■ Real estate piggy bank

Reverse mortgages are proving valuable to seniors

Many seniors live on fixed incomes in a world of rising costs. Thanks to appreciating real estate values, many of these same seniors find themselves in the awkward position of being house-rich but cash-poor. Consequently, their real estate may hold the key to unlocking a powerful illiquid asset. But can an instrument like a reverse mortgage help seniors solve their financial problems?

By Sylvie Marc ***USA consultant, Transatlantic Ventures***

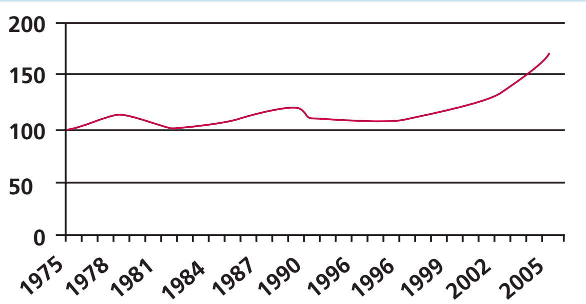
Introduced in the late 1980s, a reverse mortgage (RM, known as Lifetime Mortgage in the UK) allows a homeowner 62 or older to convert the equity in her/his home into cash, which can be used for almost any purpose - as an income supplement, to pay medical bills or other expenses, or to make home improvements. The amount one can borrow depends on age, level of home equity, the home's value and prevailing interest rates. The loan isn't repaid until the borrower dies or permanently moves from the home. After the loan is repaid (the repayment amount can't exceed the value of the home), any remaining equity goes to the borrower's heirs. Loan proceeds can be taken as a line of credit, lump-sum payment, fixed monthly payment or a combination of those.

The Federal Housing Administration (FHA), an arm of the U.S. Department of Housing and Urban Development (HUD), spawned the U.S. market for reverse mortgages when in 1987 it unveiled the Home Equity Conversion Mortgage, or HECM, as part of a RM pilot program. Fannie Mae started purchasing RMs in 1989 and by the mid-1990s had launched its own product, the Home Keeper reverse mortgage.

Some 13.2 million of american households are good candidates for a reverse mortgage

About the same time, Financial Freedom, an Irvine, California-based subsidiary of Lehman Brothers Bank, entered the market with its own proprietary "jumbo" RM product designed particularly for borrowers with high-value homes who want access to more cash than the FHA and Fannie Mae products can provide. The Fannie Mae and FHA products are available through lenders in

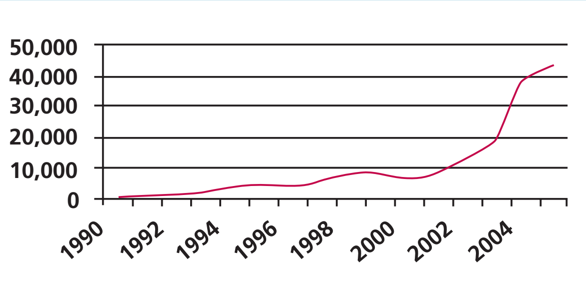
Rising single family home values



House price index for single family homes, deflated by consumer price index, 1975-2005 (1975-100). Fueled by rising home values, larger sales forces and increased consumer acceptance, the number of federally insured reverse mortgages grew by 77% in 2006.

Source : Center for retirement research at Boston College

More and more reverse mortgages



Number of HECM reverse mortgage approved, fiscal year 1990-2005. The aggregate number of outstanding HECM is limited to 250,000, according to the National Housing Act.

Source : National Reverse Mortgage landers Association

Financial Freedom and Wells Fargo
Leaders in reverse mortgages

Financial Freedom Senior Funding Corporation, a subsidiary of IndyMac Bank, is the largest originator of reverse mortgages in the United States. Financial Freedom originated over 2.9 billion dollars in loan funding in 2005 (1.6 billion dollars in 2004) on 9.1 billion dollars in home value in reverse mortgages and is now the largest servicer of reverse mortgages with a servicing portfolio of approximately 77,000 loans (30,991 loans in 2005 and 19,817 in 2004).

Financial Freedom's loan volume is comprised mainly of two types of loans : FHA's Home Equity Conversion Mortgage, the predominant reverse mortgage product in the marketplace; and the Financial Freedom cash account, which is the only jumbo reverse mortgage available and designed for homes in excess of 450,000 dollars in value. "Reverse mortgages have already proven to be an effective financial planning tool for unlocking frozen assets in order to fund long term care plans, annuities or other vehicles as well as to execute tax and retirement planning strategies," says Craig Corn, executive vice president of Financial Freedom.

All those figures are pale in comparison to the 23.7 billion dollars in reverse mortgage funds that Wells Fargo Home Mortgage forecasts will be loaned between now and 2015. Wells Fargo Home Mortgage is the US leading retail mortgage lender with a volume of 36.28 billion dollars and 14.7% market share in 2006, more than 2,400 mortgage and banking stores. Wells Fargo Home Mortgage is a leading originator of reverse mortgages with more than 30% market share. "The reverse mortgage is the perfect way to buy the product a senior needs, like long term care insurance," says Paulette Wisch, manager of Wells Fargo Home Mortgage's RM program in Colorado. "All the money used to buy that kind of product comes out of an RM tax-free, which isn't always the case with an IRA or a 401(k)."

In 1998, Wells Fargo started an “elder services program” to help clients manage both healthcare and financial resources to meet the primary concerns of frail elder: health and money. The elder services program begins with asset and estate planning.

Wells Fargo implements a five-step process that includes document identification and review, asset and liability management, healthcare planning and coordination, tax planning and coordination, and estate management and settlement. The program also involves an assessment of the client's current status, gauging the safety of the home, physical and emotional health, the strength of the current support system and social needs. Wells Fargo elder services have been instrumental in discovering and stopping financial abuse for more than 30% of their clients.

The bank now offers these Elder services in 22 offices nationwide. The bankers are often on call 24 hours a day. The cost of the service is an annual fee of 2% of assets under management for the first 2 million dollars versus a fee of 1.3% for traditional trust services. The fees vary as assets rise above 2 million dollars.

all 50 states, while Financial Freedom's Cash Account Plan is offered in 24 states.

A study by the National Council on the Aging (NCOA) estimates that of the nearly 28 million american households age 62 and older, almost half, some 13.2 million, are good candidates for a reverse mortgage. ‘’Because older Americans have almost 1.8 trillions dollars tied up in home equity, reverse mortgages have the potential to dramatically increase the ability of older homeowners to pay for long-term care,” said NCOA President James P. Firman. He also noted that over 80% of the nation’s seniors own their own homes and 73% are owned free and clear of any mortgages. NCOA identifies medical costs as the most urgent financial issue that could be resolved, at least partially, through reverse mortgages; nearly ten million senior households face health problems. ‘’There's been a lot of speculation whether reverse mortgages could be part of the solution to the nation's long term care financing dilemma," says James Firman. "Reverse mortgages have the potential to help many seniors pay for long term care services at home."

Trends

Fueled by rising home values, larger sales forces, and increased consumer acceptance, the number of federally insured reverse mortgages made in the U.S. in 2006 grew by 77%, according to the National Reverse Mortgage Lenders Association (NRMLA). The most popular type of reverse mortgage in the U.S. is the FHA-insured Home Equity Conversion Mortgage (HECM) that accounts for 90% of all reverse mortgages originated in the U.S. As of December 31, 2005 a total of 195,418 HECM loans had been

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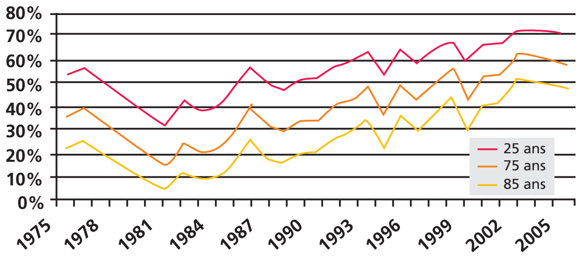
>>> issued since the program's inception in 1989. During the federal fiscal year, ending September 30, 2006 the Federal Housing Administration insured 76,351 HECM compared to 43,131 the prior year. Since fiscal year 2001, the number of endorsed HECM loans has grown an astronomical 881%. Section 255 of the National Housing Act, that governs the HECM program, limits the aggregate number of outstanding HECM to 250,000. Conceivably, the cap could be reached in the next 12 to 24 months. Efforts are currently underway to remove or expand the cap on the number of HECM loans that can be issued.

NRMLA attributes the explosive growth to several factors, including high home appreciation rates in many parts of the country, which allow seniors to access greater amounts of equity; more lenders offering the product (NRMLA now represents about 500 firms nationwide compared to 370 last year at this time); and greater acceptance of reverse mortgages as a wealth management tool. One of the biggest contributing factors are low mortgage interest rates and higher home values. Five years ago, a borrower could get somewhere around 38% of the value of their home from a reverse mortgage. Under today's conditions, that amount is about 70%. Indeed, the government's top housing official, Brian Montgomery, who serves as FHA Commissioner and Assistant Secretary of Housing at HUD, commented at NRMLA's annual meeting in September 2006, that he anticipates ''reverse mortgages will one day be as commonplace as 401(k)s and other retirement planning tools''. RM borrowers typically fall into two categories: "need" customers who use the cash to cover necessary expenses such as unexpected medical bills, home repairs, food and prescription costs ; and "lifestyle" customers whose pension or savings provide enough cash to live comfortably but who want extra money available to better enjoy their retirement years. While the factors that define those two borrower categories have held true during the current RM boom, the demographics of the typical RM borrower have chan ged. The average age of the borrower has dropped.

A few years back, that person typically was a 78-year-old widowed female, more of the needs-type of borrower. Now we see more of the lifestyle-type borrowers – 70- to 72-year-old couples. ■

“Need” customers, and lifestyle ones



Percentage of house value that could be borrowed at ages 65, 75, and 85, 1975-2005. Two categories of borrowers appear : «need» customers, who use the cash to cover necessary expenses, and "lifestyle" customers who want extra money available to better enjoy their retirement years.

Source : Center for retirement research at Boston College