The mobilization of the residential assets of senior citizens for participating in funding of expenses owing to old age.

Use of mortgage loans for life

This note is in continuation of the study on the implementation of the PVH (Mortgage Loan for Life) conducted in 2004. From this date on, French laws were adapted so as to enable the introduction of the "mortgage loan for life" and an initial offer appeared in the market in June 2007.

Though in the United Kingdom, which was then the leading global market (in proportion to the number of inhabitants), a stagnation can be observed, on the contrary, the number of reverse mortgages sold in the United States, though modest in scope, has been progressing tremendously since the annual production of HECM (Home Equity Conversion Mortgage) has been multiplied threefold, from 30,000 to more than 100,000 in just a three years span. HECM is the product guaranteed by the public authorities; it represents around 90% of the reverse mortgages.

Graph 1: Issue of reverse mortgages in the USA (in thousands of loans per month)

1) Old age funding requirements

The Gisserot report puts at 1% the annual average growth rate of the number of dependent senior citizens by 2040. This growth would witness two accelerations, corresponding to the baby-booms which followed both the world wars, between 2005 and 2020 then between 2030 and 2040. As per the retained scenario, the number of dependent senior citizens would touch the 1.2 to 1.3 million mark by 2040.

1 Cf. Joint report by the General Inspection of finances (N. Jachiet), the General Highways Council (J. Friggit) and the National Agency for information on housing (B. Vorms) and C. Taffin on mortgage loan for life and mobilization of the residential assets of senior citizens
2 “Financial perspectives of the dependency of senior citizens by 2025: forecasts and choice margins”, report to Mr. Philippe Bas, Minister for social security, senior citizens, the handicapped and family affairs.
These projections are subject to caution: interrogations are less on the increase in the number of senior citizens or even those who are very very old than on the prevalence of dependency: the epidemiology of dementia, in particular, constitutes a considerable amount of uncertainty.

Table 2: number of dependent senior citizens

![Graph showing number of dependent senior citizens over time]

Source: DREES

The scenario retained by the public authorities within the framework of the Old Age Solidarity Scheme provides in particular for the promotion of home care which implies increased expenditures on staff. The latter are therefore at the core of the expected additional costs (they make up 85% of the costs).

2/ The type of expenditures linked to dependency and their funding

Dependency related expenditures are of two different types:
- works on adaptation of housing, specific expenses taken charge of partially by ANAH (National Housing Agency),
- services to individuals, recurring expenses increasing with the degree of dependency, or housing in an institution; the expectation of people and community interest combine together for favouring maintenance at home.

ANAH funds 70% of the works related to accessibility and adaptation of houses and buildings up to a limit of 8,000 € for owner-occupants whose resources are lesser than the upper limits said to be grossed up (for example 21,022 € of reference fiscal revenue in Ile-de-France and 16,795 € in the provinces for a single person).

The funding circuits for dependency, services to individuals or housing in institutions, are complex in nature. Health insurance accounts for more than 60% of the total of the
expenses, which is a clear pointer to the fact that efforts at clarifying the boundaries between health insurance and dependency are necessary in order to bring out what is known as the "fifth pillar" of social protection.

Over and above health insurance, funding of dependency comes from three types of sources: - public finances, in the shape of APA/Personalized Allowance for Autonomy and CNSA/national solidarity fund for autonomy on the one hand, and on the other hand from tax aids, - private insurance, - the concerned households (remaining on charge).

Public contribution is characterized by the low level of its redistributive character and coherence. High income group households can benefit from considerable tax aids, higher than the APA, whereas intermediate income groups are penalized by the hike in the deterrent fee.

APA expenses are however increasing at a barely sustainable rate: 5 years after its implementation (2002), the APA is still witnessing the number of its beneficiaries increasing at a yearly rhythm (6.8% in June 2007, 8.1% for the sole beneficiaries of the APA at home) without any possible comparison with that of the number of dependent persons.

Graph 2: evolution of the number of APA beneficiaries

Source: DREES (Studies and Results no. 615, December 2007)

APA is paid by the counties with financial participation of the State, to a million dependent senior citizens. Its annual cost would amount to 4 billion euros. The amount varies depending on the level of dependency and revenues of the beneficiary. In June 2007, it represented on an average 413 euros per month for people living at home and 286 euros for those residing in an establishment.

The French market for private insurance for dependency constitutes the biggest market in the world along with the market in the United States. Its spreading is however restricted by the mandatory long term vision and the nature of the risk to be covered. Contrary to the USA, where services are provided exclusively in kind, French insurers offer the choice between service provision and payment of pensions, but at a level which appears to be insufficient. The entry point is located at around
58 years and the contribution, to the extent of 30 \( € \) per month makes it possible to get a pension (not subject to tax) of around 500 \( € \) per month.

The average cost of dependency is estimated at 1,400 \( € \) per month. It is covered, to the extent of 400 \( € \) by the average APA and 500 \( € \) by the average insurance (but these averages do not add up!). By all assumptions there still remains a considerable need for additional funding.

*The study was conducted with the assumption that the mobilization of the residential assets of senior citizens would come in as a supplement and not as a substitution for the expenditures that are presently being borne by the community. It takes into account the non-recovery of these expenditures, in particular the APA, on the succession of deceased persons.*

3/ The legitimacy of seeking recourse to PVH for the funding of dependency related expenditure

Indexing of pensioners on inflation decreases the room to manoeuvre available for increasing the contribution remaining under the charge of households. On the other hand, the increase in estates should tend to continue at a higher rate. This is particularly the case with real estate holdings owing to the extent of the property and the political will to accelerate its rate.

Over and beyond the age of 70 years, 72% of the French are owners of their main residence (tables 3 and 4). The diminution of this ratio at higher ages seems attributable to a generation effect (absence of long term credit offers\(^3\) and disincentive owing to the 1948 law) more than to a return to rental status through sale of the main residence.

The rate of holding of an immovable property is higher by a few points: in 2006, it is contained between 72% to 74% as per age for people of 60 to 80 years old and decreases subsequently. It is likely that the resale of real estate other than the main residence at higher ages comes about more frequently, in particular as regards a secondary residence, owing to financial (incurs costs without yielding anything in return) and practical reasons (difficulties in travelling).

An aid in the mobilization of residential assets would act in favour of the middle classes; moreover, ageing populations offer a considerable source for service based employments.

4/ The limitations of the present PVH

PVH is presently being offered by a sole establishment and is still in an experimental phase; owing to this fact, the costs (placement fees) are high, so that the proposed ratio, i.e. the ratio between the PVH amount and the housing value, is very low (34% at 75 years). What is more, PVH has no flexibility whatsoever: it is proposed only as capital output, i.e. in the shape of a single payment. The consumer protection norms are those fixed by the law, but their implementation is left to the initiative of the establishment.

\(^3\) Right from the end of 2007, the introduction of a “bonded mortgage loan” offer, in the aftermath of the Taffin- Vorms report of 2007, is likely to modify the present state of affairs.
Table 3: evolution of the rate of owners according to age

rate of ownership according to age
in the National Housing Surveys 1984 to 2006
(smooth curves)

<table>
<thead>
<tr>
<th>Year</th>
<th>20</th>
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<th>30</th>
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</table>

Source: INSEE (Housing Surveys).

Table 4: evolution of the rate of owners according to age (60 years and more)

<table>
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<tr>
<th>Year</th>
<th>60 to 64 years</th>
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<th>75 to 79 years</th>
<th>80 to 84 years</th>
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</table>

Source: INSEE (Housing Surveys).
5/ How to improve the performance of PVH?

Several ways can be explored. Neither subsidies, nor taxation seem to meet with the constraints that are specific to PVH. The very logic of this product would be to leave under the charge of the establishment only the share of risk which is linked to the assessment of the situation of the person who is contracting the loan (age, family status) and the value of the property as of the day of signing the contract. On the other hand, the community could bear the whole or part of the demographic risk and property risk, in particular the systemic risk. In fact, this is precisely the difficulty felt by the lenders of how to cover the risks which weigh heavily on the cost of the product and therefore the proportion of the loan. The systemic risk (a general drop in the price of housing in the aftermath of a macroeconomic or financial incident) proves to be particularly costly for the lenders since it forces them to make considerable provisions.

The American example provides a good illustration of the same. The FHA/Federal Housing Administration insures the totality of the overrun risk and the reverse mortgages that it guarantees offer a ratio higher than around 20 points to that of the market products. The latter, owing to this very fact, only pertain to high-priced properties, excluded from the scope of public guarantee.

The English equity release, which benefits from no public aid whatsoever, offers ratios comparable to those that can be observed in France. Other countries have just implemented PVH systems, but none of them have advanced enough for enabling us to draw the consequences thereof (\(^4\)). This subject is under study in Belgium and in the Baltic States; Denmark is sticking to classic mortgage extraction (with payment of interests).

The fact remains that in the cost of an occurrence, it is difficult to separate what results from individual risk and what is the consequence of systemic risk. The intervention of a public guarantee body or an organization backed by public authorities makes it possible to bring in a simple response. The FGAS could for instance bring in its guarantee to the overrun risk as it does so for the PAS in the case of loss on resale. The bank would be made accountable since, as in PAS, a part of the cost of the occurrence, i.e. of a possible overrun, would remain under its charge.

Public intervention in return enables the community to precisely define the characteristics of the product, its marketing modalities and above all the consumer protection and information rules. Thus the interest rate of the reverse mortgages guaranteed by the FHA is equal to that of the loans proposed to the premium market buyers i.e. "Treasury Bills + 1 to 1.5\%". The placement fees (origination and closing costs), so far amounting to 2\%, will be reduced to 1.5\% and the insurance charges are 2\% flat + 0.5\% on amounts outstanding. The loan can be paid, partially or fully, in the form of capital or pension. When it is partially paid in capital, the amount that has not been collected, and which progresses over the years, can be used as pension. The loan can also be repaid in anticipation in order to collect the unconsumed capital. None of these operations give rise to the payment of compensation.

\(^4\) Cf. table in annex.
The State would then have, through the intermediary of the FGAS, the possibility of precisely defining the characteristics of the PVH: cap rates, placement fees, flexibility norms, and marketing conditions. In the case of pension output, it should be exempted from tax.

The State would then have at its disposal several indicators for determining the share of the risk that it will take under its charge:
- sharing of the cost of the occurrences between the State and the lending institution (# 50/50 for the PAS);
- determination of the malus.

The State would also have the possibility of reinforcing its aid for certain usages by bearing the whole or a part of the placement fees.

The management cost of the SGFGAS is borne by the State. The consultancy costs would also be borne by the State (for example, entrusted to the ADIL\(^5\)). The guaranteed PVH can thus coexist with an absolutely free market offering.

The cost of the entire system would therefore be very low. Under all assumptions, only an enormous parameterizing error, under estimation of the increase of life expectancy or over estimation of the valuation of real estate, could render the intervention by public authorities a costly affair. This cost in such a case would not only be spread over time, but also be restricted by the rate of spreading of the PVH. The examination of our age pyramid and the example of the United States in fact show that the PVH, even supported by the State, must remain a niche product in the next fifteen years or so before it reaches its peak when the baby-boom generation will be 75 – 80 years old, around 2025-2030.

6/ Which beneficiaries?

Income is not a significant element in the case of house rich cash poor households. It is more logical to intervene taking into account a price limit of the property given as guarantee. Notarial statistics would possibly help in determining homogenous price zones and in making them evolve over time.

7/ How to forge a link between FGAS’s guarantee and the use of the funds?

Assuming that the funds would be used for the funding of works meant for the adaptation of the housing, the monitoring of the same could be entrusted to the ANAH, whose aids will come about, in certain cases, in addition to the PVH.

In the case of a pension, monitoring implies assigning of the product of this pension to accredited associations or to "a trusted third party" which is difficult to determine.

As this product is bound to spread very gradually, it is important to put a very simple system in place which will avoid the implementation of a costly administrative machinery, whereas the foremost obstacle for lending institutions is the one pertaining to
the critical mass. The simplest method would undoubtedly consist in offering a guaranteed product for operations pertaining to housings having a value that is lower than an upper limit determined by the State and in postulating that its usage will be basically earmarked for the funding of expenses relating to old age. All things considered, the support towards the consumption of modest senior citizens that is made possible by the mobilization of the residential assets can be in consonance with the policy of the public authorities. Moreover, the aim of such an outfit will be to offer the opportunity to make good use of their residential assets under affordable conditions to those belonging to modest households and who would wish to avail of the same, but it does not constitute an overall solution to the funding problem of dependency related expenses.

Claude Taffin and Bernard Vorms
7 May 2008

\footnote{The concerned numbers would not require any additional public effort}
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<tr>
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<td>Low (recent)</td>
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Ministry of Labour, Social Relations and Solidarity

Director of the Cabinet

Dear Sir,

The issue of dependency is bound to crop up with increasing acuteness. The mobilization of their residential assets constitutes one of the solutions that senior citizens could resort to.

The mortgage loan for life that you have contributed to defining is one of the means of achieving the same.

By basing yourself on practices abroad, would it be possible for you to propose the planning required so that this product, whose initial offers have just appeared in the market, may be adapted to the specific constraints of a social clientele?

With regards,

Yours sincerely,

Signature

Jean CASTEX

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