U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410

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Hearing before the House Financial Services Committee
Subcommittee on Insurance, Housing and Community Opportunity

Oversight of the Federal Housing Administration's Reverse Mortgage Program for Seniors

Wednesday, May 9, 2012

Thank you, Madam Chairman for inviting me here today to testify about the Home Equity Conversion Mortgage (HECM) program. The HECM is a government insured reverse mortgage which enables seniors, age 62 and older, to convert a portion of the equity in their homes into cash. The proceeds of the loans can be used for a variety of purposes, including the purchase of a new principal residence which better suits the senior's needs, health costs and subsistence needs at a time of reduced income.

Reverse Mortgages and the Evolution of the HECM

The Housing and Community Development Act of 1987 authorized HUD to conduct a demonstration of HECM loans for older homeowners. The original HECM demonstration allowed HUD to originate 2,500 loans under the program. The intent of the program was to provide FHA mortgage insurance on reverse mortgage loans to help facilitate origination of these loans, which enable "house rich, cash poor" seniors to tap the equity in their homes while remaining in their homes. The first HECM loan was made in October 1989.

The reverse mortgage offers an opportunity for seniors to age in place while also having access to cash at a time in life when many experience a reduction in income. Traditional debt, such as first- or second-lien home equity loans or lines of credit, can also provide cash, but the requirement for periodic repayment and an income sufficient to service the debt make this alternative approach less than an ideal solution for lower income seniors wishing to age in place. While the sale of a home may provide cash, it also entails moving to alternate housing where studies[1] have shown that most older Americans prefer aging in place. As a result of these

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[1] Bayer, Ada-Helen, and Leon Harper. 2000. *Fixing to Stay: A National Survey on Housing and Home Modification Issues.* Washington, DC: AARP, available at: http://assets.aarp.org/rgcenter/il/home_mod.pdf

considerations, the question of how retirees might be best able to use home equity—often their largest asset—to help fund their retirement has been brought to the forefront of financial planning discourse.

For older Americans, equity in the home has come to represent a major share of their total wealth. However, owner-occupied housing, as an asset, is largely indivisible—a home cannot easily be sold in increments as can a stock portfolio or have equity withdrawn gradually like a savings account. Thus, liquidating housing wealth to help meet cash needs during retirement is not easily accomplished. Converting home equity to cash generally requires the sale of the entire asset or the ability to issue debt against home equity.

A reverse mortgage is debt issued against home equity which can provide significant sums of cash without the sale of the home and without the need to make periodic repayments. Because no repayment of the mortgage balance is due until the borrower no longer occupies the home as his or her principal residence, traditional underwriting is not required to demonstrate the borrower's financial capacity (income) to service the debt. Reverse mortgages are secured only by the equity in the property and not by the borrower's capacity to repay.

The HECM loan is a reverse mortgage that offers lenders an FHA insured mortgage insurance guarantee. The HECM loan program was originally designed to meet the special needs of elderly homeowners by reducing the effect of the economic hardship caused by the increasing costs of meeting health, housing, and subsistence needs at a time of reduced income and to encourage and increase the involvement of mortgagees and participants in the mortgage markets in the making and servicing of reverse mortgages for elderly homeowners. The FHA guarantee, which is available so long as the loan is originated following FHA guidelines, enables lenders provide better loan terms to borrowers than would be available without the FHA mortgage insurance guaranty.

The HECM became a permanent FHA Single Family Mortgage Insurance Program in the FY1998 HUD Appropriations Act. Since that time, HUD has endorsed approximately 739,000 HECM loans. In recent fiscal years, Congress has included language in HUD's appropriation that waives the cap of allowable HECM endorsements each year. In doing so, Congress has acknowledged the importance of continued availability of FHA HECM loans and worked with HUD to avoid the potential of a moratorium in endorsements for this product. In the President's FY 2013 Budget, HUD proposes to permanently eliminate the statutory cap on the number of HECM loans which can be endorsed for FHA insurance. Removing this cap, which is a remnant of the original demonstration project, along with the securitization of HECM loans through Ginnie Mae, will ensure that HUD continues to contribute to meeting the needs of seniors age 62 years and older who want to age in place. The Administration's proposal will not impact the commitment authority limitations that this and all other FHA insurance programs are subject to.

HECM Consumer Protections

The authors of the HECM legislation recognized that while there were clear and worthy objectives to meet in establishing this product, in order to ensure that the needs of this vulnerable population are met and also to protect the FHA, the HECM program should include built in statutory consumer protections. The protections built into the FHA HECM mortgage are not required for private sector products and they include:

- Mandatory counseling for prospective HECM applicants from a HUD-approved independent source. Such counseling serves a dual purpose: it ensures that the applicant understands the HECM product and also determines whether less costly alternatives such as local deferred payment loans or grant programs are available before proceeding with the HECM loan.

- A statutory guaranty of cash advances to borrowers, in a timely manner, in case their lenders become bankrupt or face temporary disruptions in operations due to emergencies. This is an important benefit to the senior homeowner, especially in turbulent and uncertain economic times.

- Prohibition on excessive referral fees. Origination fees for a HECM are capped at 2% of the maximum claim amount (MCA) of up to $200,000 plus 1% of MCA for any portion greater than $200,000. The total origination fee on any loan may not exceed $6,000.

- Required anti-churning disclosures from the lender to the borrower to ensure that HECM borrowers are not being induced to refinance without benefits and/or solely for the benefit of lenders.

- Prohibition on cross-selling HECMs and annuities by any party that participates in the origination of the mortgage or in the counseling for the HECM. This is a significant benefit for HECMs since it expressly addresses a major concern that consumer groups have had with reverse mortgages in general. The use of the proceeds from a reverse mortgage to fund a long term annuity defeats the purpose of the reverse mortgage by tying up the senior's assets and often leaving them with insufficient payments from the reverse mortgage for making ends meet. Additionally, this cross-selling results in two sets of fees being paid by the borrower. Also, since payments from an annuity are counted as income for the purposes of Social Security Insurance and Medicaid, this is a further drain on borrower finances.

HECM Counseling

The requirement that consumers receive mandatory counseling from a HUD-approved counselor is perhaps the most important consumer protection feature of the HECM program. This safeguard is especially important because the counseling assists the borrower in understanding the HECM loan product and provides in depth information to help seniors make informed decisions. The objectives of reverse mortgage counseling are to educate potential borrowers on the different types of reverse mortgages available; the suitability of a reverse mortgage for their personal and financial situation, and alternatives to reverse mortgages. Counseling is also important because it is provided by certified HECM counselors at HUD-approved housing counseling agencies, independent third-party organizations that are not involved in the HECM loan transaction. Receiving counseling from a HECM certified counselor at a HUD-approved counseling agency ensures seniors have unbiased information to guide them.

In FY 2009, HUD amended HUD's HECM program regulations to incorporate new testing standards to qualify individuals to provide HECM counseling. The regulation also established a HECM counselor roster. The rule was intended to standardize and improve the quality of HECM counseling.

In order to be placed on the HECM Counselor Roster a counselor must:

- Be employed by a HUD approved housing counseling agency;
- Successfully pass a standardized exam;
- Receive training and education every two years.

Currently there are approximately 900 HECM counselors providing face to face or telephone counseling to homeowners across the country. In November 2011, the HECM counselor exam was updated to reflect program changes.

HECM counselors are required to utilize a standard protocol as part of the HECM Counseling Program. It contains detailed information on the topics to be covered in a reverse mortgage session as well as all policy guidance and program requirements issued by HUD relating to HECM counseling. In 2010, the HECM Counseling Protocol was substantially revised with input from a variety of stakeholders including HUD-approved counseling agencies, HECM counselors and FHA lenders. The revised protocol includes new elements added to strengthen and standardize HECM counseling and enhance consumer protections.

For instance, the new protocol requires that counselors provide all clients with a standard information packet. Except for emergency counseling, counselors must provide this packet to clients prior to conducting the session and must allow for sufficient time to enable clients to read the materials before the counseling session. The packet contains:

- A HUD one page document titled "Preparing for Your Counseling Session";
- National Council on Aging's Booklet, "Use Your Home to Stay at Home-A Guide for Homeowners";
- A print out of loan comparisons;
- Loan amortization schedule;
- Total Annual Loan Costs (TALC) Disclosure.

In addition, the new protocol requires HECM counselors to complete a budget review for each client using a standardized financial assessment. In order to complete the budget, counselors use a tool created by the National Council on Aging (NCOA), the Financial Interview Tool (FIT). This tool helps prospective borrowers consider the immediate financial needs and long term challenges that can make it hard to stay at home and benefit from a reverse mortgage. FIT helps older homeowners consider all of their financial obligations and how they will meet them on an ongoing basis. In addition, the new protocol requires that seniors falling below 200 percent of the federal poverty level to use NCOA's web based application, BenefitsCheckUp, to learn of services and benefits that can be an alternative source of income or reducing expenses either in lieu of or as a supplement to a reverse mortgage.

Counselors must also assess a client's level of understanding of the information being provided during the counseling session. HUD's new counseling protocols mandate that a counseling agency must withhold a counseling certificate from a client who cannot successfully answer five of ten review questions that are asked during the course of the counseling session. This aspect of the protocol is designed to ascertain the client's comprehension of the counseling session content. Clients can schedule another appointment to complete the counseling session at a later time if they are still interested in successfully completing the session and obtaining a certificate.

HUD is very concerned about the potential of financial fraud related to the HECM transaction. The revised protocol and other HUD counseling policies require counselors to caution clients against signing HECM loan proceeds to loan officers or other parties involved in the mortgage transaction and ensure clients understand the standard ways in which they can access their loan proceeds. In addition, the protocol includes information for counselors on how to report to the appropriate government agencies on suspected elder abuse.

Over the years, HUD has worked to create a strong network of expert HECM counselors as well as an ongoing training and support system for these counselors. Currently, HUD provides grant funding to NeighborWorks America to:

- Offer the standardized HECM exam in a manner that is secure, cost-effective and accessible to all current and prospective HECM counselors and that accurately reflects HUD HECM counseling requirements;
- Make available reverse mortgage loan analysis and comparison software and training and job aids on the technical tools utilized by HECM counselors;
- Provide technical assistance and peer-to-peer learning opportunities;
- Provide on-line and face to face training opportunities for HECM counselors.

In FY2011, FHA established a counseling initiative to assist HECM borrowers who are delinquent in taxes, insurance and other property charges. A working group was established with representatives from five national housing counseling intermediaries that provide HECM counseling services, the National Reverse Mortgage Lenders Association (NRMLA) and HUD. One hundred and twenty five counselors from these five intermediary organizations were selected to participate in this initiative. HECM borrowers that faced this particular challenge were referred to counselors in these five national organizations. These counselors are responsible for: 1) analyzing clients' financial situation, ability to support repayment and future property charges; 2) assisting clients with identifying options to resolve delinquency, obtaining additional financial assistance and/or support for transition out of home; 3) communicating and coordinating with clients' servicers; and 4) providing an action plan to clients and relevant follow-up.

A standard protocol was developed for this type of counseling and these counselors received specialized training during FY2011 related to this protocol. HUD also partnered with the Department of Health and Human Services and the Agency on Aging to identify Local Area

Agencies on Aging organizations in communities across the country that could also assist HECM borrowers facing this challenge to identify viable options and local resources. Over 4,307 counseling sessions have occurred since January 2011.

Complementing this effort, the Philadelphia Homeownership Center is coordinating a pilot, now in the planning phase, to assist seriously delinquent Philadelphia area HECM borrowers with mortgages deemed 'due and payable' because of unpaid property taxes or property insurance. Participating in the pilot are the Philadelphia HUD Offices of Field Policy and Management, Public Housing, and Community Planning and Development, the HHS Administration on Aging and the National Council on Aging. The pilot will begin with housing counselors contacting the borrowers by telephone. If telephone contact fails, follow-up will include a post card or home visit. Borrowers will be assisted to review options and find sources to supplement their income, for example by enrolling in state or federal benefits to which they are entitled. If they are unable to stay in their homes or find housing with relatives, attempts will be made to identify alternative housing. Local Area Agencies on Aging will help the borrowers to identify and assess options.

Managing the HECM Program in Today's Market

The FHA HECM product serves a critical market demographic. Although the private market for reverse mortgage programs reached approximately 15% of the market prior to the housing crises, it now serves approximately 2% of the market and these private programs are generally geared toward the jumbo market, where FHA loans are not available.

Although FHA has experienced a decline in the number of HECMs insured since its peak of 115,000 endorsements in 2009, the demand potential for HECM going forward remains significant. According to the 2009 American Housing Survey, 18.5 million US homeowners were headed by persons age 65 or over, of whom 16.3 million are potential HECM borrowers; 13.9 million had no mortgage debt and 2.4 million had mortgage debt estimated to be less than 40% of home value. Further, the Joint Center for Housing Studies of Harvard University projects the number of households aged 65-74 will increase by 6.5 million between 2010 and 2020. HECM insurance endorsements in FY 2011 were down by seven percent from FY 2010 levels, to 73,098 loans. This was the second straight decline in HECM endorsements, though it was not as significant as the 31 percent decline experienced in FY 2010. That larger fall in activity was likely due to reductions in equity take-out limits imposed in October 2009. The decline in FY 2011 can be attributed to a number of factors – the change in FHA mortgage insurance premiums from 0.50 to 1.25 percent, the exit of lenders from the program mid-year and a general reduction in capacity and home price declines. Despite these declines, HUD continues to see this as a vital and important program for seniors. In fact, according to current estimates, aggregate home equity held by older homeowners remains substantial. Studies by the National Reverse Mortgage Lenders Association show that for the third quarter of 2011, seniors had $3.19 trillion in aggregate home equity, down from the peak estimate of $4.02 trillion in 2006. Clearly, a large potential demand still exists in the reverse mortgage market today.

FHA Policy Changes

As with Forward mortgages, the HECM program has been impacted by the housing and financial crises. The decline in home values and resulting decrease in home equity, reduction in value of seniors' assets and investments, loss of income and increased defaults due to property charges, have all required FHA to make a number of significant changes to the HECM program. These changes focus on credit quality, risk management and sustainability of the program for HUD and for seniors. In making effective policy changes to address these risk issues, FHA has focused on:

- The FHA statutory requirement to manage stability of the MMI Fund (HECM endorsements were moved from the General Insurance Fund to the Mutual Mortgage Insurance Fund (MMI) by HERA)

- The importance of the program to meeting the needs of seniors by providing access to home equity to replace decreasing savings, asset losses and investment income and supporting aging in place.

- Creating policies that will provide clear guidance for Lenders and Servicers and reduce uncertainty regarding certain aspects of the program

- Addressing issues related to default in complying with the terms of the HECM mortgage

- The evolving use of the product and the changing borrower profile

Servicing of HECM Mortgages

As with FHA-insured forward mortgages, FHA has established guidelines for the servicing of reverse mortgages which must be followed in order for lenders to be eligible to file a claim. This includes a requirement that HECM borrowers are offered loss mitigation options.

Recently HUD issued guidance to mortgagees indicating loss mitigation tools available to them when working with seniors. The loss mitigation tools available are Repayment Plans and HECM refinance loans. Under a repayment plan, the borrower has up to two years to repay the advanced funds necessary to cover the delinquent taxes and insurance. In order for a borrower to benefit from the refinancing of a delinquent HECM to a new HECM, borrowers must have sufficient equity in their homes to satisfy the existing mortgage and cover delinquent taxes and insurance.

If a HECM borrower is unable to retain their home, options are available to avoid a foreclosure, including the ability for the borrower to sell their property for the lesser of the mortgage balance, or 95% of the current appraised value. Under this option, once the property is sold, the borrower has no further liability under the mortgage. A defaulted HECM borrower also has the option of signing a deed in lieu of foreclosure. This option helps seniors avoid the stress of foreclosure if they are unable to sell their property.

Risk Management and the HECM Program

HECM has consistently maintained a negative credit subsidy rate – that is, the program is estimated to be self-supporting through its premium revenues. However, HUD has needed to increasingly tighten HECM program terms over the last several years to make this possible. .

HUD has two main policy levers available to manage the credit risk inherent to the HECM loan. The first is through the mortgage insurance premiums (MIP) charged to the borrower. The second is by limiting the amount of equity take-out available to the borrower. These limitations are defined and administered through principal limit factor (PLF) tables for each interest rate and borrower age. The equity take-out in the PLF tables increases with borrower age, and decreases with higher interest rates.

Based upon estimated valuations of the HECM portfolio, in September 2009, HUD announced a 10 percent reduction in the PLFs for all loans originated in FY 2012. . This 10 percent reduction in equity take-out eligibility eliminated the need for an appropriation of credit subsidy to operate the program. Continued weakness in the housing market required additional action to maintain the HECM program without a subsidy appropriation for FY 2011

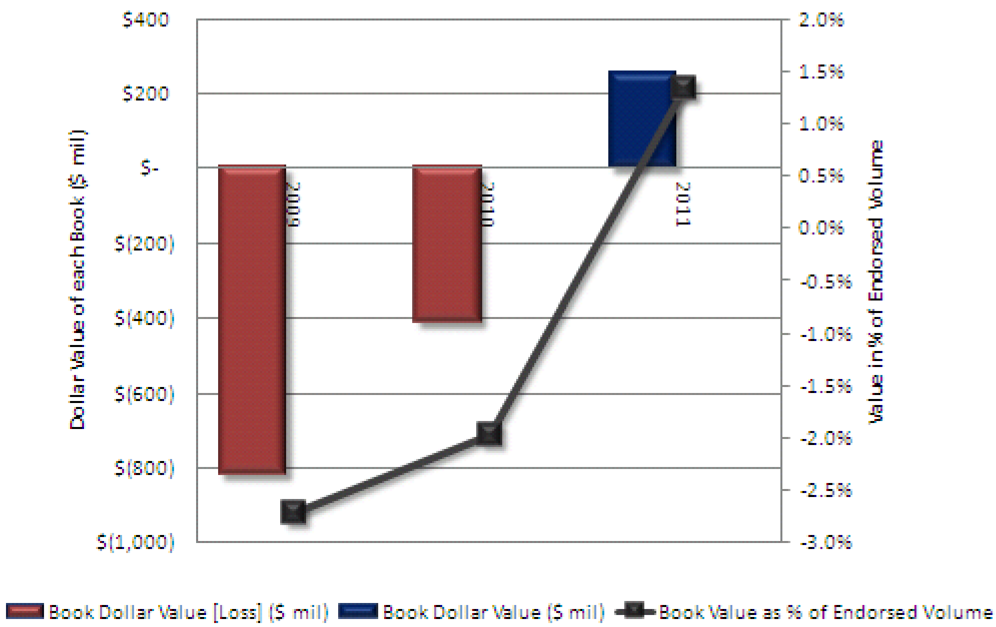
Furthermore, HUD established an industry working group to assist with the development of a new HECM product, the HECM *Saver*, to help diversify the HECM portfolio by encouraging borrowers to accept lower equity take-out limits. HECM Saver is an alternative for borrowers who need less cash and will use HECMs as an ongoing line of credit and source of funds for retirement planning. The traditional one-size fits all HECM product that existed from the program's inception was replaced by two new HECM products, *Standard* and *Saver*, for Fiscal Year 2011. *Standard* raised the annual mortgage insurance premium from 0.5% of the outstanding loan balance to 1.25%, and maintained the original upfront premium of 2% of the loan's maximum claim amount. *Standard* also utilized an enhanced actuarial modeling and assumptions to produce a new principal limit factor table. The new *Standard* factors reduced PLFs by 10 to 15 percent from the 2010 levels. This *Standard* product is designed to appeal to older seniors who need the most cash from HECM and who are less concerned about upfront loan costs.

HECM *Saver,* on the other hand, also raised the annual premium to 1.25%, but reduced the upfront premium to 0.01%, and applied an enhanced model and assumptions to produce new factors that are lower than the *Standard* factors. *Saver* is designed to minimize upfront costs to appeal to younger seniors who need less cash, and who may want a shorter term "bridge" loan to meet current needs.

HECM Independent Actuarial Reviews

The Housing and Economic Recovery Act of 2008 (HERA) moved all new HECM endorsements from the General Insurance (GI) Fund to the Mutual Mortgage Insurance (MMI) Fund beginning with endorsements made during FY 2009. The MMI Fund, which is the principal insurance fund for all of FHA singe family program mortgage insurance products, including the Section 203(b) program which is FHA's main Forward mortgage program. Under the National Affordable Housing Act (NAHA) passed in 1990, the MMI Fund is subject to an annual independent actuarial study. The review is required to estimate the economic value of the MMI Fund to determine whether the NAHA capital requirements have been met.

Figure 1. Estimated Lifetime Value of Each HECM Book-of-Business, 2009 – 2011



The FY 2011 book is actuarially sound and we expect, due to recent policy changes, that the future books of business will also yield positive economic value. The economic value of the FY 2011 book represents 1.34 percent of the FHA endorsement volume. The HECM program was substantially righted in 2011 through a more than doubling of the annual premium rate (from 0.50 to 1.25 percent), the introduction of the *Saver* option (which has a better economic value per dollar), and additional reductions in equity take-out percentages under the *Standard* option mean that HUD.

<u>Taxes and Insurance Defaults</u>

Another factor contributing to the improved value of the HECM portfolio in the FY 2011 actuarial review was new controls on the potential claim costs of tax-and-insurance arrears. HUD's regulations require a HECM borrower to maintain hazard insurance on the mortgaged property and to pay all pertinent property charges (e.g., local real estate taxes) in a timely manner. Failure to make those payments puts the loan in default.

HUD is taking the Property Charge default situation very seriously. We are aware of the challenges to borrowers in paying them. Prior to the housing crisis, increasing property values provided increased equity for seniors to access in obtaining a HECM loan. A requirement of the

HECM program is that seniors are responsible for the payment of taxes and insurance (as is required for forward mortgages). However, with the drop in property values and financial crises, the borrower's access to funds to meet the obligations of the mortgage have become more challenging.

This year, for the first time, HUD was able to make loan-level data on such defaults available to the independent actuaries. With information on incidence of default and post-default repayment plans, the actuaries estimated a statistical model that was used to forecast loan terminations due to such defaults. The requirement to call defaulted loans due-and-payable has always been HUD policy, but in January 2011 formal guidance was issued so that lenders have clear rules regarding how to address the arrears in an equitable manner.

In this policy guidance, HUD instituted controls for the level to which those arrears may grow before the loan must be declared due-and-payable. Under the new guidance, such actions occur when the lender/servicer determines that, despite counseling support, all loss mitigation options for repayment have been exhausted. This new guidance also has the effect of reducing projected losses on HECM loans because, without that guidance, the FY 2010 actuarial study projected accumulating arrears subject to possible HUD claim payments up to the time of borrower exit from the home. Now, under the guidance, projected claim payments are effectively capped at two years of such arrears.

The Future of the HECM Program

The Department is working on additional rulemaking to address risk issues and enhance program sustainability, including:

- A Servicing/Claims Proposed Rule to codify many of the changes that have been implemented through Mortgagee Letters and FAQs and to provide broader solutions/authority to ensure mortgagees comply with HUD servicing requirements on HECMs.
- A Financial and Credit Capacity Assessment Federal Register Notice with Comment Period proposing credit and financial capacity evaluation at loan approval to ensure that the senior has sufficient access to income, assets (including proceeds from the HECM) to comply with the obligations of the mortgage and living costs.
- A Mortgagee Letter clarifying and consolidating published policy, and
- Deployment of a new integrated data system to support HECM origination, servicing and claims

Although some major players have left the HECM market for varying reasons, there is tremendous need and opportunity for the HECM product. We believe that as the market stabilizes and HUD is able to complete policy and process guidance this will address risk issues to ensure sustainability of the program and address "uncertainty" issues for originators and servicers.