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IN COMMUNITY AND ECONOMIC DEVELOPMENT

## Reconsidering U.S. Housing Policy

Mortgage Fraud in the Sixth District

Rule Changes Fine-Tune Consumer Protection

Forging a Green Partnership

Report Confronts Concentrated Poverty



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### Reconsidering U.S. Housing Policy

A multifaceted, systemic approach is needed to respond effectively to the wide-ranging impacts of the housing foreclosure crisis. James Carr of the National Community Reinvestment Coalition outlines five housing-related public policy areas he believes demand serious attention.

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# Reverse Mortgages Revisited

## Legislative Changes Introduce Greater Consumer Protections

REVERSE MORTGAGES, WHICH ALLOW HOMEOWNERS TO CONVERT A PORTION OF THEIR HOME EQUITY TO CASH, ARE BECOMING INCREASINGLY POPULAR.

Despite recent troubles in the national mortgage market, growth in reverse mortgage lending is being driven by a flexible government-sponsored product and a growing supply of potential borrowers.

Like any mortgage product, reverse mortgages can be beneficial for consumers' financial stability; but the product's complexity is a downside for borrowers. While it is the consumer's responsibility to make informed decisions, new protections provided by the Housing and Economic Recovery Act of 2008 (HERA) should enhance consumer protection and education as this product develops.

### How do reverse mortgages work?

Reverse mortgages are characterized by the payment flow: rather than making mortgage payments, the borrower receives cash from the lender. This product has thus far been targeted to older adults, enabling them to borrow against their home equity to create a tax-free source of income while they continue living in their homes. Borrowers have no repayment obligation until the home is no longer their primary residence (the result of a move or death).

According to the National Council on Aging, the reverse mortgage is an important tool for seniors who intend to "age in place," living at home as they grow older. AARP also supports reverse mortgages as a valid financial option, but urges borrowers to consider whether less costly options might meet their financial needs.

The reverse mortgage market is dominated by the Home Equity Conversion Mortgage (HECM), a product administered by the Department of Housing and Urban Development (HUD) and insured by HUD's Federal Housing

Administration (FHA). Since 1989, HECMs have been originated by private lenders and purchased by Fannie Mae. Although proprietary reverse mortgage products began to appear in 1995, the recent economic turmoil has driven all HECM competition out of the current marketplace.

The government-sponsored HECM product has defined the reverse mortgage market. HECMs require borrowers to be at least 62 years old and to have a substantial amount of equity in their principal residence. HECMs use a formula to determine the maximum amount of principal a homeowner can borrow. Under HERA, HUD created a uniform national mortgage limit of \$417,000, which replaced the regionally based limits that previously existed. Borrowers can draw down payments in monthly installments, lump sums, lines of credit or a combination of these options.

Borrowers are not required to repay a reverse mortgage until a "maturity event," namely the death of the borrower, sale of the property or violation of the mortgage agreement. Although borrowers do not make payments until they no longer inhabit the home, they are required to maintain the property, pay property taxes and pay the home insurance.

The loan principal for reverse mortgages increases with each payment, as interest and other accruing charges are rolled into the total funds advanced to the borrower. HECMs are available with fixed or adjustable rates. Fees for these products include standard origination fees, a monthly servicing fee and an FHA insurance fee. Compared to forward mortgages, the comparatively high upfront fees associated with HECMs are typically offset by lower interest rates. As a result, HECMs may be an expensive option if the loan comes due within three years. Cost concerns have



recently been addressed by Congress through HERA, which placed new lower limits on HECM origination fees.

#### **The reverse mortgage market is poised for take-off**

After a period of very slow growth from 1990 to 2002, the reverse mortgage market expanded exponentially in recent years. Though they now represent only 1 percent of the overall mortgage-lending market, these loans were expected to mushroom by as much as tenfold in the next 20 years.

Given the recent changes in the economic climate, these projections may soon be seen as overstated. Although the HECM product showed marginal growth in fiscal year 2008, reverse mortgage lending overall decreased slightly. The decrease in lending was driven by the withdrawal of proprietary products and the HECM mortgage limit changes resulting from the enactment of HERA. The industry is projecting market growth in fiscal year 2009, resulting from pent up demand from 2008, eligible seniors needing additional cash to recover from substantial losses in the stock market, and an expected increase in available capital from a new Ginnie Mae securitization program.

Demographic trends point to the likelihood of escalating consumer interest in reverse mortgages. Americans 62 years of age and older currently hold an estimated \$4.3 trillion in home equity. As baby boomers quickly become age-eligible, this number will increase dramatically. Consumer interest will also be stimulated by increasing product options and innovations.

Lenders' interest in the reverse mortgage market could quicken if capital becomes available from the growth

of the secondary market, where mortgage buyers purchase loans from lenders. An established secondary market for reverse mortgages would provide greater liquidity and could broaden lender distribution channels and expand the investor base. Although the market was slowly evolving the necessary techniques to securitize these products, the economic downturn may stall or redirect its realization.

#### **Obstacles to stronger consumer protections**

Reverse mortgages are a complicated financial product, and burgeoning varieties of reverse mortgage options make it increasingly difficult for borrowers to determine which reverse mortgage, if any, is suitable. It is critical that potential borrowers of reverse mortgages, many of whom are seniors, get adequate information and, preferably, counseling. Borrowers who take out an HECM are required to complete HUD-certified counseling; but private products that do not require counseling leave consumers on their own to determine whether a reverse mortgage product will suit their needs.

Government and industry efforts to improve the value of counseling and expand its availability have faced challenges. The quality of reverse mortgage counseling options appears to vary greatly. HUD-approved agencies are, at a minimum, required to focus on product suitability and the possible alternatives, but HUD-certified counselors and their counterparts face different standards. And even within the certified group, expectations and procedures vary: counseling may be offered by video, telephone or in person, and sessions range from 10 minutes to two hours.

Recently passed HERA legislation includes provisions to improve the quality of HECM counseling by requiring HUD to establish additional standards for individual counselors. HUD is responding by implementing ongoing counselor training as well as instituting a certificate program for borrowers. Unfortunately, the cost of these improvements will probably be passed on to the borrowers.

A lack of available counselors in some locations, particularly in areas with a heavy volume of reverse mortgages, is another source of concern. Currently, the need for counselors specializing in reverse mortgages is competing with the national surge in demand for foreclosure counselors.

### **Deterring predatory lenders**

Anecdotal evidence suggests a rise in predatory lending practices related to reverse mortgages. Thus, counselors must be even more equipped to educate borrowers regarding mass marketing schemes for high-cost products and sales pressures, as well as provide general financial planning. One practice that has raised particular concern is a tactic that advises reverse-mortgage borrowers to bundle their loans with a second financial product, such as a deferred annuity or insurance. Because of the high upfront cost of reverse mortgages, using this product to

purchase annuities or insurance is almost always financially unsound.

Congress has attempted to address these predatory practices through HERA by prohibiting lenders from being associated with any other "financial or insurance activity" unless they maintain appropriate firewalls. HERA also prohibits many mortgage brokers, who are less regulated, from reverse lending by requiring all lenders to be HUD-approved. However, the regulations and supervision of this legislation have not yet been implemented.

Despite the risks, reverse mortgages offer consumers an increasingly important option for accessing additional cash as they age. But borrowers must seek sound information about whether a reverse mortgage is the right product for them. ■

### **Additional Resources**

American Association for Retired Persons (AARP): [www.aarp.org/money/revmort/](http://www.aarp.org/money/revmort/)

Department of Housing and Urban Development (HUD): [www.hud.gov/offices/hsg/sfh/hecm/hecmshome.cfm](http://www.hud.gov/offices/hsg/sfh/hecm/hecmshome.cfm)

This article was written by Heidi Kaplan, senior community affairs analyst at the Board of Governors of the Federal Reserve System. Reprinted by permission, with updates, from the spring 2008 issue of Bridges, a Community Development newsletter published by the Federal Reserve Bank of St. Louis.

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