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Reverse Mortgage Goes from Last-Chance Loan to Retirement Tool

By Brian Collins
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As regulations reshape the reverse mortgage, lenders hope to end up with a safer, more reputable product. Meantime, the changes are turning the economics of this business on its head.

Under new rules, seniors can no longer receive the entire proceeds from a Federal Housing Administration-insured reverse mortgage in one lump sum. Instead, they are generally limited to just 60% of the funds during the first 12 months. The rationing of proceeds is to make sure borrowers have some equity left when they leave the closing table, reducing the likelihood of default.

Soon, the FHA will also require reverse mortgage lenders to conduct financial assessments to ensure borrowers have the necessary residual income to pay taxes and insurance and maintain the property.

These changes alone are having a profound effect on how the reverse mortgage is pitched to seniors.

"With the new protections, financial planners are starting to view HECMs as a retirement tool," says Jeffrey Taylor, a reverse mortgage consultant who helped launched the first FHA reverse mortgage product in 1991. "It is forcing the industry to market differently and to look for a new borrower."

Previously, many seniors who were facing foreclosure used FHA-insured HECM loans as their last chance to pay off their mortgage and stay in the home. While reverse mortgages don't require monthly loan payments, borrowers are obligated to pay hazard insurance and property taxes. Many borrowers defaulted when they couldn't afford to pay taxes and insurance, prompting FHA to change its rules.

Rather than a lifeline for the desperate, the product is now more suitable as a kind of insurance for the comfortable.

"Critics claim the new borrower doesn't need a reverse mortgage. In a way they are correct," says Taylor, the president of Wendover Consulting in Greensboro, N.C. "The new borrower wants to put a line of credit in place in case they need it later down the road." HECM lines of credit can be used for emergencies or they can be tapped to boost a senior's monthly income.

Another regulatory wrinkle has mightily influenced the way reverse mortgages are structured.

Ginnie Mae, the agency that sets standards for securitization of FHA loans, has banned from its pools fixed-rate reverse mortgages that disburse funds as a line of credit. Ginnie worried that if interest rates rise, its servicers would have to finance additional draws at a loss.

Following Ginnie Mae's announcement, warehouse lenders began to pull back on funding HECMs with fixed-rate lines of credit. If this trend continues, it will be effectively shut such loans out of the market.

Seniors can still get a fixed-rate HECM and take out up to 60% of loan proceeds in a lump sum. But they have to wait 12 months or refinance (which is expensive) to tap the remaining loan proceeds.

The net result of the FHA and Ginnie reforms is that the adjustable-rate line of credit now dominates the reverse mortgage scene instead of fixed-rate products. About 75% to 80% of HECMs being originated today are adjustable-rate, according to Joe Demarkey, the director of product development at Reverse Mortgage Funding.

The shift in the market means lenders have to be more patient, too. A fixed-rate, lump-sum HECM can be securitized immediately and the issuer can take all the profits upfront. On an adjustable-rate line of credit HECM, the lender has to wait until the borrower begins to draw down the line of credit before the draws can be securitized.

Ocwen Financial (OCN), whose main business is servicing loans, wrote $163 million in FHA-insured reverse mortgages in the first quarter and reported a pretax loss of $6.3 million in its origination business. But the company expects future draws on the first-quarter crop of reverse mortgages to generate more profits down the road, at a discounted present value of $8 million.

"The shift in business to a variable rate product, with lower upfront funding and larger future draws, creates current-period losses, but will generate future period gains," Ocwen Chief Executive Ron Faris said on a May 1 conference call. "These tail earnings arise as existing loans request additional draws, which generate gains on sale with very little expense."

The company expects slow growth in reverse mortgage originations this year, Faris said.

A week later, rival servicer Walter Investment Management (WAC) reported a pretax loss of $2.8 million on its reverse mortgage origination business due to lower HECM volumes in the first quarter.

"We believe the new product profitability is superior to the historical product, but the curve is back-end weighted due the lower initial originated balances," said Walter's chief investment officer, Denmar Dixon. Higher margins will be realized as additional draws are securitized, he said.

Walter originated $245 million in reverse mortgages in the first quarter, down from $556 million in the prior quarter.

The most popular reverse mortgage now is an adjustable-rate HECM with a 10% lifetime cap. This means that with a starting interest rate of 3%, the rate cannot go higher than 13% during the life of the reverse mortgage.

Demarkey's firm, which has offices in New York and New Jersey, recently introduced a new product called HECM MAX5, billed as the industry's first adjustable-rate product with a 5% lifetime cap. If the starting rate is 3%, the rate on a MAX5 cannot exceed 8% no matter how high other mortgage rates go.

The new lender started originating HECMs in the fourth quarter of 2013 through its correspondent channel and began funding brokered loans in January. A few weeks ago, it began recruiting and hiring loan officers for its retail sales channel. Reverse Mortgage Funding is licensed in 47 states, the District of Columbia and Puerto Rico.

Demarkey and Reverse Mortgage Funding Chief Executive Craig Corn previously worked at MetLife's reverse mortgage shop.

The FHA reported last week that HECM originations totaled $4 billion in the first quarter, up from $3.4 billion in the prior quarter.

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