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New Financial Standards for Reverse Mortgages

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Reverse mortgage lenders are beginning to require senior borrowers to qualify for loans by proving that they have enough money to continue paying property taxes, home insurance premiums, and other home upkeep expenses. MetLife is the first reverse-mortgage lender to implement a financial assessment requirement. Several other lenders say they are developing similar requirements, and the federal agency that insures reverse mortgage loans supports the companies' efforts.

Reverse mortgages allow homeowners to tap the equity in their homes, receive money from lenders, and remain in their homes. They have not been heavily used by seniors to date. However, rising numbers of older Americans are approaching retirement, and virtually all studies show that their savings and investments will fall far short of their retirement needs. Using home equity is thus seen as increasingly likely for many seniors, particularly as depressed home values recover and support more attractive property appraisals.

Most reverse mortgages are made using the Federal Housing Administration's insurance program, known as the Home Equity Conversion Mortgage (HECM). These loans are only available to seniors who are at least 62 years old Borrowers must use the loan proceeds to pay off any existing mortgages and then receive a portion of their remaining home equity, either as a lump sum, monthly payments, or a line of credit.

The loans carry fees and insurance premiums that can make them expensive. Most consumer experts recommend them only as a last-resort tool for seniors who own their homes with no mortgage but may not have enough cash to pay their retirement expenses. Last year, in an effort to reduce loan costs, the FHA launched a less expensive HECM Saver loan with very low insurance premiums. At the end of September, there were about 560,000 outstanding HECM loans. California, with 93,300 loans, and Florida, with 71,100, are by far the two states with the most HECM loans.

While the HECM program requires consumer counseling to make sure seniors understand the loan, there are no income or wealth requirements that seniors must fulfill to qualify. All they need is substantial equity in their home Lenders use the value of the home as collateral and pay out differing portions of the owner's equity in the home, depending on the borrower's age and other variables.

In addition to receiving cash, the borrower is freed from ever needing to make another mortgage payment and may remain in the home as long as he or she can. Lenders' loan payments are drawn from the equity in the home that is not paid out to borrowers. But even if all that equity has been used up over time, borrowers may stay in th home and not be required to make future loan payments. Because HECMs are "non-recourse" loans, borrowers o their families can walk away from homes with a negative loan balance and face no financial repayment obligation:

Without any financial means requirements for the loans, many older borrowers have found themselves unable to afford to continue paying property taxes and home insurance premiums. Failure to make these payments is grounds for foreclosure, and as many as 25,000 HECM borrowers have been estimated to be in technical default on their loans. Private lenders and the FHA have been working for roughly two years to develop a plan to respond to this problem, but an agency spokesman says "we're not there yet," and admits that it has proven to be a very difficult issue to resolve.

By requiring financial assessments of new borrowers, lenders are trying to eliminate such problems with future borrowers. The first company to implement the standard is MetLife, which will begin using the new rules on November 14.

"It's not just about making sure the borrowers can meet their loan obligations. It's also to make sure they can successfully age in place" and stay in their homes, says Craig Corn, a vice president with MetLife Bank in charge of its reverse mortgage business.

The MetLife assessment process will evaluate a borrower's income from Social Security and other sources, how much money they are likely to earn on their retirement assets, and the equity funds they can draw down from the HECM loan they're applying to obtain. Spending needs will also be reviewed, including remaining housing expenses. This cash flow analysis will then be able to provide MetLife with a good idea of the borrower's suitability for a HECM loan.

Because the HECM program has never required financial assessments of borrowers, MetLife is basing its suitability decisions in part on those developed and used by the U.S. Department of Veterans Affairs (VA) for its home loans. The agency's loan analysis evaluates an applicant's income, housing expenses, and debts to help decide if the person can afford to buy the home in question.

In MetLife's case, Corn explains, this income analysis will be expanded to include projected earnings on an applicant's financial assets and the HECM funds themselves that would be provided if the loan is approved. He said he expected other lenders would likely have similar approaches to their financial assessments, but that there would be differences as well. "The industry will converge around the high-level elements" of the process, he predicted.