

This is a really great article that should be read by everyone.

John G. Karavas

**Reverse Mortgages
can be great for new
home purchases**

NRMLA Questions Validity of Consumer Reports Reverse Mortgage Investigation

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When researching a product, be it a flat-screen television or a car, many of us often turn to Consumer Reports for an evaluation of what is available. But after reading their reporting on reverse mortgages in the September 2009 issue ("Reversals of fortune: The next financial fiasco? Can it be reverse mortgages"), one has to question whether there is any validity to anything that ever appears in the magazine.

The piece (which appears without a byline) was reported and we can assume written by Andrea Rock, who recently appeared on a local Los Angeles television newscast further knocking the product. The combination of Ms. Rock's unbalanced reporting, the frightening headline and the photo of a sad widower holding his recently deceased wife's photo, combine to scare seniors who are potential borrowers away from reverse mortgages. The piece is largely comprised of inaccuracies, a perfunctory level of research that misinterprets many of the facts and does not touch on recent improvements in the product, and three real life stories used as examples that are a few years old and probably could not reoccur given recent regulations adopted both in the states and federally. People tend to turn to Consumer Reports to help investigate a product that they are interested in purchasing, but the information in this article is comparable to reporting on televisions and ignoring that flat screens exist.

There are now over 400,000 reverse mortgage loans outstanding in the United States. Reports from both AARP and our large banker members indicate that upwards of 93% of the borrowers feel the product has improved their lives. They have primarily utilized these loans to pay off mortgages and reduce their monthly expenses, to avoid foreclosure, to afford in-home health care. But where is even one of these hundreds of thousands of success stories in Consumer Reports?

Instead of running the photo of the desolate Ernest Minor holding his deceased wife's photo and facing foreclosure, for example, the magazine could well have run a photo of James Clark from the state of Washington whose wife passed away recently and could not stay in his home and meet

his monthly expenses without her pension and social security. Mr. Clark took out a reverse mortgage, paid off his forward mortgage, and now not only can afford to remain in his home, but also has a line of credit that provides him with some financial breathing room for the first time.

The article reports (and inaccurately) that "Reverse mortgages started out as a niche product to give cash-strapped seniors supplemental income." Actually the product was conceived by senior advocates and FHA to allow seniors to utilize the equity in their homes to stay in their homes. Among the product's intentions (and now its achievements) was keeping health care costs to taxpayers down by reducing hospital and nursing home stays. (HUD is currently proposing a study aimed at quantifying the positive effect of reverse mortgages on individuals and also on our society.)

Consumer Reports' five and a half page article is so full of misinformation and bias that it calls for a detailed refutation. So let us go through some of the story's specifics:

Causes for concern

The article opens by acknowledging reverse mortgages "can be valuable" but as "a last resort" for seniors who want to stay in their homes. But, it reads, "those loans can be terrible for customers who don't understand the complicated rules governing them and how quickly high fees and interest charges can balloon."

Frankly, the only thing "terrible" about reverse mortgages is the doling out of misleading information to seniors, be it from a grandstanding politicians or poor magazine reporting.

The fees and interest charges, which are misunderstood and miscalculated in Consumer Reports, are comparable to any mortgage product. In fact, the fees and costs associated with an FHA Home Equity Conversion Mortgage (HECM) are similar to those incurred with a traditional FHA forward mortgage. And the largest part of the fees is to pay for FHA insurance, a valuable concept actually that protects borrowers if their lender's operations are disrupted for any reason or if their home value decreases over the life of the loan and that provides seniors with more money than any non-insured product would.

There is no mention in the article that reverse mortgages may be the only product in the country that requires counseling before you purchase it, that both counselors and lenders must be approved by HUD, that a new counseling protocol is about to be issued that will require continuing education and testing every three years, or that a lender is required to provide a Total Annual Loan Cost (TALC) disclosure that projects all the possible costs over varying durations for the loan. One would think that

anyone who reports to consumers on the product has a responsibility to provide that information. Consumer Reports chose not to.

As far as not understanding the complicated rules, the Consumer Reports piece throughout demonstrates a complete lack of respect for the intelligence of America's seniors. The counselors and lenders in this field consistently demonstrate profound concern for their clients, provide reams of information and are always available to answer questions. This is a service business.

The hyperbole continues:

The article reports that "the use of loans is exploding," which might be good news for the industry— were it true. But a growth of 5% in 2008 and another 5% in 2010 is not an explosion by anyone's imagination.

It reports that lenders take no risks and push the loans on seniors for spending on "vacations, new cars and more." Given the amount of regulation (HUD, FHA and half a dozen regulatory agencies) and NRMLA's Ethics review process, anyone who sells the product inappropriately is taking perhaps the hugest risk of all—ruining their professional reputation. And all indications are that since the financial crisis hit, the vast majority of borrowers are using their loans to pay mortgages, keep up on their monthly bills, or, as NRMLA President Peter Bell says, use the funds to cover bills as they wait for their portfolios to regain some of what has been lost.

The article then says that "Lawmakers and regulators are getting worried." Well, we count five in the whole country who have expressed concern— Senator Claire McCaskill, California assemblyman Mike Feuer, Minnesota Attorney General Lori Swanson, HUD Inspector General Kenneth Donohue and Comptroller of the Currency John Dugan, whom, despite some specific criticisms, has said he is a fan of the product. While the others have spewed scary rhetoric, none can provide details that back up their claims of widespread senior abuse when challenged by us or by the press. Without facts, this rhetorical barrage has been irresponsible—and reporting it as fact is even more irresponsible. With the exception of Dugan's OCC STAFF, none of these people have become involved in the ongoing reexamination and retooling of the product being lead by FHA and supported by six other banking and other regulatory agencies in collaboration with associations such as AARP and NRMLA.

As a result of these rather lurid but under researched assumptions, Consumer Reports then states its investigation has found "more cause for concern." The article argues:

—"Loan bailouts have soared." It reports that the FHA federal insurance fund has taken over \$381.3 million in loans based on a study of more than

500,000 loans over two decades. But it ignores the fact that the FHA insuring these 500,000 loans has taken in over \$7 billion of income from the HECM program in that time as recently reported by the Congressional Budget Office.

The ability to assign loans to FHA when the loan balance grows to 98% of the maximum claim amount is a feature that was designed into the HECM program to entice lenders to participate. It assures a lender that there is a definite point at which it can exit the transaction – without impacting the senior homeowner. Assignment of loans is ordinary and expected. It does not mean that the FHA insurance fund is losing money on payouts for loan assignments. Interest continues to accrue and servicing fees continue to be assessed and added to the loan balance and will ultimately be collected by FHA when the loan is finally terminated. In many cases, there is a substantial amount of equity remaining in the property after a loan has been assigned.

The article also fails to report that among the three payment options for borrowers—lump sum, life tenure or term payments, or line of credit—only those who take lump sums typically end up with loan balances that might exceed the value of the property at disposition. As Jerry Wagner of Ibis Software, one of the leading industry analysts, recently reported, “No one has ever lost money on a tenure payment loan or line of credit.”

–“Taxpayers are being tapped to subsidize reverse mortgages for the first time” referring to the \$798 million appropriation called for by the President’s Office of Management and Budget, which our research indicates is based on a further, extremely pessimistic projection of future decline in home values. In addition to the \$7 billion in mortgage insurance revenue collected in previous years, thorough research of current events by Consumer Reports would have revealed that the predicted shortfall is now being questioned and still an unsettled issue in Congress.

–“Marketing can be misleading,” which we all agree with. In response, the HUD Inspector General, GAO and FTC are keeping an eye on industry advertising. In addition, NRMLA has recently expelled or suspended members for advertising deemed in conflict with our Code of Ethics and Professional Responsibility and referred inappropriate actions by non-members to the appropriate authorities for further follow-up.

–“Unsuspecting borrowers have become cash cows for lenders and others who encourage them to use their mortgage proceeds to buy financial products such as deferred annuities.” There was an earlier period in the product’s history of cross-selling of reverse mortgages by insurance salesmen who had an ulterior motive of using loan proceeds to fund the purchase of other products. But that issue was addressed by a provision in the Housing and Economic Recovery Act of 2008, implemented by HUD in

October, 2008 that requires any individual involved in a HECM reverse mortgage transaction to be an employee of an FHA-approved lender or correspondent. Yet again, Consumer Reports makes an alarming statement without researching and calling attention to the good work and new regulations in this area under discussion or on the table at HUD and within many state legislatures.

All of this indicates the reporting in this piece seems to be lacking in the kind of rigorous research one would expect of a well-reputed national publication, even more surprising since all the players in this sector are accessible and all the new information is readily available. Instead, the Consumer Reports article lazily relies on the easiest and most clichéd criticisms of a complex situation.

Outdated Stories

The Consumer Reports article provides three slanted stories as examples written to horrify interested borrowers, or anyone else who does not examine the facts provided. Let's look at them one at a time:

The first story is of Ernest and Norma Minor who took a reverse mortgage on their Marysville, California home in 2005 to cover the health care expenses of her multiple medical problems. At the time, the loan was the only option for the Minors to remain in their home and cover their medical bills, a fact that is not reported in the Consumer Reports story. The lender was Financial Freedom and the Minors went through counseling with a HUD-approved counselor and signed a document to confirm this.

Norma Minor was 68 at the time, but Ernest was not yet 62, below the age required for a HECM. He chose to remove his name from the deed. The Minors solved their immediate problems, using \$70,000 to pay off their existing mortgage and lower monthly expenses and \$91,700 to pay her medical bills, fix their roof, and for other expenses.

In July of 2007, Norma died. Since she was the exclusive borrower, Financial Freedom called her loan to be due and payable, as is required under HUD rules. But the housing market took a dive and value of the house had shrunk to \$130,000. The only way for Minor to satisfy the loan was to put the house up for sale.

Consumer Reports writes, "Minor was surprised to receive a letter from Financial Freedom saying that (his wife's) death made the mortgage payable." And also that, "he and his wife never understood that he risked losing the home." But in addition to the counseling session in which this was explained, Financial Freedom insists both borrowers sign a Non-Borrower Spouse Ownership Interest Certification which states clearly that in the event of the borrower's death, the non-borrower would have to pay off the

loan or sell the house. The Minor case was no different. One would assume that if Consumer's Reports researched this, they would have been made aware of such signed certificates. But the magazine chose to ignore the existence of documents which would have altered their portrayal of the Minor story.

In addition, even elementary research should have revealed to Consumer Reports that revisions in counseling over the past two years would now assure anyone taking out a HECM today that they would be advised of the possibility of non-borrower occupants having to vacate the home upon the death of the person whose name is on the deed.

Despite the requirement by HUD regulations that under these circumstances the loan was required to be paid back within one year from Mrs. Minor's passing, Financial Freedom held off foreclosing on the property for an additional two years to give Ernest the opportunity to find alternative resources.

The second story described by Consumer Reports is of Brett and Cathy Palmer who received a notice from the Wilmington Savings Fund Society Bank that as heirs they were responsible for the balance on a reverse mortgage Cathy's mother had taken. The amount that had been drawn down had been \$77,000 in 1993, but the balance requested in 2007 was \$588,000.

How could that possibly be, you ask? A HECM purchased in 1993 at that amount would have a balance of about \$200,000 today at the interest rates over the past 14 years. But Cathy's mother did not take out an FHA-insured HECM. In fact, Cathy's mother had purchased a proprietary reverse mortgage with a shared appreciation feature – a product that has not been available anywhere for nearly a decade now. With that type of product, the lender is eligible to receive a payment representing a percentage of the home's increase in value over the life of the loan – in exchange for providing a larger benefit to the borrower than would have been available without the equity share. Cathy's mother agreed to give the lender 100% of the house's appreciation. Shared appreciation reverse mortgages were an early product introduced before the advent of the FHA HECM — and in a period of considerably higher interest rates than are available today — that gave the lender a participation in the growth in value of the home as an additional protection. In exchange for that equity share, the borrower received a larger benefit than would have been available without it. In any case, those types of products no longer exist, which is why it is an inappropriate example in a magazine story on reverse mortgages published in 2009. It's the "flat screen case."

The third story is about Miguel and Laura Posada who took out a \$100,000 reverse mortgage on their Sacramento home in 2005 from U.S. Financial

Mortgage. The loan officer at U.S. Financial allegedly pushed the Posadas to put the proceeds into an annuity that he claimed would help qualify them for extended care health coverage under Medical. This is another outdated example from 2005. But it is now 2009 and U.S. Financial Mortgage no longer exists. The secondary market, which buys the loans and securitizes them, caught onto their scheme and stopped doing business with them, which pushed them out of business. And an insurance brokerage set up to pull such schemes would be precluded by HUD from being involved in the sale of reverse mortgages today.

While Consumer Reports was digging out these outdated, no longer applicable stories, we have been focusing on current stories: Like the one about the lender in Central Florida who kept 30 families out of foreclosure in the month of March alone. Or the 83 year old woman outside Miami who needed a hip replacement, was turned down five times by her insurance company that was waiting for her to die, took out a reverse mortgage, paid for the surgery, then used the balance to hire a lawyer and sued the insurance company, which then paid her back for the surgery. Or the gentleman outside of Denver who was suffering from diabetes, lost a leg and needed transportation to his dialysis, who could not keep up on his real estate taxes and whose bathroom had failed and was using his sink for everything. He took out a reverse mortgage, paid up his taxes, fixed his bathroom and now can afford transportation to his weekly dialysis treatments.

Errant Calculation

Consumer Reports calculates that a 74 year old borrower who takes out a HECM on a \$300,000 house with a monthly adjustable interest rate in the New York City area would receive \$182,541. It goes on to report that the loan would cost \$15,000 in closing fees plus another \$15,000 over the life of the loan in insurance premiums and monthly servicing fees. It then calculates the cost is one sixth of the amount borrowed.

This is not accurate. Since the costs are actually a part of the loan, the amount borrowed in this scenario would actually be \$197,541 (\$182,541 plus \$15,000), so the percentage of the costs is lower than reported. In addition, the article fails to mention that if the loan is taken as a line of credit, the untapped balance continues to grow, which lowers the percentage of the costs even further.

Furthermore, a significant component of the \$15,000 in closing costs was the 2% upfront mortgage insurance premium (\$6,000) paid to the federal government, to FHA, on this loan. In return for paying that mortgage insurance premium, the 74 year old borrower received over 60% of the value of the home in initial reverse mortgage proceeds. A loan without such mortgage insurance might have saved the \$6,000 in upfront mortgage

insurance premium, but would also have provided a benefit that would have been less than 45% of the value of the property, a difference of over \$50,000.

NRMLA would have been and still is happy to share the model that demonstrates this with Consumer Reports.

In addition, the article fails to report that closing costs vary from state to state and in many locations they are less expensive than in New York.

The Future

The Conclusion of the Consumer Reports article looks to the future and expresses concern that proprietary reverse mortgages, which are not currently available and which are not insured by FHA, will make a comeback. Because proprietary products do not involve the government, they are free of some of the regulations. But the NRMLA Code of Ethics and Professional Responsibility sets the same standards for proprietary products as for HECMs, including counseling and restrictions on cross selling. And over 95% of the proprietary mortgages offered before the funding disappeared were offered by NRMLA members.

Consumer Reports says that its publisher, the Consumers Union, believes that sellers of reverse mortgages should be required to make sure the loan is suitable to the borrower. FHA, working hand in hand with the industry, AARP and other interested parties, recently designed and is currently implementing a new counseling protocol to help prospective borrowers determine if a reverse mortgage is suitable for their own individual circumstances. Because every case is completely different, it is the senior homeowner, with assistance from an independent, objective HUD-approved counselor, who can best decide if a reverse mortgage fits his or her needs. Additionally, HUD is implementing a financial assessment, to be done by both counselors and lenders, to help prospective borrowers determine whether they will be able to sustain themselves in the home and pay taxes, insurance and home maintenance costs, if they follow through with the reverse mortgage.

This is not reported. The Consumers Union asks for proprietary loans to require one-on-one counseling, which all of our members already do.

At its core, as NRMLA has said before, the reverse mortgage is a compassionate financial product. Those who conceived it found the means to provide hundreds of thousands of American seniors with comfort at a difficult time in their lives. That is not to say that the product is yet perfect or that there are not swindlers out there trying to take advantage of seniors with cash. But there are many people in and out of the government working

together on a daily basis to improve the product and police the industry.
And, we are making great strides.

It is not too much of a stretch to expect a publication like Consumer Reports that wants to be depended upon, to vigorously explore and report on the entire present situation rather than to publish an incomplete view of the industry full of unsubstantiated fear-mongering. They should know better.

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