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Reverse Mortgages and Interest Rate Risk

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Abstract

We develop and apply a valuation model that quantifies the interest rate risk inherent in fixed-rate reverse mortgages. Consistent with intuition, our results show that the interest rate risk of a reverse mortgage is greater than that of either a typical coupon bond or a regular mortgage. Somewhat surprisingly, we find that this difference in interest rate risk is extremely large. In fact, the interest rate risk of a reverse mortgage often is several orders of magnitude greater than the interest rate risk of other fixed-income securities.

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