Research Department
Federal Reserve
Bank of
San Francisco

April 28, 1978

FRBSF Weekly Letter

# Mortgage for the Elderly

American homeowners, especially elderly homeowners, have become increasingly aroused over the paradoxical situation they face — beset by escalating property taxes and home costs, yet unable to realize the increased equity value of their homes while still living in them. Their hopes may be raised, however, by a recent little-publicized ruling of California's regulatory authorities, authorizing state-chartered savings-and-loan associations to offer reverse-annuity mortgages. California S&L's are well-known for their innovative spirit, so any experience they may gain with this new mortgage instrument will be carefully watched at the national level.

The reverse-annuity mortgage, if administered with proper safeguards, has great potential for alleviating economic and psychological strains on older homeowners. By allowing the borrower to draw upon the increased equity value in his or her home in the form of an annuity, this mortgage instrument provides a supplemental source of income which could prolong home residency. Availability of this type of financing also could help control welfare costs by reducing the need for special subsidies to the elderly. But at the same time, a significant lengthening in the duration of home occupancy by the older age group would reduce the stock of single-family housing available for younger home-seekers, and could thus stimulate even heavier demand pressure for this currently most popular form of housing.

The numbers involved suggest a large potential market nationwide for reverse-annuity mortgages. In 1976, there were 10.5 million homeowners in the 65-and-over age bracket (see chart). Homeowners accounted for 71 percent of all households in this age bracket — only slightly below the 75-percent homeownership share in the 35–64 age group.

**How it works**

The California Savings and Loan Department, by a regulatory order effective February 10, 1978, permitted state-licensed savings-and-loan associations to experiment over a four-year period with certain mortgage instruments — including the reverse-annuity loan — as alternatives to the conventional fixed-rate mortgage. The reverse-annuity mortgage would be *unamortized* and would be payable in full only upon the borrower's death or sale of the property. In the case of joint borrowers, the loan would be payable upon the death of the last surviving borrower. Incidentally, the amount of the loan could not exceed 95 percent of the property's market value.

Under the loan agreement, the borrower receives payments from an annuity which the *lender* purchases from

(continued on page 2)

Research Department
Federal Reserve
Bank of
San Francisco

Opinions expressed in this newsletter do not necessarily reflect the views of the management of the Federal Reserve Bank of San Francisco, nor of the Board of Governors of the Federal Reserve System.

a life insurance company. These annuity payments are net of the loan-interest payments, which the insurance company deducts and pays directly to the lender. The annuity may be for a specified term or for life. However, the payments may be deferred for a specified number of years, although the lender may make some loan advances to the borrower during that deferred period.

The reverse-annuity mortgage is designed for the homeowner who has a substantial equity in his home or has paid off any prior mortgage. For homeowners selecting a life annuity, the older borrower has an advantage over the younger homeowner of higher monthly payments because of actuarial considerations. But an agreement of this type could be confusing for elderly borrowers, so the new regulations require the lender to provide the borrower with complete information regarding the gross and net annuity to be received and the amount of debt to be collected at death or on the prior sale of the property. Where the debt rises over time, the lender must also provide a complete monthly-debt schedule. In addition, each lender offering alternative mortgage instruments must make descriptive pamphlets, approved by the S&L Commissioner, available to prospective borrowers.

**Advantages**

In many areas of the nation, particularly in California, property values have skyrocketed in recent years—and property taxes have skyrocketed with them. Many elderly homeowners, living on relatively fixed incomes, have been hard-pressed to meet rising property taxes and home-maintenance costs, despite (in many cases) several-fold increases in the market value of their homes. For these individuals, the reverse-annuity mortgage would provide a supplemental source of income to meet their higher costs. With these supplemental payments, they could continue to live in their present homes and would not have to relocate elsewhere. Aside from economic benefits, this type of financing would avoid the psychological traumas involved when older people are uprooted from their accustomed environment and friends.

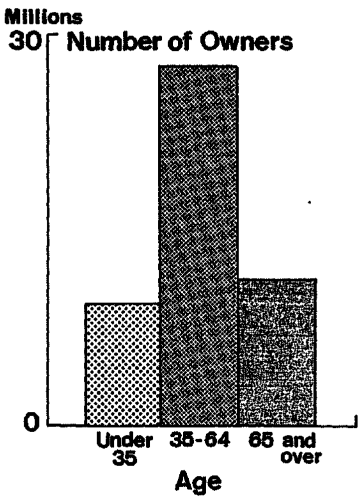
Availability of reverse-annuity mortgages might also be advantageous for taxpayers generally. The provision of annuity-loan income to senior citizens and the avoidance of the problems associated with forced home sales could reduce welfare costs for the elderly. (There is a cloudy legal issue, however, as to whether loan-annuity payments would affect a borrower's eligibility for Medicaid or Supplemental Security Income.) This type of mortgage instrument also could obviate the need for some special legislative programs, such as California's current provision for delayed real-estate tax payments for certain older homeowners.

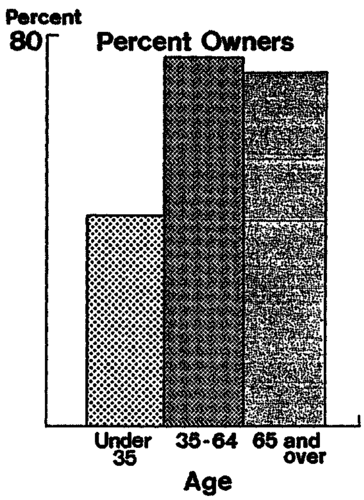
**Other implications**

Escalating property taxes and maintenance costs have made home-ownership uneconomic for many older persons, and thus have helped to free up a growing proportion of the housing stock for younger home-seekers. But the reverse annuity, by lengthening the period of home occupancy for the older age group, could significantly reduce the housing stock available to other age groups. In some areas, single-family houses are already in short supply, with strong demand pressures contributing significantly to the rapid rise in home prices. In California, with its 1.8 million residents in the 65-and-over age group, widespread availability of reverse-annuity mortgages could place further pressure on available housing, to the disadvantage of younger residents and in-migrants seeking housing.

All of these considerations may be academic at the present time, as none of the California state-chartered associations have yet implemented the authority to offer reverse-annuity mortgages. Because of the innovative nature of this instrument, however, substantial lead-time for implementation can be expected. Moreover, the current mortgage environment may also suggest caution. Savings-and-loan associations are presently faced with reduced savings inflow at a time of record mortgage commitments. Until forward commitments are brought into better balance with primary sources of funds, S&L's are not likely to begin an experiment with a new loan instrument that will open up a whole new dimension in mortgage demand.

**Ruth Wilson**



Research Department
Federal Reserve
Bank of
San Francisco
Alaska • Arizona • California • Hawaii
Idaho • Nevada • Oregon • Utah • Washington



## BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

| Selected Assets and Liabilities Large Commercial Banks | Amount Outstanding 4/12/78 | Change from 4/5/78 | Change from year ago Dollar | Percent |
|---|---|---|---|---|
| Loans (gross, adjusted) and investments* | 109,714 | 274 | 12,019 | 12.30 |
| Loans (gross, adjusted)—total | 86,525 | − 322 | 12,684 | 17.18 |
| Security loans | 2,137 | − 539 | − 682 | − 24.19 |
| Commercial and industrial | 26,610 | 214 | 3,026 | 12.83 |
| Real estate | 29,127 | 156 | 6,506 | 28.76 |
| Consumer instalment | 15,278 | 42 | 2,794 | 22.38 |
| U.S. Treasury securities | 8,364 | 268 | − 2,130 | − 20.30 |
| Other securities | 14,825 | 328 | 1,465 | 10.97 |
| Deposits (less cash items)—total* | 106,729 | − 910 | 10,509 | 10.92 |
| Demand deposits (adjusted) | 30,775 | 132 | 2,127 | 7.42 |
| U.S. Government deposits | 358 | − 239 | 58 | 19.33 |
| Time deposits—total* | 73,869 | − 522 | 8,212 | 12.51 |
| States and political subdivisions | 6,455 | 100 | 1,135 | 21.33 |
| Savings deposits | 31,800 | − 266 | − 301 | − 0.94 |
| Other time deposits‡ | 33,167 | − 190 | 7,107 | 27.27 |
| Large negotiable CD's | 14,840 | − 327 | 5,336 | 56.14 |

| Weekly Averages of Daily Figures | Week ended 4/12/78 | Week ended 4/5/78 | Comparable year-ago period |
|---|---|---|---|
| **Member Bank Reserve Position** | | | |
| Excess Reserves(+)/Deficiency (−) | − 57 | + 103 | + 17 |
| Borrowings | 16 | 15 | 0 |
| Net free(+)/Net borrowed (−) | − 73 | + 87 | + 17 |
| **Federal Funds—Seven Large Banks** | | | |
| Interbank Federal fund transactions | | | |
| Net purchases (+)/Net sales(−) | + 1,951 | + 332 | + 1,468 |
| Transactions with U.S. security dealers | | | |
| Net loans (+)/Net borrowings (−) | + 111 | + 467 | + 1105 |

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

**Editorial comments may be addressed to the editor (William Burke) or to the author. . . .**
**Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.**