



STATEMENT
BEFORE THE
SPECIAL COMMITTEE ON AGING
OF THE
UNITED STATES SENATE
ON
**“REVERSE MORTGAGES:
POLISHING, NOT TARNISHING, SENIORS’ GOLDEN YEARS”**

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Thank you for the opportunity to testify on reverse mortgages AARP is releasing today in conjunction with this hearing, including data from the first national survey of reverse mortgage shoppers.

It is particularly fitting that the Special Committee on Aging is holding this hearing as we approach the 20th anniversary of the enactment of the federal Home Equity Conversion Mortgage (HECM) insurance program in February 2008. In 1982, this Committee held the first Congressional hearing on reverse mortgages and issued a report calling for the federal mortgage insurance program that was enacted nearly five years later. Today's hearing provides the opportunity to take stock of the progress made in the past 20 years to identify important issues that will affect the future of reverse mortgage options for older homeowners.

Entitled "Reverse Mortgages: Niche Product or Mainstream Solution? Report on the 2006 AARP National Survey of Reverse Mortgage Shoppers," AARP's report provides a comprehensive look at the trends and issues shaping the reverse mortgage industry and consumer experiences with such loans. The rhetorical question in the title summarizes the state of reverse mortgages in the United States today. After many years of very low volume and slow growth, the number of loans insured by the HECM program has increased substantially in recent years – from under 7,000 loans in FY 2000 to over 107,000 loans in FY 2007. Nonetheless, only one percent of older households have taken out a reverse mortgage, and public attitudes reflect a lack of knowledge about and wariness toward such loans.

The report we are releasing today includes the following sources of information:

- *The first ever survey of reverse mortgage shoppers* -- a national telephone survey of 1,509 reverse mortgage counseling recipients, including 1,309 homeowners, 807 of whom had decided to take out a reverse mortgage ("borrowers") and 502 of whom had not taken out a reverse mortgage at the time of the survey ("non-borrowers"). To focus on the needs of homeowners who are likely to have long-term care needs, 200 additional interviews were conducted with representatives of homeowners who had a power of attorney (POA), enabling them to make legal/financial decisions on behalf of a homeowner.
- *An additional national telephone survey* of 1,003 persons age 45 and older, replicating a 1999 survey on consumer awareness of and interest in reverse mortgages.
- *Analyses of U.S. Department of Housing and Urban Development (HUD) data* on characteristics of borrowers, use of loan types, and characteristics of HUD's loan portfolio.
- *Information from unpublished research* on a small Connecticut reverse mortgage program targeted to older homeowners with long-term care needs.

Findings from the Report

The report reaches five conclusions and offers 16 recommendations to deal with emerging issues facing both older homeowners and the reverse mortgage industry.

Conclusion 1: FHA's Home Equity Conversion Mortgage insurance program has successfully created the foundation for the financial infrastructure of the reverse mortgage industry.

The HECM program has been a public policy success story. In the 20 years since it was authorized, the program has proven to be essential in creating the foundation for the reverse mortgage industry. Among the important achievements of FHA's pioneering efforts are:

- an insurance model that pools the risks involved in open-ended loans that do not become due until the homeowner dies, sells the home, or moves permanently;
- flexible payment options that allow consumers to address a variety of needs through monthly payments for a specific term or for the borrower's tenure in the home, a lump sum, a line of credit, or combinations of these approaches;
- a line of credit payment option with a growing availability of loan funds over time that has become a model for the reverse mortgage industry;
- a total annual loan cost (TALC) disclosure that is more complete than the annual percentage rate (APR) disclosure required for other loans;
- mandatory counseling that educates consumers about reverse mortgages and alternative ways to address their needs;
- the backing of the federal government, which has resulted in secondary market funding of these loans, first from Fannie Mae and more recently from Wall Street investors, who are beginning to establish more competitive interest rates; and
- collection and publication of data on loan risks and performance, with the most comprehensive and significant data being published this year on the program's financial performance from its beginnings in 1990 to 2006.

Conclusion 2: Reverse mortgages have enabled older homeowners to address a range of needs and desires with a high level of initial satisfaction.

AARP's survey found that older homeowners were able to address a wide range of needs and desires with reverse mortgages. When borrowers were asked about the main use to which they had put their loan proceeds, the most frequent responses were retiring an existing mortgage (19 percent), home repairs and improvements (18 percent), improving the quality of their lives with extras (14 percent), and paying for everyday expenses (10 percent). 5 percent of borrowers said that addressing health and long-term

care needs was the main use for their loans, most frequently to pay for prescription drugs. Borrowers in fair or poor health, especially those for whom a family member was acting with a power of attorney, were much more likely to report using their loans to pay for home care services and home modifications to remain independent.

Though relatively small percentages of borrowers used their loans to make investments or purchase annuities and/or long-term care insurance products, these uses are generally not in the interests of consumers. The involvement of some lenders in marketing such financial products requires more consumer protections, improved consumer education and greater emphasis on ethical marketing practices.

The survey found high levels of initial borrower satisfaction with HECM loans—83 percent reported that their loans had completely or mostly met their financial needs, and 93 percent reported that their reverse mortgages had had a mostly positive effect on their lives. These findings reflect short-term assessments because more than 9 in 10 borrowers had obtained their loans within the past 3 years, so we do not know the long-term satisfaction rate with reverse mortgages. (Indeed, more research is needed in precisely this area.) Consumers reported high levels of satisfaction with reverse mortgage lenders (90 percent satisfied) and counselors (95 percent satisfied), though non-borrowers were four times more likely than borrowers (23 to 6 percent) to report that they were not satisfied with their lender experience.

Conclusion 3: Loan costs are too high.

Consumer concerns about high costs, as reflected in the AARP Survey and other research, most likely represent the single greatest impediment to greater acceptance of reverse mortgages. When asked to identify the main reason they decided against a reverse mortgage, high costs were the leading reason by a 3-to-1 margin over the next most frequently cited main reason—that borrowers decided a reverse mortgage was not necessary given their financial circumstances. Even two-thirds (69 percent) of borrowers deemed the costs high.

To illustrate the costs associated with these loans, during the month in which the AARP Survey was conducted, the total lifetime transaction costs on a fairly typical federally insured HECM reverse mortgage for a borrower age 74 living in a \$300,000 home could have been about \$30,000—about half of which comes from upfront fees and the other half from ongoing monthly fees over the life of the loan. These cost estimates do not include any loan proceeds to meet the borrower's needs or any interest charges. Origination fees charged by lenders have risen dramatically, with the maximum allowable fee rising 303 percent between 2000 and 2006.

Conclusion 4: Consumer knowledge about and confidence in reverse mortgages is low.

Consumer impressions of and attitudes toward reverse mortgages are still in the formative stages. According to surveys conducted by AARP, consumer awareness among individuals ages 45 and older increased from 51 percent who had heard of reverse mortgages in 1999 to 70 percent in 2007. But the share of respondents who indicated a willingness to consider a reverse mortgage in the future declined from 19 percent to 14 percent. Perhaps more ominous for future growth of the reverse mortgage industry, interest in using a reverse mortgage in the future remained constant between 1999 and 2007 at 10 percent among respondents age 65 and older but declined sharply from 24 percent to 16 percent among respondents age 45–64.

Most consumers admit that they do not know much about these loans, and misunderstandings about reverse mortgages are still common. Data from research cited above indicate that many consumers are still wary of such loans. A 2007 Harris survey found that reverse mortgages ranked last among various mortgage products in terms of respondents' understanding of the product. Only 25 percent said they had favorable impressions of reverse mortgages, compared to 71 percent who reported favorable impressions of fixed-rate forward mortgages.

A small market in its formative stages, like the reverse mortgage market, can be particularly susceptible to bad press and the resulting negative impact on consumer confidence. It is prudent to take steps now to build consumer confidence with measures that improve consumer information and prohibit unethical marketing practices.

Conclusion 5: More research is needed on how consumer uses of reverse mortgages change over the course of their loans as well as on the long-term impact of these loans on their financial well-being.

One consequence of the sampling limitations of the AARP Survey is that the results focus on the short-term experiences of HECM borrowers. Future research should focus on the longer-term effects of having a reverse mortgage, such as changing health and disability needs over time as borrowers encounter age-related disabilities or long-term care needs later in life. Another aspect of the long-term effects of reverse mortgages deserving of future research is the impact of such loans on asset divestiture and the ability to address needs in late life. Put directly, are some reverse mortgage borrowers trading their long-term savings in home equity for short-term consumption in ways that will jeopardize their future financial security and ability to pay for long-term care services?

Future research should also focus on the reasons why the average duration of HECM loans (6 years) is so short in relation to the median remaining life expectancy of the average HECM borrower assumed by HUD, which is 12 years (Szymanoski et al, 2007). Why are these loans being repaid so soon? How do these borrowers and their heirs assess their experiences with these loans? Since over 9 in 10 borrowers in our survey had

obtained their loans within the past three years, these are key questions that our survey results cannot answer. The unique qualities of reverse mortgages call for a unique kind of financial literacy as older homeowners explore the best ways to manage this asset in a manner that will address their needs over the remainder of their lives.

Policy Recommendations

The 16 recommendations in the concluding section of the AARP report suggest ways that HUD and the lending industry can reduce costs, improve products to meet diverse needs, strengthen consumer information and protections, and build consumer confidence in reverse mortgages to make them a more mainstream financial instrument for older homeowners.

1. Changes to the HECM Program to Reduce Costs and Build Consumer Confidence

The AARP Survey found that high loan costs are clearly leading some homeowners who might otherwise benefit from reverse mortgages to forgo these loans. Congress and HUD could take several steps to reduce the cost of the program and build consumer confidence in reverse mortgages.

Recommendation 1: Remove the limit on the number of reverse mortgages that FHA can insure to promote higher volume and more competitive pricing. Note that this provision is included in the AARP-supported FHA Modernization Act (H.R. 1852/S. 2338), which has passed the full House and the Senate Banking Committee and awaits action by the full Senate.

Recommendation 2: Establish a single national limit on home values in the HECM program only if the cap on allowable origination fees is reduced substantially. This pair of provisions is also included in the FHA Modernization Act.

Recommendation 3: Reduce the mortgage insurance premiums charged to consumers under the HECM program consistent with the actuarial soundness of the program.

Recommendation 4: Develop policies to avoid foreclosing on consumers who run out of funds to pay property taxes and homeowners insurance.

Recommendation 5: Clarify that the HECM non-recourse limit means that borrowers or their estates will never owe more than the value of the home.

2. Product Innovations to Reduce Costs and Meet the Growing Diversity of Consumer Needs

Most prospective borrowers are interested in a line of credit, but some do not want or need the full credit lines they are eligible for under the HECM program. They would prefer much smaller credit lines with lower costs but do not have that option. Because “lite” products would involve smaller loan amounts, they would be less costly to consumers because the risk to lenders and the FHA would be lower. Other innovations could include low-cost public reverse mortgages or publicly subsidized loans to meet specific needs such as home repairs, taxes, and long-term care needs.

Recommendation 6: HUD and proprietary reverse mortgage programs should develop reverse mortgages with reduced costs for those who want to borrow small amounts.

Recommendation 7: HUD and proprietary reverse mortgage programs should develop reverse mortgages that permit borrowers to increase their available loan funds in the future without all the costs of a formal refinance.

Recommendation 8: HUD and proprietary reverse mortgage programs should develop “reversible mortgages” that can shift from forward to reverse mortgages as homeowners age and their ability to make mortgage payments decreases.

Recommendation 9: States and localities should initiate low-cost public reverse mortgages to defer payment of property taxes and finance home repairs and modifications for older homeowners.

Recommendation 10: HUD and the U.S. Department of Health and Human Services (HHS) should create incentives for state-based demonstrations to lower the cost of reverse mortgages used to support the independence of older persons with disabilities or long-term care needs.

Recommendation 11: Congress should repeal provisions in the 2000 American Home Ownership and Economic Opportunity Act that authorize forgiving the upfront mortgage insurance premiums on HECM loans whose proceeds are used entirely to pay for long-term care insurance.

3. Improvements to Consumer Counseling and Information

The AARP Survey found that significant percentages of respondents answered “don’t know” when asked to assess reverse mortgage costs. Most respondents indicated that they had not received information on alternatives to reverse mortgages. These findings suggest that individuals and entities providing information to prospective borrowers and counseling clients should take more time and care to make certain consumers understand the costs and potential alternatives to meet their needs. As the market grows and the products become more diverse, special efforts will be required to establish and enforce high standards for individual counselors and the information they give

consumers. Counselors should serve as an independent source of unbiased information for consumers and should not have conflicts of interest; for example, reverse mortgage lenders or agents marketing investment or insurance products should not be able to provide counseling or decide which counseling agencies they will pay for this service.

Recommendation 12: HUD should improve the kinds of information it gives to consumers to enable them to understand potential alternatives to reverse mortgages.

Recommendation 13: Sufficiently fund reverse mortgage counseling services. One way to do so is by using some of the mortgage insurance premium collected by HUD to fund HECM counseling.

Recommendation 14: Provide earlier and more complete counseling on the “rising debt, falling equity” nature of reverse mortgages as well as the effects of interest rate or home value changes.

4. Improvements in the Marketing Practices of Lenders

A recent newsletter from the National Reverse Mortgage Lenders Association (NRMLA) stated, “As more companies enter the reverse mortgage business, the need for higher educational and ethical standards becomes critically important” (NRMLA, 2007). The following recommendations are designed to elevate the marketing practices used by companies and individuals who originate reverse mortgages, especially related to the marketing of financial products paid for with reverse mortgages that may not be in the interests of consumers.

Recommendation 15: Lenders should participate in education and accreditation programs that promote the ethical marketing of reverse mortgages.

Recommendation 16: State and federal agencies should develop new cost disclosures and suitability standards for reverse mortgages that are used to purchase investments, annuities, and long-term care insurance.

Final Word

The reverse mortgage industry is at a critical juncture in its development. After many years of low volume, the number of HECM loans made in fiscal year 2007 exceeded 100,000 for the first time. The infrastructure of mortgage insurance, originators, servicers, and investors has been developed, and enough performance data have been collected to evaluate the risks associated with such loans over time. In addition, tools have been developed to counsel consumers about reverse mortgages and alternatives. The initial response from consumers who participated in this survey has largely been

positive with respect to their experiences with the loan process and in meeting their needs.

However, if reverse mortgages are to move from a rather exotic niche of the mortgage market to a more mainstream financial option for greater numbers of older homeowners, government agencies, lenders, and consumer advocates must work together to lay the foundation of the next generation of reverse mortgage products, services, and regulations. Moving from a low-volume, high-cost market to one characterized by higher volume and more competitive pricing will require reducing costs and building consumer confidence. Recent industry and public policy developments create the conditions for addressing these problems, but the recent collapse of the subprime mortgage market provides some sobering lessons on problems that can occur if high fees and inappropriate marketing practices are allowed to continue.