Testimony

of

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National Reverse Mortgage Lenders Association

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In 1988, Congress authorized HUD to insure Home Equity Conversion Mortgages, FHA-insured reverse mortgages, to help meet the financial needs of elderly homeowners. (P.L. 100-242, Sec. 417).

A reverse mortgage is a form of home equity loan that was designed specifically for older homeowners, generally on fixed incomes, to enable them to draw down on their equity currently, but defer repayment until they vacate their home. The underlying concept is that retirees on fixed-incomes often have an asset base of home equity that can help fund their needs, including home maintenance and health care, when their current income and other resources might be insufficient for doing so.

After a thoughtful period of research and analysis, spearheaded by the late Edward Szymanoski, an career economist in the Office of Policy Development & Research at HUD, who dedicated his career to analyzing our nation's housing challenges, the Department initiated the HECM program, as a demonstration program, with the first loans closed in 1990.

Ed had great foresight in developing the HECM, but his crystal ball might not have shown him all the possible scenarios that have evolved. He didn't see the issues of non-traditional households, non-borrowing spouses or many individuals outliving their life expectancies. He didn't see severe drops in home values that forced people into early retirement in a down economy, as we experienced ten years ago. He didn't realize paying real property taxes might become a burden for borrowers down the road. As brilliant as Ed's concept was, it has required tweaking over the years.

Significant changes to the program, implemented by HUD as it learned from experience have included:

- Enhancing counseling to include financial assessment and Benefits Checkup;
- Requiring "set-asides" of reverse mortgage proceeds for borrowers appearing vulnerable in financial assessment;
- Reduced principal limit factors that provide a lower amount of funds to borrowers and preserve more equity for future interest accrual;
- Higher mortgage insurance premiums;
- Limitations on the amount of equity that can be withdrawn in the first year of a HECM;
- Loss mitigation tools for borrowers in default;

- Protections for non-borrowing spouses.

Since the HECM program's inception, over a million homeowners have utilized the program to organize and manage their finances in retirement. Most have been successful; that is the HECM enabled them to remain in their home until they passed away. Others have remained in their homes until it was no longer physically possible for them to do so and then moved in with family or to a care facility.

The HECM is a highly misunderstood instrument. There is a lot of angst and concern about reverse mortgages. There are a lot of misconceptions about the product. There are a lot of misperceptions about the mandatory counseling. There are a lot of misunderstanding of regulatory requirements governing lenders and lender motivations. There are a lot of misconceptions about what HUD has and has not done, and what it could and should do with the HECM program. There is a dearth of publicly available information on loan terminations, an item called for in the Waters-Heck legislation under development, and a step forward NRMLA supports.

Just yesterday, FHA issued two mortgagee letters to address some of the shortcomings in its procedures that had adversely impacted non-borrowing spouses seeking to sustain themselves in their homes. I believe this new guidance will address many of the issues that have led to this hearing.

It is NRMLA's objective to shed light on this subject and share knowledge. The housing wealth of older home owners, the home equity possessed by U.S. homeowners over 62 years old, estimated to be $7.1 trillion, is an essential resource for addressing our nation's looming aging and longevity crisis. The products our members offer seek to make that resource available to homeowners.

<u>Misperception of Lenders' Requirement & Motivations</u>

There is a widespread notion that lenders are looking to take advantage of unsuspecting borrowers. Critics and some consumer advocates express a belief that lenders actually want to foreclose. This is misguided; lenders are in the business of making loans, not owning real estate.

Foreclosure is oftentimes the routine manner of terminating a reverse mortgage transaction. When a borrower passes away and the loan balance exceeds the value of the home, there is little incentive for the heirs to take any other action. In other cases, there is no next of kin able to step in and handle a property disposition or payoff. Lenders must also act within HUD specified time frames in handling foreclosures, inhibiting their flexibility to work with borrowers in default. (A Mortgagee Letter issues earlier this week will now provide flexibility in some case.)

Over half of the foreclosures, according to data we've collected from two major servicers, are attributable to death of the borrower. Another 15% is attributable to non-occupancy, typically due to the borrower moving in with family elsewhere or into a care facility.

Under 7% are due to tax and insurance defaults. In a HECM, when a borrower fails to pay their real estate taxes, property insurance or homeowner association dues, the loan servicer steps in and advances those funds on their behalf. At that point, they are in default on the loan.

To prepare for this hearing NRMLA collected data from two major servicers with significant HECM portfolios. Both are third-party sub-servicers that handle HECMs on behalf of multiple lenders. Both reported on loans that had not yet been eligible for assignment to HUD.

The first servicer looked at a portfolio of 329,752 HECM loans. Of that, 18.1% or 70,220 loans, went to foreclosure. However, over 75% of those were due to death and/or non occupancy of the home by the borrower. Only 5% of the loans in this portfolio ended up in foreclosure due to a tax and insurance default.

The second servicer, reporting on a portfolio of 179,341 HECM loans, found that 22% or 39,431 loans went to foreclosure, but of those 50.3% were due to the death and another 15.3 % to the non-occupancy of the borrower. It appears in the second portfolio that only 7.5% of foreclosures were due to a tax and insurance default.

It is interesting to note for comparison purposes that in looking at research on defaults and foreclosures for other types of purchase and refinance mortgages, 13.6% of loans originated in 2007 ended up in delinquency. Overall, over 73% of those loans ended up in foreclosure or are persistently delinquent and likely to be foreclosed. (Source: What Fueled the Financial Crisis? An Analysis of the Performance of Purchase and Refinance Loans, Laurie Goodman and Jun Zhu, Urban Institute, April 2018)

In a HECM, loan servicers, upon advancing funds on a borrower's behalf will notify the borrower of their default and work with them on a repayment plan for the funds advanced. If the borrower fails to stay current on the repayment plan, the lender must request authorization from FHA before it may call the loan due and payable.

A HECM is occasionally blamed for being the cause of a homeowner's foreclosure for nonpayment of taxes when, in fact, if the homeowner failed to pay real estate taxes with a forward mortgage or even on a home owned free and clear with no mortgage, they would face foreclosure. Furthermore, with the HECM servicer advancing funds on the borrower's behalf and willing to work out a repayment plan that can be spread out over five years (current rule; previously HUD rules limited plans to two years), HECM borrowers actually have an additional safeguard not available to other homeowners who fail to pay their taxes.

In doing a fair assessment of reverse mortgages and their impact on individual borrowers, it is important to look not only at the end results, but also the circumstances they faced at the time of loan origination.

In many cases, particularly HECMs originated before the industry and HUD fully understood the need to include a financial assessment as part of reverse mortgage origination, the borrower was overburdened with mortgage payments and, oftentimes, consumer debt payments, at the time of origination. Falling behind on these obligations, they faced losing their home because their income was insufficient to make all the payments. The reverse mortgage enabled them to get rid of the monthly payments required by their "forward" mortgage, providing an opportunity to focus on their other expenses and needs.

The elimination of a monthly mortgage payment, coupled with the information that prospective borrowers gain from the Benefits Checkup and other topics discussed during the mandatory counseling session, are enough to get homeowners back on track and preserve their ability to remain in their homes. In fact, the large majority of HECM borrowers remain in their homes until they pass away.

Another sizable cohort of HECM borrowers leave their homes before passing away because health conditions or an inability to further maintain the home force them to move in with a family member or enter a care facility. If the balance on the HECM at that point exceeds the market value of the home, borrowers will simply let the home go to foreclosure. Similarly, when there is no next of kin to step in and handle a sale of the home, the loan will go into foreclosure. These are the loans that result in non-occupancy.

As far as loans to borrowers with non-borrowing spouses, much of this practice occurred during the Great Recession ten or eleven years ago. Critics blame it on lenders seeking higher remuneration for larger balances. In reality, it was often requested by borrowers needing to obtain a higher amount of loan proceeds, because that was necessary to pay off their existing indebtedness and sustain them in their home.

It is important, as I stated earlier, to understand the particular circumstances and situation upon origination to determine whether the outcome from a HECM has been beneficial or detrimental to a homeowner. There is a tendency by some to jump to the conclusion that something is wrong with the HECM program or the lenders who participate, but that is a simplistic response that fails to dive deeper into the matter and examine what is truly happening.

In the balance of this testimony, I will try to address the questions raised in the subcommittee's letter of invitation.

(1) What is your assessment of the recent proposed legislative and administrative changes to the HECM program that were included in HUD's recently released housing finance proposal?

Proposal to Eliminate the HECM Single National Limit and Replace it with Area-by-Area Limits

The single national loan limit for HECM borrowers was first introduced in a bill by Chairwoman Waters (HR 1852) in 2007. That bill made several changes to HECM including setting the HECM loan limit at the GSE conforming loan limit. The committee report then noted:

> "Also provides for a uniform nationwide mortgage loan cap on FHA reverse mortgage loans, equal to the GSE conforming loan limit [thus eliminating the local median home price determination otherwise used for Section 203(b) loans]."

This provision was adopted into law as part of the 2008 Housing and Economic Recovery Act (HERA). The Act also raised GSE loan limits in high cost areas up to 115% of the local median home price – not to exceed 150% of the GSE conforming loan limit. Subsequent increases in the GSE limit have raised the HECM single national limit, as well.

There were compelling reasons the change from area-by-area limits to a single national loan limit was made.

A primary reason is that area-by-area limits are a concept that was created for a specific purpose on the FHA "forward" mortgage programs. In the FHA "forward" mortgage program, the goal is to empower middle-income consumers, particularly first-time homebuyers, to purchase an equivalent home in any market across the country. That equivalent home costs more in Los Angeles than it does in St. Louis, for example. Hence, the differential with maximum mortgage amounts for specific areas.

In a HECM, on the other hand, a homeowner is accessing home equity, their own housing wealth that they have accumulated over the years by paying down a mortgage and utilizing those funds, to age in place. The costs of aging, whether they include purchasing durable medical equipment, paying for prescription medicines, covering Medicare supplement premiums, etc. do not differ much from one geography to another.

Area-by-area loan limits penalize homeowners who have improved and maintained their homes over the years and have accumulated more equity as a result of higher home values. For example, at current rates and policies, a 70 year-old homeowner in St. Louis with a home worth the Area Limit for FHA forward mortgages of $317,000, would receive approximately $159,000 from a HECM at today's rates. A 70 year-old owner of a $425,000 home would be able to receive approximately $215,000.

If the area-by-area limits were used for these two homeowners, they both would be able to receive only the $159,000 amount.

With longevity increasing and aging getting ever more expensive, homeowners need to be able to access as much of the accumulated wealth that they have built up (saved, in effect) in their homes as they can.

Applying the forward mortgage concept of "area limits" to a financial resource (HECMs) created for a completely different population at a completely different time of their life would be ill-advised. This discussion took place in the Committee when the single national limit was enacted in 2007-2008 and that provision should remain in place.

<u>Proposal to Eliminate HECM to HECM Refinance Loans</u>

There has been concern that refinancing borrowers from one HECM into a newer HECM with a larger principal limit is problematic. Besides increasing the potential balance that FHA insures, short-term refinancing causes payoffs of existing HECMs quicker than investors expected, diminishing their appetite for purchasing HECM-backed securities.

HUD's response has been to propose simply doing away with such refinances. This is overkill.

There are numerous instances where refinancing a HECM makes sense. There are other ways to address this issue.

As a borrower becomes older, their property gains value and/or interest rates go down, a higher principal limit (the amount that can be borrowed on a HECM) can become available. This is useful in numerous situations.

For example, a borrower who takes out a HECM at age 68, might find that they need more cash available ten years later when their health care costs increase or they need additional funds to pay for real estate taxes or property upkeep. If their property has gone up in value to support a higher loan amount, they should be able to access it. If access to more funds helps avoid a tax or insurance default, or helps a senior receive care at home, that option should be available.

A HECM to HECM refinance could also be a mitigation tool for borrowers in default or for non-borrowing spouses who would like to place themselves into a borrower position. Having this option available, in many cases, can protect the FHA insurance fund from having to pay a claim.

To discourage churning of HECM loans, FHA should implement requirements for seasoning before a loan can be refinanced and deploy a net benefit test to make sure that a homeowner is getting a financial benefit commensurate with the costs of a refinance. The industry has tried to implement these provisions on a voluntary basis, but they will be far more effective if required by HUD.

(2) Why is there a dearth of private reverse mortgage products available?

This is an outdated question. Over the past two years, proprietary reverse mortgages have been brought to market by several major reverse mortgage lenders.

However, these products typically have to be approved by each state in which they will be offered, a process that is expensive and time-consuming for lenders, so the tendency is to offer them in the most active markets first. All offerors of these products are at work seeking approval for additional states.

Proprietary products have typically been utilized on higher value homes than HECMs, with more affluent borrowers. They are now beginning to be used for condominiums that do not meet HUD's requirements.

(3) How has HUD addressed some of the aggressive marketing tactics, including the impact of celebrity endorsers, that have been problematic?

I believe this is more the responsibility of CFPB and FTC than HUD. That being said, HUD does monitor lenders for performance, including their consumer communications. CFPB also audits lenders for compliance and has taken several enforcement actions for wrongful advertising.

As far as celebrity spokespersons, that is a fact of life in how advertising is conducted in America. Having a celebrity in a commercial for reverse mortgages is no different than featuring Dennis Quaid in ads for e-Insurance, Sally Fields for the dietary supplement Boniva, or Julia Roberts for Lincoln-Continental autos. The ads are designed to draw the viewers attention. It is not expected that consumers act because the celebrity told them to.

(4) How diverse is the reverse mortgage industry, and what is being done to promote increased diversity in the industry?

This is not an area in which NRMLA has focused, so my answers can only be observational. Our members come from a variety of ethnic and cultural backgrounds. I only see our members' employees who attend our conferences and participate in our activities, not those working in operational roles at their offices around the country. One observation I would make is that the ratio of women to men participating in this field far exceeds many other areas of commerce.

NRMLA, in an informal manner, does seek to broaden inclusiveness in our industry by attending and speaking at programs offered by other associations, including the Asian Real Estate Association, Latino organizations like National Council of La Raza, and trade associations serving minority professionals, to discuss the opportunities that exist in our field.

(5) How has HUD responded to the issues of nonborrowing spouses?

While it can be argued that HUD has not moved quickly enough on this topic, the rules they put in place to provide the Mortgagee Optional Extension sought to address this situation for the legacy cases that exist. As of earlier this week, HUD has issued a Mortgagee Letter updating those procedures to provide more flexibility for HECM loan servicers and non-borrowing spouses to work together on such cases. This is a major step forward.

Also, HUD has had a policy in place the past few years that enables an eligible non-borrowing spouse to remain in the property after the borrower is deceased.

(6) Can you comment on reports of predatory targeting of minority homeowners in the context of the HECM program?

As in many businesses, there might have been some brokers or originators that have targeted such communities, but they would be the exception, not the norm. In fact, of the companies that appeared to concentrate their marketing on minority neighborhoods as pointed out by the recent USA Today article, few remain in business.

However, on this topic, it is also important to, once again, look at the circumstances of loan origination. It is conceivable that for older homeowners in lower income neighborhoods living on limited fix income, a HECM might have been the best credit option available. Limited, fixed incomes might have rendered some homeowners unacceptable for other credit instruments. Homes that require repairs might be ineligible for other types of financing, whereas the HECM program has mechanisms for carrying out home repairs in conjunction with obtaining the loan.

(7) Can you comment of the financial stability of the HECM loan portfolio and its relation to the FHA's Mutual Mortgage Insurance (MMI) Fund?

The annual scoring of the HECM program in the FHA actuarial report has fluctuated tremendously in recent years. To some extent, this might be because we are using the wrong metrics.

Determining the net present value of cash flows for all outstanding HECMs, as is done in that analysis, requires a high degree of speculation on how long borrowers will remain in their homes, at what pace they will draw down their available funds, how home price appreciation will perform, what will interest rates be and what will the federal cost of funds be? All these factors must be projected out for thirty years, a highly speculative process.

Just to look at one factor, for instance, if interest rates don't rise at a rate as projected (which has been the experience in recent years), the projected compounding of higher rates will distort the actual bottom line adversely.

Furthermore, the consultants that have developed reports for HUD have not always taken into account the impact of programmatic changes that HUD has undertaken and have had a positive effect on the program. They are working with outdated information and projecting new losses on historical losses, failing to recognize the impact of changes. For example, financial assessment has had a beneficial effect in lessening defaults for property charges, but that has not necessarily been reflected in the actuarial analyses. HUD's appraisal review requirements will also have an impact that it is too soon to quantify.

Finally, the costs of resolving loans with defaulted borrowers or where the borrower has vacated the home and it is able to be disposed appear to be much higher for the loans that have been assigned to HUD and are being serviced by HUD's contract servicer when compared to loans being resolved and properties disposed by private lenders prior to assignment. These higher costs are then extrapolated to the entire portfolio, even though losses are less severe in the non-assigned portfolio.

Conclusion

The HECM program is an important financial instrument for helping older homeowners age-in-place. Reverse mortgages are a relatively new concept in the world of personal and residential finance and we are experiencing a learning curve. A partnership of the industry, HUD and various other stakeholders have tried to respond as we learn from experience and readily work together to amend procedures to address the issues that arise.

NRMLA thanks the Subcommittee for hosting this hearing and taking an interest in this topic.