

REVERSE MORTGAGES AND FINANCIAL LITERACY

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The value of Canadians' primary residences makes up a significant part of their wealth around retirement – around 33 percent, on average. As a result, many Canadians may examine how to turn this wealth into income in retirement. One option is a reverse mortgage, a somewhat complex financial product that allows a homeowner to convert a portion of the equity of their principal residence into cash. The borrower is not obligated to make payments before moving out, selling or dying. In addition, the borrower is insured against the risk that the loan is worth more than the house when it is sold. However, very few Canadians take out a reverse mortgage – recent data show that just over two percent of Canadian households reported planning to obtain a reverse mortgage as a source of income upon retirement. How important is financial literacy in explaining the take-up of reverse mortgages?

This publication finds that:



Those with higher financial literacy tend to have better knowledge of the existence of reverse mortgages, but they are not more likely to have a higher demand for reverse mortgages at any cost.



The most financially literate Canadians are most sensitive to prices – those with the highest levels of financial literacy are more likely to choose reverse mortgages when interest rates create financial conditions that are favourable.

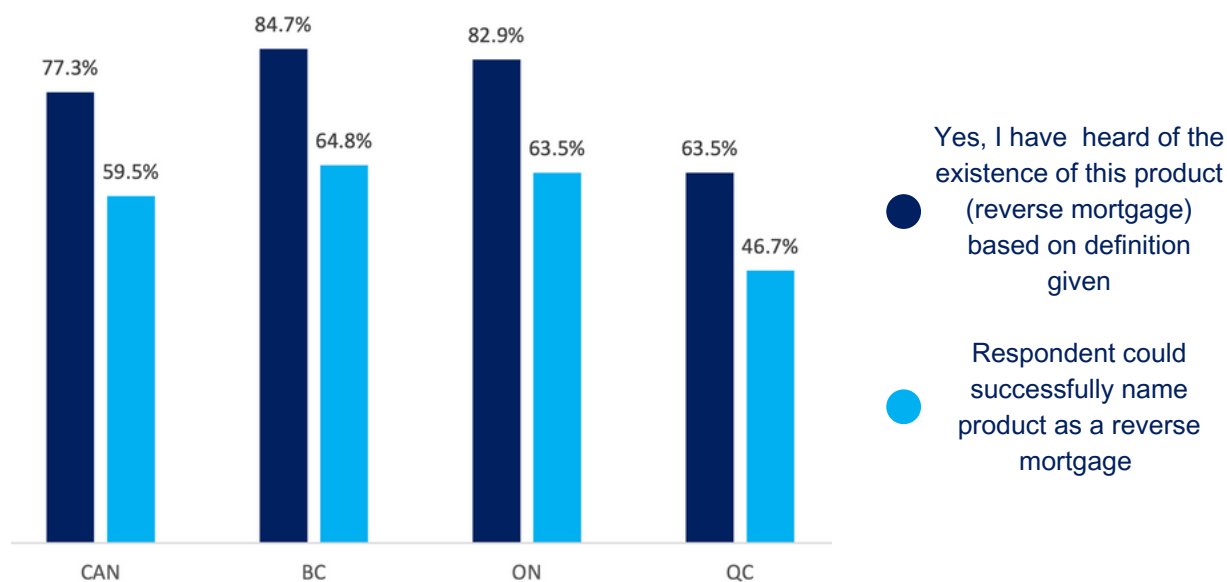


Respondents who expect higher price growth of their homes appear to be more likely to take out a reverse mortgage, and vice versa for those who expect house price declines. This hints to a desire to smooth consumption over time rather than to insure against falling house prices.

POTENTIAL POLICY IMPLICATIONS

- Governments that are interested in exploring ways to ensure more retirees can turn the wealth of their primary residence into retirement income must acknowledge that these products are poorly understood by a large proportion of the population.
- The muted demand for these products is, however, not simply a direct result of low financial literacy for most households.
- Financial education combined with lower interest rates for these products could increase the use of house equity to finance consumption in old age.

Key Figure – Knowledge of Reverse Mortgages in 2017



Respondents in our survey were asked a series of questions. To start, without naming the financial product, we first presented a sentence containing the definition of a reverse mortgage to the respondents. Then, respondents were asked if they had ever heard of this financial product. Roughly 77.3% of eligible Canadian homeowners (dark blue) claimed to have heard of that kind of financial product. Fewer homeowners from Quebec answered having heard this definition, a difference of nearly 20 percentage points with the two other provinces. Then, we asked those who claimed to have heard of this financial product if they could name it and only 59.5% of these homeowners could name the product in question (light blue).