Reverse Mortgage Design

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ABSTRACT

We study the role of housing wealth for the financing of retirement consumption, focusing on the design of the financial products that allow households to tap into their home equity. Our model results show that bequest and precautionary savings motives have difficulty generating the high homeownership rates late in life observed in U.S. data. In an attempt to match the data we consider two model features: (i) retirees value property maintenance less than potential buyers of the property; (ii) for psychological reasons, retirees derive utility from remaining in the same house. We show that for these retirees reverse mortgages can be beneficial, but the insurance provided by the government agency can induce excessive moral hazard from borrowers and lenders. We use our model to evaluate different mechanisms for limiting moral hazard, and at the same time designing the loans in a way that they can be beneficial to retirees.


Keywords: Household finance, reverse mortgages, retirement, housing wealth.

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