The Reverse Mortgage Puzzle, Part II

By Dave Lindorff and Kerry Pechter *Fri, Apr 15, 2016*

Last week we focused on the HECM product, and how it became less generous after the financial crisis. This week we examine the role of the banks—large ones and smaller ones—and their roles (or former roles) in the distribution of HECMs.

Of the factors that help popularize a financial product, energetic distribution may be the most important. And that energy comes from a combination of robust wholesaling, the presence of a trusted brand-name manufacturer, positive media coverage, and (not least) competitive incentives for the sales force.

Little wonder then that Home Equity Reverse Mortgages (HECMs for short) aren't getting much traction. The HECM market has none of those must-have ingredients. Yes, it's got government backstopping, positive academic research, a hypothetically deep market and a plausible story line. But those elements aren't enough.

This week, we offer the second installment of a series on why the HECM industry is stalled just when it should be growing. Last week we focused on the HECM product, and how it became less generous after the financial crisis. This week we examine the role of the banks—large ones and smaller ones—and their roles (or former roles) in the distribution of HECMs.

The mega-banks ramped up their reverse mortgages businesses before the financial crisis, through internal growth or acquisition, and then abandoned HECMs after the crisis, when alleged mishandling of foreclosures attracted regulatory scrutiny and bad publicity. Sales today are still well below the 2007 peaks, but decision-makers at niche mortgage companies and regional banks told us they see signs of recovery.

Big banks enter and exit HECMs

The reverse mortgage business would certainly be healthier if America's biggest financial institutions, with their thousands of sales reps and (in the case of banks) ubiquitous branches, were still promoting and selling them, but they stopped doing that four or five years ago.

Wells Fargo, Bank of America, and then-MetLife Bank were, prior to their departure, mainstays of the reverse mortgage business. Wells Fargo had entered the reverse mortgage business in 1990—only two years after Ronald Reagan created them (and, some say, the germ of the 2008 crisis) by signing the Housing and Community Development Act of 1987.

When HECMs got hot in 2007—sales jumped 41% that year—Bank of America bought the $4 billion reverse mortgage portfolio of Reverse Mortgage of America from Seattle Mortgage. The next year, MetLife purchased EverBank Reverse Mortgage in April 2008 and folded it into MetLife Bank. At the time, *American Banker* predicted that by 2028 one in five new mortgages in the US would be a HECM.

But then the financial crisis hit. Latent risks in the reverse mortgage business, along with those of mortgages generally, quickly became apparent. Too many people who had taken lump sum HECMs and blown the money were not paying the required taxes or insurance, creating a looming foreclosure crisis for which the government was ultimately on the hook.

By mid-2009, the Office of the Comptroller of the Currency was investigating HECMs and in 2011, the OCC slapped MetLife Bank, Wells Fargo, Bank of America and five other financial giants with charges of "unsafe and unsound practices related to residential mortgage loan servicing and foreclosure processing."

Suddenly, HECMs—a relatively miniscule business for the big banks—became more trouble than they were worth. Bank of America and Wells Fargo got out in 2011. MetLife followed in 2012, selling its HECM servicing business to Nationstar and its $7.5 billion in bank deposits to General Electric. MetLife didn't want the regulatory hassles that went with being a bank holding company. Major reforms of the HECM program (see Part I of this series) soon followed. Amid the turmoil, HECM sales slumped to a seven-year low.

Second-wave HECM sellers

The mega-banks' departure from the HECM business left it to niche firms like American Advisors Group, All Financial Services, and Senior Reverse Mortgage, which lacked national brand recognition. Some of these firms later ran afoul of the new Consumer Financial Products Bureau (CFPB), which regulates HECM lenders. The Bureau found their ads misleading or their recordkeeping on customer payments deficient.

Often turning to late-night TV and hiring pitchmen like the late actor and Senator Fred Thompson or Henry ("the Fonz") Winkler to hawk the product, some lending firms have been accused of improperly referred to their HECM loans as "government programs" or "government insured," implying that the borrower was insured against loss, when in fact the lender is. In February 2015, the CFPB charged three lenders with "misleading consumers."

"You have to worry about a product that private companies are resorting to advertising on late-night TV," said Deborah Lucas of MIT, author of research on HECMs. "It's true that reverse mortgages have gotten a bad reputation," conceded Peter Bell, CEO of the National Reverse Mortgage Lenders Association (NRMLA).

One of those private companies—the one who hired Sen. Thompson as a pitchman, in fact—is Orange, Calif.-based American Advisors Group, or AAG. According to Reverse Mortgage Insight, AAG originated a total of 14,569 reverse mortgages in 2015, or 25.8% of the HECM market. The second-largest player, Finance America Reverse Mortgage, originated 7,344 reverse mortgages last year.

AAG uses a lead generation model to market its reverse mortgages, according to its CEO, 37-year-old Reza Jahangiri. Reps at three phone banks take calls from people who respond to its TV, Internet and print ads and forward the leads to licensed brokers. The brokers typically work from homes and earn a salary plus commission.

"Many of them worked for the reverse mortgage units of MetLife, Wells Fargo and Bank of America," Jahangiri (at right) told *RIJ*. "We also have loan officers in the field who develop their own leads, building relationships with advisors, insurance agents and others." AAG also buys closed loans from other lenders or accepts client referrals. "But retail is the biggest part of our business," he said.

A private company, and not a deposit-taking institution, AAG originates the loans, collects upfront application and closing fees, and funds loans from its own equity or with financing from banks like UBS. AAG sells the closed loans to the Government National Mortgage Association ("Ginnie Mae"), which securitizes them. With the proceeds of those sales, AAG discharges its bank loans.

AAG does about 12% of its business with low-income people whom it requires to agree to set-asides of funds from their HECM to ensure payment of taxes and insurance premiums, and to make needed repairs. Another one to two percent of the HECMs go to those wealthier homeowners who want to open a HECM-LOC (line-of-credit) and let its capacity grow untapped. It's a percentage he expects will grow.

Most of its clients fall between those two extremes. "About 50% of our customers," he says, "are people with average sized homes who have urgent expenditures—such a medical issue. They open a HECM-LOC, draw perhaps $20,000 to meet those expenses, and then keep the rest available for emergencies and peace of mind." The remaining clients have homes worth $230,000 or more and have existing mortgage debt. "They pay off that debt, eliminating a monthly income drain, and then have the credit line left over to use as needed."

A regional banker hosts a radio show

Regional banks are also helping to fill the HECM distribution vacuum left by the mega-banks. One of them is Pittsburgh-based Dollar Bank, a $7.2 billion federal savings bank serving southwestern Pennsylvania and northeastern Ohio. "I love this product," said Randy Davis, assistant vice president for residential lending at Pittsburgh-based Dollar Bank, in a phone interview.

Davis (at left), who is salaried, said he has closed 281 reverse mortgages over the past three years, including 176 in the city of Pittsburgh. Another loan officer handles all the reverse mortgages in Cleveland, where the bank also operates. Half of their HECM applicants are Dollar Bank customers. The rest come through promotional efforts by the bank, including advertising and a monthly radio program that Davis hosts.

He has seen the HECM borrower profile evolve, especially since the 2013 reforms in the program. "A reverse mortgage used to be a product for single retirees struggling to get by," Davis told *RIJ*. "Now I see it used by people who want to get rid of a mortgage. When a reverse mortgage eliminates an $800 or $1000 monthly bill, that can be a life-changer." Financial advisors are beginning to refer wealthier people, "who see [HECMs] as a good investment strategy." Dollar Bank does not charge an origination fee on HECM loans, he added.

The process of taking a customer through the process of obtaining a reverse mortgage is more time consuming than in a forward mortgage. "It can take two or three days of meetings to explain these things," he said.

"But I don't mind that. My biggest obstacle is still the stories about people being ousted from their homes. Those stories were true, but foreclosure can't happen if both spouses sign the loan, if you do a financial assessment, and as long as the tax payments, insurance payments and needed repairs are made."

While Dollar Bank is the only bank now offering HECMs in the Pittsburgh and Cleveland markets, Davis expects—and welcomes—competition. "All community banks will eventually offer this to their customers," he predicted. "That would bring the costs down, the way it has with home equity lines of credit. I don't know how long it will take, but eventually reverse mortgages will be as common as home equity loans."

Preaching HECMs at a Virginia church

Not every story is quite as rosy. At another regional bank, a mortgage broker who also handles reverse mortgages has seen signs of renewed demand for HECMs. "We have a lot of people come in and ask about reverse mortgages. Some see the ads on late night TV and don't trust them, so they come to see us," said the broker, who asked not to be identified because he was speaking without his employer's permission.

"Others see the printed materials that we've started putting out in the branches about our reverse mortgages. As a loan officer, I also look for opportunities to educate people. Four or five libraries let me present programs on the product. One of our branches in Virginia set up a session in a church that was attended by several hundred people," he told *RIJ*.

"Under the new rules, we have to do a financial assessment of new applicants. We look for a good credit history–a record of paying their bills on time–and an income stream that will allow them to pay their taxes and homeowner's insurance and to maintain the home. We've had to arrange a set-aside out of the loan proceeds to cover those costs for only one applicant so far. The set-aside was based on life expectancy of the borrower, which was 10 years."

Difficulties remain. "Reverse mortgages remain a small segment of our business, I think, because of misconceptions about the product—that the bank ends up with the deed to the property, or that the heirs will be stuck with the debt." The flow might be larger, he said, if financial advisors in the bank's investment program sent clients to the loan department to look into reverse mortgages. But they don't. "We have a job to do educating our financial planners, because they don't have that mindset."

NEXT WEEK: Why Few Advisors Recommend HECMs.