibility.

Attitudinal barriers to using home equity

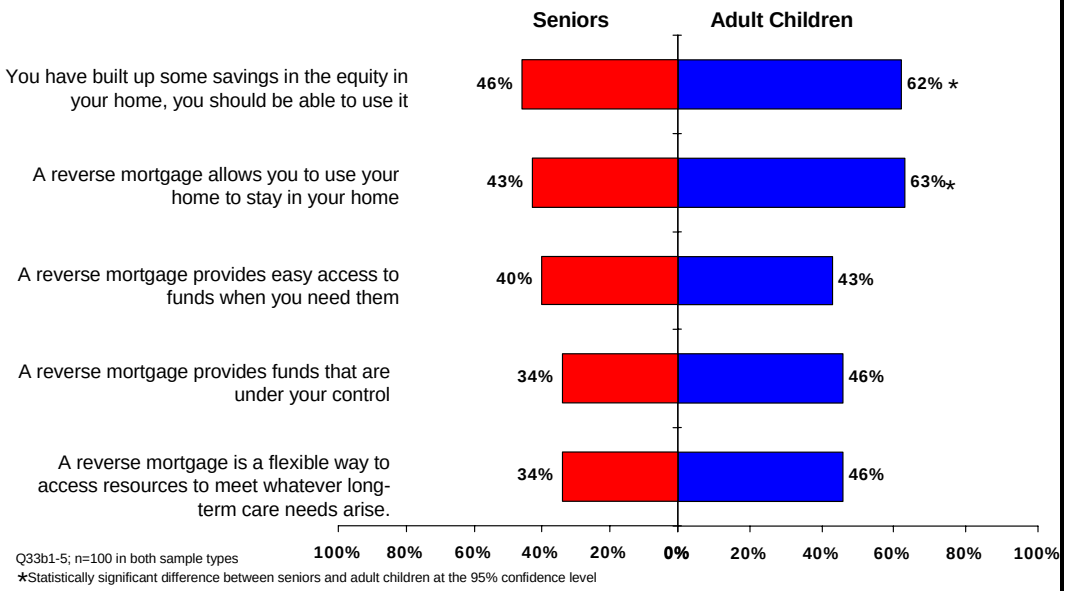
There are other factors that can deter seniors from deciding to take out a reverse mortgage for long-term care. The most common consumer attitudes that could limit the use of the HECM program typically include:

- Housing wealth is not regarded as a financial resource (fungible asset)
- Desire to leave a bequest
- Saving home equity as "insurance" for emergencies

Addressing these barriers would increase the likelihood that older homeowners would tap home equity to pay for long-term care.

Figure 4.3. Attitudes of senior homeowners and adult children of homeowners to using home equity

For each of the below statements, please indicate how likely that statement will INCREASE the likelihood of your making use of (supporting the use of) a reverse mortgage. Percent likely (7-10).



Q33b1-5; n=100 in both sample types

*Statistically significant difference between seniors and adult children at the 95% confidence level

House as a non-fungible asset

One of the biggest challenges to increasing the use of reverse mortgages is that many older homeowners do not regard housing wealth as a financial resource ("fungible asset"). In our telephone interviews, seniors and adult children were asked about their attitudes toward the role the home can play in their lives (or the lives of their parents) as they age. Among the senior respondents, 77 percent simply think of their house as a place to live, and not as an investment. Without additional education and incentives, these elders are not likely to make consumption decisions based on home equity.

An intriguing finding of the telephone interviews is a significant generational difference in attitudes toward the home. Adult children were far more likely than senior respondents to regard the home as a source of immediate funds (Figure 4.3). Almost two-thirds of adult children respondents (62 percent) believe in using home equity versus less than half of seniors (46 percent). Younger respondents (63 percent) are also significantly more likely than seniors (43 percent) to believe that a reverse mortgage can help seniors continue to live in at home. These results suggest that families can play an important role in promoting the use of reverse mortgages for in-home services and supports.

Most seniors respondents (79 percent) feel a strong connection to their home and have strong memories associated with it (72 percent). Older homeowners may be unwilling to spend their housing wealth since the home provides comfort, security, and a network of supportive family and friends.

Bequest motive

Nearly 80 percent of senior respondents to the telephone interviews conducted for this study reported a desire to leave a bequest to their children. Seniors are more likely than adult children to see the home as an inheritance. Only about half (54 percent) of adult children respondents expected an inheritance. Other studies have shown that most (67-78 percent) families think leaving an inheritance is somewhat to very important (Munnell et al. 2002). Differences in attitudes toward bequests between households with and without children are typically very small.

The role of bequest motives among impaired elders is not well understood. Most studies have found that parents overwhelmingly choose to divide their estate equally among their children (Menchik 1980, 1988; Wilhelm 1996). McGarry and Schoeni (1997) found that parents typically do not give financial assistance to children in exchange for caregiving.

Other research, however, suggests that unequal estate division is more common among parents who need long-term care. Among unmarried parents who need help with ADLs or IADLs, 28 percent intend to disinherit a child or divide their bequests unequally among their children (Brown 2004). In addition, 63 percent of these elders plan to exclude at least one child from the set of beneficiaries for life insurance. These parents bequeath an average of $12,000 more to children who currently provide care than to their non-caregiving siblings. Those without current care needs bequeath an average of $21,000 more to the children they identify as likely future helpers. Similarly, Light and McGarry (2003) found that about 8 percent of women (average age 62) with at least two children intend to divide their estates unequally among their children. Among these mothers, one in four (25 percent) indicate that such unequal bequests will favor children who provide support. It appears that poor health increases the likelihood that women intend to give unequal bequests in response to caregiving and other assistance from specific children.

Children are the primary source of help at home for impaired older Americans. Only 6 percent of children who provide ongoing care to their parents receive direct payments for their time (Brown 2004). With a substantial amount of bequeathable wealth tied up in home equity, taking out a reverse mortgage could have an impact on parents' ability to encourage family caregiving and defray children's costs of informal care. Knapp (2001) examined the influence of a variety of socioeconomic factors on demand for reverse mortgages. He found that when family ties are weak, as measured by rate of out-migration of people age 25-39, demand for reverse mortgages among older homeowners in these regions increases. Megbolugbe et al. (1997) found that the economic well-being of children of the elderly also influences the decisions older homeowners make regarding the accumulation or liquidation of housing wealth. Senior households whose adult children are not doing well financially tend to increase home equity ("trade up") when they sell and move to another home. In contrast, households with children who are economically well-off tend to trade down.

House as "insurance"

Most respondents to the telephone interviews were interested in holding on to home equity as a way to manage risk. Almost three-quarters (72 percent) of seniors believe that owning a home is the best way to feel financially secure. Half (50 percent) agreed with the statement that the equity in the home serves as "insurance" against unforeseen financial needs. Fifty-nine percent feel that it is risky to borrow against the equity in their homes. Lenders suggest that a "depression-era mentality" encourages some older Americans to view debt of any kind as risky and unwise.

Consequences of preserving home equity

Researchers have found that the ability to live at home supports the independence and choice that is important for positive self-image among older people. For many older households, home equity is their main financial buffer against substantial medical and long-term care expenses. If homeowners are saving the house for precautionary reasons, then uncertainty about future long-term care needs will discourage them from liquidating housing wealth through a reverse mortgage.

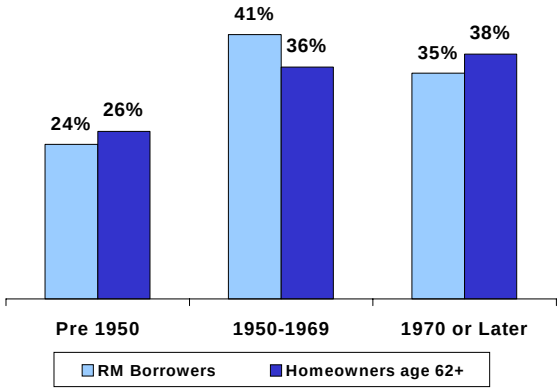
Encouraging older Americans to retain their home equity, either through public policy or social norms, however, may be placing seniors at greater risk of ending up in a nursing home. Without adequate support, it can be difficult for impaired elders to continue to live at home. For example, elders age 75 and older who fall are significantly more likely to need institutional care in the next year (Donald and Bulpitt 1999). With limited incomes and non-housing assets, older homeowners who want to preserve housing wealth face stark choices when confronted with the need to pay for long-term care: they either sell the house, struggle to stay at home, or turn to government help through Medicaid.

Elders who sell their home can face serious problems. Relocating often entails the loss of familiar activities along with support from family and friends. This can reduce quality of life and may accelerate cognitive decline (Bassuk et al. 1999). The limited number of affordable and appropriate senior housing options also makes it difficult for frail elders to continue to live in the community. Older persons may struggle to find affordable and suitable housing near family caregivers, health and other services, and transportation. There is often a long waiting list for government subsidized housing, and seniors may have to wait many years for these units.

Impaired homeowners who want to continue living independently also may be exposed to financial risks including deteriorating homes and mounting debt. Sixty-two percent of all older homeowners live in houses that were built before 1970 and are at least 35 years old. A high proportion of reverse mortgage borrowers (65 percent) also live in such older homes (Figure 4.4). Older homes often need repairs that may be difficult or costly for impaired elders on a budget. Homes that are deteriorating lose equity and may also pull down property values throughout the neighborhood. In addition, these homes can become an increased risk to lenders.

Another challenge for most older homeowners is that their homes were not designed to meet their changing needs as they age. Home modifications can increase the safety and comfort of the home environment. However, 36 percent of Americans age 45 and older have not made home modifications because they cannot afford to do so (Bayer and Harper 2000).

Figure 4.4. Year house was built among RM borrowers and homeowners age 62+



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

The financial challenges of "aging in place" may also be reflected in the growing number of Americans age 65 and older who are going into debt. More than 50 percent of older Americans who end up in bankruptcy say that they filed because of unpaid medical expenses (Warren 2004). Average self-reported credit card debt among indebted seniors increased by 89 percent between 1992 and 2001 to $4,041. Among seniors with incomes under $50,000, about one in five families with credit card debt spends over 40 percent of their income on debt payments, including mortgage payments (Draut and McGhee 2004). Seniors are the fastest-growing group in bankruptcy. In 2003, about 96,000 older Americans filed for bankruptcy. Over the past decade, the number of seniors who filed for bankruptcy tripled (Warren 2004).

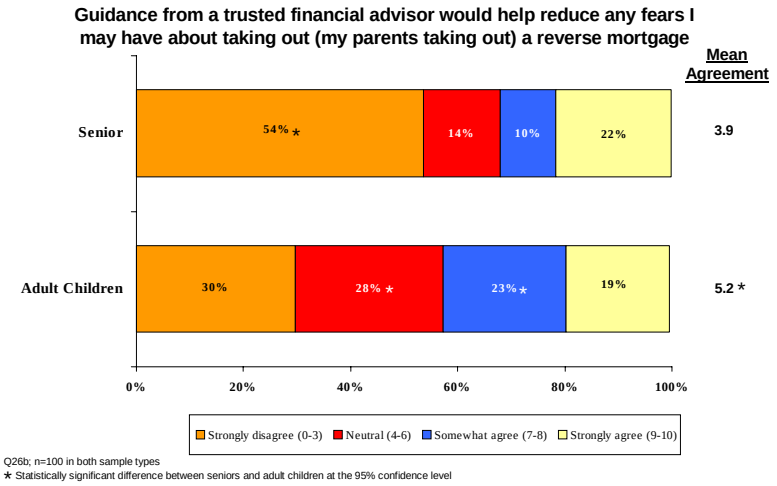
Consumer attitudes toward incentives for reverse mortgages

Reverse mortgages can offer older, impaired homeowners additional options for continuing to live at home. However, financial and other incentives may be needed to overcome deeply held beliefs regarding the use of home equity among today's older homeowners. As part of the telephone survey, respondents were asked about different incentives that could address their concerns and encourage greater use of reverse mortgages.

Incentive #1: Guidance from a trusted financial advisor would help reduce any fears I may have about taking out (my parents taking out) a reverse mortgage.

About half (46 percent) of senior respondents are concerned about making wise decisions regarding the use of their home equity. Ensuring that consumers can obtain guidance from a trusted advisor could increase interest in reverse mortgages among consumers. About one in five respondents (22 percent of seniors and 19 percent of adult children) strongly agree with the need for professional advice before taking out the loan (Figure 4.5). Adult children are significantly more likely than seniors to agree that their fears about their parents/their own use of a reverse mortgage would be allayed by receiving trusted financial guidance.

Figure 4.5. Incentive – Guidance from a financial advisor

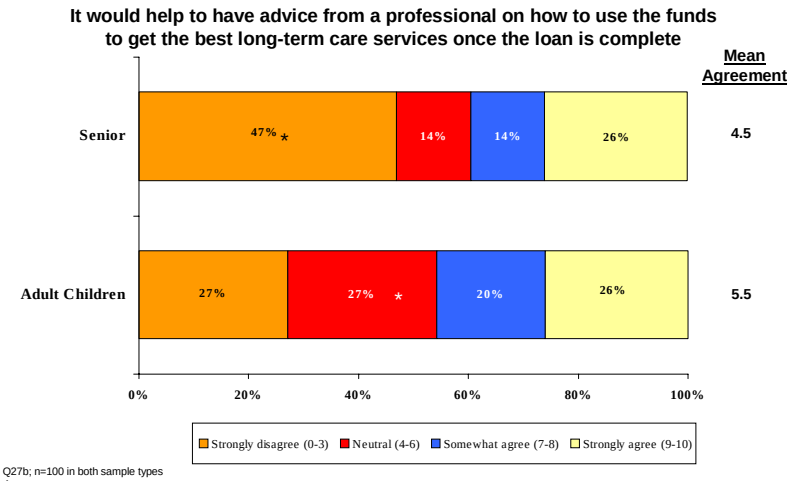


Q26b; n=100 in both sample types
* Statistically significant difference between seniors and adult children at the 95% confidence level

Incentive #2: It would help to have advice from a professional on how to use the funds to get the best long-term care services once the loan is complete.

Navigating the complex and fragmented long-term care system in the United States can be difficult for most families. Getting advice from a professional on how to use the funds from a reverse mortgage for the best long-term care services shows more promise than the other potential incentives for increasing interest in reverse mortgages among both seniors and adult children. About four in ten (40 percent seniors, 46 percent adult children) agree (7 to 10 on a 0-10 scale) that it would help to get this professional advice once the loan is complete (Figure 4.6).

Figure 4.6. Incentive – Professional advice to help manage loan funds



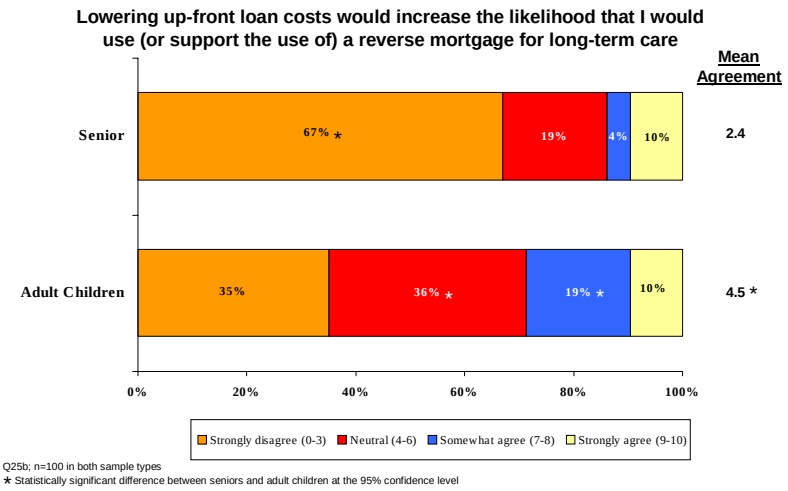
Q27b; n=100 in both sample types
* Statistically significant difference between seniors and adult children at the 95% confidence level

Incentive #3: Lowering upfront loan costs would increase the likelihood that I would use (or support the use of) a reverse mortgage for long-term care.

Of the potential motivations tested, reducing upfront loan costs appears to have the least influence on interest in reverse mortgages among seniors. Over two-thirds (67 percent) strongly disagree that lowing costs would encourage them to tap home equity for long-term care (Figure 4.7). Adult children are significantly more likely to be persuaded to support their parents' use of a reverse mortgage than seniors are to actually make use of a reverse mortgage themselves by the mortgage provider lowering the upfront costs of the loan.

This unexpected finding may reflect the fact that most survey respondents may not be aware of the upfront expenses associated with this product. These results also reaffirm the observation that the cost of the loan, while important, many not be the most critical issue that consumers consider when initially considering a reverse mortgage. As they decide to take out a loan, however, it is likely that these costs become a greater concern for potential borrowers.

Figure 4.7. Incentive – Reduce loan costs

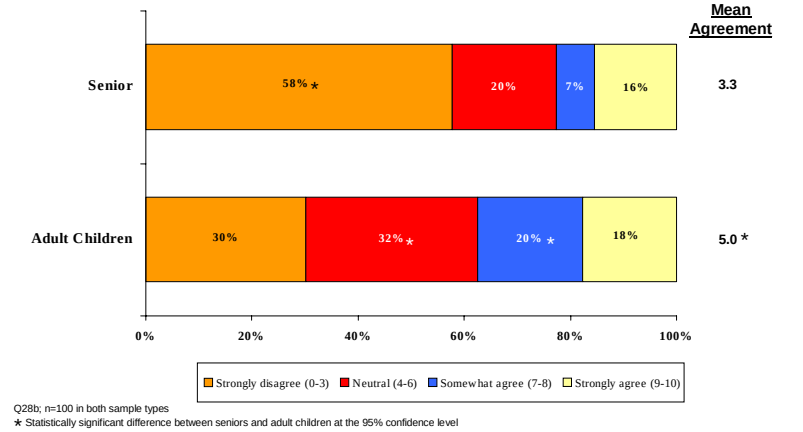


Incentive #4: If I (my parents) could get help with property taxes, home repairs, or homeowners insurance, I would be more likely to use (support the use of) a reverse mortgage for long-term care.

House-rich-and-cash-poor elders may have difficulty keeping up with the expenses of maintaining a home as well as paying for long-term care. Reverse mortgage borrowers who do not fulfill these obligations risk foreclosure of their loan. States may be able to encourage the use of reverse mortgages for long-term care by helping borrowers with property taxes, home repairs, or homeowners insurance. Almost one in four seniors (23 percent) agrees that this type of assistance could increase support for using reverse mortgages for long-term care (Figure 4.8).

Adult children (38 percent) are more likely than seniors to be influenced by aid with taxes, home repairs, and insurance.

Figure 4.8. Incentive – Financial assistance with property taxes, insurance or repairs

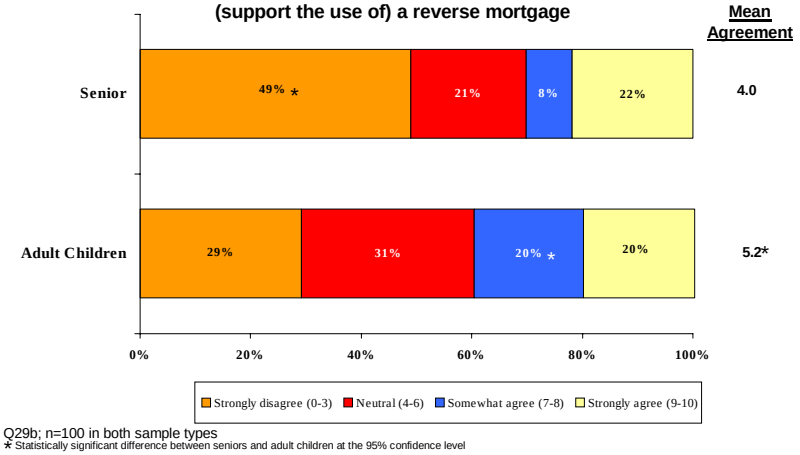


The Administration on Aging supports borrowers who need help to live at home through Area Agencies on Aging (AAAs) that are part of its Aging Network. Local AAAs help older citizens remain active in their communities. These agencies may offer minor home repairs or modifications to the home to maintain a safe home environment. These services would be especially important for reverse mortgage borrowers who lack the expertise and financing for basic repairs.

Incentive #5: If the government had a program to help the senior stay at home if they spent all the reverse mortgage money paying for long-term care, I would be more likely to use (support the use of) a reverse mortgage.

The risk of impoverishment due to long-term care costs is a concern among many older Americans. When compared to other incentives, a significant proportion of senior respondents (51 percent) were interested in the possibility that the government might offer a program that would protect borrowers who exhausted their loan paying for long-term care.

Figure 4.9. Incentive – Public program to reduce risk of impoverishment



Q29b; n=100 in both sample types
* Statistically significant difference between seniors and adult children at the 95% confidence level

Government assistance to help the older homeowners stay at home, even if their reverse mortgage proceeds run out, is a strong potential motivator for about one in five seniors (22 percent) and adult children (20 percent). Adult children are significantly more likely than seniors to agree that this type of government program would increase support for use of reverse mortgages.

Policy issues and concerns

High levels of homeownership and home equity present an important opportunity to enhance the lives of older Americans who live in the community. The findings in this chapter suggest that the long-term care already plays an important role in the decisions older homeowners make about liquidating their housing wealth. However, the options that they consider are often very limited because of strong feelings about the family home. The current limited demand for reverse mortgages suggests that, in order to preserve home equity for emergencies, many impaired elders cope as best they can until family caregivers and non-housing resources are exhausted. At that point, they are likely to liquidate home equity by selling the house and moving to a nursing or assisted living facility or living with children. Through education and targeted incentives, elders may be encouraged to tap home equity sooner to pay for in-home services and supports that can help them avoid or delay institutionalization.

One of the biggest challenges will continue to be elderly homeowners' desire to preserve their equity against unanticipated expenses. Reverse mortgages should have greater success if policymakers can develop incentives and programs that allay homeowners' fears of impoverishment if they use housing wealth to pay for long-term care.

The interview results suggest that offering incentives without also providing substantial education about the value of "using the home to stay at home" will not likely result in great success. An important finding of the telephone interviews was that adult children respond far more favorably to proposed incentives for using reverse mortgages to pay for in-home services

and supports. Half or more of senior homeowners strongly disagreed with most incentives presented to them during the interview. These findings suggest that educating adult children about reverse mortgages will be critical to promoting this financing option for long-term care.

To increase interest in the use of reverse mortgages, educational campaigns could target professionals who advise seniors who are dealing with long-term care issues. Elders who have recently returned home from an accident or illness, or those recognizing the onset of limitations, are most likely to be interested in products and services that can help them "age in place" (Tenenbaum 2002).

It will be important to incorporate the attitudinal factors affecting elderly homeowners' decisions into educational programs on reverse mortgages for long-term care. Consumers need to become aware that these loans offer impaired homeowners additional funds to maintain their independence and enhance their choices. As part of this effort, the potential of using home equity to finance in-home services and supports should be emphasized. Aging and Disability Resource Centers, along with other state and local agencies, could play an important role. This will also require that the staff at these agencies receive additional training on reverse mortgages and the appropriate use of this financial tool among impaired, older homeowners.

ENDNOTES

1. According to the Federal Interagency Forum (2001), between 1992 and 2001, the average share of seniors' incomes derived from assets dropped from 21 percent to 16 percent. The share from pensions fell from 20 percent to 18 percent.
2. These services include homemakers, geriatric care managers, adult day centers, transportation services, and respite care. Sometimes modest changes, such as grab bars, touchless faucets and light switches, or more substantial modifications, such as a ramp, can make the difference between staying home and having to move to a nursing facility.
3. These expenditures include payments by Medicare and other health insurance, as well as out-of-pocket expenses borne by older households.

PART V. ROLE OF GOVERNMENT

Today, few older Americans are tapping home equity through reverse mortgages, regardless of the consequences for aging in place. Many older homeowners 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. To the extent that seniors view housing wealth as a form of "insurance," demand for reverse mortgages will be strongly influenced by the availability of alternatives to deal with this risk.

In the United States, long-term care is often regarded as a public responsibility. Government does play an important role in providing a safety net to poor elders. However, public assistance through Medicaid is restricted and mainly pays for services only after catastrophe strikes. Under this system, the desire of seniors to protect housing wealth is often at odds with the objectives of government programs to be a payer of last resort and to serve as a safety net for the truly needy. Efforts to create a substantial "win-win" for government and consumers by promoting greater use of reverse mortgages could therefore be enhanced though initiatives that encourage impaired elders to tap their home equity rather than shelter this asset. With appropriate incentives and careful protections, government policy may be able to significantly alter the dynamics and momentum of this private sector financing option.

This chapter examines how current government policies can promote as well as discourage older Americans from using reverse mortgages to pay for long-term care at home. This evaluation takes a close look at Medicaid policies regarding home equity for financial eligibility criteria, asset transfers, and estate recovery programs. Home equity plays an important but not always straightforward role in the means-tested Medicaid program.

Federal incentives for reverse mortgages for long-term care

In 2000, Congress passed a provision within the American Homeownership and Economic Opportunity Act that authorizes HUD to waive the upfront mortgage insurance premium for Home Equity Conversion Mortgage (HECM) borrowers who use all the proceeds of their reverse mortgage to purchase a tax-qualified long-term care insurance policy. This option would enable the typical older homeowner with a house worth $100,000 to save $2,000 in upfront costs. HUD has not yet published regulations to implement this provision of the HECM program.

This new law represents an important first step to encourage homeowners to use reverse mortgages for long-term care. However, many senior advocates are concerned that HECM borrowers who opt for this provision lose a great deal of flexibility in how they can use their reverse mortgage funds (Ahlstrom et al. 2004). By requiring that seniors use the entire proceeds of the loan to pay insurance premiums, this new option places borrowers at risk of impoverishment if they cannot afford to pay for services that are not covered by their insurance policy. The risk of lapsing coverage also increases when borrowers who would otherwise not be able to afford a policy run out of funds or are unable to pay increases in premiums. Requiring older homeowners to use all the funds for insurance may make it difficult for them to pay for daily and other expenses, such as repairs or taxes, that enable them to continue to live at home and receive loan payments. In addition, this incentive will not help borrowers who pay directly for in-home services and supports.

State loan programs to help homeowners

Seniors often find it difficult to live at home because they cannot afford home repairs or rising property taxes. Most state or local governments have made efforts to support "aging in place" by addressing these financial concerns through a variety of low-cost home loans. Some of these loans can only be used for only a specific purpose, like home repairs. Others are similar to conventional reverse mortgages and can be used for any purpose. There are usually restrictions on who can apply for these loans and the amount of funds that are available to borrowers.

Single purpose loans

In 2003, 24 states and the District of Columbia provided property tax deferral programs (Baer 2003). These programs allow older and disabled homeowners to defer payment of some or all of their property taxes until they die or sell the house. Property tax deferral loans function as a special type of reverse mortgage, in that they generally provide annual loan advances that can be used only to pay property taxes. Borrowers are not required to make payments on this loan for as long as they continue to live in the home. Deferred taxes become a lien against the value of the home.

The availability of property tax deferral and eligibility rules for these programs vary considerably by state. Most programs require borrowers to be at least 65, and eligibility is often limited to homeowners with low or moderate incomes. The amount of the loan varies in different programs. Borrowers may receive some part of the property tax bill for that year or a specific amount. In the most restrictive programs, the loan can only be used to pay for special assessments.

Many local and some state government agencies also offer deferred payment loans to help seniors repair or improve their homes. This type of reverse mortgage gives borrowers a one-time, lump-sum payment that they will not need to repay for as long as they live in the home. These loans may be used only for the specific types of repairs or improvements that each program allows. These can include the installation of ramps, rails, and grab bars to enhance accessibility to the home, or storm windows, insulation, or weather-stripping to improve a home's energy efficiency.

Some deferred payment loan programs forgive part or all of the loan if the borrower lives in the home for a certain period of time. These programs may charge fixed interest, usually at simple rather than compound rates. Borrowers may be able to combine this type of loan with a reverse mortgage if the program agrees to be repaid after the HECM loan is paid.

Reverse annuity mortgages

Several states have at some time offered reverse mortgage programs to seniors. Currently, there are two programs in effect and several others that have been discontinued.

The Montana Reverse Annuity Mortgage Loan Program is a state-run loan program has been in existence since 1989. The program is open to Montana citizens who are at least 68 years old and own their home free and clear. The amount of the loan available through the program is capped at 80 percent of the FHA appraised value of the home. Closing costs are set on a sliding scale. Borrowers can receive payments either in a lump sum or as monthly payments for up to 10 years. The loan is non-recourse, and the proceeds can be used for any purpose.

The Rhode Island Housing and Mortgage Finance Corporation offers discounts on HECM loan costs to elder homeowners age 62 and older whose annual household incomes do not exceed $78,000 (depending on household size). The origination fee for HECM loans under this program is limited to 1 percent of the value of the home (rather than 2 percent of the value of the home as is typical in the private sector).

The New Jersey Home Mortgage and Financing Agency offers lower closing costs. They charge a fixed origination fee of $1800 to borrowers who obtain a HECM loan through its office. In addition, the agency charges a moderate monthly servicing fee ($25).

The Connecticut Housing Finance Authority (CHFA) recently discontinued a program that provided reverse mortgages exclusively for long-term care to Connecticut residents age 70 and older due to low demand. During its existence, from 1995 until 2003, less than 80 loans were closed. Applicants paid a $1,500 origination fee to the CHFA. The program did not charge a monthly service fee, and the interest rate was fixed at 7 percent. To qualify, applicants had to meet the financial eligibility requirements for the single-family homeownership program in Connecticut.

Several other early public reverse mortgage programs have been discontinued since the implementation of the HECM program. Pennsylvania helped seniors pay for closing costs of a reverse mortgage. The Virginia Housing Development Authority offered a reverse annuity mortgage program (Virginia Senior Home Equity Account). As early as 1980, the San Francisco Development Fund offered fixed term reverse mortgages to homeowners age 62 and older in California (Weinrobe 1987). These loans made monthly payments to borrowers. Loan duration was limited to a maximum of 12 years, and the interest rate was fixed for the life of the loan.

In addition, some states provide a rebate of property taxes and heating expenses to low-income elderly. States may also offer a special homestead exemption or freeze the assessed value of the property for seniors to reduce their property taxes.

Treatment of home equity under Medicaid

Medicaid is the largest payer of long-term care for older Americans. Spending on home care through Medicaid for the elderly is expected to reach $10.8 billion in 2004, while payments for nursing home care could reach $36.5 billion (Congressional Budget Office 2004). These Medicaid payments represent about 35 percent of our nation’s total expenditures for paid long-term care services.

As a federal-state health insurance program, the basic rules for Medicaid eligibility are set by the federal government. States have discretion in implementing these policy guidelines, resulting in a very complex long-term care system (Bruen et al. 2003). Under federal law, state Medicaid programs must cover certain aged, blind, and disabled people. States also have the option to extend coverage to certain groups of seniors who do not qualify for mandatory benefits under Medicaid, often because their income and assets exceed those of mandatory coverage categories.

Treatment of home equity for Medicaid beneficiaries also varies by state and is reflected in regulations concerning:

- Financial eligibility criteria for Medicaid benefits
- Transfer of assets prior to Medicaid application

- Medicaid estate recovery

The perceived need among seniors to hold onto housing equity is strongly influenced by the way these policy provisions affect their ability to access Medicaid long-term care services.

Eligibility

Medicaid is a means-tested public assistance program that was designed to help older Americans with low incomes and those who have high health and long-term care expenses. In order to qualify for benefits, an applicant must meet stringent income and asset requirements. The equity that seniors have built up in their home, however, is treated differently under Medicaid from other assets. For eligibility purposes, a home of any value is not a countable resource so long as it remains the applicant's primary residence.

When a Medicaid beneficiary leaves the home and enters a nursing home, issues concerning the home become more complex. In all but a handful of states, the home will remain exempt as long as the spouse resides in it or the beneficiary has a subjective intent to return, regardless of the medical likelihood of returning home. A few states have stricter rules, such as limiting the exemption to six months unless a doctor certifies that the resident is likely to return home. Some protections may exist for the spouse and certain other relatives living in the home. In any case, when the house becomes a countable asset, it will have to be sold. The equity available from selling the home is likely to make the beneficiary ineligible for Medicaid for a period of time due to excess countable resources.

A separate issue arises with respect to placing a lien on a homestead. Federal Medicaid law prohibits the use of liens except in specifically prescribed circumstances. One such circumstance is when an individual has been determined, after notice and opportunity for hearing, to be "permanently institutionalized." Unlike the subjective intent to return home, which need bear not resemblance to the actual likelihood of returning, "permanent institutionalization" refers to a condition based on an objective determination that an individual is not likely to return home. Once such a determination is made, absent certain protected relatives living in the home, the state is authorized to place a lien on the residence. The home retains its status as an exempt resource, but the state now has the authority to recover the cost of assistance provided through Medicaid when the home is sold, or when the beneficiary dies (absent the presence of certain protected relatives). The issue of liens is discussed in more detail below.

Transfer of assets

Medicaid imposes limits on the ability of impaired homeowners to gift the home or transfer this asset for less than fair market value and still be eligible for this program. These rules are especially important for moderate-income homeowners who would qualify for Medicaid as "medically needy." The "medically needy" have large medical bills, which reduce their income to meet Medicaid eligibility requirements (a process termed "spend down"). The medically needy in institutions must contribute all of their income toward the cost of their care except for a small personal needs allowance. There are higher allowance amounts for beneficiaries who receive services at home and must pay for their living expenses out of pocket. In addition, seniors who receive Medicaid benefits through the medically needy option must have very limited assets, which cannot exceed $2,000 for individuals or $3,000 for couples in many states.

With some exceptions, Medicaid's provisions to protect against the impoverishment of spouses allows the community spouse of a nursing home resident to keep the family home, along with some of the couple's income and other assets while still qualifying the nursing home spouse for

Medicaid. The community spouse is allowed to keep all income that is solely in his/her name, plus a portion of the nursing home spouse's income if necessary to meet the protected income amount, plus half of all assets up to a maximum.[1] The nursing home spouse must contribute all of his/her income toward the nursing home cost except for a small allowance for personal needs, to pay for health insurance premiums, taxes, and medical expenses not covered by Medicaid, and to cover whatever is needed to bring the community spouse and any dependents up to the protected income amount. Spousal impoverishment protections are required for married Medicaid nursing home beneficiaries. Most states also extend this protection to the spouses of beneficiaries who receive assistance at home through Home and Community-Based waivers (Bruen et al. 2003).

To curb perceived abuses of Medicaid by people thought to be wealthier, Medicaid law limits eligibility for people who transfer assets within 36 months (or for transfers to certain trusts, 60 months) before entering the nursing home. These provisions also restrict the use of trusts. Regulations regarding transfer of home equity, however, are still relatively liberal.

Under current law, Medicaid beneficiaries can transfer their home without incurring transfer of asset penalties to 1) a spouse, 2) a dependent child (under age 21 or a child of any age who is blind or disabled), 3) a sibling who has been living in the home for at least one year prior to the recipient entering the nursing home or 4) a child who lives in the home and provided care to the Medicaid beneficiary for two years. Moreover, since the home is a non-countable resource, seniors may be able to reduce their countable assets to qualifying levels by paying off any debt on the home, buying a larger home, or paying for home repairs and renovations. Older homeowners may also be able to protect home equity by using a reserve life estate to transfer title to the home to their adult children.

Estate recovery

Under federal law, states are required to recover payments made to Medicaid beneficiaries age 55 and older for nursing facility services, home and community-based services, and related hospital and prescription drug services.[2] They must also recover from permanently institutionalized individuals on whose homes they have placed a lien. States have the option to recover payments for all other Medicaid services provided under their state Medicaid plan for individuals age 55 and older. Since housing assets are not counted in determining whether a person qualifies for Medicaid, home equity is the main resource that is usually available to help defray public costs.

There are limits on a state's right to recover Medicaid benefits. Recovery cannot be made before the death of a surviving spouse or if the beneficiary has a child who is under age 21 or who is blind or permanently disabled. There are also protections related to the enforcement of a lien on the homestead for certain siblings and adult children who lived with the beneficiary before they needed assistance from Medicaid.

When a Medicaid beneficiary dies, the state must file a claim in probate court.[3] In some states, the costs of probate and cost of last illness, along with mortgages, funeral expenses and unpaid taxes, have priority over claims made by Medicaid. Medicaid agencies in other states chose to file under "cost of last illness" and gain priority over other creditors (Sabatino and Wood 1996). In addition, when the spouse of a deceased Medicaid beneficiary dies, the state may file a limited claim against the spouse's estate as means of recovering some or all of public costs. Few states pursue this type of recovery because it can be expensive and administratively difficult.

The surviving spouse or heirs of a deceased Medicaid beneficiary are not required to use personal funds to repay the debt owed to the state for long-term care. However, if the family home is subject to estate recovery, the heirs may want to use their own funds to pay the Medicaid claim and keep the home. Oregon allows families of Medicaid beneficiaries to keep the family home by paying back the debt owed the state over time.

States are required to waive the recovery of Medicaid expenditures in cases where recovery would result in undue hardship for the survivors. These situations typically include those in which the asset to be recovered against is a family farm or family business that is the sole income-producing asset of the survivors, or homesteads of modest value.

Use of liens

One area of Medicaid policy that can have a direct impact on the feasibility of using reverse mortgages for long-term care is the use of liens. Liens are a legal instrument that prevent the beneficiary or the beneficiary's family from selling the home without first paying costs incurred by Medicaid. Use of liens could make it difficult for the spouse of a Medicaid beneficiary to obtain a HECM loan since the home must be the primary loan to qualify for this program. States differ in their use of these liens, due to variations in Medicaid programs and state property laws. Some states do not use any type of Medicaid lien. In some states it is illegal to put a lien on homesteads.

Two types of liens are associated with Medicaid: estate recovery liens and Tax Equity and Fiscal Responsibility Act (TEFRA) liens. Only the latter – placed on real property owned by a living Medicaid beneficiary – are explicitly authorized by the Medicaid law. Estate recovery liens have been found by certain courts to be permitted, but are not specifically discussed in the statute. Estate recovery liens may be placed on the property of a deceased Medicaid beneficiary against whose estate the state has authority to recover. However, the state cannot recover Medicaid expenses while a spouse or dependent or disabled child is living.

The surviving spouse and dependent or disabled children of a deceased Medicaid beneficiary can sell the home and use the proceeds as they wish. States may start estate recovery proceedings if a sibling or caregiver moves out of the home. Some states, including Nevada and Washington, place a lien on the home of the surviving spouse as soon as the Medicaid beneficiary dies. To address the concerns of surviving spouses, in April 2004, the Supreme Court of Nevada ruled that Medicaid liens will be released in that state if the surviving spouse wants to sell or refinance the property, or obtain a reverse mortgage.

Medicaid TEFRA liens may be placed on the home of a living Medicaid beneficiary. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA '82) authorized states, at their discretion, to place liens on the homes of Medicaid nursing home beneficiaries prior to the death of the Medicaid recipient if the recipient, after notice and opportunity for a hearing, is determined to be "permanently institutionalized" and not reasonably expected to return home. These TEFRA liens are only used if the Medicaid beneficiary pays part of the cost of care as a condition of receiving Medicaid. This lien must be released if the nursing home resident does returns home. In addition, TEFRA liens cannot be placed on the home if it is occupied by the beneficiary's spouse, child who is under age 21 or any age who is blind or disabled, or a sibling with an equity interest who resided in the house for at least one year before the individual became institutionalized. This type of lien also cannot be enforced as long as there is living in the house a brother or sister who has

lived continuously in the house for the year immediately prior to the beneficiary being admitted to the nursing home. This is also true when an adult child provide care to the elder and lived continuously in the home for at least two years before the parent was admitted to the nursing home.

Other governmental factors

The current structure of Medicaid presents additional obstacles to homeowners that could limit the use of the HECM program. These include:

- Risks to Medicaid eligibility from taking out a reverse mortgage.
- Nursing home eligibility standard to access Medicaid home and community services.

Addressing these barriers would increase the appeal of reverse mortgages, especially for Medicaid beneficiaries and financially vulnerable seniors who are likely to turn to government programs for assistance.

Risk to eligibility

Reverse mortgage payments can affect eligibility for government benefits, including Medicaid. Generally, loan payments will not be counted as income for eligibility purposes if they are spent within the same month that they are received. If these funds are not spent, however, they could accumulate and render an elder ineligible for Medicaid if their resources are over the allowable limits for eligibility. In some states, regularly monthly payments from a reverse annuity mortgages may be counted as income for purposes of Medicaid whether or not they are spent within the month they are received.

Nursing home eligibility standard to access Medicaid home and community services

Among seniors who live in the community, there are 4.8 million “dual eligibles” who participate in both Medicare and Medicaid because of very low incomes and poor health (Kasper et al. 2004). Not all dual eligibles qualify for the full range of Medicaid benefits, including long-term care. About 15 percent are eligible only for assistance with their Medicare premiums, deductibles, and other cost sharing requirements (Ryan and Super 2003).

To receive services under the Medicaid Home and Community Based Services (1915c) waiver program, impoverished elders have to be so severely impaired that they meet the state’s eligibility requirements for nursing home care. This can make it difficult for seniors who do not yet meet the Medicaid threshold to obtain public assistance for in-home services and supports. As an alternative, dual eligibles who are homeowners may be interested in liquidating a portion of their home equity to pay for in-home services and supports that could enable them to continue to live at home. Strong and appropriate government incentives will be needed to encourage this group of homeowners to tap their home equity.

Policy issues and concerns

High levels of housing wealth among today’s seniors are a direct consequence of government policy to offer guaranteed home loans through the GI Bill and tax laws that allow mortgage interest deductions. Widespread availability of the thirty-year mortgage has also fundamentally altered consumer attitudes toward debt. Even older Americans are now willing to refinance their

homes and assume such lengthy mortgages. Having encouraged older Americans to accumulate over $2 trillion in housing wealth, is there now a need to create public policy that will incentivize older homeowners to voluntarily tap home equity to pay for long-term care?

As the second largest expenditure in most state budgets, Medicaid continues to be targeted for cost control efforts (Smith et al. 2004). In this tight fiscal environment, reverse mortgages could play an important role in supplementing public funding for long-term care. Additional cash from these loans also supports family caregiving and enables impaired elders to select the services they prefer. These loans could enhance government efforts to rebalance our country's long-term care system toward increased community-based services.

Government initiatives that incorporate home equity will need to ensure that there will be no adverse consequences for Medicaid beneficiaries. Many consumer advocates are concerned that efforts to promote the use of reverse mortgages will erode spousal protections. If reverse mortgages became mandatory to qualify for Medicaid, the healthy spouse who is still living at home could be left without any assets. Many could become trapped in an inappropriate living situation because they no longer have the financial resources to move out of a house that has become unsafe or too much to handle. The current public system for long-term care offers strong spousal impoverishment protections that permit the healthy spouse to preserve assets, including the home. Any proposed reforms to the long-term care financing system using reverse mortgages must be carefully evaluated to determine their potential impact on older homeowners and their families.

Promoting greater use of reverse mortgages for long-term care can be done incrementally, or as part of a larger effort to encourage seniors with resources to share more of the cost of Medicaid services. States could begin to encourage the use of reverse mortgages by addressing government regulations, along with program requirements and restrictions, that may present obstacles for impaired elder to "use their home to stay at home." Eliminating such regulatory and eligibility barriers could unlock additional housing wealth by making the use of home equity more attractive to impaired, older homeowners.

Through demonstration programs, the Centers for Medicare and Medicaid Services (CMS) has an opportunity to develop innovative approaches that use reverse mortgages to help impaired elders continue to live at home as long as possible. One option would be to develop a Medicaid "Partnership" approach based on reverse mortgages, with characteristics similar to the current public-private programs for long-term care insurance. The Department of Health and Human Services could also allow states to experiment with programs that target Medicaid beneficiaries who are ineligible to qualify for in-home services under a waiver program because they have not yet met the criteria for admission to a nursing home. These efforts may be able to encourage older Americans to voluntarily use home equity to pay for in-home services and supports.

Reverse mortgages can also be examined within the broader estate recovery plans of a state. These loans may offer an alternative way to recoup the funds that states spend on Medicaid beneficiaries for long-term care. In many ways, the Medicaid program for seniors is structured like a reverse mortgage. Beneficiaries receive an interest-free loan, which does not need to be repaid until they permanently move out of the home, or after the death of the last homeowner (possibly including the children of the beneficiary). However, once the Medicaid "loan" becomes due, the likelihood that the costs incurred by beneficiaries will be recovered from their estates is small in most states (Sabatino and Wood 1996).

As the population ages and the pressure on state budgets rises, it becomes increasingly important to find effective ways to improve our long-term care financing system. Between 1984 and 1999, the median net worth among households headed by persons age 65 or older increased by 69 percent, from $93,000 to almost $158,000 (Federal Interagency Forum on Aging 2000). Since many elders now have sizable estates, there are even greater incentives to protect these assets by engaging in Medicaid estate planning. State legislators are already considering options to tighten Medicaid eligibility rules and strengthen Medicaid estate recovery programs to reduce public expenditures for long-term care. The possibility of mandating the use of home equity to qualify for Medicaid has also been raised (Center for Long-Term Care Financing 2004). In this dynamic environment, it is important that policymakers begin to identify the appropriate use of this financing tool. With appropriate incentives, careful protections, and innovative products, greater use of home equity could offers an important option for seniors to manage assets to pay for long-term care than spending-down or turning to Medicaid estate planning.

One reason that elders turn to Medicaid estate planning is because they do not plan ahead for their long-term care needs. State and federal government could include the use of reverse mortgages in their educational efforts on long-term care. Consumer outreach can help older homeowners and their families understand the benefits and limitations of using a reverse mortgage to "age in place." Greater awareness of the potential of reverse mortgages will help seniors consider this product as a mainstream option rather than as a last resort.

ENDNOTES

1. In 2003, federal spousal impoverishment protections required that the community-based spouse be allowed to keep at least $1,492.50 but not more than $2,266.50 of the couple's monthly income (Section 1924 of the Social Security Act; U.S. Code Reference 42 U.S.C. 1396r-5).

2. The Omnibus Budget Reconciliation Act of 1993 (OBRA '93) made recovery of the cost of care from Medicaid recipients' estates mandatory and a condition of receiving federal matching funds.

3. Under probate laws, an estate is usually defined as all real estate and personal property that passes from a deceased person to an heir through a will or by rules of intestate succession (Sabatino and Wood1996). OBRA '93 gives states the option to expand the definition of the estate to include property that passes directly to joint owners or to beneficiaries under a trust, and any other property that the individual has any title or interest in at the time of death.

VI. OPTIONS FOR ACTION

Addressing consumer concerns about reverse mortgages and 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.

This chapter presents a wide array of options that hold significant potential to promote the appropriate use of reverse mortgages for long-term care at home. There are five key areas that could serve as a starting point for further policy debate and the development of consensus for future action. The public and private sectors could consider:

1. Examining Medicaid policy and public incentives for reverse mortgages.
2. Strengthening consumer protections for borrowers who use reverse mortgages to pay for in-home services and supports.
3. Increasing awareness and acceptance of reverse mortgages for long-term care.
4. Promoting innovations that reduce the cost of tapping home equity while providing strong value over time.
5. Additional research on ways to increase the use of home equity for long-term care.

These options flow from the study's research, strategy sessions, and informal conversations with members of the Expert Panel. They also reflect many of the regulatory and legislative concerns raised as part of evaluations of the HECM program.

1. EXAMINE MEDICAID POLICY AND PUBLIC INCENTIVES

Some policymakers feel that the best hope to reform our nation's long-term care financing system is to encourage greater personal responsibility. This is not likely to happen soon, however, if liquidating housing wealth does not make financial sense to older homeowners and their families. For many Americans, the equity they have built up in their house is their only financial safety net. With so much at stake, seniors need additional support from government to leverage their home for long-term care.

Government could make it more attractive for consumers to voluntarily "use their homes to stay at home" by creating the right mix of incentive programs. In addition, a key challenge for policymakers will be to find appropriate ways to ensure that impaired borrowers who benefit from pubic incentives for reverse mortgages use these funds to pay for in-home services and supports. There will also be a need to reduce regulatory barriers.

1A. CLARIFY THE PRIORTY OF LIENS UNDER MEDICAID

Since reverse mortgages must be in first lien position, state use of Medicaid liens could be a deterrent to promoting home equity to pay for long-term care. Fannie Mae requires that any outstanding liens against the property must be paid in full at the loan closing. Borrowers who

take out a reverse mortgage prior to applying for Medicaid are unlikely to face any problems since the reverse mortgage lien would have priority over any lien filed at a later date. If a state places a lien on a home when one spouse goes on Medicaid, the community spouse will not be eligible to apply for a reverse mortgage.

As states get more aggressive with estate recovery, they are more likely to use liens and impose them sooner. Clarification of Medicaid rules to ensure that Medicaid liens will be released if the surviving spouse wants to sell or refinance the property, or obtain a reverse mortgage, would help remove impediments to using home equity for long-term care among surviving spouses.

1B. EASE THE USE OF LOAN PAYMENTS FOR MEDICAID RECIPIENTS

Homeowners with limited resources may be reluctant to take out a reverse mortgage for fear that these funds could limit their access to Medicaid and other means-tested programs. A loan advance cannot affect Medicaid eligibility as long as the funds are spent in the calendar month in which they are received. But if assets at the end of any month exceed the Medicaid limit, eligibility for this public program may be lost. Allowing states more flexibility in the treatment of loan payments could allay consumer concerns.

Borrowers may also face impediments in accessing Medicaid, depending on the loan disbursement method they select. If borrowers elect the annuity option and receive regular monthly payments from their loan, these funds may be regarded as income in some states and can limit Medicaid eligibility. It will be important for states to ensure that these payments are treated as proceeds from a loan and not as income for the purpose of determining eligibility and benefits under means-tested programs.

1C. ENABLE MEDICAID BENEFICIARIES TO USE FUNDS FROM A REVERSE MORTGAGE TO PURCHASE NON-COVERED HOME AND COMMUNITY-BASED SERVICES

For seniors qualifying for nursing home services covered by Medicaid, states have developed waiver programs that pay for services provided in a person's home and community (HCBS 1915(c) waivers). However, there are limitations to these waiver programs that can make it difficult for beneficiaries who have limited financial resources to continue to live at home. One important exclusion is that federal Medicaid dollars are not available to pay for "room and board" expenses such as the costs associated with maintaining a home, food, and utilities.

In addition to not paying for housing costs, HCBS waiver programs often do not cover all needed services. Private funds from a reverse mortgage could be used to purchase a wider variety of services than public funds, which pay for only a limited set of authorized services. States could be encouraged to incentivize Medicaid beneficiaries to use reverse mortgages to pay for home modifications and other services that the recipient's state Medicaid program does not cover. These resources could also make it easier to pay for transition costs and other services that Medicaid nursing home residents need if they want to move back to their home.

1D. DEVELOP MEDICAID BUY-IN PROGRAMS WITH HOME EQUITY

The Department of Health and Human Services (HHS) could allow states to experiment with programs that encourage impaired, older homeowners to leverage their financial resources by allowing them to buy-into the Medicaid program using home equity.

As private-pay clients, reverse mortgage borrowers could access a whole continuum of supportive service options, such as fiscal intermediaries, geriatric care managers, and managed care long-term care programs that can help delay institutionalization. States could make it easier for reverse mortgage borrowers with modest incomes to access public programs that offer these services before they become financially eligible for Medicaid. This could be achieved through buy-in programs that allowing impaired elders to use these loans to pay for some or all of the cost of the services they need to manage their care and continue to live at home.

The following community service programs are primarily funded by Medicaid but could be expanded to include private pay reverse mortgage borrowers:

- Consumer-directed care models (Cash and Counseling): Cash and Counseling programs offer consumer-directed supportive services, where participants can hire their choice of workers and purchase other goods and services. These programs offer a fiscal intermediary service to help clients make decisions about discretionary use of funds.
- Medicaid waiver programs such as the New York Long Term Home Health Care Programs (also known as "Nursing Homes without Walls"): As an alternative to facility care, these innovative programs allow severely impaired elders who qualify for nursing home care to live independently by providing a wide array of services at home. These services can include nursing care, rehabilitative therapies, nutritional planning, housekeeping, and help with home modifications.
- Managed long-term care programs: CMS has developed the Social HMO program and Program of All-Inclusive Care for the Elderly (PACE) that offer acute and long-term care for seniors who need the nursing home level of care. For most participants, the comprehensive service package permits them to continue living at home rather than be institutionalized.

Greater coordination between public and private funding through reverse mortgages could help provide additional funds for these programs and foster a more seamless financing system for aging in place.

1E. ENABLE STATES TO TARGET OLDER HOMEOWNERS AT RISK FOR MEDICAID

Due to their limited non-housing financial resources, most seniors become eligible for Medicaid when they need substantial long-term care services. States, working with the federal government, could develop incentives to use home equity to pay for earlier interventions that support aging in place and reduce the risk of institutionalization. To achieve this goal, Medicaid rules need to allow more flexibility for incremental expansions in eligibility. With more flexible standards, reverse mortgages could be a valuable tool to keep homeowners with modest incomes from deteriorating to the point where they qualify for Medicaid nursing home care.

Under our current long-term care financing system, seniors with limited financial resources struggle to stay home. Medicaid can only help these elders when they reach a crisis point and qualify for government-subsidized care. One option for states would be to target Medicaid beneficiaries who are ineligible to qualify for in-home services under a waiver program because they have not yet met the criteria for admission to a nursing home. Funds from a reverse

mortgage would allow seniors to pay for chore services and transportation, or make home modifications, at a time when these interventions are likely to be most effective.

Another option would be to leverage state-funded, community-based programs that provide in-home services for seniors who do not qualify for means-tested programs. States could target a portion of these state funds to pay some or all of the upfront costs of reverse mortgages for impaired homeowners who are at risk of needing Medicaid.

1F. DEVELOP A PUBLIC-PRIVATE PARTNERSHIP PROGRAM FOR REVERSE MORTGAGES

An important incentive would be to allow elders who use reverse mortgages to pay for in-home services to protect a specified amount of assets from any Medicaid estate recovery. Under this type of public/private partnership, borrowers who use a certain portion of the equity in their homes to pay for long-term care could receive more favorable treatment under Medicaid's asset or resource rules than other beneficiaries.

Four states—California, Connecticut, Indiana and New York—already use this approach to promote the purchase of long-term care insurance through the LTC Private/Public Partnership programs. In addition, Massachusetts waives the estate recovery requirement for people who purchase a qualified long-term care insurance policy. These programs can offer many insights to guide the use of partnerships to promote reverse mortgages. Insurance companies who participate in these Partnership programs like the concept because it offers a significant incentive to buy private coverage. The government "seal of approval" for Partnership policies also has helped make long-term care insurance a mainstream product. A reverse mortgage partnership program could be developed as an independent demonstration program, or by expanding existing Partnership programs.

1G. EXPLORE WAYS TO USE REVERSE MORTGAGES AS AN ALTERNATIVE TO ESTATE RECOVERY

Estate recovery programs are one of the main methods used by states to offset public spending. This approach has been unpopular and problematic, and many states recover only a small proportion of the funds they spend for long-term care. Incentivizing the use of reverse mortgages can support an alternate "pay as you go" model for Medicaid financing. This approach could rapidly add more private funds into the long-term care system and help reduce the need to recover payments from the estates of deceased Medicaid beneficiaries.

It will take considerable experimentation at the state and local levels to develop an alternative to estate recovery. Support from CMS and private foundations would encourage states to study the feasibility of this concept. As part of this effort, industry, government agencies, and private organizations need to work together to help stakeholders assess different strategies for incorporating home equity into the long-term care financing system.

Using public dollars to subsidize upfront loan costs would be a significant departure from current Medicaid long-term care practice and policy. Mandatory Medicaid state plans only are authorized to pay for direct services. A similar approach has been taken by states for optional plan services and waiver programs. Congress would have to change provisions in the Social Security Act to expand these payments to include reverse mortgage costs. HUD could provide another avenue for the federal government to reduce loan costs. The HECM program may

already waive upfront mortgage insurance premiums for the purchase of long-term care insurance.

HHS could fund a demonstration program to have a few states identify the most effective structure for using reverse mortgages as an alternative to estate recovery. Alternatively, HUD could develop a limited demonstration program to test the use of specialized HECM loans for people with disabilities. States could combine such a specialized HECM product with a variety of other incentives to promote the use of home equity as a way to reduce Medicaid spending and enable impaired borrowers to continue to live at home with dignity.

2. STRENGTHEN CONSUMER PROTECTIONS

Deciding to take out a reverse mortgage is a complex financial decision that has significant legal and financial implications for borrowers and their families. Lenders and counselors emphasize that reverse mortgages are not appropriate for all older homeowners. Consumers who are thinking about using housing wealth to finance in-home services and supports need additional information to understand their risks and options. It also be important to help impaired seniors determine whether they can realistically continue to stay at home before they incur the expenses of taking out a reverse mortgage.

With greater awareness comes a need for greater protections against the risk of predatory lending, fraud, and abuse. Older homeowners would benefit from easy access to knowledgeable advocates who can help them deal with growing pressure from unscrupulous care providers, insurance agents, home repairmen, and others who want seniors to use a reverse mortgage to pay for their services.

2A. INCLUDE LONG-TERM CARE AS PART OF COUNSELING ON REVERSE MORTGAGES

To maximize the benefit of reverse mortgages, seniors need effective tools to help them make sound decisions so they can live at home for as long as possible. To deal with the high cost of long-term care, some component of long-term care should be included in the counseling required for reverse mortgages. The type of information that counselors should provide will vary depending on the needs of the borrower. Most reverse mortgage borrowers do not need long-term care. Fact sheets and brochures may be appropriate for borrowers who do not have any immediate need for these services. More lengthy counseling will be important for impaired borrowers and those who intend to participate in a government-sponsored incentive program. In developing these materials, it will be important to consider the special needs of seniors with disabilities and those who have limited financial expertise.

Additional training on long-term care services and insurance could be required for HUD counselors. AARP could play a key role in developing training materials and educating borrowers about potential uses of home equity for in-home services and supports, as well as alternatives, through its national network of HUD-approved reverse mortgage counselors. It also will be important to encourage other organizations that advise seniors on long-term care to become HUD-approved counselors for reverse mortgages. To achieve these goals, HUD may need to seek additional training funds from Congress for HECM counselors.

The Ana can help inform seniors and their families about reverse mortgages through the aging network. Counselors who participate in the National Family Caregiver Support Program can be a trusted source of advice to inform adult children who care for elderly homeowners about this new financing tool. In addition, Aging and Disability Resource Centers could play an important role in educating seniors about private sector financing options such as reverse mortgages.

2B. DEVELOP STANDARDS TO APPROPRIATELY MARKET REVERSE MORTGAGES FOR LONG-TERM CARE

The current view in the reverse mortgage industry is that every borrower's situation is unique and counseling is the key to appropriate decision-making. Fannie Mae advises lenders not to make recommendations on how borrowers might use these funds. To address the special challenges of living at home with a disability, however, may require additional criteria to determine whether a reverse mortgage is appropriate for borrowers who need long-term care. These standards may be particularly important for impaired borrowers who receive government incentives for reverse mortgages.

While reverse mortgages can unlock substantial amounts of home equity, this product may not be a good choice for elders who have few other resources and need paid assistance to continue to live at home. For these elders, selling the house may be a better option. Severely impaired elders with very limited resources also are likely to obtain long-term services through Medicaid without first tapping into their home equity. To help borrowers make informed choices, one approach would be to develop and use standards outlining the appropriateness of this financing option for borrowers who rely on in-home services and supports to live at home. These standards could define basic borrower characteristics (age, income, level of impairment, ability to live at home, etc.) to help lenders and consumers make determinations with regard to the special needs of borrowers with disabilities. These standards could be formulated in collaboration with the National Association of Insurance Commissioners (NAIC), which has developed such standards for long-term care insurance.

Issues of appropriateness would also need to be addressed with the implementation of provisions under Section 201(c) of the American Homeownership and Economic Opportunity Act of 2000, which authorized HUD to waive the upfront mortgage insurance premium for borrowers who use all the proceeds of a HECM to purchase a tax-qualified long-term care insurance policy. States typically require that long-term care insurance agents give the proposed insured a buyer's guide at the time of application. In addition, the Personal Worksheet must be completed by the long-term care insurance applicant and submitted along with the application. Similar materials could help borrowers who are considering a reverse mortgage to pay directly for in-home services and supports.

2C. STRENGTHEN ADVOCACY UNDER THE OLDER AMERICANS ACT FOR REVERSE MORTGAGE BORROWERS

Title VII of the Older Americans Act, the Vulnerable Elder Rights Protection Program, provides advocacy on behalf of vulnerable older people who are unable to advocate for themselves due to physical or mental disabilities, social isolation, limited educational attainment, or limited financial resources. Title VII includes two advocacy programs (Programs for the Prevention of Abuse and Exploitation and State Legal Assistance Development Programs) that can offer

important protections to reverse mortgage borrowers who are likely to be at high risk of financial exploitation.

The AoA could encourage and support the National Center on Elder Abuse to promote public education, both to professionals serving seniors and to reverse mortgage borrowers to help them avoid being victimized or exploited. As part of this effort, educational materials on reverse mortgages could be made available through the Clearinghouse on Abuse and Neglect of the Elderly. Additional funds will need to be allocated through the Older Americans Act to support these efforts.

2D. REINFORCE EFFORTS TO PROTECT SENIOR HOMEOWNERS FROM ABUSIVE LENDING AND OTHER EXPLOITIVE PRACTICES

The substantial amounts of equity that seniors have in their home can be a target for abusive lending practices. While efforts have been made to address such problems within the HECM program, FHA needs to do more to ensure that the home equity of impaired elders remains safe and secure. The FHA should strengthen and enforce laws to preclude further participation by offending lenders in the HECM program.

The Neighborhood Reinvestment Corporation could be encouraged to continue providing financial literacy classes, including information on reverse mortgages, to seniors through its regional NeighborWorks organizations. In addition, the Certified Aging-In-Place Specialist (CAPS) program could be promoted as a way to help consumers age in place. CAPS professionals include remodelers, general contractors, designers, architects, and health care consultants who have been specially trained to help elders with home modifications and remodeling projects that promote aging in place. The CAPS program was developed by the National Association of Home Builders in collaboration with AARP.

2E. HELP BORROWERS AVOID FORECLOSURE

HECM borrowers must keep their house in good repair, pay property taxes, and keep their hazard insurance current. If they fail to do so, then lenders have the right to foreclose on the loan. Fannie Mae and HUD are reluctant to enforce their right to take the home from these borrowers and have instituted procedures to help elders meet their obligations. However, lenders are becoming concerned as a small but increasing number of borrowers fail to pay property taxes and insurance, or maintain the property.

As reverse mortgages foster greater collaboration between the housing and aging communities, there may be opportunities to provide additional supports for borrowers who have limited resources and live in homes that they are unable to maintain.

2E1. Provide easy access to the Section 504 Rural Home Repair Loan and Grant program for reverse mortgage borrowers

The USDA should coordinate with HUD and HHS to ensure that impaired reverse mortgage borrowers who live in rural areas can access the Section 504 Rural Home Repair Loan and Grant Program. This program is available to homeowners who are at least age 62 and have very-low incomes (as defined by USDA Rural Development). Seniors may use grant funds to repair, improve, or modernize their dwellings, including making the home safe and accessible to people with disabilities. Homeowners can get a loan of up to $20,000 at a 1 percent interest rate or

receive a home improvement grant of up to $7,500. Section 504 grants could be an important source of additional funds to help ensure that rural borrowers do not lose their homes because they cannot make the home safe or pay for needed repairs.

2E2. Clarify the role of state property tax deferral liens on eligibility for reverse mortgages

Deferred property taxes become a lien against the value of the taxpayer's home. If the state recorded a property tax lien against the home, the reverse mortgage lender cannot approve the loan without first paying off the property-tax lien or assuring that the state takes a second lien position.

As an incentive to get older homeowners to use a reverse mortgage to pay for long-term care, the state could change its regulations to ensure that its property tax deferral program takes a second lien position for homeowners who use their reverse mortgage for in-home services and supports. Under these conditions, there is a risk that tax deferral programs could produce a loss of local revenue in cases where the value of the reverse mortgage loan exceeds the value of the home. States could take the additional step of reimbursing local governments for the deferred property taxes that would be owed by these borrowers.

3. INCREASE CONSUMER AWARENESS AND ACCEPTANCE

Education will be critical to accelerate the use of reverse mortgages for long-term care. Many consumers have not heard about reverse mortgages, and fewer are familiar with these loans. Greater consumer awareness of the product would help eliminate the stigma and address misconceptions that discourage homeowners from considering this financing option. Any campaign to raise awareness of reverse mortgages will face the challenge of asking consumers to change deeply held attitudes the house and adopt behaviors that are often seen as risky.

As a starting point, consumers need to understand this financial tool and why it is important as a funding source for long-term care. Consumer outreach also can help older homeowners and their families see reverse mortgages as a more dynamic instrument that can help them utilize rising home appreciation and increase their ability to "age in place." Understanding the potential of reverse mortgages will help seniors consider this product as a mainstream option rather than as a last resort. Special educational programs will need to be developed to target different segments of the older homeowner population, including less financially sophisticated elders.

3A. DEVELOP STATE AND NATIONAL EDUCATIONAL CAMPAIGNS

Federal and state government, in concert with the mortgage industry and nonprofit organizations, could sponsor educational programs through national media, community-based organizations, and the Internet. These campaigns could involve a wide variety of public and voluntary organizations. HHS should include information on reverse mortgages as an integral part of any educational and training programs on long-term care financing. State Medicaid programs could target educational efforts on applicants for home and community-based care services or others who are deemed "at risk" for spending-down and needing public assistance.

There are many resources and ongoing activities that can serve as a foundation for these efforts. Education and training programs on using home equity for long-term care can incorporate

consumer materials on reverse mortgages that are available from AARP, the National Reverse Mortgage Lenders Association, Fannie Mae, and the mortgage industry. These organizations also offer online calculators to help consumers estimate how much money they can obtain through different products and loan payment options. The extensive marketing strategies developed to increase consumer understanding and awareness of long-term care as part of the recent federal education campaign also can help to guide other educational programs on reverse mortgages for long-term care (KPMG Consulting 2001).

3B. ENCOURAGE COMMUNITY GROUPS TO INFORM SENIORS AND THEIR FAMILIES ABOUT REVERSE MORTGAGES

Many seniors are reluctant to discuss their ability to continue to live independently with their adult children (Barrett 2001). Since family involvement is a crucial part of the long-term care education process, the public and private sectors need to work together to raise awareness of reverse mortgages across the population, not just among seniors.

Community-based organizations, churches, and leaders within the community will be important partners to deliver messages about reverse mortgages and long-term care to a broad audience. Though they may be familiar with long-term care, however many of these groups are reluctant to counsel elders on financial issues. Grassroots efforts by aging organizations and the mortgage industry can help community groups learn about reverse mortgages through seminars and educational materials. In 2004, NRMLA designated one week in November as National Aging in Place Week. During this week, consumers around the country are able to talk with experts and get "hands-on" experiences that highlight the potential of reverse mortgages as a financing option for home modifications.

Outreach by state aging departments and local aging networks can help community organizations get information. This could be accomplished through individual efforts or as part of the work of the Aging and Disability Resource Centers. Several states, including California, Indiana, Michigan, Nebraska, New Jersey, New York, North Carolina, Ohio, Rhode Island, Texas, and Washington, already promote reverse mortgages through fact sheets and other materials on their state websites (National Governors Association 2004). The federal government could publicize federal Internet resources s as the Long-Term Care website that can help consumers and clients evaluate the appropriateness of using home equity to pay for long-term care.

3C. EDUCATE SENIOR ADVISORS

Professionals who advise seniors can be an important vehicle to get information to consumers at a time when they are dealing with long-term care planning. Financial advisors are starting to include reverse mortgages in their retirement planning kit. However, many major banks and investment firms still do not offer this product, citing low demand for this specialized loan. Increasing distribution will play a critical role in expanding the market, and financial advisors will need to be educated about this type of mortgage.

Motivating credit unions, financial planners, accountants, tax attorneys, insurance agents, and other senior advisors to promote reverse mortgages will be challenging. The concept of a reverse mortgage is often not seriously considered because it is still too unfamiliar. Financial advisors and estate planners also regard the house as a protected asset under Medicaid. In addition, Section 8(a) of the Real Estate Settlement Procedures Act (RESPA) and HUD's Regulation X prohibit these professionals from being compensated for referring their clients to lenders. HUD

requires its counselors to inform borrowers that financial planning services are unnecessary to obtain a HECM loan, and that any fees charged by these advisors are ineligible for payment from the proceeds of this loan.

3D. FOSTER DIALOGUE BETWEEN PUBLIC AND PRIVATE SECTORS

The development of appropriate products and policies will be driven by the ongoing exchange of ideas between the aging community and the mortgage industry. Messages highlighting the potential of reverse mortgages for long-term care could be targeted to leaders of government agencies, nonprofit organizations, advocacy groups, and businesses that are concerned about preserving the financial security and independence of seniors.

The distinct financing and regulatory structures of the housing and long-term care systems increase the importance of bringing all the stakeholders together in a coordinated effort. Symposia and other meetings of experts can help promote discussion, reinforce the overlaps between these issues, and reveal the potential impact of policy changes on different constituencies. It will also be important to find champions within the various organizations who can serve as "translators" to help everyone understand one another's vocabularies. Greater collaboration can also increase coordination of efforts among individual organizations that are working to raise awareness of reverse mortgages (e.g., CMS Long-Term Care website, Fannie Mae's American Dream Commitment Initiative, the National Reverse Mortgage Lenders Association National Aging in Place Week).

4. REDUCE THE COST OF TAPPING HOME EQUITY

The costs associated with taking out 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. We need to make sure that substantial closing costs do not consume a sizable portion of the funds these elders have to pay for the in-home services and supports. Reducing the loan costs may also be an effective strategy to incentivize middle income elders to "use their home to stay at home" rather than turn to Medicaid estate planning.

4A. LOWER UPFRONT COSTS

Fannie Mae, HUD, and the mortgage industry are currently exploring a range of options to reduce fees and other upfront costs associated with reverse mortgages. One possibility they are considering would incorporate service fees into the interest rate that borrowers are charged on the loan. While this would reduce the apparent cost of the loan, this approach would not increase the amount of funds available to pay for long-term care. The following cost-saving options could have a greater impact on impaired homeowners.

4A1. Waive the upfront mortgage insurance premium for severely impaired borrowers

The mortgage insurance premium is a major part of the upfront costs of a reverse mortgage. FHA insurance was designed to protect borrowers and lenders against the uncertainties that arise when borrowers keep the loan for many years. These risks are likely to be minimal among severely impaired elders who will only be able to remain in their homes for a short time.

Reducing or eliminating mortgage insurance premiums for impaired borrowers must be carefully evaluated to ensure that the FHA fund that insures reverse mortgages continues to be self-supporting. Some policymakers believe that if the HECM program required budgetary subsidies for FHA insurance, it could start a public policy debate over the budgetary priority of mortgage assistance versus other types of housing assistance.

4A2. Change current law on mortgage insurance premium reductions

The American Homeownership and Economic Opportunity Act of 2000 amended Section 255 of the National Housing Act to waive the upfront mortgage insurance premium for a reverse mortgage used to purchase long-term care insurance. While this kind of new government incentive is an important first step, the current language of the law unduly limits consumers' options by requiring participants to use the entire payment exclusively for long-term care insurance.

In order to increase access to reverse mortgages for long-term care, current law must be amended. One option would be to change the current law so that borrowers do not have to use the entire proceeds of the loan for private insurance. These changes would enable consumers to use part of the payments for insurance, leaving some remainder for other purposes. In addition, for borrowers independently assessed to need long-term care (who would be excluded from purchasing insurance due to underwriting), the law could be expanded to enable them to waive the upfront mortgage insurance premium.

Given the difficulty of addressing all the limitations of the current law by further amendments to the National Housing Act, a better approach may be to repeal the changes to Section 255 and have Congress develop more effective legislation for lowering upfront mortgage premiums to promote the use of reverse mortgages for long-term care.

4A3. Encourage states to pay for some or all of reverse mortgage closing costs for impaired borrowers

To help reduce their long-term care expenditures, state Medicaid programs could subsidize mortgage insurance, origination fees, and other closing costs for long-term care beneficiaries. This approach might make this financing option more attractive to seniors with limited resources, including Medicaid beneficiaries who live in the community, and increase the amount of funds available for in-home services and supports. State funds, possibly through state housing finance agencies, could serve as an alternative way to fund these costs, especially for the at-risk population who does not yet qualify for Medicaid.

4A4. Reduce closing costs on loans to impaired borrowers

HUD could place lower limits on origination fees that lenders charge to impaired borrowers. In addition, HUD could reduce servicing fees that lenders charge for these borrowers. This would make HECM loans more affordable for borrowers who are not likely to stay in their home for a long time. A concern of the industry is that lower compensation may make the people who originate and service reverse mortgages more reluctant to deal with a product that is already seen as complex and time consuming.

5. PROMOTE INNOVATION

To encourage the use of reverse mortgages specifically for long-term care, impaired homeowners could benefit from specialized products and features that go beyond the current "one size fits all" HECM program. The market for these loans could also be expanded by creating new loan options that could make it easier and more affordable for borrowers to pay for innovative community care programs.

5A. CREATE REVERSE MORTGAGE PRODUCTS FOR LONG-TERM CARE

Homeowners might be more willing to tap home equity if they were offered innovative reverse mortgages with features that provide higher payouts for people who a terminal illness or a shortened life expectancy. Specific options for consideration could include:

- Medical underwriting: Base loan payments on a rated-up age for impaired borrowers with reduced life expectancy. Payments the borrower receives under this option would be much higher than a conventional reverse mortgage. Currently, FHA uses the 1979-81 US Decennial life table for white females as the source of life expectancy information to calculate the maximum loan size. This is a conservative assumption, since this group is the one with the longest life expectancy.
- "Pay as you go" alternative: Restructure the loan so that costs are spread out over a longer period, rather having them paid upfront. One option would be for HUD to adjust the upfront reserve fund set-aside for servicing fees to reflect the remaining life expectancy of participating homeowners. With a shortened time period, the amount of service fees withheld from the loan would be reduced and the amount available to impaired borrowers would increase proportionately.
- Short-term loans: These could include fixed-term loans with different pricing than conventional reverse mortgages. Lenders could set interest at a fixed rate and waive mortgage insurance for these loans.

HUD could encourage the development of these types of products and features as part of a larger demonstration program that would target specialized HECM loans to impaired senior homeowners.

5B. LINK REVERSE MORTGAGES TO OTHER FINANCIAL PRODUCTS

The financial services industry may be able to find ways to leverage the funds from a reverse mortgage by developing specialized strategies and products, including hybrids, for seniors who want to age in place. Some financial advisors are already suggesting that borrowers with substantial home equity could pay for long-term care insurance premiums entirely from the annual growth in the HECM line of credit. Lenders could also work with the insurance industry to foster the development of single-premium or limited-premium long-term care insurance products for seniors. This type of policy would eliminate the risk that seniors lapse their coverage due to premium increases.

Another strategy would be to add an optional insurance or annuity feature to a reverse mortgage, so that borrowers continue to receive monthly payments even if they sell the home by placing the proceeds from the sale into an annuity (see for example Murtaugh et al. 2001). This option would

be especially valuable to very severely impaired borrowers, by making it easier for them to transition from the home to an assisted living facility.

5C. INCORPORATE REVERSE MORTGAGE FUNDING INTO COMMUNITY CARE MODELS

Financial incentives for reverse mortgages would be strengthened by linking them with efforts to ensure that borrowers use these funds for long-term care, and have access to quality home and community services. One approach could identify ways to use reverse mortgages to help fund a coordinated service delivery network for older homeowners who live in "naturally occurring retirement communities" (NORCs). NORCs arise in areas that become increasingly populated by elderly residents who are "aging in place." While most current NORC services programs target elders who live in apartments, there are efforts underway throughout the country to extend this concept to neighborhoods where high concentrations of elders live in their own homes ("open" NORCs).

Open NORCs may serve as good test sites to develop affordable, private-pay services for senior homeowners with moderate incomes who are at risk of spending-down should they need long-term care ("tweeners"). Finding ways to incorporate funding through reverse mortgages into open NORCs could be enhanced by working with faith-based organizations that are participating in the NORCs Aging in Place demonstration project funded by the Department of Health and Human Services and administered by the Administration on Aging. NORC service programs assist seniors with: on-site assessments, information and referral services, case management, counseling, education/prevention programs, and recreation programs. These programs have also offered other services such as transportation, financial management, and support groups.

6. ADDITIONAL RESEARCH

Any proposed reforms to the long-term care financing system must be carefully evaluated to determine their potential impact on older homeowners and their families. An added challenge will be to identify appropriate target populations and the leverage points where incentives are likely to produce the greatest impact on rebalancing the long-term care system and reducing government costs. As part of this effort, more rigorous research is needed to develop reliable estimates of the magnitude of the potential reverse mortgage market in different parts of the country.

To develop appropriate incentives, it will be important to increase our understanding of the reasons why elderly households are reluctant to liquidate housing equity. More research will help identify evolving consumer perceptions of the reverse mortgage product, its price, and the effectiveness of promotional messages. Such information enables policymakers and the industry to develop strategic plans to appropriately shape these marketing elements. Since this will be a "learn as we go" process, it will be important to monitor and evaluate the market over time in order to modify ineffective strategies and keep up with changing consumer expectations.

6A. LEARN MORE ABOUT BORROWERS AND NON-BORROWERS

Our knowledge of homeowners who elect to take out a reverse mortgage is fragmentary. Much of the data come from scattered sources including loan application forms, lender records, focus groups, and anecdotal reports from HECM counselors. A national survey of reverse mortgage

borrowers and non-borrowers would be important to increase understanding of what drives prospective borrowers and to provide baseline data to monitor market trends.

6B. EVALUATE THE POTENTIAL OF REVERSE MORTGAGES IN EACH STATE

It is unlikely that a single, national financial incentive program will emerge quickly. To accelerate the process, each state could conduct an analysis of the potential market for using reverse mortgages among its citizens. There are significant differences in home equity by region and other local demographic characteristics. This research also would be critical to evaluate the appropriate role of incentives, since Medicaid regulations and the long-term care market varies significantly across states.

6C. ASSESS THE UNIQUE NEEDS OF RURAL AND MINORITY HOMEOWNERS

Data from the American Housing Survey indicate that minority and low-income homeowners typically have lower home equity and are less likely to take advantage of refinance opportunities (Northaft and Yan 2004). These groups may need special incentives and supports to be able to fully take advantage of a program that encourages the use of reverse mortgages for long-term care.

Seniors with disabilities who live in rural areas face many challenges. Non-metropolitan elders more often assess their health as fair or poor than the metropolitan elderly (Coburn & Bolda, 1999). There are many barriers to accessing in-home services and supports in rural areas, including fewer types of services, the need to travel long distances to get services, and a lower level of service awareness among elders (National Rural Health Association 2001). One innovative strategy is to bring PACE programs into rural communities (PACE and NRHA 2003). Additional research can assess the benefits and limitations of using home equity to support aging in place for rural elders. These studies could also examine the appropriate role of reverse mortgages in supporting the expansion of the PACE model into rural areas.

6D. UPDATE INFORMATION ON MEDICAID ESTATE PLANNING PREVALENCE AND PRACTICES

Many believe that one of the biggest impediments to reverse mortgages is the practice of sheltering home equity through Medicaid estate planning. Research was conducted in the mid-1990s to examine the prevalence of these practices, in response to the passage of OBRA 93. This early research found that the incidence of asset transfer is low (Short et al. 1992, Sloan and Shaye 1993, Wiener 1996). More recent studies suggest that changes in policy and behavior may be increasing the transfer of assets (Basset 2004).

This topic needs to be revisited to determine the impact of rising household wealth among elders, growing numbers of elderly couples and increased longevity of men, and the development of the reverse mortgage market. Research questions that could be of interest to policymakers include the prevalence of this practice, changes in consumer motivation including the role of adult children, and the types of strategies financial planners may use to artificially impoverish their clients. Another objective of this research could be to track what happens to home equity of Medicaid beneficiaries—among both singles and couples—between their initial date of eligibility and two to three years later. Researchers could also develop better estimates of the potential for Medicaid cost recovery through policies that incorporate home equity.

6E. EVALUATE THE ROLE OF REVERSE MORTGAGES TO HELP MEDICAID NURSING HOME BENEFICIARIES TRANSITION INTO THE COMMUNITY

One of the objectives of the New Freedom Initiative is to reduce institutional bias by helping Medicaid beneficiaries transition from the nursing home to the community, if this is their wish. Since the Health and Retirement Study focuses on community dwelling elders, this analysis did not examine the potential of using reverse mortgages to help Medicaid beneficiaries in nursing homes who want to transition back to the community. Reverse mortgages can pay transition expenses and cover care management costs that facilitate a move from the institution to community living. Borrowers could also pay for home modifications and assistive technology that they need for successful aging in place.

Little research has been done to determine the appropriate use of reverse mortgages for these very severely impaired elders and how to best provide an incentive to tap home equity. Specific research questions could include the number of homeowners among Medicaid nursing home residents, the characteristics of this population, and the potential size of loan payments.

PART VII: CONCLUSIONS

The possibility of using home equity to improve the lives of older Americans has attracted the attention of economists and housing experts for many years. Within the debate on long-term care financing, however, this financial resource has largely been ignored. The findings of this study suggest that this policy perspective may need to change.

Home ownership is an important goal in American society that has influenced public policy for many years. As a result, home equity now represents a substantial proportion of the net worth of today's seniors. Well-intentioned efforts to protect the home, however, may also have unintended consequences as Americans live longer and face a greater chance of needing long-term care. Social norms and public policy that discourage appropriate liquidation of home equity can increase the risk that seniors will not have enough money to maintain their independence or the home they cherish.

Demand for in-home services and support is growing in our rapidly aging society, placing an increasing burden on state Medicaid programs. 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. The results of this study suggest that greater use of home equity could open new avenues for public and private resources to complement one another and meet the needs of impaired seniors who live at home. Several major themes emerge from this analysis:

- Encouraging greater use of home equity could have a widespread impact. Of the nearly 28 million American households age 62 and older, almost half (48 percent), or about 13.2 million, are candidates to use a reverse mortgage for long-term care.
- Homeowners are already considering long-term care needs when they make decisions about liquidating their housing wealth. Innovative policies and products that strengthen the "house as insurance" strategy could make it more attractive for consumers to voluntarily "use their homes to stay at home."
- Reverse mortgages could enhance government efforts to rebalance our country's long-term care system toward increased community-based services. Additional cash from these loans supports family caregiving and enables impaired elders to select the services they prefer. Long-term care financing strategies that offer greater flexibility should appeal to more older Americans and can encourage greater personal responsibility.
- Many 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. Government incentives for reverse mortgages may encourage impaired seniors to access home equity sooner and reduce the need to recoup public payments for long-term care 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.

Reverse mortgages have a number of positive features for impaired, older homeowners. By using a reverse mortgage to liquidate a portion of their housing wealth for long-term care, 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.

Despite the promise of this financing option, the funds that could be tapped to pay for in-home services and supports through home equity are limited. As a consequence, increasing the use of reverse mortgages by itself will not solve our nation's long-term care financing problems. However, government can help leverage limited housing assets by creating the right mix of incentives as part of a public-private approach to funding services for "aging in place." This will be especially important for homeowners who have sufficient resources to live in the community, but not enough to cover substantial long-term care expenses. Reverse mortgages also could have greater success if policymakers can reduce homeowners' fears of impoverishment if they use housing wealth to pay for long-term care. Some type of "insurance" mechanism will be important to protect borrowers against catastrophic long-term care costs. This can be achieved through private products that link to reverse mortgages or in partnership with Medicaid. It will also be important to substantially lower upfront costs for reverse mortgages in order to make this financing option more cost effective for impaired seniors.

Given the financial challenges facing today's older Americans, it will be important that any new policy on reverse mortgages includes additional consumer education and decision support, as well as strong consumer protections. Care must be taken to ensure that incentives are targeted appropriately and that consumers have the information they need to make informed choices on how to use their most valuable financial asset. Encouraging greater use of home equity to promote aging in place raises many issues that policymakers will need to consider as they evaluate the potential for further action with this financing option.

Reverse mortgages are being increasingly seen as an intriguing option that could have a greater role in the long-term care financing debate. While the focus of this report has been on government efforts, it is clear that the financial services industry, along with nonprofit organizations, also can play important roles. It will be important that the public and private sectors work together to build alliances that can overcome barriers and enhance the value of this product for older households. 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.

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David S. Carey
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National Committee to Save Social Security and Medicare

Yung-Ping (Bing) Chen
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