

Reverse mortgage marketplace heats up; New Zealand-based company enters the fray, but many advisors are cool to the product

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With the arrival of a New Zealand-based company in Canada, the marketplace for reverse mortgages has become considerably more crowded.

Mississauga, Ont.-based Seniors Money Ltd. , which introduced its reverse mortgage product in Ontario in August and plans to rollout nationally by early 2008, has placed its bet squarely on Canada's growing seniors population.

"We believe the timing is right," says Nick DiRenzo, president and CEO of Seniors Money, owned by Seniors Money International Ltd.of Auckland.

Aimed at seniors who need income in retirement, a reverse mortgage allows a homeowner to borrow against his or her property. As a rule, a borrower gets a lump sum and makes no monthly payments, although providers now offer some flexibility in terms of how the money is received (a lump sum or in regular payments) and whether or not the borrower will regularly pay the interest. Interest accumulates on the principal and the debt is repaid when a pre-set term ends or when an owner moves (or dies) and the home is sold.

Reverse mortgage providers say the products are suitable for those who still have a lot of living left to do — but don't want to sell their homes and downsize in order to do so.

"This isn't about the big lottery win to buy a house in the south of France or whatever," says DiRenzo. "These are middle-market Canadians who are not looking to make a major change in their lives. They just want to make their everyday lives more comfortable."

Seniors Money is going head-to-head with Home Equity Income Trust, which opened its doors in 1986 and, through its subsidiary, Canadian Home Income Plan, today boasts 6,500 reverse mortgages worth \$654.6 million. Until the arrival of Seniors Money, CHIP was the only national financial services company dedicated exclusively to home equity lending. It offers its products through banks, credit unions, mortgage brokers and investment and financial planning firms.

Although many advisors suggest reverse mortgages are a niche product that can be a relatively costly source of funds compared to the alternatives, DiRenzo notes that Canada's demographics and seniors' growing appetite for income point to an expanding market.

There are 4.3 million seniors in Canada and that number is expected to double by 2026. More than half — 2.3 million — are homeowners, with 1.4 million owning their homes outright. And the biggest asset for most of these seniors is their homes. According to Statistics Canada, 77% of a senior's net worth is in home equity. At the same time,

DiRenzo points out, “Seniors are living longer, have more active lifestyles and they need to fund those lifestyles.”

Seniors Money is hitting hard against the reigning player. For its launch, it’s highlighting a 7.5% variable rate against CHIP’s prime-plus-2%. (The prime rate is currently 6.25%.) Both companies also offer five-year fixed rates.

Reverse mortgage providers use a formula based on the borrower’s age, the location and type of home and a home’s appraised value to determine how much equity can be converted into cash. The formula at Seniors Money, for instance, allows loans of up to 15% of a home’s value for 60-year-olds, which increases each year to hit 45% for those aged 90. The formula takes into account how long people tend to stay in their homes (based on actuarial tables) and aims to leave the homeowner with 50% equity at the end of the reverse mortgage, says DiRenzo. The company also offers an add-on feature, for an upfront cost and a lowered loan limit, that will guarantee this amount of equity at the end of the term.

Here’s an example of how the product works, based on calculations provided by Greg Bandler, senior vice president of sales and marketing for CHIP. If a couple, both 72, have a \$600,000 detached home in Toronto, they are eligible for a loan of slightly more than \$221,500. Assume they have the mortgage for 15 years, the average length of a reverse mortgage, says Bandler. Also assume loan rates range from 8.45%-9.45% (CHIP has a loyalty program for long-term borrowers that lowers the rate). After 15 years, they would owe slightly less than \$796,600 in principal and interest. If the home appreciates by 6% (the national average is 5% this year, according to ReMax Canada), it would be worth about \$1.4 million, leaving roughly \$640,000 in equity.

Borrowers can choose to pay all or part of the accrued interest once a year and receive a discount of 1% on the next review date.

Set-up fees start at around \$1,200, but that figure doesn’t include home appraisals or legal costs.

But what happens if growth rates falter, or a homeowner lives longer than expected and the balance owing exceeds the fair market value of the home? Could a homeowner’s heir lose the home and be saddled with debt?

Both Seniors Money and CHIP address this issue by promising borrowers that total charges will never be more than the value of the home. DiRenzo is quick to point out that this scenario threatens very rarely — if, for example, the borrower takes a loan very early on and holds onto it for decades.

Competition from the newcomer makes it even more critical advisors read the small print before recommending one product over another, says Bandler. CHIP’s rates are compounded semi-annually, for example, while Seniors Money compounds monthly.

In addition, CHIP has a few bells and whistles that can further lower the borrowing rate, Bandler says. For example, it recently introduced a new feature that provides a one-percentage-point discount for borrowers who commit to paying down a loan’s interest. This will be particularly attractive for younger seniors who still have an income, he says.

CHIP's loan/value ratio is, on average, about 30%, according to Bandler. "It's a conservative approach to ensure that there's money left over if they move or sell the house," he says.

CHIP has spent two decades building up an advisor referral network and Bandler says that these relationships are key to building the business further.

Although CHIP provides a referral fee to advisors, the real benefit is the added investment opportunities clients will need to satisfy once they free up some of their home equity.

However, some advisors say reverse mortgages are an expensive way to get cash.

As most seniors choose the option of not making any interest payments (they are, after all, taking out a reverse mortgage to free up some funds), the debt can easily balloon. As a result, some advisors are wary of recommending the products.

"Most of the time, reverse mortgages come into play as a result of bad planning," says Lyle Atkins, financial planner at Independent Financial Counsellors Inc. in Winnipeg. Atkins, a member of the Retirement Planning Association of Canada, says that people sometimes get themselves into a trap in which they haven't sufficient savings for retirement because they've been so focused on paying down their mortgage, even into retirement. He knows of one situation in which a client pushed to get her mortgage paid down for the first five years after retiring only to turn around and consider a reverse mortgage to get her through the next period.

And there are other, less expensive products for cash-strapped homeowners, says Darrell Starrie, also a member of RPAC and president and senior financial advisor for Strategic Financial Concepts Inc. in Edmonton.

Home equity lines of credit, for instance, tend to come at a much better rate and can be a more straightforward way of borrowing, he says. It's easier for seniors to see the interest they're paying — and take action to alleviate it — with a line of credit.

But lines of credit aren't a cure-all. First, they can require regular repayments. Many seniors consider reverse mortgages in the first place because they don't have any extra cash, so regular payments aren't an option. Second, they are often dependent on income level. Reverse mortgage providers don't need to know how much a borrower earns or has earned. What matters is the age of the borrower and the value of his or her home. Another difference to consider is that seniors won't be forced to sell their homes with a reverse mortgage, whereas they might to settle a line-of-credit debt.

PJ Wade, strategist and Toronto author of reverse mortgage primer *Have Your Home and Money Too*, says a reverse mortgage should not be an individual's first choice, but can make sense in those situations in which a senior is cash-strapped and does not want to move.

She cautions that advisors should carefully crunch the numbers with clients because interest can accumulate very quickly.

And clients need to consider practical choices: juggling other investments, moving to a smaller home in the same neighbourhood or arranging a line of credit. IE