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REVERSE MORTGAGES

How rate volatility is changing reverse mortgages

By Bonnie Sinnock   November 27, 2023 4:00 AM

Reverse mortgages have a history of evolving in response to market stresses, and the recent gyrations in interest rates are now spurring a new round of policy experimentation aimed at helping the market better adapt to the kind of risk that's materialized recently.

Some of that risk has manifested as consolidation, with Finance of America buying assets from American Advisors Group, Guild buying Cherry Creek to expand its reverse mortgage division, and Reverse Mortgage Funding filing for bankruptcy.

Remaining players are facing the challenge of maintaining ready sources of cash as rising interest rates have increased the costs for funding loans that have to be bought out of a securitization or draws that have been subject to delays going into one.

It's been a serious concern that has threatened the business' viability, according to some. But agencies in this government-dominated market, notably the Federal Housing Administration and Ginnie Mae, have begun responding to these concerns with policies and proposals aimed at managing those costs.

"A commitment to reverse mortgages is something that Ginnie Mae and FHA are both in lockstep on," said Ginnie Principal Executive Vice President Sam Valverde. "What you're seeing is concrete action from us and FHA to see if we can return liquidity to issuers for the sake of this program."

That suggests reverse mortgages policies could evolve for the better in response to the rate risk seen recently, similar to the way they have after other market challenges that resulted in reforms involving financial assessments, taxes and insurance.

So while some worry about the threat that recent rate volatility, consolidation and liquidity concerns pose to reverse mortgages, others think those challenges will lead to improved operating conditions.

That, in conjunction with other attractions of the product in the current market, could engage players that may have gained economies of scale from consolidation. It may too draw opportunistic new entrants in ways that may revitalize the industry.

What follows is a breakdown of some of the challenges that have intensified for reverse mortgages as a result of recent market conditions, how policymakers are responding, some projections for some possible outcomes and a general sense of the market's current outlook.

The non-active loan issue and what FHA might do about it

The Federal Housing Administration insures Home Equity Conversion Mortgages, the most common form of reverse product, protecting lenders and borrowers. Ginnie Mae guarantees payments to investors from HECM-backed securities.

The carrying costs have become more of a concern recently for issuers of HMBS due to the way rising interest rates impact loans that reach 98% of the maximum claim amount, because they then have to be bought out of pools.

Expenses related to financing those loans through warehouse lines of credit when they're bought out have become particularly high recently because of rate mismatches that put issuers at a disadvantage, particularly if they have what are known as nonactive loans.

Loans become nonactive for reasons that include the last surviving borrower passing away, defaults on T&I payments, or a change in occupancy.

"If a loan is nonactive and needs to go through the foreclosure process, then the HMBS issuer needs to hold that loan on the warehouse line for quite a long time," said Robert Sivori, a former reverse mortgage executive now working for Brean Strategic Advisors. He currently serves as a senior advisor at that company.

The potential remedy the Federal Housing Administration has proposed for nonactive loans is one that would shorten the timeline for assigning these mortgages to HUD, taking responsibility for financing the buyouts off an issuer's hands earlier.

How Ginnie is trying to improve participation procedures

Ginnie, meanwhile, is trying to address another concern that's added to costs in another part of the process.

When HECMs are placed in mortgage-backed securities the subsequent draws after the first one get securitized separately in what are known as participations.

What Ginnie has done about this is to lift some restrictions it had on participations so that they could be securitized more quickly. With Ginnie's change, they may be able to obtain more liquidity by broadening their financing options

This measure and the aforementioned one at the FHA are relatively new so it's hard to tell how effective they'll be or whether they'll have unintended consequences. Furthermore, they don't address all concerns in the market.

But Valverde and other trade groups say they'll continue to work on issues like this.

"It's our understanding that there are more policy changes coming," said Steve Irwin, president of the National Reverse Mortgage Lenders Association.

Prospects for existing and new players

Clearly costs have been weighing heavily on the reverse mortgage industry, but consolidation does potentially open up economies of scale for the companies that get larger as a result, and the circumstances also possibly offer up opportunities for companies that start with a clean slate.

So while another wave of consolidation is possible if policy changes aren't substantive or fast enough to address current cost concerns, there's potential for expansion as well as contraction.

"There are many for potential participants who are looking to enter the market. A significant number of forward mortgage lenders understand that the HECM program is beneficial additional product offering," Irwin said.

The current product potential

Senior demographics have long been considered promising from an origination standpoint but challenging to tap given how much explanation and counseling reverse mortgages require, and the higher rates seen recently challenge the ability to make bother traditional loans and HECMs.

In the case of the latter, when rates go up, the amount of equity reverse mortgage borrowers can withdraw from their homes shrinks.

But with much of the older population reluctant to give up lower rates they got in the past and the growth in the use of reverse mortgages as retirement products has added some attractions to them.

While higher rates have reduced the degree to which home equity can be tapped, seniors still have plenty of it: near $12.7 trillion in NRMLA's latest report, which reflects second quarter numbers.

And some companies, notably top reverse-mortgage lender Finance of America, have been introducing other products that could be promising, such as a proprietary second lien that allows people 55 and up to withdraw home equity without disrupting lower-rate primary mortgage financing they may have.

Another thing that may be compelling when it comes to reverse mortgages is that they have some benefits that traditional home equity products don't that could be helpful in the current market environment.

HECMs work to the financial advantage of heirs in either a situation where the home is sold to pay off the mortgage at a price above the amount owed or if the transaction brings in less than the outstanding debt. In the first instance, they get the excess, in the latter circumstance, they owe nothing.

The fact that HECMs have advantages for heirs, are government backed, don't require mortgage payments and increase the ability to borrow over time as they build in implied appreciation could be helpful if the credit cycle does turn again soon, as some economists were forecasting at deadline.

Sivori chose not to comment on the potential shift in the economic cycle. However, he highlighted another advantage of HECMs, emphasizing their safeguarding effect against concerns similar to the Great Recession when certain abruptly canceled or capped home equity lines of credit for their existing borrowers.

"The FHA insurance premium is paying for protections like that that are built into the product," Sivori said.