

# The PROMISE and PERILS *of* Reverse Mortgages

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*“The demographics of this nation . . . guarantee that this business will expand.”*

—BRIAN D. MONTGOMERY,  
FEDERAL HOUSING ADMINISTRATION (FHA) COMMISSIONER,  
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

*“We fully expect the HECM [Home Equity Conversion Mortgage] to become a common part of retirement planning, just as common as 401(k)s or Social Security is today.”*

—ROBERT COUCH,  
FORMER PRESIDENT OF GINNIE MAE,  
CURRENT HUD GENERAL COUNSEL

**W**ith the FHA commissioner whispering in one ear and the former president of Ginnie Mae whispering in the other, it’s hard not to get excited about reverse mortgages. In fact, 55,218 Home Equity Conversion Mortgages (HECMs) have

been originated in just the first quarter of 2008—more than in the entire year of 2005. ☞ Combine an estimated growth rate of 70 percent a year for this product versus declining volume in traditional mortgage products, and it becomes clear why you cannot afford to ignore this market opportunity. But then, even the most hopeful of expectations can occasionally go awry. ☞ “We have a world-class baggage system that is going to work perfectly on day one.” Those were the fateful words spoken only a

week before the opening of London Heathrow Airport’s \$8.6 billion Terminal 5, before it collapsed into chaos in March 2008.

**The allure of reverse mortgages is strong in the current slow mortgage environment. But before diving in, lenders need to consider some key business requirements of this promising niche.**

The resulting turmoil caused 15,000 baggage items to be lost and passengers to become so angry that British Airways had to plead with them not to abuse its staff.

Is now the time to jump into the market and start originating reverse mortgages? Not without first planning and preparing for your big debut.

As with any new initiative, you need to pour your heart and soul into it in order to succeed. Do not treat reverse mortgages like “business as usual,” or you may well find yourself in a situation much like British Airways and be left holding the bag.

When the focus is on the bottom line, it is not the time to merely stumble on a new lending initiative. This article discusses some of the risks and pitfalls of originating reverse-mortgage loans and provides suggestions to consider as you prepare to open a whole new source of loan volume for your firm.

### Everything bad is good for you

Originating mortgages is all about the customer—or at least it should be. Customer-centric lenders succeed because they can

efficiently provide the right product (money to buy a house) at the right time (now). Organizations have enlisted an army of originators prepared to close deals quickly, efficiently and with as little human contact as is needed. Traditional mortgage (non-reverse) borrowers are willing to forgo high-touch communications because they care primarily about 1) getting money and 2) getting it quickly.

When originating reverse mortgages, the same customer-centric

approach is still key to success, except now there is a different customer with completely different needs.

Everything that was trained out of your originators for being “bad” in the regular mortgage world is now an asset.

Briefly, this is a profile of a reverse-mortgage borrower:

■ **Long time horizon:** Borrowers are not in a rush to close. Similar to reallocating a 401(k), even if it’s better to do it now, one will put it off or do it at one’s leisure. A person may drag out the process of a reverse mortgage for a long time, because there is no pressing impetus. After all, there is no house to be purchased.

■ **Lack of understanding:** Borrowers do not understand all of the immense varieties of products that can be tailored to their needs. In addition to the government-sponsored programs, the private market is beginning to offer a variety of other loan options. Which reverse-mortgage loan option is right for your borrower?

■ **Low confidence:** Let’s face it—a reverse mortgage just sounds like a scam. What? No down payment? You send me money every month? You won’t kick me out of the house? Reading down the list of reverse-mortgage benefits sounds a lot more similar to a “You’ve just won \$1 million” sweepstakes letter than a Truth-in-Lending statement. Borrowers can go into the process being a bit suspicious and with little confidence.

The target borrower market is also expanding. Originally, the target market was low/moderate-income seniors on a

fixed income with a home that was owned free and clear, or with a modest outstanding principal balance (OPB). The new market includes the expanded baby boomer wave with limited retirement savings. These consumers will be looking to supplement their retirement income with funds from equity and the desire to reduce their monthly fixed housing expense.

Both of these market segments will be relationship-driven and will be a source of additional mortgage leads for the professional reverse-mortgage loan officer. Oh, and by the way, don’t forget that the loan officer will not only be interacting with the senior borrower, but probably with the senior’s adult children as well—and they will have a direct interest in the product and service offered to their parents. Of course, these adult children also can be prime leads for their own new home loan or a loan refinance. So offering outstanding service to the parents can lead to additional traditional loan business.

To address these profiles, a reverse-mortgage originator should have an empathetic personality with good listening skills, and be the kind of professional who inspires confidence. The loan originator should have a natural affinity for dealing with older persons, whose deliberate pace could infuriate others.

Patience and listening are at a premium, for there are a lot of problems that a reverse mortgage can solve if customized correctly. The originator must be willing to spend large amounts of face time with each customer—even driving them to and from their Department of Housing and Urban Development (HUD) counselor appointment, if necessary. Independent counseling is mandatory for federally insured programs, and required under most current private reverse-mortgage programs. These counseling sessions not only educate the customer, but can build trust between the customer and the originator.

The originator must make each touch point a way to generate confidence with the borrower, and slowly educate and move the process forward while knowing that one misstep could cause the loss of a customer and possible public relations damage to the firm.

The question of product choice is critical to the process. Listen, listen and listen some more to make sure that the products being offered to the senior borrower are the right ones. Narrow the products offered to them to a select few that are appropriate and address their needs. Be prepared to explain the benefits in clear terms they can understand and relate to.

Offering a large quantity of undifferentiated products will create high stress levels and a tendency to avoid selecting any product. All in all, the disposition of a successful reverse-mortgage originator is much more akin to a nurse with great bedside manner than what we have come to expect from our traditional mortgage originators.

### Blazing a path to success

Choosing the right originator to represent the firm to senior borrowers is just the first step to creating a successful reverse-mortgage program. The originator needs the support of a dedicated reverse-mortgage group that includes processors, underwriters and secondary market staff. This group should be focused solely on reverse mortgages so that the systems and staff are all in sync.

*Originating mortgages is all about the customer—or at least it should be.*

It is very important to make sure that the product is delivered to the borrower in the most efficient manner without impacting the traditional mortgage loan workflow. This is similar to the reasons why mortgage firms tend to establish separate groups to handle state bond programs. Within this group, loan processors should be selected who are warm, personable, open and efficient. Interactions with senior borrowers need to reinforce the company's long-term concern for them.

Poor customer service will be magnified with the public because of the potential perception that the lender is taking advantage of vulnerable senior borrowers. More so than with your standard business, your community reputation is at stake if you are seen as abusing the trust of senior consumers. This is particularly important to a lender who depends on community relationships for its core business strategy and that intends to invest in reverse-mortgage loans and retain the servicing.

### Keep it simple

You should strive for simplicity of process and programs. Technology should be employed to improve workflow and provide a tickler system and the appropriate reverse-mortgage calculation tools to the loan officer and loan processor. A targeted workflow and/or tickler system is necessary due to longer lead and processing timeframes.

As much as possible, limit the data-gathering requirements that must be fulfilled by the senior borrower. Focus on gathering reliable data from public sources. Keep senior borrowers informed of the progress of their loan request. This will instill confidence in them and reduce their stress levels.

In addition to normal secondary-market risks, reverse mortgages are especially vulnerable to the market's perception of geographic property value and loan-to-value ratios (LTVs). Instead of a declining balance, the OPB will increase over time. It is this increase in the OPB that drives the focus on current and future value. The market will tend to anticipate market property values relative to the OPB and price accordingly. Spreads between a standard mortgage and a reverse mortgage with the same interest rate will widen or contract continuously.

Prepayment speeds are also likely to be calculated for different products and borrower characteristics as loan volume increases and the data become available. This will also impact the market-price spread. Until the secondary market improves for reverse mortgages, it would be wise to keep a high coverage ratio to limit market risk.

Key to an effective reverse-mortgage loan program is the ability to understand the current estimated value of a home in the loan origination process. You can't wait for the formal appraisal to estimate this value. The solution is to incorporate access to an automated valuation model (AVM) tool at the point of sale. This will allow the loan originator to confirm that the senior borrower has enough equity to qualify for a particular loan product.

In the traditional loan origination process, the focus is on qualifying the customer with a credit report and a FICO® score. In the reverse-mortgage market, credit is not part of the assessment criteria, but property value is essential. However, the credit report is important as a tool to confirm that the senior borrower either has a loan on the property or does not.

Just as in the standard mortgage process, a title report must be obtained to confirm ownership and to determine if there are outstanding liens against the property.

### What got you here won't get you there

Knowing the intricacies of reverse mortgages is only the first step toward succeeding in the market. Technology is an enabler that will allow a business to achieve its strategic objectives. We have broken down the technology requirements for the reverse mortgage arena into three main tiers:

■ *Unable to compete:* With no new technology, calculations such as the principal limit factor will need to be done by hand. It would require an originator to manually look up the 203-b limits county by county. This level of manual labor is onerous, inefficient and ineffectual. You will not be able to compete without some investment in technology.

■ *Entry into market:* With some additional investments in technology, one can start originating reverse mortgages in volume. The bare minimum requirements are the ability to capture additional data fields and the ability to capture the estimated value early in the process. It is important to recognize that this level of technology only enables you to enter the reverse-mortgage market, but it does not necessarily mean you will excel or even succeed in it.

■ *Technology as a strategic differentiator:* If reverse mortgages play a prominent role in your strategic vision (and we think they should), the right technology can be what makes your organization best in breed—for example, not only having the ability to estimate current property value early in the process, but as an investor/servicer to be able to estimate future property value. There are myriad potential ways to use technology to your strategic advantage.

In our own technology work, a significant portion of projects fall into the entry or defensive categories. That is, companies typically only use technology in order to enter a market (buying a loan origination system), remain competitive (product and pricing engine), stop from breaking the law (Sarbanes-Oxley Act compliance) or prevent losses (fraud prevention).

With the variability and complexity of reverse mortgages, the room for building a sustainable competitive advantage is very large. Let's examine just a few of the many things you can do with technology as a strategic differentiator.

### What do these data mean?

According to Frances X. Frei, associate professor of business administration at Harvard Business School, Cambridge, Massachusetts, Mayfield Village, Ohio-based Progressive Casualty Insurance Co. is the industry leader in data analytics. It has sophisticated information technology (IT) systems that pull together a plethora of information beyond the traditional age and driving record in order to determine the risk profile of a driver. It can more accurately predict if you will get into an accident than other insurance companies can.

Progressive is famous for providing the rate quotes of other

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insurance companies alongside its own. What most people don't realize is that when Progressive gives you a quote from another provider that's lower than its own, that means it doesn't want you as a customer. The company would rather you place your insurance business with the competition.

In the notoriously competitive auto insurance industry (similar to the mortgage industry), Progressive knows you will be an unprofitable customer—so the company would rather you self-select into the arms of a competitor. The lesson here is that technology has provided Progressive with the information needed to establish a competitive advantage.

How could your organization use technology to become the best in your niche? What will your organization do with its accumulated data? As a local community lender trying to maintain relationship banking, how will you gain a competitive edge with the data you collect in the reverse-mortgage market?

Historically, the typical mortgage was approved based on the borrower's ability to make timely loan payments—which is why FICO scores are important. Now, with reverse mortgages, mortgage-approval decisions are no longer focused on the credit of the borrower and his or her ability to make timely payments. Instead, they are based on the property's current value and anticipated future value.

Never before has property value been the primary driver of a mortgage. Running a cursory AVM may allow you to enter the market, but in order to become an industry leader, you must build the technology to allow you to strategically differentiate yourself from the competition.

As an investor/servicer in reverse mortgages, there is not the same concept of loan default or real estate-owned (REO). You will not end up owning the house if there is a default, but you may facilitate the sale of the property as certain borrower life-events occur. As an investor in reverse mortgages, it is important that you are able to understand the variables surrounding your asset—for example, its current value, the status of your borrower, and events that could impact the value and condition of the property.

Suffice it to say, the servicing process for reverse mortgages is quite different from the standard mortgage servicing process. You don't have monthly payments due from the borrower, but you may have a fixed monthly payment to be remitted to the borrower or even a draw on a reverse-mortgage line of credit.

You will need to establish contact procedures with the borrower to make sure he or she is still occupying the property, that taxes are being paid and the property is being maintained.

The reverse-mortgage industry is still in its infancy—even with its phenomenal growth rate. Total HECM production in 2007 was still only 108,000 loans. So now is the time to develop your market strategy, loan process, appropriate staffing and the right technology to support your venture. **MB**

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