Get Ahead With the New Reverse Mortgage Rules

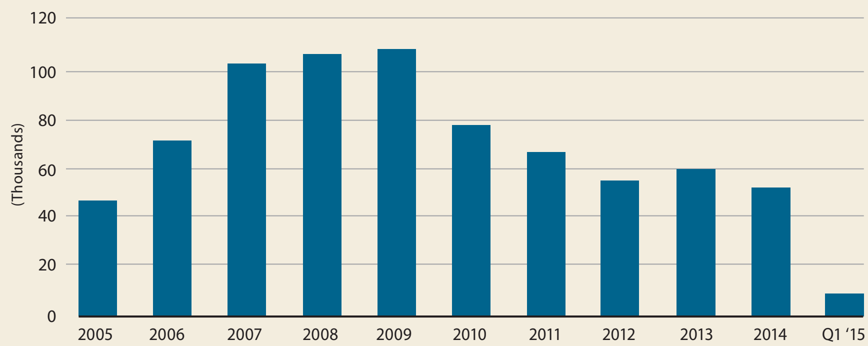
Financial assessment requirements change perceptions of Home Equity Conversion Mortgages

By Alain Valles

Since President Ronald Regan signed the 1988 law authorizing government insurance of reverse mortgages, hundreds of thousands of senior borrowers have converted their homes' liquid equity into accessible cash using reverse mortgages — or, more accurately, Home Equity Conversion Mortgages (HECMs). This past November, the U.S. Department of Housing and Urban Development (HUD) announced dramatic changes to the HECM program. These changes were scheduled to go into effect on March 2, 2015, but HUD announced a delay of 30 days to 60 days this past February, so they will now go into effect this month or next.

Home Equity Conversion Mortgages (HECM) regaining popularity

Reverse mortgage originations rose sharply during the bubble years, peaking in 2009, but declined steadily over the past five years. Recent data from the U.S. Department of Housing and Urban Development (HUD) shows a possible rebound in fiscal-year 2015, however. Data from the first three months of FY 2015, which began this past October, show HECM originations on course to rival FY 2013. January HUD data continues this upward trend, hitting a high mark not seen since February 2014.



Source: **U.S. Department of Housing and Urban Development**

Total HECM Loans

New guidelines

The most significant new guideline is the requirement that every borrower must undergo a financial assessment prior to approval. This financial assessment will verify the borrower's ability and willingness to pay financial obligations associated with the HECM loan. Specifically, borrowers will have to demonstrate they have the means to pay real estate taxes and home insurance, both of which are obligations of a reverse mortgage.

For the past 25 years, no income verification or asset review was required for a HECM loan, but that will change with the financial assessment. Reverse mortgage borrowers will need to provide tax returns, paystubs and bank statements, and will be required to meet residual income levels and have a satisfactory credit profile. In essence, what once was a loan with the least amount of paperwork will become as paper-intensive as the U.S. Department of Veterans Afairs loans.

The financial assessment requirement addresses a problem that resulted from HECM borrowers who could not or chose not to pay external property charges. These charges included items such as real estate taxes, hazard and flood insurance premiums, ground rents, condo or planned unit development fees, homeowner association fees and other special assessments levied by municipalities or state laws. In some cases these defaults led to seizures of homes by local tax authorities, and significant losses to HUD. It created a real mess.

To ensure funding will be available for tax and insurance obligations, borrowers who do not meet the standards of the financial assessment will be required to establish a fully funded or partially funded life expectancy set-aside. This requirement may narrow the number of potential reverse mortgage borrowers. The life expectancy set-aside is based on:

- **The sum of current property taxes plus hazard and flood insurance premiums;**

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- **A factor reflecting increases in tax and insurance rates;**
- **The expected average mortgage interest rate; and**
- **The life expectancy of the youngest mortgagor.**

Compared to conventional mortgage financing, where a three-month escrow account for paying taxes and insurance (T&I) is typical, the fully funded life expectancy set-aside is significantly longer because it is tied to the life expectancy of the borrower. These periods range from three years for borrowers 95 years and older, to 12 years for 75-year-old bor-rowers and 21 years for 62-year-old borrowers. Without dramatizing the impact, a monthly T&I cost of $500 could easily reduce the amount of available reverse mortgage proceeds to the borrower by $50,000 or more. This could result in some seniors no longer being able to qualify for reverse mortgages because of their lack of equity.

Senior borrowers who meet the "willingness to pay" criteria — satisfactory credit — but don't have sufficient income to meet residual income guide-lines for the "ability to pay" criteria may utilize the partially funded life expectancy set-aside. The amount withheld from the mortgage proceeds for this set-aside is based on a calculation of the gap in residual income and may not exceed the projected cost of property charges.

Borrowers who meet the financial assessment guidelines are not required to establish a set-aside. These borrowers would need to pay property charges on their own, but there would be no impact on the reverse mortgage proceeds available to them.

New opportunities

The financial assessment will noticeably change the origination and processing of reverse mortgages. More documents must be gathered from borrowers, extending the decision process and underwriting turn times. The reverse mortgage will become similar to traditional or forward mortgages, which may be a difficult transition for many companies and could decrease the number of seniors who can qualify. There will likely be industry consolidation as many companies may choose to exit the HECM space altogether.

Brokers will need to verify with their current reverse mortgage lenders that they fully understand the new changes and have the capacity and resources to handle the increased requirements of the new rules. There is nothing worse than having senior clients count on you, only to let them down because of forces beyond your control.

Many in the reverse mortgage industry are lamenting these changes, but change also brings new opportunities. The HECM program will be stronger thanks to fewer T&I defaults, and the stigma associated with reverse mortgages being the "loans of last resort" will diminish.

The best news is that there are no pending changes to the many benefits of reverse mortgages. Borrowers still have no requirement to make monthly mortgage payments, and can still receive a monthly check for life or get a line of credit insured to grow for as long as they live in the home.

The new-and-improved reverse mortgage will likely be embraced by aging baby boomers and their trusted advisers as an additional retirement tool that can help ensure future cash flow if and when needed. Seniors can use reverse mortgages in numerous ways to ensure a comfortable retirement and secure financial future. Just a few examples include:

- **Deferring social security to maximize future benefits**
- **Protecting against inflation**
- **Funding an active lifestyle**
- **Not being a burden on family**
- **Protecting home equity from nursing-home costs**
- **Funding long-term care**
- **Accessing tax-free cash if or when needed**

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Mortgage brokers and bankers with senior clients should take the time to educate themselves about the ins and outs of the new rules surrounding reverse mortgages. You may be pleasantly surprised to find out that even with the financial assessment requirements, reverse mortgages still can help your clients secure their financial future throughout their golden years, while also helping to grow your business. ■