FEATURE

Reverse Mortgages: Should the Elderly and U.S. Taxpayers Beware?

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REVERSE MORTGAGES ARE BECOMING POPULAR IN AMERICA, though it is only a small niche in the multi-trillion dollar banking industry. It has, however, begun to attract the interest of banks, mortgage brokers, insurance companies and Wall Street investors who are looking for new profit centers in the wake of the subprime mortgage meltdown. Seniors who might be considering these loans, and U.S. taxpayers who have suffered from the subprime mess, should carefully evaluate how the reverse mortgage market is developing. Reverse mortgages are complex financial transactions that have considerable closing costs, but when used correctly and under the right circumstances, have the potential to greatly enhance the lives of the senior borrowers who obtain them. This article will introduce the reader to the reverse mortgage market, provide information about the growth in reverse mortgages, describe the characteristics of these loans, and outline issues of concern.

INTRODUCTION

The role of the reverse mortgage is to put money in the pockets of seniors by allowing equity depletion during the owners' lifetime. Seniors who are 62 or older and who have paid off their home mortgages (or owe only a small balance) are able to tap into their home equity to generate extra cash. These senior borrowers can take the money as a lump sum, a line of credit, monthly payments, or a combination of a credit line and regular payments. The borrowers, unlike with traditional mortgage or home equity loan, do not need to meet income or credit requirements to qualify, and don't have to repay the loan until they no longer use the home as their principal residence. These mortgages are called "reverse" because of the nature of payments. In this case, the homeowner is not the party who makes payments; the bank makes payments to the homeowner. The loan is not repaid until the property is sold or upon the death of the borrower when repayment is settled through normal probate procedures.

Seniors are living longer, and the recent economic crisis has negatively affected their investment portfolios. Not only has the value of their investments dropped, fixed-income securities are providing low income yields. In addition, in many parts of the country home values have declined. Reverse mortgages can give older Americans greater financial security. Many seniors use the income from these loans to supplement social security, meet unexpected medical expenses, make home improvements, and cover other costs.

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ORIGINS AND EVOLUTION OF REVERSE MORTGAGES

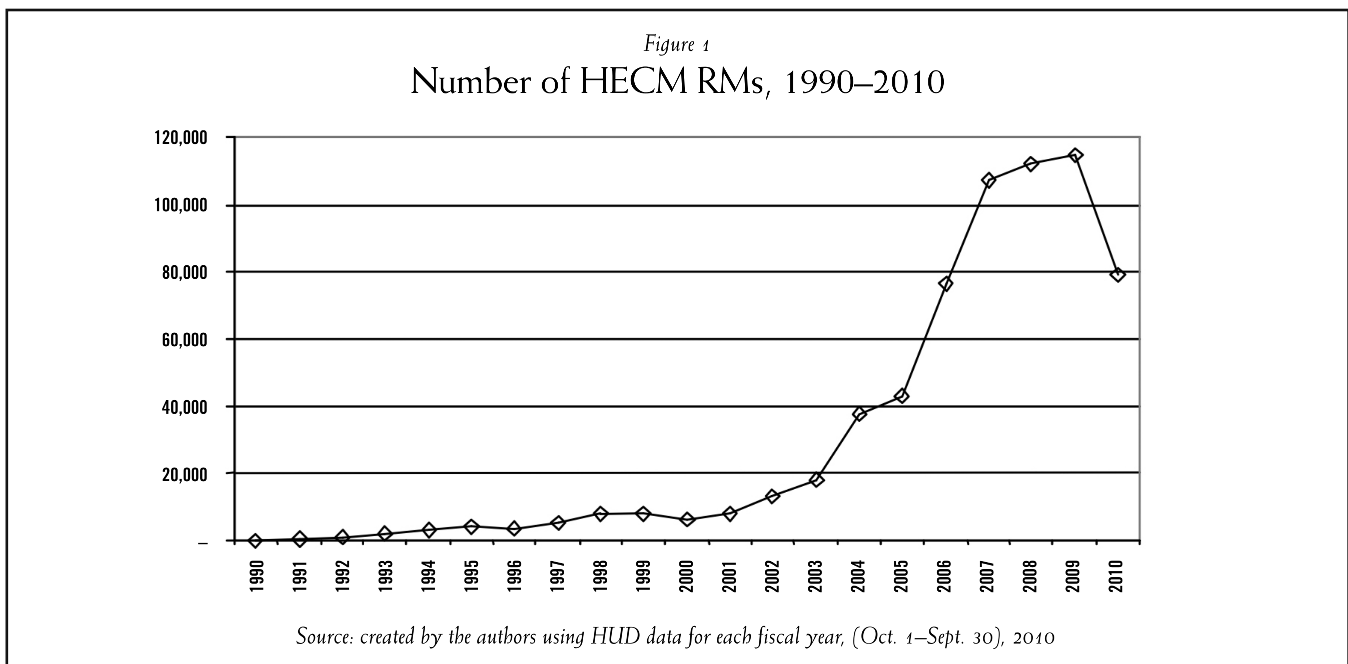
As far back as the early 1960s, equity conversion loans were being offered by private financial institutions. These lenders introduced shared appreciation mortgages, reverse annuity mortgages, deferred payment loans, and sale/leaseback offerings that varied greatly and were largely unregulated. During the 1980s, financial institutions attempted to expand the reverse mortgage market to take advantage of increased home equity values among seniors. These early efforts to exploit new business opportunities with seniors did not prosper.

Senior advocates and academia thought there was a place for reverse mortgages as a way to remediate the impact of poverty on elderly homeowners. Congress was lobbied by these advocates to create an equity conversion product that was standardized and would be acceptable to the lending industry. In 1988, Congress authorized a prototype insured by the Federal Housing Administration (FHA), a branch of the U.S. Department of Housing and Urban Development (HUD). This initiative was the genesis of the government's Home Equity Conversion Mortgage (HECM) program.

The HECM is the federally insured reverse mortgage product. A commercial lender makes the HECM loan, and the government's primary role is to insure it. It is insured by the FHA. HECMs account for nearly all reverse mortgages originating in the U.S. today. From very modest beginnings, the HECM program now insures more than 600,000 loans. Between 2000–2009, HECMs grew at a compound annual rate of approximately 40 percent. In 2009, 114,692 of these loans were made. In 1996, Fannie Mae developed a reverse mortgage of its own called the "Home Keeper," but this product was discontinued in 2008. Just before the recent financial meltdown, a handful of private financial institutions offered a variety of equity conversion products. These private reverse mortgages were all securitized and when the private mortgage securities market collapsed, the relatively small part of it directed to reverse mortgages collapsed as well (Figure 1).

Figure 1

Number of HECM RMs, 1990–2010



Source: created by the authors using HUD data for each fiscal year, (Oct. 1–Sept. 30), 2010

Even though the housing market has been shaken by the subprime mess, and home values have dropped in most parts of the country, there is still a tremendous potential demand for reverse mortgages. The population of seniors in the U.S. is booming. In 2000, the senior population (65 and older) was 35 million, and projections indicate an increase to 64 million in this age group by 2025.[1] Today, the country's approximately 37 million seniors make up more than 12 percent of the population, and they are expected to represent around 18 percent of total U.S. population by 2025.[2]

Data from the American Housing Survey, conducted by the U.S. Census Bureau, suggests there is as much as $2.8 trillion in home equity.[3] In 2008, the National Reverse

Figure 2

HECM Borrower Statistics

Fiscal Year	Average Borrower Age	Borrower: Single Female	Single Male	Multiple
1990	76.75	57.32%	16.56%	26.11%
1991	76.54	56.04%	13.88%	30.08%
1992	76.57	57.66%	15.03%	27.31%
1993	75.64	54.97%	14.37%	30.66%
1994	75.13	54.75%	14.47%	30.77%
1995	76.00	56.46%	13.54%	30.00%
1996	75.88	56.40%	12.54%	31.06%
1997	75.90	56.59%	13.23%	30.18%
1998	75.66	55.98%	14.10%	29.92%
1999	75.26	54.78%	14.48%	30.75%
2000	75.96	56.79%	13.00%	30.21%
2001	75.54	54.46%	13.66%	31.88%
2002	75.13	51.36%	13.97%	34.67%
2003	74.30	48.61%	14.19%	37.20%
2004	74.26	48.62%	15.19%	36.20%
2005	73.78	46.01%	16.05%	37.94%
2006	73.75	44.49%	16.66%	38.85%
2007	73.54	44.60%	18.20%	37.21%
2008	73.06	43.83%	20.62%	35.55%
2009	72.91	41.18%	21.83%	36.99%
2010	72.93	42.71%	22.02%	35.27%

Source: summarized by the authors using HUD data, 2010

Mortgage Lenders Association estimated that seniors had perhaps $4 trillion in home equity.[4] Whichever statistic is correct, there is a lot of senior home equity that could be tapped. Even many of the poorest seniors have built up home equity. The 2007 American Housing Survey found that more than 700,000 seniors with annual incomes below $5,000 owned their houses, free and clear. The report showed that another 2.4 million seniors with annual incomes below $15,000 had no mortgage debt.[5] Additionally, more than 7 million seniors with annual incomes below $30,000 owned their home free of debt.[6]

BORROWER MOTIVATION

As a result of the housing and economic crises, reverse mortgages are being marketed to seniors with renewed vigor. Historically, retirees on fixed incomes sought reverse mortgages as a way to cope with the costs of health care, housing and other basic needs. Their one big asset, home equity, could provide much needed financial relief, and would enable them to stay in their home. The current economic environment combines lowered home values and investment holding values with lowered interest rates, creating a reduction in seniors' incomes.

Today, however, lenders are using a sales pitch that tells seniors who are falling behind on their mortgage payments to use a reverse mortgage to avoid default. The reverse mortgage can save their home, but these borrowers need to bear in mind that the majority of the proceeds will probably be used to pay off their primary mortgage with little left over for other needs. Seniors who are contemplating a reverse mortgage must make sure that they have adequate savings to support themselves. Another sales pitch suggests using a reverse mortgage to cover everyday expenses, perhaps temporarily, during this time of economic hardship. This idea would appeal to seniors who are "house rich, cash poor." Some seniors, who previously would have sold their home and moved to a different type of housing, are finding mortgage relief in reverse mortgages. In today's economic environment, the

reverse mortgage can sustain these seniors until they can sell their house.

LENDER MOTIVATION

The potential origination fees from reverse mortgages are enormous. The market for the reverse mortgages is far larger than the traditional mortgage market. Most people only buy or sell a home every 5–10 years, but there are millions of seniors sitting in homes with huge amounts of equity. With the collapse of the housing market, home values have declined, credit has dried up and fewer homes are being bought and sold. Mortgage departments have historically been a huge source of revenue for banks. The current housing market isn't generating nearly as much profit as in previous years. Enter the reverse mortgage. Here is a product with a huge borrower base. Here is a product that doesn't require any credit analysis. Here is a product that is government guaranteed so the bank doesn't have to worry about losing money in a foreclosure. The fees on reverse mortgages have been very high, which, in turn, creates higher profits for the lenders.

During the past couple of decades, mortgage market lenders' profits have been driven by loan volume. As in the forward mortgage business, most reverse mortgage loans have been sold to Fannie Mae (it stopped accepting new commitments after Oct. 4, 2010), Ginnie Mae or into the secondary market rather than being held by lenders. The sale of loans enables lenders to replenish their capital so that they can make more loans and, therefore, generate greater transaction fees.

The subprime debacle provides plenty of evidence that loan originators have been willing to sacrifice responsible lending practices to generate greater loan volume, higher fees and, ultimately, greater profits. Chasing volume and relaxing underwriting standards are often cited as the prime reasons for the subprime fiasco. In 2008 a report from the U.S. Government Accountability Office (GAO) showed that more than 1,500 lenders made their first reverse mortgage loans, and that 2,950 lenders offered HECMs.[7] However, a market consolidation trend has been taking place since 2008.[8] The number of reverse mortgage lenders has been decreasing, and the biggest lenders have been growing larger. There were only 1,883 lenders left by 2010. In 2010 the number of large lenders decreased by 3 percent, and the number of smaller lenders dropped by 47.7 percent, to 1,136 lenders.[9]

Mortgage brokers serve as intermediaries who bring mortgage lenders and borrowers together. Their compensation depends on finding and originating loans. During the subprime mortgage boom this group was quite often responsible for pushing inappropriate mortgage loans on borrowers without any regard for whether the borrowers needed the loans or could afford the payments. Brokers don't get paid unless they close loans. Mortgage brokers who are originating reverse mortgages have a financial incentive to originate as many loans as possible.

There are some reverse mortgage products that are more profitable than others. Can we trust mortgage brokers to be more responsible this time? Seniors often assume that brokers are duty bound to look out for the borrower's best interest—they aren't. Mortgage loans are considered business transactions in which the parties are responsible for protecting their own best interest. In many states, brokers and lenders owe no fiduciary duty to borrowers.

As we saw with subprime mortgages, "push" marketing is being used extensively to sell reverse mortgages. Advertising for reverse mortgages can be found on TV, the Internet, in the mailbox and over the telephone. Celebrities are acting as spokespersons reassuring seniors that reverse mortgages are a good thing and can provide extra money to fund a better lifestyle. Most of the time the marketing promotes the reverse mortgage as a way to increase consumption of items that are not necessities.[10] Reverse mortgages are complicated financial transactions that should be considered carefully. Increased competition, loan volume and the vast number of potential reverse mortgage borrowers raises the question of whether this market will see the same abuses that were seen in the subprime market.

REVERSE MORTGAGE CHARACTERISTICS

Virtually all reverse mortgages being originated today are FHA HECMs. The following outline highlights this particular type of reverse mortgage.[11]

Borrower Requirements

You Must:

- be 62 years of age or older;
- own the property outright or have a small mortgage balance;
- occupy the property as your principal residence;
- not be delinquent on any federal debt;
- participate in a consumer information session given by an approved HECM counselor.

Mortgage Amount Based On:

- age of the youngest borrower;

- current interest rate;
- lesser of appraised value or the HECM mortgage limit (currently $625,000).

Financial Requirements Include:
- no income or credit qualifications are required of the borrower;
- no repayment as long as the property is the borrower's principal residence;
- closing costs may be financed in the mortgage.

Property Requirements—The following eligible property types must meet all FHA property standards and flood requirements:

- single-family home, or one four-unit home with one unit occupied by the borrower;
- HUD-approved condominium;
- manufactured home that meets FHA requirements.

Payment Plans:
- Tenure—equal monthly payments as long as at least one borrower lives and continues to occupy the property as a principal residence;
- Term—equal monthly payments for a fixed period of months selected;
- Line of Credit—unscheduled payments or in installments at times, and in an amount of the borrower's choosing until the line of credit is exhausted;
- Modified Tenure—combination of line of credit plus scheduled payments for as long as the borrower remains in the home;
- Modified Term—combination of line of credit plus monthly payments of a fixed period of months selected by the borrower.

The settlement charges on reverse mortgages cover basically the same costs that are involved on a forward mortgage, but there are some differences. The following types of costs will typically be associated with the HECM reverse mortgage:[12]

- mortgage insurance—2 percent of the lower of home value or maximum loan limit, and an annual premium of 1/2 percent of the loan balance;
- origination fee—set by regulation at 2 percent of the FHA loan limit, with a minimum fee of $2,000 and a maximum of $6,000;
- appraisal fee;
- title insurance;
- title, attorney and county recording fees;
- survey, if required;
- credit report fee, flood certification fee, pest inspection.

In addition, a monthly service charge of $30–$35 to cover the cost of servicing the loan will be added monthly to the balance of the loan. None of the upfront costs are necessarily out-of-pocket, and they can be included in the loan amount.

Reverse mortgages have long been considered one of the most expensive ways to extract cash from one's house. Declining property values and stricter lending limits imposed by the FHA in 2009 slowed the growth in the reverse mortgage market. From Oct. 1, 2009 to March 31, 2010, reverse mortgage origination volume dropped by 22 percent compared to the same period one year earlier.[13] As home values continued to fall, HUD cut the amount of equity that reverse mortgage borrowers could extract by 10 percent. In many cases, that meant homeowners no longer qualified for a reverse mortgage large enough to pay off their regular mortgage, and this is a basic requirement for getting loan approval. Lenders still saw this market as enormous and weren't willing to back away.

Recently, financial institutions such as Wells Fargo, Bank of America, MetLife Bank, and Financial Freedom have all waived their origination fees and other charges on certain reverse mortgages.[14] The reduced fees on reverse mortgages are a result of another important industry development: investor demand for mortgage-backed securities that include reverse mortgages. During the past two years, lenders have started securitizing reverse mortgage loans by converting them into Ginnie Mae-backed bonds. These are popular with investors because of their government guarantees and high yields relative to Treasury bonds. Investors are willing to pay a premium for that kind of safety with a higher yield and, therefore, lenders are passing on some of that premium to borrowers in the form of lower fees.

PROCEEDS FROM THE REVERSE MORTGAGE

The amount of money a senior will receive from the reverse mortgage ultimately will depend on the following five factors:

- What is the appraised value of the property? What health and safety repairs must be considered? Are there any existing liens on the house?
- What are the prevailing interest rates on reverse mortgages?

- What is the age of the senior? Frequently, the older the borrower, the bigger the reverse mortgage payment.
- How will the payment be taken?
- Is the value of the property higher than the national loan limit set by HUD?

EXAMPLE OF THE REVERSE MORTGAGE PAYOUT

There are numerous sites[15] devoted to calculating the proceeds that are possible from using a principal residence to enter into a reverse mortgage. Following are examples from a Reverse Mortgage (RM) calculator site using a home valued at $200,000 with owners at three different ages (75, 70 and 65). We have used the RM calculator found on the Financial Freedom Web site.[16] Also, we have picked a zip code that would place the house in Davidson County, Tenn. This way, we are able to get a good general view of the RM output for a single person living in an average-priced home in Nashville, Tenn. and the surrounding area.

The actual outputs of the discussed reverse mortgage calculation results can be seen below.

Sample Reverse Mortgage Payout

Parameters
75 years of age

Home Value	$200,000
Zip Code	37211
Number of residents	1
Date of Birth	8/1/1935

	HECM Monthly LIBOR 175 Variable Rate	HECM Fixed*
CASH AVAILABLE		
Cash Available	$115,425	$121,297
OR MONTHLY INCOME		
Monthly Income Available	$688	N/A
OR LINE OF CREDIT		
Credit Line Available	$115,425	N/A
Annualized Growth Rate	2.59%	N/A
OR ANY COMBINATION OF THE ABOVE		
For example: 1/2 Cash Available, 1/4 Monthly Income and 1/4 Line of Credit.		

Source: https://b2b.financialfreedom.com/calculator/

Sample Reverse Mortgage Payout

Parameters
70 years of age

Home Value	$200,000
Zip Code	37211
Number of residents	1
Date of Birth	8/1/1940

	HECM Monthly LIBOR 175 Variable Rate	HECM Fixed*
CASH AVAILABLE		
Cash Available	$107,324	$113,697
OR MONTHLY INCOME		
Monthly Income Available	$589	N/A
OR LINE OF CREDIT		
Credit Line Available	$107,324	N/A
Annualized Growth Rate	2.59%	N/A
OR ANY COMBINATION OF THE ABOVE		
For example: 1/2 Cash Available, 1/4 Monthly Income and 1/4 Line of Credit.		

Source: https://b2b.financialfreedom.com/calculator/

Sample Reverse Mortgage Payout

Parameters
65 years of age

Home Value	$200,000
Zip Code	37211
Number of residents	1
Date of Birth	8/1/1945

	HECM Monthly LIBOR 175 Variable Rate	HECM Fixed*
CASH AVAILABLE		
Cash Available	$99,738	$106,497
OR MONTHLY INCOME		
Monthly Income Available	$516	N/A
OR LINE OF CREDIT		
Credit Line Available	$99,738	N/A
Annualized Growth Rate	2.59%	N/A
OR ANY COMBINATION OF THE ABOVE		
For example: 1/2 Cash Available, 1/4 Monthly Income and 1/4 Line of Credit.		

Source: https://b2b.financialfreedom.com/calculator/

(All numbers listed above are estimates only. Computations for HECM Fixed Product have been done considering the rates available as of: 08/05/2010. The rate used is for the lump sum draw option.)

HUD introduced a new reverse mortgage product as the second reverse mortgage option in October 2010.[17] The new HECM Saver is a reverse mortgage product insured by the FHA that has low up-front loan closing costs. Also, this product competes with regular home equity lines of credit because it has lower insurance premiums. The new product lowers the cost of entry for borrowers by charging only 0.01 percent (versus 2 percent for HECM Standard) of the maximum claim amount as an up-front mortgage insurance premium.

However, the loan limits are substantially lower than on the standard reverse mortgage. The HECM Saver has principal limit factors roughly 11–23 percent less than the standard product, and is offered in both a fixed and adjustable rate format.[18] Lower loan limits reduce default risk for the FHA and taxpayers of the country. The HECM Saver loans appeal more to those who only wish to pull a little cash out of their homes now, and expect to pay it back when possible.

CONTROVERSIAL ISSUES AND CONSUMER PROTECTION

History has taught that where senior citizens and cash are involved, scammers are not far behind. An article in *The New York Times* states that hundreds of reverse mortgage applicants have complained about high-pressure or unethical sales tactics that steered them toward mortgages with high fees.[19] A 2009 report, "Subprime Revisited: How the Rise of the Reverse Mortgage Lending Industry Puts Older Homeowners at Risk," by the National Consumer Law Center, suggests as much.[20] The report says the following:

> "Many of the same players that fueled the subprime mortgage boom—ultimately with disastrous consequences—have turned their attention to the reverse market. Lenders, including some of the nation's largest banks, view that market as a source of profits that have dried up elsewhere. Mortgage brokers see it as a new source of rich fees. Predators who once reaped profits from exotic loans have now focused on wresting more wealth from vulnerable seniors. And securitization, which allowed subprime loan originators to disassociate themselves from the downside risks of abusive lending, is becoming commonplace in the reverse mortgage industry."[21]

The authors of this article also have concerns about protecting the elderly as well as U.S. taxpayers. The last thing the U.S. needs is a new scam that is harmful to mortgage borrowers and is detrimental to taxpayers. There is no doubt that there will always be some unscrupulous characters who will try to take advantage of others, but we also feel that the reverse mortgage market is not likely to be a repeat of the subprime mess. Having said that, there are issues that need to be discussed and hopefully resolved with more consumer legislation to protect seniors.

During the subprime boom, the use of "yield spread premiums" provided mortgage brokers an incentive to increase the interest rates or add prepayment penalties to mortgage loans, thereby making those loans more profitable for lenders and investors. HUD has established caps on origination fees in an effort to curb profiteering in the reverse mortgage market.[22] Even though brokers are not permitted to collect any additional origination fees of any kind from borrowers, the regulations do not prohibit lenders from paying additional fees—yield spread premiums—to brokers. Yield spread premiums pose a serious threat to senior borrowers who are unlikely to understand the cost menu that brokers and loan originators use to generate increased benefits to themselves and potential investors.

Another area of concern is often called the "annuity trap." Even though the Housing and Economic Recovery Act of 2008 included a prohibition on lenders' ties to sellers of other financial products, we have concerns about enforcement.[23] There is no doubt that prior to this legislation, one of the greatest abuses of reverse mortgages came from originators who helped seniors cash out equity in their homes to buy expensive and complicated insurance policies, annuities or other financial products. Regrettably, HUD has yet to issue a final rule with respect to the cross-selling ban. It is imperative that it do so and, furthermore, it must strictly enforce the ban because in search of hefty commissions, there will be those who attempt to circumvent the prohibition.

A recent press release from the National Reverse Mortgage Lenders Association announced that it will soon be offering a Certified Reverse Mortgage Professional Loan Originator designation.[24] Applicants will be required to have a minimum of two years of service originating reverse mortgages, at least 50 closings, 12 hours of continuing education, and submission to a background check before they can sit for the exam. While this sounds like a better situation than prevailed for those selling subprime mortgages, there is still concern that seniors may take too much comfort in dealing with

someone with a fancy certification. Mortgage brokers get paid when they sell something.

Reverse mortgage applicants are required to participate in HUD-approved counseling sessions before the loan is approved. Counseling sessions are to be conducted by an independent third party who is neither directly nor indirectly associated with the mortgage originator.[25] Furthermore, lenders are required to provide borrowers with a list of at least ten HUD-approved counseling agencies.[26] Lenders are not permitted to pay for these counseling sessions, either directly or indirectly. Counselors are required to specifically discuss the following topics:[27]

- options other than reverse mortgages that are available to the homeowner, including other housing, social service, health and financial options;
- other home equity conversion options;
- reverse mortgage tax consequences, particularly the effect on eligibility for assistance under federal and state programs, and the impact on the estate and its heirs;
- the financial implications of reverse mortgages.

Counseling sessions are a good idea. Reverse mortgages are complicated financial instruments, and entering into such an arrangement is an important decision that impacts seniors for the rest of their lives. There are critics who say these counseling sessions are often brief and unhelpful. Some of the counseling sessions are actually done over the phone. According to a report by the U.S. GAO, counseling provides, at best, limited protection for senior borrowers. By participating undercover in reverse mortgage sessions the GAO found:[28]

- some counselors exaggerated how long the sessions lasted;
- almost half did not discuss alternatives to reverse mortgages (a requirement);
- none of the sessions covered all of the required topics;
- some counselors encouraged borrowers to use their proceeds to buy unneeded insurance or other products;
- occasionally, reverse mortgage materials included misleading claims.

Some senior borrowers report that their sessions lasted only 10 minutes rather than the 60–90 minutes that most counselors say is needed to fully explain the loans.[29] If counseling is required, and it should be, it is important that counseling be available and timely. This is important to the mortgage lenders, who complain that the counseling requirements create a bottleneck that reduces loan volume. The government hasn't adequately funded counseling so many of the nonprofit groups that provide it have sought funding from reverse mortgage lenders. *The New York Times* reported that Money Management International, one of the largest reverse mortgage counseling companies, often asks lenders for funding. Money Management International received $900,000 in 2007 from reverse mortgage lenders.[30] This sounds like a conflict of interest. We are fearful that the effectiveness of counseling has been undermined by inadequate funding and the limited availability of trained counselors. Counseling may help meet disclosure standards, but it doesn't seem totally effective in educating seniors about the complexities of a reverse mortgage.

TAXPAYER RISK

Virtually all of the reverse mortgages written today are insured by FHA under the Home Equity Conversion Mortgage program. FHA insures the lender against loss in the event the loan balance at termination exceeds the value of the property. It also insures the borrower that any payments due from the lender will be made, even if the lender fails. HECM loans are nonrecourse loans, so the lender cannot seek restitution in excess of the value of the property at loan maturity. In order to fund the HECM insurance program, HUD charges an initial mortgage insurance premium of 2 percent of the value of the home (subject to lending limits) plus a recurring fee of 0.5 percent. Using this rate structure, HUD developed the principal limit factors that determine the amount of money borrowers are eligible to receive.

Until September 2009, the principal factors governing the money available to senior borrowers remained unchanged. In generating the principal limit factors HUD has postulated that home prices would appreciate at 4 percent annually, a figure that is consistent with historic data.[31] As we all know, home prices have fallen since the housing bubble burst in 2006. In response to falling home values, HUD, in October 2009, cut the amount of equity that reverse mortgage borrowers could extract by 10 percent. Because the HECM program is mandated to be a zero subsidy program, HUD was faced with the options of discontinuing the program or reshaping the program to comply with its original mission.

HUD asked for nearly $800 million in 2010 in taxpayer money to boost its loan-loss reserves because of continuing home price declines.[32] This represents the first taxpayer subsidy in the 20-year history of the program. HUD has opted not to increase insurance premiums on

reverse mortgages, even though the subsidy is a sign that such an action might be called for. Looking forward, the amount of losses in the reverse mortgage market as a result of the decline in home prices won't be known for years. There may not even be losses if the housing market stages a decent price recovery, but what we thought we knew about the housing market has been turned upside down during the past five years. Prudent actions taken today might avert serious problems like those seen in the subprime market.

CONCLUSIONS

The recent upheaval in the U.S. housing market provides an interesting opportunity to reevaluate our country's use of reverse mortgages. Our population is aging, and many seniors have seen their home equity erode along with their financial assets. Seniors, in growing numbers, may need to tap the equity in their homes. Recent changes in reverse mortgage products and the growing interest on the part of lenders and Wall Street to originate and securitize these mortgages has increased the likelihood that more and more seniors will draw upon the equity in their homes.

Reverse mortgage products have had a history of high closing costs. These costs appear to be falling. The industry also has some history of high pressure or unethical sales tactics. It now appears that some of the abuses have been remedied with legislation that better protects seniors. There is some evidence that even though seniors are required to participate in counseling sessions, the counseling may be inadequate.

It's fair to say that U.S. taxpayers don't want to experience another financial crisis that is rooted in another mortgage product. The subprime mess should provide a lesson about mortgage lending. Since reverse mortgage loans have nothing to do with the borrower's income, these loans don't face the same default risks as subprime lending. By cutting the amount of equity that reverse mortgage borrowers can extract from their homes, HUD has lessened the risk of problem loans. If the housing market, however, experiences further home value declines, the reverse mortgage program could cause trouble. If home prices start to appreciate, it's less likely there will be losses in this program. ■

ENDNOTES

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