

**THE FHA REVERSE MORTGAGE PROGRAM:  
A MAJOR OPPORTUNITY TO HELP AMERICA'S SENIORS**

by the  
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## **I. The FHA Home Equity Conversion Mortgage Program**

The FHA Home Equity Conversion Mortgage (HECM) is the nation's oldest and most popular reverse mortgage product. Over 90 percent of all reverse mortgages made in the U.S. are FHA-insured HECMs. The HECM has been available since 1989 to homeowners 62 or older. Eligible property types include owner-occupied 1- to 4-family homes, manufactured homes built after June 1976, condominiums and townhouses. Legislation passed by Congress in 2000 made cooperative units eligible for the first time. But the U.S. Department of Housing and Urban Development is still developing guidelines to permit this. Properties must meet FHA minimum property standards.

The size of a HECM varies by: (1) the borrower's age; (2) the value of the home; (3) current interest rates; and (4) FHA lending limit. Currently, the FHA lending limit varies by county from a low of \$172,632 to a high of \$312,896 (for high-cost metropolitan areas). FHA provides free software to lenders to help compute the applicable loan amount for each borrower.

Borrowers can choose to receive the proceeds from a HECM as (1) a upfront lump sum payment, (2) fixed monthly payments (for a set period; or, for as long as the borrower occupies the home), (3) a line of credit, or (4) a combination of these. (In Texas, due to state law, the line of credit option is currently unavailable.)

As a safeguard, all prospective borrowers must receive counseling from a HUD-approved, nonprofit housing counseling agency, or a certified AARP telephone counselor, before they can apply for a HECM. Upon completion of the counseling session, borrowers receive a certificate that must be shown to the lender when they apply for the loan.

The fee that a lender charges is limited by HUD rules. The origination fee can't exceed the greater of \$2,000 or 2 percent of the maximum claim amount (the FHA lending limit). At present, this 2 percent fee ranges from \$3,453 (2 percent of \$172,632) to \$6,258 (2 percent of \$312,896). The full origination fee, as well as other closing costs, may be financed as part of the HECM. This means a senior incurs very little out-of-pocket expense to get a reverse mortgage. FHA Mortgagee Letter 00-10 spells out the size of the origination fee that may be charged to borrowers and what the fee cap covers.

HECM borrowers must also pay an FHA insurance premium, equal to 2 percent of the loan amount upfront, plus an annual premium thereafter equal to 0.5 percent of the loan amount. Borrowers can refinance a HECM and pay the upfront premium only on the additional amount by which the loan balance increases in the refinance.

The interest rate is the same no matter which lender a senior chooses. Interest rates are adjusted either monthly or annually (the borrower chooses) and based on an index called the 1-year U.S. Treasury Constant Maturity Rate published weekly by the Federal Reserve. Both the monthly and annually adjusted rates have lifetime caps.

The monthly or annual adjustments don't alter the monthly payments that borrowers can receive (if they have chosen the monthly payment option). Instead, the adjustment affects the total interest that is charged on the loan, which is added to the loan balance while the loan is outstanding and is paid when the loan becomes due.

A borrower is not required to make any mortgage payments to the lender during the life of the HECM. The HECM becomes repayable, in full, when the sole remaining borrower dies or no longer occupies the home as his or her principal residence (e.g., through a sale of the home or a permanent move out of the home). The repayment obligation is equal to the sum of the total funds received by the borrower, interest, and any closing costs and other charges financed as part of the loan.

The borrower or borrower's heirs/estate may pay off the loan and keep the home. If not, the lender is repaid when the home is sold. If the sales proceeds exceed the amount owed, the excess proceeds go to the borrower or borrower's heirs/estate. If the proceeds are less than the amount owed, FHA absorbs the shortfall and makes an insurance claim payment to the lender.

About 400 lenders are currently involved in the origination and/or purchase of HECMs. Most of these are correspondents who sell the loans to one of a small number of major lenders who fulfill a role in the industry as "seller/servicers." Fannie Mae is the primary investor, and purchases all HECM loans.

In May 2000, HUD completed its second comprehensive report to Congress on the HECM program<sup>1</sup>. That report, "*No Place Like Home*," shows that the HECM program is on a sound financial footing. In this respect, the program has been successful. Only a very small number of claims have been made to the FHA Insurance Fund, while the program has generated a positive net income to the Fund.

## **II. Why HECM is an important program**

Today over 34 million Americans are over age 65.<sup>2</sup> This is expected to double in the next 30 years to almost 70 million.<sup>3</sup> By 2030, 20 percent of Americans will be over age 65.<sup>4</sup> Almost four out of five seniors own their own homes, meaning that there are about 27 million senior homeowners today, and that number will rise in the future. Seniors of all races have the highest rates of homeownership.<sup>5</sup>

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<sup>1</sup> "No Place Like Home: A Report to Congress on FHA's Home Equity Conversion Mortgage Program," HUD, May 2000.

<sup>2</sup> U.S. Bureau of the Census, Current Population Reports.

<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> "Housing Our Elders: A Report Card on the Housing Conditions and Needs of Older Americans," HUD, November 1999.

In addition, senior homeowners have a lower median income than any other demographic group (\$23,311 for seniors, and \$43,581 for all homeowners nationwide), yet seniors have the *highest* median home equity (\$80,000 for seniors, compared to \$57,000 for all homeowners and only \$19,000 for homeowners under age 35).<sup>6</sup> This indicates that conversion of home equity into income could significantly increase the relatively low incomes of senior homeowners.

This is obviously important from a public policy perspective. Seniors are a large and growing segment of the population. As seniors age, their incomes do not generally increase, while their needs do. Homes need repairs and accessibility improvements, chronic illnesses require ongoing treatment and expensive prescription drugs, cars wear out and must be replaced with more expensive ones, and people with declining mobility may need more daily help with household tasks. Seniors who cannot afford these growing expenses either forego them—thereby, sacrificing quality of life, independence, and even their health—turn to families, who are often hard pressed to help; take out expensive home equity loans, which must be repaid on a current basis; seek government assistance; or sell their homes in order to access their home equity. Studies by AARP have shown that seniors will sacrifice considerable quality of life in order to remain in their homes for as long as possible.<sup>7</sup>

Reverse mortgages offer an ideal way to avoid these dire consequences while maintaining seniors' desired independence in their own homes. Seniors do not have to repay the loans until they die or move out of the home. They can never owe the lender more than the home is worth when the loan is due. They can use the money in almost unlimited ways, and with payment plans that can be tailored to suit their needs and financial goals. Reverse mortgages can also save the federal government money through reduced demand for health care and other benefits. Proceeds from reverse mortgages can be used to:

- pay for home repairs, cost-saving energy improvements, and improvements to accessibility that can prevent injuries;
- pay for ongoing in-home health care, so the senior can avoid expensive government-paid hospitalization or nursing home care;
- pay for one or more new or used cars, or a wheelchair-accessible van;
- pay for expensive prescription drugs that may not be covered by any government or private insurance plan;
- pay for motorized wheelchairs and other life-enhancing equipment that Medicare or private insurance may not pay for;
- many other uses that can help seniors maintain their dignity, avoid asking hard-pressed children for help, and enjoy life.

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<sup>6</sup> The State of the Nation's Housing 2000, Harvard University Joint Center for Housing Studies.

<sup>7</sup> Fixing to Stay, AARP, May 2000.

### III. HUD's Responsibility

The advantages for seniors, their families, and the government of a robust reverse mortgage program are clear. The HECM is the dominant reverse mortgage product in the market and HUD can help promote the program to make reverse mortgages widely available to as many seniors as possible. Congress has clearly expressed great interest in the program, particularly its potential to help seniors afford long-term care, thereby helping to reduce the millions of dollars in eventual federal expenditures for seniors' health care needs.

The Centers for Medicare and Medicaid Services, a federal agency within the Department of Health and Human Services, and the Robert Wood Johnson Foundation funded a study by the National Council on Aging (NCOA) that explores the potential of encouraging seniors to utilize their home equity to cover their long-term care needs. In 2000, the nation spent \$123 billion a year on long-term care for those age 65 and older, with the amount likely to double in the next 30 years. Nearly half of those expenses were paid out of pocket by individuals and only three percent were paid by private insurance; government health programs pay the rest.

NCOA's report—titled *Use Your Home to Stay at Home: Expanding the Use of Reverse Mortgages to Pay for Long Term Care*—showed that reverse mortgages can help an estimated 13.2 million elderly homeowners pay for long-term care, allowing many to remain independent in their homes longer. Of the 13.2 million eligible households, an estimated 9.8 million currently have an impairment that can make it hard to live at home.

In total, these households could access as much as \$695 billion in home equity through reverse mortgages. For individuals, the extra cash could go a long way to help with family caregiving and other long-term care expenses. For example, a borrower aged 75 years old with a home worth \$100,000 could receive a reverse mortgage that could pay a family caregiver \$500 a month for almost 12 years; \$1,120 a month in adult day care services for almost five years; or \$2,160 a month in home care—daily care for at least four hours—for 2.5 years.

But, despite the huge potential market, and the clear public policy advantages of the HECM program, the program remains under-utilized. Since the program's inception, more than 150,000 HECM loans have been originated<sup>8</sup>. HUD has, on occasion, touted the potential for the program, but the updating and modernizing of the program that is required has not been allowed to take place

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<sup>8</sup> HUD Statistics Through May 2005

## **IV. Proposals for Action to Improve the FHA HECM Program**

The nation's reverse mortgage lenders have worked tirelessly since 1989 to make the HECM program widely available and widely understood. Over the past couple years NRMLA has submitted written suggestions, held meetings with HUD officials, and worked with Congress to promote a number of program reforms and marketing efforts that could help the program better serve our nation's seniors.

### **1. Raising HECM Cap.**

In response to rapid growth in the reverse mortgage program, a key legislative priority for NRMLA in 2005 will be to raise, or eliminate altogether, the existing cap on the number of outstanding FHA Home Equity Conversion Mortgages. Section 255 of the National Housing Act, which governs the HECM program, limits the aggregate number of outstanding HECMs to 250,000. Conceivably, the cap could be reached in the next 12-24 months.

NRMLA requests your support of H.R. 2892 sponsored by Representatives Michael Fitzpatrick (R-PA) and Jim Matheson (D-UT). The legislation eliminates the current HECM cap. There are eight original co-sponsors, including Rep. Sue Kelly (R-NY), Vice Chairman of the Financial Services Committee, Barney Frank (D-MA), the ranking minority member, and Reps. Gary Miller (R-CA), Ginny Brown-Waite (R-FL), Patrick McHenry (R-NC), Katherine Harris (R-FL), and David Price (D-NC). The legislation is bipartisan, enjoys the endorsement of AARP and has no cost to the federal government. In fact, the program has been determined to generate money for the FHA General Insurance Fund through its mortgage insurance premium. A Senate version is expected to be introduced shortly.

### **2. Establish a single national loan limit for HECM.**

The 2000 Homeownership and Economic Opportunity Act (P.L. 106-569) required HUD to study and report to Congress on the feasibility of establishing a single national loan limit for the HECM program. One of the biggest stumbling blocks that prevents better understanding of the program is the variance in loan limits around the country. While variable loan limits make sense from a public policy perspective for the FHA home purchase mortgage program, it does not make sense for the HECM. Costs for health care, new cars, home improvements, and other expenses do not vary significantly around the country. The variable loan limits mean that a senior living in a "high-cost" area with high FHA limits can access more of his/her home equity than can a senior living in an identically valued home in another "low-cost" area.

This is unfair to seniors in low-cost areas and complicates the administration and marketing of the program. Lenders with centrally located information centers find it hard to accurately tell an inquiring senior exactly how much cash he/she can get out of a HECM. Lenders and counselors cannot develop standard marketing or consumer information materials that explain how much they can get from a HECM—it all depends on where they

live. This has severely hampered the marketing of the program and understanding of it among seniors.

NRMLA commissioned Milliman USA to undertake an actuarial analysis of the FHA HECM program. The Milliman USA study concludes that the mortgage insurance premium currently assessed under the HECM program provides a vast sum of surplus income to the FHA insurance fund. The Milliman USA analysis also illustrates that changing to a single-national mortgage limit would not place the FHA insurance fund at any greater risk.

**NRMLA recommends that the Administration support and Congress pass legislation establishing the maximum FHA limit as the single loan limit for all HECM loans.**

**3. Review and revise the premium and fee structure for HECM.**

One of the most common complaints lenders receive, and one of the major deterrents to seniors who are considering HECMs, is the relatively high closing costs associated with them. FHA charges a 2 percent upfront mortgage insurance premium (MIP), which many seniors find high when added to origination fees, appraisal fees, and other closing costs. Seniors apparently are especially sensitive to upfront costs, and the costs do appear to make HECMs uncompetitive with other types of conventional home-equity loans that are offered as “no-cost” or “low-cost” loans.

**NRMLA recommends that Congress and HUD, in partnership with the reverse mortgage industry, immediately review the mortgage insurance premium structure for the HECM and determine whether there is a way to restructure these costs to reduce the upfront costs to seniors.**

**4. Implement various regulatory initiatives that would allow the HECM program to serve more senior homeowners.**

Current HUD rules stand in the way of greater utilization of the FHA HECM program in several areas. For example:

HECM for Home Purchase is an example of a regulatory initiative that would be helpful. While it was initially anticipated that seniors would use HECMs to remain in their current homes, many homeowners are interested in buying new homes that better fit their current needs. There are convoluted procedures that can be used to finance a home purchase with a HECM, but the process should be made more straightforward.

There is currently a restriction that if the cost of required repairs exceeds 15% of a home’s value, the repairs must be made prior to the HECM loan. It can be difficult for a senior to obtain the funds necessary for carrying out such repairs from sources other than the HECM. This standard should be reviewed to see if alternative safeguards for the FHA insurance fund can be devised.

**5. Improve and Increase Resources for Marketing of HECM.**

NRMLA has embarked on an ambitious consumer education campaign to raise public awareness and confidence in reverse mortgages. The industry urges HUD to embark on a major informational campaign, similar to the one successfully implemented a few years ago to publicize the FHA 203(b) program and the Homebuyer Protection program. Another idea that has been discussed is asking the Social Security Administration to send out consumer information brochures along with Social Security checks to seniors.

**NRMLA recommends that HUD utilize some of its consumer outreach and public affairs resources for a comprehensive marketing and consumer education campaign to increase awareness of seniors and the general public about reverse mortgages.**

## **V. Conclusion**

A healthy, active HECM program could be a key component for helping seniors take control over their financial situation. Reverse mortgages are a promising way to unlock billions of dollars in home equity, providing financial security, independence, and great improvement in the quality of life for thousands of senior homeowners and their families. Wider acceptance of reverse mortgages can mean reducing the need for costly increases in federal spending on health care and other benefits for seniors in the future. Because the FHA HECM program is the primary source of reverse mortgages, Congress and HUD should work more closely with the reverse mortgage industry to make needed program changes and devote greater effort to managing and promoting the program. This will result in more senior homeowners enjoying the benefits of this outstanding program. NRMLA and all its member lenders stand ready to assist Congress and HUD in this vitally important effort.