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Memorandum to the Presidential Transition Committee
Re: FHA HECM Reverse Mortgage Program

Submitted by Peter H. Bell, President
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Consumer interest in the FHA-insured Home Equity Conversion Mortgage (HECM) program has been growing recently as older homeowners explore utilizing these reverse mortgages to pay-off existing balances on onerous “forward mortgages,” replace diminished income from dividends and lower yields on certificates of deposit, or cover the costs of in-home care and assistance. There are a few areas where administrative and/or legislative changes to the HECM program could give the program far greater utility.

1.) Increase the HECM single national loan limit to the maximum allowed under FHA “forward” mortgage programs, or \$625,500 (after January 1.)

The Housing & Economic Recovery Act (HERA) replaced the previous county-by-county loan limits for HECM with a single national limit, set at the “limitation established under section (305(a)(2) of the Federal Home Loan Mortgage Corporation Act for a 1-family residence.” (HERA, Sec. 2122 (a)(5))

When HERA was under consideration by Congress, many involved in the process, including House Financial Services Committee Chairman Barney Frank and the House committee staff, believed that this meant the single national loan limit for HECM would be the maximum amount allowed for a single family home under the law governing Freddie Mac, meaning the maximum for high cost areas, or \$625,500, after January 1, 2009.

However, because of the way the language reads, it has been interpreted by legal counsel at HUD that the Department can choose to implement the provision either (a) at the high cost area limit of \$625,500; or (b) at the current Freddie Mac base limit of \$417,000. The Department, in consultation with OMB, chose to implement the loan limit at the lower level. The explanation given to us has been that they felt a higher limit might “crowd out” any non-FHA reverse mortgage activity.

The fact of the matter is that there are no proprietary non-FHA reverse mortgages available in the market today and even when they were previously available, they were really oriented towards homes with values exceeding \$750,000. As a result, senior homeowners with homes exceeding \$417,000 in value are constrained in the amount of funding available from a reverse mortgage. In some cases, where their existing indebtedness exceeds the amount available due to this loan limit constraint, homeowners are unable to obtain a HECM and are forced to sell the home and move out or face foreclosure.

Chairman Frank has indicated a willingness to straighten out this issue in forthcoming legislation, but based on comments made to us by FHA Commissioner Brian Montgomery and other HUD staff, we believe an administrative decision can be made to simply implement the existing provision in HERA at the higher level.

2.) Counseling Funding Issues

HERA contains a provision, initiated by Sen. Claire McCaskill, which bars lenders from providing any financial support to counseling agencies that provide the statutorily required counseling that all prospective borrowers must obtain before submitting an application for a HECM loan. Sen. McCaskill felt that FHA should utilize some of the mortgage insurance premium (MIP) income generated by the program to cover the costs of providing counseling to HECM borrowers.

HUD, however, has taken a position that prior budget law precludes the use of MIP funds for anything other than paying insurance claims. As a result, there is a tremendous shortfall in the availability of funding for HECM counseling.

Prior to enactment of HERA, counseling was funded by a combination of a direct appropriation (roughly \$3-4 million annually), financial contributions from lenders to counseling agencies, and, more recently, a new provision implemented by HUD that allows borrowers to pay for the counseling. (For a sense of magnitude, counselors conducted approximately 130,000 counseling sessions in FY'08 at a cost of \$125 each, for a total of \$16,250,000).

Prior to HERA, HUD funds covered the costs of those sessions that did not result in a loan and lenders paid for those sessions that did lead to a loan. Now, borrowers are being asked to pay the amount that had previously been covered by lenders, causing a few issues.

When borrower paid counseling was first proposed, the thinking was that the counseling fees could be paid from borrowers' loan proceeds, once loans were closed and disbursed. However, a number of counseling agencies said that they could not afford to wait the few months between providing counseling and loan closing to get paid and began charging prospective borrowers upfront, causing hardship in some cases and deterring homeowners from seeking HECMs in others. Counseling agencies are also supposed to provide counseling at no cost to clients who demonstrate "hardship," but it has been left up to each individual agency to determine its policy for doing this. The appropriated funds are now generally being used to pay agencies for hardship cases, as well as to pay for those sessions that do not result in a loan. However, the current appropriation falls short of the need.

A solution we've discussed with the housing subcommittee is to seek an FY 09 appropriation that would be sufficient to cover the full amount of counseling, so agencies could be paid at the time of counseling for all sessions. Borrower payments, from funds disbursed at closing, could then be paid into a fund to replenish part of the appropriation. In subsequent years, appropriations could be sought to pay for the hardship cases and fall-out cases, and payments from borrowers would cover those sessions that do result in loans.

3.) Systems Upgrades at HUD

One of criticisms of the HECM program has been the upfront costs to consumers. That has been partially mitigated by a new limitation on origination fees enacted in HERA, but more can be done.

One of the reasons that lenders are forced to charge as much as they do on HECMs is the high cost of "manufacturing" the loan. One particular problem is the outmoded management information system utilized to report loans for insurance. Under HUD's IACS systems, HECM lenders must enter each individual loan manually, requiring maintaining data entry staff to do nothing other than enter every transaction, one loan at a time. Relatively simple system enhancements that would enable lenders to unload batch files with multiple loans would help reduce the cost of originating, processing and insuring these loans.

4.) Revise Mortgage Insurance Premium Structure to Reduce Upfront Costs

Under the HECM program, borrowers pay an FHA mortgage insurance premium that is comprised of two components, an "upfront" MIP and an "ongoing" MIP. Currently the upfront MIP is 2% of the "maximum claim amount" (the lesser of the actual value of the property or the FHA loan limit). The current ongoing MIP is ½ % per year of the actual outstanding balance on the loan.

While we recognize that the performance of the HECM program might not permit an overall reduction of the MIP at this time, we believe a re-distribution of the MIP, with a smaller upfront collection and a higher ongoing premium, would make the program more attractive to homeowners and reduce criticism of upfront costs. According to a study that our association had conducted by Milliman USA a few years ago (and shared with the Department), eliminating the upfront 2% MIP and increasing the ongoing MIP from ½ % to .9 % would yield equivalent mortgage insurance income (in present value) to FHA as the present formula. Other iterations could yield similar results, as well. Changes to the HECM MIP structure can be made administratively by the Department.