Reversals of fortune

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Just memories

Ernest Minor faces losing his home after a reverse mortgage came due following the death of his wife, Norma.
Photograph by Edward Caldwell

Ernest Minor is packing up his Marysville, Calif., home. After his wife, Norma, died in 2007, a reverse mortgage came due—a whopping bill of more than $200,000. (The home's current value is $130,000.) Now Minor, who says he was misled into thinking the loan was a good way to pay for Norma's mounting medical bills, is likely to be evicted.

(Comment by John Karavas: If Mr. Minor was a title holder of the home at the time of the reverse mortgage was taken, the foreclosure of the house would not be happening as long as he maintained homeowners insurance, paid his property taxes and kept the house in sound condition.

As a non-titled spouse living in the home of a reverse mortgage borrower, he was most likely asked by way of a signature acknowledgement the question, "Do you fully understand the implications of the reverse mortgage on a non-titled spouse if the titled spouse no longer lives in the house? Therefore there is an opportunity for the non-titled spouse to come to an understanding of the circumstances of the reverse mortgage. Mr. Minor would have had an opportunity to become a titled borrow on the loan if he had so elected prior to the closing. Many times a non-titled spouse living in the home will elect to continue off title, when the non-titled spouse

is under the age to qualify for the Reverse Mortgage and the cash benefits of the RM are needed. The couple would have additionally been reminded of the circumstances of a non-titled spouse living in the home during the FHA certified counseling discussion with the borrower and non-titled spouse.

With regard to the "high insurance premium" that is discussed later in this article, that insurance purchase will pick up the shortfall and pay for the difference between the loan obligation and the net retail sale proceeds of the house. So if the net value of the sale proceeds is $122,000 than the insurance premium payment will cause FHA to pay the bank's shortfall of $78,000, plus. There will be NO repayment obligation on the behalf of the borrower's estate. That benefit alone is probably worth the insurance premium paid.)

Reverse mortgages can be valuable as a last resort for seniors who want to stay in their homes and have significant equity but need money to supplement income or banish an existing mortgage payment. With a reverse mortgage, they can trade some of that equity for a lump sum and monthly payouts.

But 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. They can without any remaining equity to cover unexpected costs later in life.

(Comment by John Karavas: The reverse mortgage process is substantially educational. The mortgage originator should be taking an instructive approach, including a full explanation of each form that the borrower is signing. In addition the required counseling session connected to all FHA insured RM loans requires an educational counseling session discussing all of the conditions of the transaction. And finally all forms are explained by the closing attorney at the time of the closing. Lastly after all this, the borrower has an additional three days to reconsider the transaction, after the formal closing. So there is plenty of time to ask questions when something is not understood when presented, and additional time to change one's mind, even after the closing.)

Use of the loans is exploding as lenders—who shoulder almost no risks—push them to the growing ranks of retired baby boomers, especially for spending on vacations, new cars, and more.

(Comment by John Karavas: Many lenders do not offer reverse mortgages as they view them as a closing process that takes too long and a profit opportunity that is minimal. This is based on discussion I have had with bankers who do not offer the Reverse Mortgage product.

With regard to what the money is spent on, yes one can go on vacation, buy a new/replacement car, and more. The lack of restrictions as to how the money is spent is viewed by this writer as a plus, not a negative.)

Lawmakers and regulators are getting worried. "The people who are making these loans and advertising them so heavily to seniors on cable TV get the rewards but escape the risks that comes with them. It's going to be the sequel to the subprime-mortgage mess," says Sen. Claire McCaskill, D-Mo., who is pushing for reverse-mortgage industry reforms.

(Comment by John Karavas: Marketing is nothing more than a sign in the window crying "Come see what I have" and never intended to be full disclosure. My guess is that Senator Claire McCaskill also uses the same technique when running for re-election. I would also suggest that the full disclosure process prior to a formal completion of the loan transaction substantially exceeds any full disclosure practices practiced by the senator, or any other elected official.)

A *Consumer Reports* investigation has found more cause for concern: Loan bailouts have soared. The annual sum of reverse mortgages taken over by a federal insurance fund has more than quadrupled in four years, from $81.3 million in 2004 to $381.3 million in 2008, according to our analysis of more than 500,000 loans over two decades.

(Comment by John Karavas: Yes, the reverse mortgage is not for everyone's circumstances. Borrowers do need to take a comprehensive look at how the product will be helping them, and be very aware of any financial shortfalls that could take place. An excellent resource for anayzing the impact of a reverse mortgage and one's future personal cash flow can be accessed without charge at the borrower's district Agency on Aging Office.)

Taxpayers are being tapped to subsidize reverse mortgages for the first time. Usually, insurance premiums paid by borrowers have covered bailouts of mortgages by the fund. The payouts to lenders occur under certain circumstances, such as when the eventual sale of a borrower's home doesn't cover the money owed on the loan. Now the Department of Housing and Urban Development says that $798 million in taxpayer money must be budgeted in the next fiscal year to cover potential losses that won't be covered by the premiums.

(Comment by John Karavas: Imagine a bailout for Senior Homeowners! OMG that would take available money away from companies like AIG, Bank of America, Citibank and the rest!

Actually there is a discussion about increasing the insurance premium charges, which is now 2% of the appraised value of the home, plus 1/12 of

½% each month on the loan balance. Also there is another discussion which involves lessening the lending limit to retain more dollars of the total home value to help fund the shortfalls. Both of these options will increase the amount of money available to the federal government by lessening the amount of money available to the senior home owner.

Marketing can be misleading. Too often sales pitches emphasize the positives and play down the high costs of the loans. At a March 2009 industry conference in New York City, one speaker delivered advice on the "10 Commandments for Selling to Seniors," including beginning the pitch with appeals to emotions rather than reason.

(Comment by John Karavas: Marketing never tells the full story. Although with the educational process attached to the reverse mortgage transaction, it may be impossible to find another product or service that has a comparable or greater full disclosure process than the FHA insured Reverse Mortgage home equity loan.)

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 that can be inappropriate for their situation. And the required counseling for the mortgages can be far too skimpy.

(Comment by John Karavas: Wikipedia defines "cash cow" as "… a product or a business unit that generates unusually high profit margins: so high that it is responsible for a large amount of a company's operating profit. This profit far exceeds the amount necessary to maintain the cash cow business, and the excess is used by the business for other purposes."

Based on my personal knowledge, and the lack of interest of many banks to not enter the reverse mortgage business because of the high cost of the transaction, I will assume that this statement by the reporter at Consumer Reports is more emotional than based on fact. Although, yes there has been some loan officers in the past who have attached the requirement of buying an income annuity to the obtaining of a reverse mortgage. It is unfortunate that this can happen, but the federal legislature, FHA and HUD have all addressed this practice and anybody today practicing the attachment of the two products will be violating the law – and that's a very good thing.)

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