

Reverse mortgages: Polishing not tarnishing the golden years

by Chris Pummer

Carol Anthony learned the cause of her mother's digestive problems only after they grew severe enough to land her in the hospital. Mental anguish from a financial mistake her 80-year-old mother made -- and hid from her family -- was literally eating her up inside.

Believing she was buying a \$10,000 insurance product, the elderly woman was taken in by an aggressive salesman who sold her a costly reverse mortgage and a \$125,000 deferred annuity that tied that money up for 20 years, Anthony said.

"He got a commission on the reverse mortgage and the annuity -- neither of which my mother needed nor understood," said the King City, Calif. woman, who was able to buy back her mother's house as part of a settlement agreement.

Anthony relayed her mother's story in testimony Dec. 12 before the U.S. Senate Special Committee on Aging, which is probing predatory lending practices in the fast-growing reverse-mortgage market.

"Some salesmen are ... convincing seniors to swallow this double dose of bad financial advice: Take the cash from a reverse mortgage and use it to fund an unsuitable annuity," said Sen. Herbert Kohl, (D-Wis), a committee member. "Long-term annuities are almost always inappropriate for seniors, as they can tie up retirement savings far beyond one's life expectancy."

Playing to fear

Congressional investigators found unscrupulous reverse-mortgage sales people are seizing the opportunity to sell inappropriate financial products to seniors with home equity unlocked with proceeds of a reverse mortgage. In so doing, they're simultaneously exploiting older Americans' two biggest fears: Having to move out of their home and outliving their financial resources.

Such sales practices are counter to Congress's intent in creating reverse mortgages in 1986 as a last-resort tool for lower-income homeowners 62 and over to generate desperately needed income -- and not as the means to buy exotic investment and insurance products.

"People who are good candidates for reverse mortgages lack enough income for daily needs," AARP Policy Director John Rother said. "But in interactions with a lender, when it becomes clear they don't have other products the lender has to offer, the salesperson may see this as a big opportunity" to up-sell the borrower.

While federal law requires reverse-mortgage applicants get independent counseling to verify they understand the terms of the loan, the counselor is often suggested by the lender and the counseling does not address whether a given loan is appropriate or a good deal. Nor does the law require counseling on the highly sophisticated products that may be hawked by the reverse-mortgage sales representative.

Riches waiting to be made!

A staff member for the Senate committee said there are now 1,400 lenders in the reverse-mortgage market, and many are aggressively recruiting loan officers with the promise of earning \$100,000 to \$200,000 a year on a "once in a lifetime boom."

Recruiting material from a San Diego-based reverse-mortgage lender declares: "Great fortunes will be made by those who learn to offer and originate Reverse Mortgages. There are 76 million 'baby boomers' who are just starting to enter their retirement years... The potential origination fees for reverse mortgages today are in excess of \$42 billion. How will you get your share?"

A Mt. Laurel, N.J.-based issuer trumpets in its material that its reverse-mortgage loan officers can earn \$5,000 per transaction “when you include the product sales of life, annuity and LTC!”

Many insurers are getting into the reverse mortgage business, which poses an immediate and serious conflict of interest, says Prescott Cole, a San Francisco-based attorney with the Coalition to End Elder Financial Abuse who testified before the committee.

“The absolute last thing you’d ever want to do with a reverse mortgage is to buy an annuity or long-term-care insurance,” Cole said. “Reverse mortgages should only exist for one category of senior --- the low-wealth senior -- because a high-wealth senior would never want to take one out because they’re still very expensive.”

Added Rother: “Even though fees are coming down, reverse mortgages are a very costly, and to take such an expensive product and use that to invest in an annuity is an extremely expensive way to buy yourself protection against longevity.”

What is a reverse mortgage?

A reverse mortgage is a special type of home loan that lets a homeowner convert a portion of the equity in his or her home into cash. The equity built up over years of home mortgage payments can be paid to you. But unlike a traditional home equity loan or second mortgage, no repayment is required until the borrower(s) no longer use the home as their principal residence. HUD's reverse mortgage provides these benefits, and it is federally insured as well.

Source: U.S. Dept. of Housing and Urban Development

‘Financial suicide’

Cole said a \$100,000 reverse mortgage may require \$16,000 in closing costs and ultimately consume a total of \$180,000 in surrendered home equity over 10 years.

“A low-wealth senior is committing financial suicide if they get a reverse mortgage to finance a deferred annuity,” Cole said. “This is very expensive loan to use to buy a very anemic instrument that may pay on average 3% a year.” After years of little market activity, the reverse mortgage business is taking off. AARP found that 31% of the 345,762 loans issued in the last 21 years were made in fiscal year 2007.

Yet older Americans also are cooling to the notion of using a reverse mortgage to tap their home equity. An AARP study this year found 70% of Americans 45 and older have heard of reverse mortgages, up from 51% in 1999, but the number of older Americans who would consider taking one out fell from 19% to 14%.

Donald Redfoot, a representative of AARP’s Public Policy Institute in Washington, urged the Senate committee to develop clearer and more comprehensive disclosures for reverse mortgages, along with suitability standards for those used to buy investments, annuities and long-term-care coverage.