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**“Long Term Sustainability for Reverse Mortgages:
HECM’s Impact on the Mutual Mortgage Insurance Fund”**

Hearing before the

Subcommittee on Housing, Transportation, and Community Development

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Chairman Menendez, Ranking Member Moran, and Members of the Subcommittee:

Thank you for the opportunity to testify on behalf of AARP on the long term sustainability of reverse mortgages and HECM's impact on the Mutual Mortgage Insurance Fund. I am Lori Trawinski, Senior Strategic Policy Advisor in AARP's Public Policy Institute.

As the largest nonprofit, nonpartisan membership organization representing people age 50 and older, AARP advocates for policies that enhance and protect the economic security of older individuals. AARP has a long history of involvement with the Home Equity Conversion Mortgage (HECM) program. In the mid 1980's, AARP supported the creation of the HECM pilot program. Recognizing the need to protect older, potentially vulnerable consumers from loss of home equity, AARP advocated for the requirement that HECM borrowers obtain housing counseling from HUD-certified providers prior to applying for a reverse mortgage loan.

Throughout the life of the HECM program, AARP has continued to advocate for consumer protections, conduct research on reverse mortgage issues, and develop policy recommendations to address the changes in this market. We are honored to be here today to present our views.

1. Programmatic Challenges of the HECM Program

Choice of Loan Proceeds Payout

The HECM program was designed to provide access to cash by allowing homeowners age 62 and older to tap a portion of their home equity without having to repay the loan as long as they lived in the house. It was viewed as a tool to assist homeowners who wanted to age in place. Borrowers could choose to receive their loan proceeds as a monthly payment over time, a payment for a set period of years, or as a line of credit to be used as needed. Within the line of credit option is the option to take all proceeds in a single lump sum payment. At the onset of the program, it was expected that most borrowers would choose to receive a monthly payout over time to supplement their income. However, by 2006 it was noted that borrowers more frequently chose the line of credit option, and many borrowers drew a large amount of loan proceeds early in the loan term.¹ The HECM market changed further in 2009 as securitization of HECM loans contributed to a major shift in borrowers choosing loans with a fixed interest rate, which required them to take all proceeds in a single lump sum payment at the onset of the loan. By 2010 nearly 68 percent of borrowers took proceeds in a lump sum and the fixed-rate product has continued to dominate the HECM market.

Research indicates that many borrowers take lump sums because they have existing mortgages that must be paid off as a condition of getting the HECM loan. In addition,

¹ Donald L. Redfoot, Ken Scholen, and S. Kathi Brown, *Reverse Mortgages: Niche Product or Mainstream Solution?*, AARP Public Policy Institute, December 2007, p. 56.

many borrowers are interested in using the proceeds to pay off other forms of debt.² Some of this need derives from higher amounts of forward mortgage debt being carried later in life than in the past, and an increase in the overall indebtedness of Americans in general.³ Increasing use of full-draw lump-sum payouts could also reflect a change in how reverse mortgages are marketed. Whatever the underlying reason, borrowers who take the full draw on day one of the reverse mortgage loan exhaust their borrowing capacity immediately and have no access to future funds. In addition, interest accrues on a large balance and accumulates rapidly.

Average Age of HECM Borrowers is Decreasing

Also notable has been a decrease in the average age of borrowers from 76 years old in fiscal year 2000 to 72 years old as of September 2012. Recent research found that of potential borrowers who received reverse mortgage counseling in 2010, 46 percent were under age 70.⁴ These changes may indicate that people have a need for higher amounts of money earlier in retirement, or even prior to retirement. Younger borrowers who take out reverse mortgages have access to a smaller percentage of their home's value, since the amount that can be borrowed is based on the life expectancy of the youngest borrower. The concern is that by drawing down home equity earlier, people will have no access to additional cash later in life when they may encounter major health problems or other emergencies that require financial resources. Also, by waiting until later to take out the reverse mortgage loan, borrowers would have access to a larger amount of funds.

Tax and Insurance Defaults

Reverse mortgage borrowers are responsible for paying property taxes, homeowner's insurance, and homeowners' association dues and assessments as a condition of the loan and as specified in the mortgage note. Failure to do so places the loan into default (delinquency) status and unless these charges are paid, the loan will become due and payable and the loan will go into foreclosure. According to HUD, 57,600 loans or 9.8 percent of active HECM loans were in technical default for nonpayment of property taxes and/or homeowners insurance as of June 2012. Borrowers' nonpayment of property taxes and insurance is a problem that has been well known for many years. In its evaluation report of the HECM program to Congress in March 2000, defaults were noted and it was suggested that HUD develop a loss mitigation strategy for handling these situations.⁵ In 2010, the Inspector General of HUD conducted an internal audit of the HECM program and found HUD was not tracking almost 13,000 defaulted loans and that HUD had granted

² Barbara Stucki, *Changing Attitudes, Changing Motives*, National Council on Aging and MetLife Mature Market Institute, August 2011, p.14.

³ Lori A. Trawinski, *Assets and Debt across Generations: The Middle Class Balance Sheet 1989-2010*, AARP Public Policy Institute, January 2013.

⁴ *Ibid*, p.8.

⁵ David Rodda, Christopher Herbert, and Hin-Kin Lam, *Evaluation Report of FHA's Home Equity Conversion Mortgage Insurance Demonstration*, Final Report, Abt Associates, March 31, 2000, pp.53 and 62.

deferrals on these loans and had no formal procedures in place regarding how servicers should manage defaulted loans.⁶ In January 2011, HUD issued Mortgagee Letter 2011-1 that provided loss mitigation guidance and procedures for dealing with delinquent loans.

Modeling Assumptions for Reverse Mortgages

Reverse mortgage models include assumptions about future home prices, loan termination speeds, and mortality. The collapse of the housing market and its aftermath was unanticipated and thus was not accurately captured in the models used to calculate program risk. Since many loans were originated during the height of the run-up in house prices, many HECM loans are likely underwater, meaning the value of the loan exceeds the value of the home. Sharp price declines translate into higher loan losses if loans terminate prior to house prices recovering to their level at the time of loan origination. This is the major source of projected losses going forward. In addition, HUD's earlier assumptions regarding mortality rates were too high, as it appears borrowers have been living longer than originally projected and the interaction between two borrowers was not estimated accurately.⁷ HUD found that surviving borrowers are living longer and staying in the home longer than predicted. As loans terminate more slowly than predicted, the likelihood that loans will reach their maximum claim amount and be assigned to HUD increases, and thus will require support from the insurance fund. Future interest rates will also impact the growth rate of loan balances for adjustable rate loans, and if interest rates rise sharply, loans will reach their maximum claim amount sooner and will be more likely to be assigned to HUD.

2. Need to Address and Improve Consumer Protections to Ensure Long-term Sustainability

Tax and Insurance Defaults

AARP believes the tax and insurance default situation must be addressed. Given that this has been a problem since the beginning of the HECM program, and this problem has been well documented for over a decade, a resolution—while not an emergency—is long overdue. While we support the idea of tax and insurance escrows or set-asides, the public should have the opportunity to comment on the specifics of such program changes during the normal rulemaking process to ensure that changes contain adequate consumer protections and are reasonable regarding the amounts to be escrowed or set aside.

⁶ HUD Office of the Inspector General, Audit Report 2010-FW-0003, August 25, 2010.

⁷ National Reverse Mortgage Lenders Association webinar on the President's FY 2014 Budget, April 12, 2013. Charles Vetrano, Deputy Assistant Secretary, Risk Management and Regulatory Affairs, HUD discussed this issue during the webinar.

Financial Assessments

One of the main features in the design of the HECM loan was that income and credit history were not part of the underwriting process. The thought was that older Americans—who have accumulated equity in their homes over a period of many years—should have access to that equity without having to sell their home or take out a home equity loan. Many older homeowners with limited incomes would not qualify for a traditional home equity loan, since it would require monthly payments. Since the HECM loan did not require repayment as long as the borrower lived in their home, the underwriting process was largely based on the life expectancy of the youngest borrower, existence of current liens on the property, and a verification that the borrower was not in default on any federal debt.

AARP supports the use of financial assessments to examine a borrowers' ability to pay property taxes, homeowners insurance, homeowners' association dues and assessments, and to be able to maintain the property. However, we do not believe that credit scores should be part of the financial assessment. Rather, the determination should be whether borrowers have the ability to meet their basic living expenses, financial obligations and property charges, and this should be determined after taking the cash flow from the potential reverse mortgage into consideration.

AARP believes it is important to ensure that following a reverse mortgage, a borrower will have the ability to maintain payments for their obligations; if not, the reverse mortgage should not be made. Denying a loan may enable some homeowners to retain any equity they may have, instead of merely staving off the inevitable loss of a home with a loan that is destined to fail.

Suitability

AARP believes that the Consumer Financial Protection Bureau should develop suitability standards and regulations regarding lender responsibilities to provide assurance that borrowers take out loans or find other alternatives that are best suited to their needs. Housing counselors are prohibited from recommending any loan or other course of action. Their role is to educate, answer questions and verify that the borrower understands the basics of the loan. Lenders, on the other hand, are able to recommend reverse mortgage loan products without regard to the needs of the consumer.

Product Availability

In the past, many lenders only offered certain reverse mortgage products to borrowers. The available loan products were: fixed-rate standard loan, adjustable-rate standard loan, fixed-rate saver loan, and adjustable-rate saver. However, many lenders only offered borrowers the fixed-rate standard product. The National Reverse Mortgage Lenders Association (NRMLA) recently issued Ethics Advisory Opinion 2013-1, which directs its

members to “offer and describe the full range of products and programs generally available in the marketplace that may provide a bona fide advantage to such consumers.” For the HECM program, this means lenders would describe the standard adjustable, fixed-rate saver, and adjustable-rate saver with potential borrowers. Previously, the NRMLA Code of Ethics required its members “to describe to consumers the range of programs and products *offered by the Member* that may provide a bona fide advantage to such consumers.” While we commend NRMLA for making this improvement, there is no enforcement mechanism to ensure that this advisory is followed. In addition, all reverse mortgage lenders are not NRMLA members. AARP recommends that the Consumer Financial Protection Bureau consider promulgating rules in this area to ensure that consumers are aware of all available products.

Housing Counseling

Housing counseling is a major component of the consumer protections for reverse mortgages. We believe that opportunities to improve HECM counseling remain. HECM counselors tell us that they often require two or more hours to cover all topics required by the HECM counseling protocol. In contrast, other counselors, and specifically many who conduct counseling via telephone, manage to conduct a session in less than one hour. We believe that this discrepancy may highlight a potential problem with the consistency and quality of counseling, and we urge HUD to monitor this situation.

HECM for Purchase Program Fraud

Older Americans are often targets of fraud and financial exploitation. The reverse mortgage housing counseling program is designed to help protect older homeowners from fraud. Unfortunately, fraud sometimes occurs despite this safeguard. It seems that the HECM for Purchase program provides an opportunity for fraudsters to convince people to take out reverse mortgages on low-value, uninhabitable homes based on inflated appraisals. People are told they can get a home for free, fraudsters provide the downpayment funds and create a gift letter as the source of the downpayment, and then obtain reverse mortgage proceeds—in an amount that exceeds the amount of the downpayment they had provided.⁸ Victims are then left with uninhabitable homes and bills for property taxes, unaffordable repair and maintenance needs, and homes that cannot be insured. AARP encourages HUD to conduct an evaluation of the HECM for Purchase program to determine how to strengthen safeguards in this area. Working with HUD fraud investigators, the FBI, and the Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of the Treasury, HUD should be able to measure the amount of fraud that has occurred within this program and to modify the program to better protect consumers.

⁸ Andrew Carswell, Martin Seay, and Michal Polanowski, *Reverse Mortgage Fraud Against Seniors: Recognition and Education of a Burgeoning Problem*, *Journal of Housing for the Elderly*, Vol. 27: pp. 146-160, January-June 2013.

Loss Mitigation

Additional funds should be allocated to foreclosure mitigation counseling. Every effort must be made to assist borrowers who have the capacity to become current on their property taxes, homeowners insurance and homeowners association dues and assessments so that they will not lose their home to foreclosure. HUD should expand the repayment timeline for borrowers who are in default beyond the current 24 month repayment period. The current program has not reached the vast majority of borrowers who are in technical default for failure to pay property taxes, homeowners' insurance premiums, or both. Attention must also be paid to borrowers who have failed to pay their homeowners association dues and assessments, as these payments are vital to the ongoing operation and maintenance of condominium associations.

Advertising and Marketing

Mass advertising of reverse mortgage loans should not be misleading or deceptive. Advertisements for reverse mortgages should contain explicit language that these products are loans, that borrowers must meet certain obligations under the terms of the loan or they can be foreclosed upon, and that celebrities are paid spokespersons.

Marketing of reverse mortgages through "free lunch" seminars should be closely monitored, since reverse mortgages are often presented as a means to pay for investment products at these seminars.⁹ AARP urges the Consumer Financial Protection Bureau and state financial regulators to monitor the use of free lunch seminars to ensure that no inappropriate marketing or cross-selling of other financial products is occurring.

Recent changes in the marketing of reverse mortgages have occurred and may warrant further monitoring. Some lenders have suggested that borrowers take out a reverse mortgage to delay claiming Social Security at age 62. By allowing the Social Security benefit to grow, they suggest that borrowers are better off. But these marketing tactics often do not adequately present the long-term cost of the reverse mortgage, and downplay the fact that the person is leveraging their house. AARP is concerned about the negative impact on consumers that may result from marketing reverse mortgages for this purpose.

3. Benefits to Seniors Who are Able to Age in Place

AARP research has found that nearly 90 percent of people over age 65 want to stay in their home as long as possible.¹⁰ Aging in place is the ability of people to live in their home as they age and retain their independence in an environment that is safe and comfortable. The benefits of aging in place to an individual include: the ability to maintain

⁹ AARP research found that reverse mortgages were mentioned in the marketing materials or in the presentation 24 percent of the time. See Lona Choi-Allum, *Protecting Older Investors: 2009 Free Lunch Seminar Report*, AARP Knowledge Management, November 2009.

¹⁰ Teresa A. Keenan, *Home and Community Preferences of the 45+ Population*, AARP Research & Strategic Analysis, Washington, DC, 2010, p.4.

a familiar environment; be part of a community; have opportunities for social interaction to prevent isolation; higher life satisfaction, happiness and self-esteem; and better physical and mental health outcomes. To put it simply: people prefer to stay where they are for as long as possible.

But the benefits of aging in place do not accrue solely to individuals, as government budgets also benefit. The longer people can remain at home, the less need there is for institutional care, such as nursing homes. This translates into lower governmental costs. By providing home and community-based services to assist people who wish to remain in their homes, studies have shown that the costs are lower compared with institutional care.¹¹

Reverse mortgages, when used properly, can provide some homeowners with a source of funds to help them to age in place. Reverse mortgages are often used to fund home modifications like ramps or other health-related renovations and maintenance and repairs, or to pay for home healthcare assistance.

4. Impact of the HECM on the Mutual Mortgage Insurance Fund and Potential Changes to Protect Taxpayers

The FHA Mutual Mortgage Insurance (MMI) Fund only includes HECMs issued since FY 2009. HECMs issued in prior years are included in the General Insurance Fund, and are not analyzed in the actuarial review of the MMI Fund. Approximately 300,000 loans were included in the FY 2012 actuarial review. While actuarial reviews provide a much needed assessment of the health of the insurance fund at a moment in time, it is important to keep in mind that the report is based on many assumptions that may not prove to be true over time. If house prices recover, the outlook for the MMI fund will greatly improve. As market dynamics change, the outlook for the future also changes.

For example, the FY 2012 actuarial review assumes that HECM saver loans will make up 7.5 percent of HECM loans through 2019. However, HUD recently eliminated the HECM fixed-rate standard product, which accounted for 65-70 percent of HECM loans. If borrowers shift to the HECM fixed-rate saver product, this will greatly impact the MMI Fund projections. One impact will be lower inflows into the MMI fund as a result of the much lower upfront mortgage insurance premium on the saver product. However, the lower principal limits of saver loans will decrease the long-term risk to the fund since saver loan proceeds are lower.

Alternatively, if borrowers shift to the adjustable-rate standard product, upfront premiums collected will be higher, but so will loan payouts, and increased interest rate risk will affect

¹¹ Wendy Fox-Grage and Jenna Walls, *State Studies Find Home and Community-based Services to be Cost-Effective*, AARP Public Policy Institute, Washington, DC, Spotlight 2, March 2013.

the fund. In short, there are a number of ever changing variables in a continually evolving marketplace that impact the measure of the health of the MMI Fund at any moment in time.

Problems with the current HECM program were discussed in Part 1 above and solutions are presented in Part 2 and Part 5 below. The fact that the MMI Fund may require an appropriation from Congress in FY 2013 is a serious matter. But it is important to understand that the largest driver of MMI Fund losses is the sharp decline in house prices, the large number of loans originated during the height of the market, and the higher loan proceeds and lower mortgage insurance premiums that existed previously. HUD has already taken steps to address these issues by lowering principal limits in 2009 and again in 2010, and by raising both upfront (on the standard product) and ongoing mortgage insurance premiums (on both standard and saver products).

During a recent webinar, HUD's Risk Manager indicated that the need for funds from Treasury is a result of loans issued prior to 2009 and it is unlikely the gap can ever be closed.¹² Given this assessment, the situation is not likely to be improved with a quick fix. It is important to make changes to the current program that are responsible and reasonable, with the understanding that shoring up the fund going forward is unlikely to eliminate losses from loans made in the past.

5. Opportunities to Improve the HECM Program

Implement Changes to Strengthen the HECM Program including: financial assessments, tax and insurance set-asides or escrows and limitation of upfront draws for certain purposes through public rulemaking.

AARP supports making changes to the HECM program that will enhance its long-term sustainability by promulgating rules through the public rulemaking process. We look forward to evaluating and commenting on the specific program changes proposed to ensure that consumer protections are adequate and access to credit remains for all qualified borrowers.

Require HUD to Evaluate the HECM Program Every Two Years and Report to Congress

This testimony demonstrates that HUD has failed to act to improve the HECM program when problems were identified. The tax and insurance default issue should have been addressed years ago. Major shifts in loan product usage should have led HUD to investigate and question why this shift was happening so quickly. The management of this program needs to be active and responsive when changes are observed. We believe that regular evaluation and reporting to Congress will provide HUD with much needed

¹² National Reverse Mortgage Lenders Association webinar on the President's FY 2014 Budget, April 12, 2013.

encouragement to address problems that will ultimately protect the program and taxpayers.

Implement a Suitability Standard

Regulations are needed to ensure that consumers receive a loan that is best suited to their needs. The CFPB should promulgate suitability rules. In the current environment, lenders are permitted to recommend any loan product, while housing counselors are prohibited from providing advice. Consumer protections need to be strengthened in this area.

Require Lenders to Present All Loan Products

Lenders have been able to control access to products in this marketplace, without having to provide complete information regarding product availability to consumers. Consumers need more assurance that they are being treated fairly and have access to the full range of products that are available.

Conduct a Study of HECM for Purchase Fraud

HUD should conduct a study on HECM for Purchase fraud to determine the prevalence of this type of fraud. Working with HUD fraud investigators, the FBI, and FinCEN, HUD should be able to measure the frequency of fraud that has occurred within this program and to develop stronger consumer protections for borrowers who engage in HECM for Purchase transactions.

Urge the CFPB to Conduct a Study on the Appropriate Use of Reverse Mortgages

Recent changes in the marketing of reverse mortgages indicate a shift from advocating their use as a tool to help older Americans age in place to a financial planning tool to be used as a type of investment portfolio insurance when investment values fall, or as a means to delay filing for Social Security benefits. The idea is that if investment values fall, a borrower can use their reverse mortgage line of credit to obtain funds, while not depleting their investment account when asset prices are low. When asset prices recover they can repay the loan. The inherent risk in this strategy is that the asset price recovery must exceed the costs of the loan, which cannot be known in advance. Likewise, the suggestion that someone should leverage their house to obtain a higher Social Security benefit requires an analysis that is dependent on many factors and might not result in a net benefit to the borrower when loan costs are factored in. While use of reverse mortgages for these purposes is not illegal, care must be taken to ensure that the HECM program remains true to its original mission to provide older homeowners with access to home equity through FHA-insured reverse mortgages so they can age in place.

Conclusion

AARP supports making changes to the HECM program to ensure its long-term sustainability and to protect both borrowers and taxpayers. We strongly believe that program changes should occur through the regular public rulemaking process. Consumers, stakeholders and the general public deserve to have the opportunity to provide comments on proposed rules. We urge Congress to require HUD to evaluate the HECM program every two years and to act expeditiously to implement changes to the program through the rulemaking process. AARP supports the continuation of the HECM program and we look forward to working with Congress and other stakeholders to ensure that older Americans can tap their home equity with safe, affordable, government-insured reverse mortgage loans that enhance their ability to age in place.

Thank you for the opportunity to share AARP's views. I would be happy to answer any questions.