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U.S. retirees return to reverse mortgages, big banks stay away

Many retirees haven't saved enough to cover expenses for the rest of their lives

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Many retirees haven't saved enough to cover expenses for the rest of their lives. But many of them have one major asset – a home. A reverse mortgage allows them to borrow against that, and they don't have to make any payments on the loan until they move or die.

Borrowers took out $15.3 billion of the loans in 2013, an increase of 20 percent from the year before, according to industry publication Inside Mortgage Finance. The record year was 2009, when there were $30.21 billion of reverse mortgage loans made.

Brokers and bankers say the 77 million retiring baby boomers will likely help fuel further growth in the loans in the coming years, making the business a growth spot in a home loan market where volumes have recently been declining.

But at this stage, most bigger lenders are uncomfortable with the loans — for example, in 2011, Wells Fargo & Co and Bank of America backed out of the business. Wells has cited factors including unpredictable home values and the level of delinquencies as reasons for it to stay away from reverse mortgages.

The government agency that guarantees these loans, the U.S. Federal Housing Administration, found them to be risky, too. Losses on reverse mortgages were a big reason for the agency's $1.7 billion taxpayer bailout last year – and some experts worry it could end up in similar trouble again.

"The FHA is at risk from these loans, and the taxpayers are at risk too," said James Bothwell, a consultant and former chief operating officer of the Federal Home Loan Bank system.

The agency has made changes to its reverse mortgage program in the last year to try to make the loans safer.

“As with any mortgage product, there is risk to financing a loan, but we have made, and continue to make, significant efforts to mitigate that risk,” both when making loans and when recovering money at the end of the loan, said Melanie Roussell, a spokeswoman for U.S. Department of Housing and Urban Development. The FHA is part of the department.

What makes these loans potentially toxic for lenders and the government also makes them attractive for borrowers: a homeowner who is at least 62 years old gets a lump sum of money, a line of credit, or monthly income from their reverse mortgage, and potentially does not have to repay the loan for decades. During those years, the loan accumulates interest, which is currently just above 5 percent for a fixed-rate loan. When it is time to pay off the loan, the home may not be worth enough to cover the debt, potentially leaving the FHA with losses.

Given that reverse mortgage lending volume is still small relative to the $9.4 trillion U.S. mortgage market, the risk to the financial system is manageable, analysts said.

SMALLER LENDERS

It is smaller lenders that see an opportunity in reverse mortgages, and are still convinced there is a real opportunity for growth.

“The market is huge. It’s underpenetrated,” said Denmar Dixon, chief investment officer at independent mortgage company Walter Investment Management Co at a conference in December.

Every day, 10,000 baby boomers turn 65, the traditional retirement age in the United States. And 48 percent of them report they are not on track to cover the basics in retirement, according to financial services company Fidelity. Sixty percent have less than $100,000 in retirement savings, estimates brokerage Charles Schwab Corp.

Walter’s larger rival, Ocwen Financial Corp, estimates the potential size of the reverse mortgage market at $1.9 trillion, leaving a lot of room for growth from the $90 billion of these loans outstanding at the end of September.

Lenders charge high fees for making these mortgages, and then bundle them into U.S. government-guaranteed bonds that are sold to investors. The margins on selling these loans can be three to five times the margins on regular mortgages, said Don Currie, president of lender High Tech Lending. Banks can also collect fees for performing tasks like sending out account statements to borrowers.

To tout the benefits of the product, reverse mortgage lenders have turned to Hollywood pitchmen. Liberty Home Equity Solutions, which Ocwen purchased in April 2013, uses Robert Wagner, star of the “Hart to Hart” television series, in its advertisements. Commercials for Quicken Loans’ One Reverse Mortgage featured “Happy Days” star Henry Winkler. Fred

Thompson, a former U.S. Senator and star on television's Law & Order series, promotes loans for American Advisors Group.

While volume for these loans is rising, traditional mortgage lending is expected to fall 37 percent in 2014 as higher rates choke off refinancing activity, according to forecasts from the Mortgage Bankers Association.

"There are lots of mortgage lenders who see declining volumes and may view (reverse mortgages) as an opportunity to increase revenues," said David Stevens, president of the MBA and a former commissioner of the FHA.

BROADLY HURT

Loans that the FHA guaranteed were broadly hurt after the financial crisis as home prices dropped more than 30 percent nationally. But the agency suffered disproportionately big losses on reverse mortgages — these loans made up just 7 percent of the portfolio of loans the agency guaranteed, but contributed to 17 percent of the losses.

Reverse mortgages can sting lenders and guarantors because they depend so heavily on home prices for repayment.

During stable times, regular mortgages are made based on the borrower's ability to repay, with foreclosure and sale of the home available as a backstop in case the borrower defaults.

For reverse mortgages, the collateral, namely the home, is just about all the lender can rely on. Home prices, which are still below their 2006 peaks, have been rising in the past couple of years, and economists do not see much risk of a significant drop in the near term.

But forecasting home prices over decades is much more difficult.

To help reduce its risk, in April 2013 the FHA limited the amount a homeowner can borrow as a lump sum to 60 percent in the first year, up to the maximum cap of $625,500. The prior limit was 100 percent.

The FHA is also creating new rules that will require lenders to make sure a borrower can pay for taxes, insurance, and upkeep on their home.

For some homeowners, reverse mortgages can fill a real need. Janie Baratta, 63, was getting hounded by bill collectors after her husband died in 2012. The former biological researcher at the University of California at Irvine had $50,000 in credit card bills she had run up during his illness, and there was still a $1,500 mortgage on her three-bedroom ranch in Irvine, California. Her $4,000 pension and social security were not enough to cover her expenses.

Then in 2012, she got a $300,000 reverse mortgage from High Tech Lending. Today, her credit cards are paid off. So is her regular home loan.

Reverse mortgage delinquencies can hurt the FHA, and are at least part of the reason why the loans carry such high interest rates and fees: a reverse mortgage now can carry a rate of just over 5 percent, against the current 30-year rate for government-backed mortgages of around 4.3 percent.

Reverse mortgages also discourage elderly homeowners from undertaking repairs and maintenance that someone else might do more proactively, said Mark Calabria, a former staff member of the Senate Banking Committee. That can hurt the value of the property, which in turn cuts into the proceeds that lenders will receive when it comes time to sell the home, leaving the FHA potentially on the hook because of its guarantee.

“How you care for the property matters,” for future values, said Calabria, now the director of financial regulation studies at the libertarian Cato Institute in Washington, DC.