September 20, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: A Review of the FHA's Home Equity Conversion Mortgage Program

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The Subcommittee on Housing, Community Development and Insurance will hold a legislative hearing entitled, "Protecting Seniors: A Review of the FHA's Home Equity Conversion Mortgage program (HECM)" at 2:00pm. on Wednesday, September 25, 2019, in room 2128 of the Rayburn House Office Building. This will be a single-panel hearing with the following witnesses:

- **Sarah Bolling Mancini,** Staff Attorney, National Consumer Law Center
- **Alicia Puente Cackley,** Director, Financial Markets and Community Investment, Government Accountability Office (GAO)
- **Peter H. Bell,** President & Chief Executive Officer, National Reverse Mortgage Lenders Association (NRMLA)
- **Laurie Goodman**, Vice President, Housing Financial Policy, Urban Institute

Purpose

This hearing will examine the Federal Housing Administration's (FHA's) Home Equity Conversion Mortgage (HECM) program, which remains the only source of federal backing for reverse mortgages. The program was created in 1988 to help seniors access the equity in their homes without being forced to sell their home ,or enter into home equity loans with unaffordable payments. This hearing will explore the benefits that the program offers for seniors as well as some of the challenges that the program has encountered.

Background

A reverse mortgage is a loan that allows older homeowners to borrow against the equity in their homes. Unlike a home equity loan or line of credit, which generally require borrowers to make regular payments over a period of time to pay off the loan, a reverse mortgage does not require any payments on principal or interest until the borrower sells the home or passes away, at which point the loan, including accrued interest, is repaid from the home sale proceeds. The vast majority of reverse mortgages are HECM loans. By providing federal backing for these loans, FHA assumes the risk that the home sale proceeds will be insufficient to cover the total loan amount. While the outstanding loan amount will not be passed onto the heirs of the borrower, any surplus amount from the proceeds after paying off the HECM loan do get passed onto the heirs.

Under the FHA guidelines for HECM loans, a borrower must be at least 62 years old, own the home outright (or have already paid a considerable amount on the mortgage, and use the property as a principal residence) with no other encumbrances on the property, demonstrate the ability to pay property taxes and insurance, and participate in counseling. A borrower has the option to receive a lump-sum payment, a monthly annuity (for as long as the borrower stays in the home), monthly payments for a set period of time, a line of credit, or some combination of those options. The most popular option is a line of credit. Generally, the interest rate for HECM loans is adjustable, except that borrowers can choose a fixed interest rate for lump sum payments. The maximum loan amount varies based primarily on the appraised value of the home, the age of the borrower, and the current interest rate. Although borrowers are not required to make payments on a HECM loan until the borrower chooses to sell the home or passes away, a foreclosure can occur if a borrower is found to be out of compliance with FHA requirements, which include making timely payments of property taxes and insurance. A HECM loan can offer a supplementary source of retirement income that allows them to age in place and doesn't require them to sell their home or make unaffordable payments on a home equity loan. As most seniors are on fixed incomes, HECM loans can also help pay for unexpected costs such as increased health care costs or home and auto repairs.

While HECM loans offer borrowers important benefits, including the deferral of any payments until the sale of the home or death of the borrower, reverse mortgages can be more expensive than home equity loans and lines of credit, because of the origination fees and closing costs.[1] Further, because the interest payments accrue over the life of a HECM loan, which often extends for a borrower's lifetime, it can drain a borrower's home equity to a greater degree than other financing options that require payment of the loan over a potentially shorter fixed period of time, after which interest payments cease as well.

Non-Borrowing Spouses

Until August 2014, FHA rules for the HECM program provided that the age of the youngest *borrower* be used to calculate the size of the reverse mortgage payout.[2] This meant that HECM borrowers could get a bigger payout by removing the younger borrower from the home's title, thereby rendering the older spouse the youngest borrower according to FHA's policies. Lenders were incentivized to encourage couples to take out HECM loans with the older spouse as the only borrower because of the resulting larger loans netted larger brokerage fees. Some borrowers were assured by their mortgage brokers that either spouse could remain in the home even if the named borrower passed away, and others were not informed of the consequences of the borrowing spouse's death.[3] As the media and lawsuits have documented, this resulted in unfortunate circumstances wherein the passing of a HECM borrower would trigger an immediate due and payable status on the loan, leaving a grieving non-borrowing spouse to face foreclosure if the spouse could not immediately pay off the entirety of the loan balance.[4]

A group of non-borrowing spouses who found themselves in this situation brought suit against HUD in 2011.[5] Represented by the AARP Foundation, the plaintiffs argued that by allowing for this loophole to manifest in its rules governing the program, HUD had failed to comply with the plain language of the statute, which states that the HECM loan will not become due and payable until the homeowners'

[1] CFPB, "Reverse Mortgages: Report to Congress," Jun. 28, 2012.
[2] ML 2014-07.
[3] Coalition led by the National Consumer Law Center, Comments to the Department of Housing and Urban Development on Notice and Request for Comment Regarding the Alternative Option for Claim Payment Announced in Mortgagee Letter 2015-03, filed Mar. 9, 2015.
[4] The New York Times, "Surviving Spouses with Reverse Mortgages Win Case," Oct. 1, 2013.
[5] *Bennett v. Donovan*, 4 F.Supp. 3d 5, 2013 U.S. Dist. Lexis 140440 (D.D.C., 2013).

death (or other triggering event).[6] Importantly, the statute specifies that "for the purposes of this subsection, the term 'homeowner' includes the spouse of a homeowner."[7] In September 2013, the court ruled in favor of the plaintiffs.[8] Because the challenge was brought under the Administrative Procedures Act, the court could not order HUD to provide the plaintiffs with specific relief; instead, the court remanded the dispute to HUD to fashion appropriate relief of its own making.[9] However, a similar suit was filed shortly afterwards that mirrored the arguments in the first case, but as a class action suit, the plaintiffs sought injunctive relief to force HUD to use its authority to protect all plaintiffs in the class from foreclosure following the death of a borrowing spouse.[10]

After fighting the issue in courts for years, HUD issued a mortgagee letter in January 2015[11] that extended the "Mortgagee Optional Election" (MOE) for all nonborrowing spouses affected by HECM loans issued before August 4, 2014 that meet a certain criterion. (Beyond August 4, 2014, HUD policies were revised prospectively to ensure all HECM loans were underwritten using the age of the youngest spouse whether or not they were a borrower.) Under the MOE, if a non-borrowing spouse is still living in the home upon the death of the borrower, the lender can assign the loan to HUD, and HUD is expected to defer foreclosure until the death of the non-borrowing spouse. In order to be eligible for this relief, a non-borrowing spouse must have been married at the time of death of the borrower or in a committed relationship, must continue to live in the property as their principal residence, and must obtain marketable title within 90 days. According to advocates and lenders, this relief has been limited in reaching all non-borrowing spouses that need such relief due to the narrow eligibility criteria. For example, it can be very difficult to obtain title within this tight timeframe.[12] Further, relief is provided when the borrower has passed but is not provided in cases where the borrowing spouse has entered a rehabilitation or assisted living facility.

Servicing Issues and Foreclosures

A recent USA Today news article shed light on some of the problems that persist with foreclosures of reverse mortgages despite attempts by Congress and the HUD to improve the program.[13] According to the article, nearly 100,000 reverse mortgages have failed, with urban African American neighborhoods feeling a disproportionate impact. Specifically, USA Today's investigation found that reverse mortgages end in foreclosure six times more often in predominantly black neighborhoods than in neighborhoods that are 80 percent white. The article attributes these trends to accounts of unscrupulous lenders that targeted vulnerable households with few options for accessing capital while glossing over the risks and requirements associated with reverse mortgages. The article points out that while regulators claim actual evictions of seniors are rare, there is no way to verify this claim because HUD does not collect this data, let alone report it.

Without reliable data to track foreclosures, including the reasons for those foreclosures, it is difficult to define the scope of the issue. However, according to advocates, there remain substantial issues with unnecessary foreclosures on HECM loans not only as a result of issues with non-borrowing spouses

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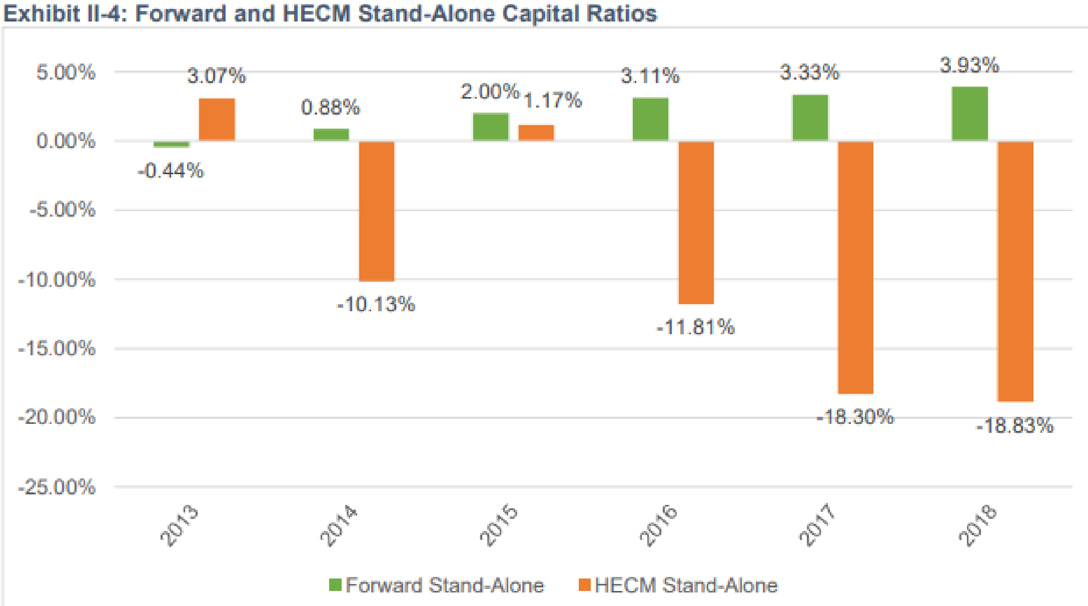
[6] 12 U.S.C §1715z-20(j).
[7] *Id*.
[8] *Bennett v. Donovan*, 4 F.Supp. 3d 5, 2013 U.S. Dist. Lexis 140440 (D.D.C., 2013).
[9] *Id*.
[10] *Plunket v. Castro*, 2014 U.S. Dist. LEXIS 163824 (D.D.C., Nov. 24, 2014).
[11] ML 2015-03
[12] *See, e.g.*, the National Consumer Law Center, "Priorities for Consumers with HECM Reverse Mortgages," Sep. 2015.
[13] USA Today, "Seniors were sold a risk-free retirement with reverse mortgages. Now they face foreclosure.," Jul.5. 2019.

described above but also due to FHA policies that fail to provide sufficient loss mitigation or clear communication to borrowers. For example, while it is *mandatory* for servicers to evaluate FHA borrowers for loss mitigation prior to initiating foreclosure proceedings in the forward mortgage context, doing so is *optional* for HECM borrowers. This means that HECM borrowers can face foreclosure without any meaningful opportunity to correct the issue that led to the foreclosure. Even when borrowers are offered loss mitigation, advocates have criticized FHA's loss mitigation options for HECM borrowers as being too limited and for failing to adequately accommodate many seniors who have disabilities as a result of their advanced age.[14] Advocates have also criticized communications sent to HECM borrowers as being difficult to understand.[15]

The Financial Health of the HECM Portfolio

FHA's Mutual Mortgage Insurance Fund (MMI Fund) includes both forward single-family mortgages insured by FHA as well as HECM loans. A variety of factors -- including increased life expectancy of borrowers (which lengthen the life of a HECM loan), uncertainty of home prices, interest rates, appraisal bias, and other factors that affect the property value and mortgage balance -- have contributed to significant volatility in the performance of the HECM portfolio historically. According to the annual actuarial reviews of the MMI Fund, the value of single-family mortgages under the MMI Fund has consistently increased since FY2012, while the value of HECMs has fluctuated between negative and positive values and has become increasingly negative in recent years (see chart below).[16]

Exhibit II-4: Forward and HECM Stand-Alone Capital Ratios



SOURCE: U.S. Department HUD/FHA, October 2018.
Refer to data table C-2 in Appendix C.

[14] *Id.*
[15] *Id.*
[16] FHA, "Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund," FY 2018.

In the most recent actuarial review, the cash flow net present value of HECMs was negative $13.63 billion,[17] which has prompted some commentators to reignite calls for the HECM loan portfolio to be separated from the MMI Fund.[18] However, as FHA notes in that Report, favorable actual and projected economic conditions that increased the Economic Net Worth (ENW) of the HECM portfolio for that fiscal year were offset by changes to FHA's modeling that lowered the ENW by $1.24 billion. FHA has also made other changes to the program that are expected to improve the financial health of the program but haven't yet fully manifested in the actuarial reviews. For example:

- Since 2013, HUD has limited lump sum payments by reducing the amount that borrowers could draw during the first 12 months of the loan and increased mortgage insurance premiums if initial draws exceed 60 percent of the principal limit.[19]
- Since 2015, HUD requires that borrowers' credit histories and their ability to pay taxes and insurance be taken into account in approving HECMs. Borrowers may be required to set up a "life-expectancy set-aside account," an escrow account where a portion of funds that would otherwise be proceeds to the borrower are deposited to ensure payments are made.
- Since 2017, HECM insurance reimbursement for lenders' property charge advances (e.g., payments made on behalf of borrowers for property taxes, insurance, etc.) are limited to two-thirds of the total payments made.[20]
- Since 2017, principal limit factors, which are used in determining the maximum loan amount, were reduced, which results in reduced amounts that seniors can borrow.[21]
- Since September 2018, HUD is requiring two appraisals for some HECMs to help reduce appraisal bias.[22]

Legislation

- Discussion draft from Representative Heck that would make several reforms to the HECM program to address ongoing issues with non-borrowing spouses facing foreclosures as well loss mitigation. This bill closely mirrors H.R. 4160, the "Preventing Foreclosures on Seniors Act of 2017," from the 115th Congress.

[17] *Id*.
[18] HousingWire, "Should reverse mortgages by pulled from FHA's Fund?" Jan. 2, 2019.
[19] ML 2013-01; ML 2013-27
[20] 24 C.F.R. §206.129(d)(3)
[21] ML 2017-02
[22] ML 2018-06