

How Recent Changes in Reverse Mortgages Impact Older Homeowners

Reverse mortgages offer older homeowners a way to tap home equity to meet financial needs in retirement. However, the collapse of the mortgage market in 2008–2009 has led to major changes that impact consumer choices. While consumers have more product choices, reverse mortgages are generally more expensive and more complicated—leading to more scrutiny from Congress and regulatory agencies charged with protecting consumers.

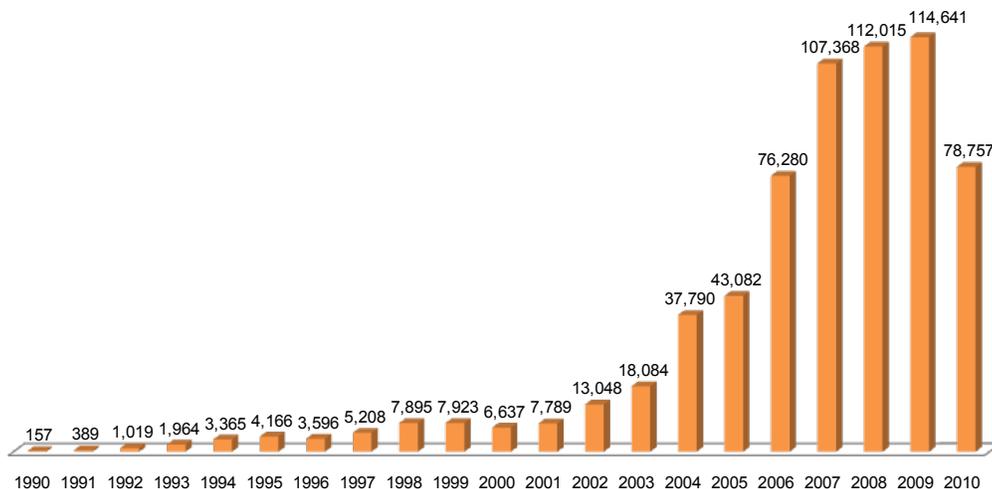
Use of Reverse Mortgages Grows

A reverse mortgage is a loan secured by the home that requires no repayment until the last borrower dies, moves permanently, or sells the home. Such loans are generally nonrecourse loans—meaning that, under most circumstances, neither the borrower nor the heirs will owe more than the home is worth.¹ Loans insured by the Federal Housing Administration’s (FHA) Home Equity Conversion Mortgage (HECM) program constitute more than 90 percent of all reverse mortgages. Since the program began in 1989, more than 660,000 loans have been made—three-quarters

(74 percent) of them in the most recent five fiscal years (see figure 1). More than half a million HECM loans are still in force.²

In 2006, AARP conducted a national survey of reverse mortgage borrowers and homeowners who went through counseling and decided not to take out a loan. When asked the “main reason” for looking into a reverse mortgage and the “main use” to which they had put the loans, borrowers most frequently mentioned paying off their existing mortgages and making home repairs or improvements (see table 1). Homeowners who had enough interest to go through

Figure 1
Number of HECM Loans for Fiscal Years 1990-2010



Source: U.S. Department of Housing and Urban Development, FHA HECM Characteristics Report, 2010.

Table 1
Reasons for Looking into Reverse Mortgages and Main Uses by Borrowers**

	A Reason for Looking into a Reverse Mortgage**		Main Reason for Looking—Borrowers (n = 946)	Main Use by Borrowers (n = 946)
	Borrowers (n = 946)	Non borrowers (n = 563)		
Pay off mortgage	40%	40%	19%	19%
Home repairs/improvements	47%	43%	14%	18%
Improve quality of life	73%	68%	18%	14%
Everyday expenses	50%*	40%	9%	10%
Emergencies/unexpected	78%*	66%	13%	9%
Pay off nonmortgage debt	28%	27%	6%	7%
Health or disability	28%*	21%	7%	5%
Property taxes/insurance	29%*	21%	4%	5%
Financial help to family	15%	13%	2%	2%
Investments, annuities, or long-term care insurance	13%	17%	2%	1%
Household chores	18%	19%	1%	1%

Source: Redfoot, Scholen, and Brown, 2007.
 * Statistically significant difference at the 0.05 level between borrowers and nonborrowers.
 **For the first two columns (“a” reason), multiple responses were allowed per respondent. For the last two columns (“main” reason), only one response was allowed per respondent.

counseling but did not apply for a loan most frequently cited high costs (63 percent of nonapplicants) as a reason for not applying for a reverse mortgage.³

Since 1990, the average age of HECM borrowers has declined, and borrowers are more likely to be part of a couple (see table 2).⁴ The trend toward borrowing at earlier ages raises concerns about the long-term impact of reverse mortgages on financial security, especially in light of data from the U.S. Department of Housing and Urban Development (HUD) indicating that the duration of such loans averages only six to seven years for younger borrowers.⁵

Table 2
HECM Borrower Characteristics, 1990–2010

	1990	2000	2010
Average age	76.7 years	76.0 years	72.9 years
Single female	57.3%	56.8%	41.2%
Single male	16.6%	13.0%	20.3%
Multiple borrowers	26.1%	30.2%	37.0%
Average home value	\$108,717	\$141,670	\$279,880

Source: U.S. Department of Housing and Urban Development, FHA HECM Characteristics Report, 2010.

Mortgage Market Meltdown Drives Up Interest Costs

Until 2006, Fannie Mae purchased nearly all HECM loans. During those years, Fannie Mae set interest rates and required that all loans have adjustable rates. When the mortgage markets collapsed, costs soared as Fannie Mae allowed interest rates to float, leading to higher interest rates. Fannie Mae’s share of HECM purchases precipitously declined until it announced in 2010 that it would no longer purchase such loans.

In the absence of Fannie Mae funding, mortgage-backed securities issued by Ginnie Mae, an arm of HUD, have become the almost exclusive means of funding HECM loans. In contrast to Fannie Mae loans, the vast majority of Ginnie Mae loans have been fixed-rate loans in which the borrower is required to withdraw the full loan limit at closing. As a marker of how rapidly this transition took place, in the nine months between March and December 2009, the percentage of such fixed-rate, full-draw loans

soared from less than 3 percent of HECMs to 70 percent, where it has remained.

While such loans may be well suited for homeowners who need to borrow large sums (e.g., for a homeowner who must retire a forward mortgage to avoid foreclosure), they may be much more expensive for those whose needs could be met without the full-draw requirement. Interest rates are higher on such loans, and borrowers must pay interest on the full loan limit from the moment of closing. On the other hand, these loans typically have lower or no upfront origination fees and often have no ongoing servicing fees.

FHA Raises Costs of Reverse Mortgage Insurance to Reduce Its Risks

The recent decline in home values has led the Office of Management and Budget (OMB) to conclude that funding for HECM mortgage insurance was inadequate to cover future risks of the program, despite repeated actuarial studies that have affirmed the soundness of the program.⁶ In light of OMB's concerns, the following four actions were taken:

- FHA reduced loan limits by 11 to 15 percent over the past two years.
- FHA increased the ongoing portion of the mortgage insurance premium (MIP) paid by borrowers by 150 percent—from an annual interest add-on of 0.5 percent to 1.25 percent.
- Congress appropriated a \$150 million credit subsidy for the program in fiscal year 2011.
- FHA introduced a new loan option, the “HECM Saver,” to increase the volume of low-risk loans as a percentage of the insurance pool.

In October 2010, FHA introduced the “HECM Saver” loan, which essentially eliminates the hefty upfront MIP of

2 percent of the home value in exchange for loan limits 10 to 18 percent lower than standard HECM loans. For borrowers who need relatively small loans for short periods of time, the Saver can be less expensive, though interest rates have been 0.25 to 0.5 percent higher than standard HECM loans, and origination and other fees may be higher as well. FHA is hoping that premiums generated from these low-risk loans will offset anticipated losses on other types of reverse mortgages.

Defaults and Foreclosure Risks Rise

Loan defaults and potential foreclosures have arisen as a major issue for the HECM program. Unlike forward mortgages, where defaults result from the failure to make loan repayments, defaults with reverse mortgages are mostly due to the failure to pay property taxes or the required homeowners insurance. The number of loans that are delinquent in making such payments has grown to an estimated 30,000, or nearly 6 percent of all outstanding loans. HUD has recently announced steps to avoid foreclosures,⁷ but more foreclosures can be expected in the future on loans whose borrowers cannot or will not pay their taxes or homeowners insurance.

Congress Boosts Consumer Protections

Congress has passed two recent consumer protection laws in response to reports that financial products unsuitable for older borrowers—such as annuities, long-term care insurance, and investment products—are being sold to reverse mortgage borrowers.^{8,9} The Housing and Economic Recovery Act of 2008 forbids requiring the purchase of any financial product with HECM and forbids originators from having any financial interest in selling another financial product.

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The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires the Consumer Financial Protection Bureau (CFPB) to conduct a study to “identify any practice as unfair, deceptive, or abusive with a reverse mortgage transaction” and to develop an integrated model disclosure standard for reverse mortgages. In addition, the Federal Reserve Board is exploring new disclosures to show how loan balances grow over time so that consumers will have a more understandable tool for planning the use of their home equity over their retirement years.^{10,11}

More Research Needed

For homeowners who are “house-rich, but cash-poor,” reverse mortgages can be a lifeline that enables older people to remain independent while meeting basic needs. However, declining home values and the resulting collapse of the mortgage markets have had a major impact on all aspects of reverse mortgages.

While some of these changes have the potential to create more consumer choice in loan options, the costs of reverse mortgages have generally increased and the choices have become more complicated. More research is needed on the consequences of reverse mortgages for long-term financial security—especially in light of the data indicating that borrowers are taking out larger loan amounts earlier in their retirement years. Providing safe and affordable reverse mortgage options and improved counseling and disclosures will be crucial in establishing the consumer confidence needed for expansion of this important financial option.

¹ Recently, the Department of Housing and Urban Development (HUD) has changed its definition of nonrecourse. Under this ruling, if a borrower or heirs want to pay off the loan and keep the home, they will owe the full mortgage balance, even if the debt exceeds the current home value. This ruling is being challenged in court.

² U.S. Department of Housing and Urban Development, “FHA HECM Characteristics Report,” 2011, <http://www.hud.gov/offices/hsg/rmra/oe/rpts/hecm/hecmmenu.cfm>.

³ Donald L. Redfoot, Ken Scholen, and S. Kathi Brown, *Reverse Mortgages: Niche Product or Mainstream Solution?* AARP Public Policy Institute Report #2007-22, 2007.

⁴ U.S. Department of Housing and Urban Development, “FHA HECM Characteristics Report.”

⁵ Edward J. Szymanoski, James C. Enriquez, and Theresa R. DiVenti, “Home Equity Conversion Mortgage Terminations: Information to Enhance the Developing Secondary Market,” *Cityscape: A Journal of Policy Development and Research*, 9, no. 1 (2007): 5–46.

⁶ U.S. Department of Housing and Urban Development, “An Actuarial Analysis of FHA Home Equity Conversion Mortgage Loans in the Mutual Mortgage Insurance Fund, Fiscal Year 2009,” 2009.

⁷ U.S. Department of Housing and Urban Development, “Home Equity Conversion Mortgage Property Charge Loss Mitigation,” HUD Mortgagee Letter 2011-01, 2011.

⁸ Government Accountability Office, *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers*, GAO-09-606, 2009.

⁹ Tara Twomey, *Subprime Revisited: How Reverse Mortgage Lenders Put Older Homeowners’ Equity at Risk*, National Consumer Law Center, 2009.

¹⁰ ICF Macro, “Design and Testing of Truth in Lending Disclosures for Reverse Mortgages,” Federal Reserve Board, 2010.

¹¹ Federal Reserve Board, “Proposed Truth-in-Lending Mortgage Regulations,” 12 CFR Part 226, Regulation Z, Docket Number R-1390, 2010.

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