

# KNOWING THE RULES OF THE GAME

**Line of Credit  
Growth**

  
**Guaranteed  
Growth**

  
**Tax-Free Cash**

**Partial  
Prepayments**

  
**Fixed Rate  
HECMs**

  
**The LESA**

  
**NBS  
Protection**

  
**The 95%  
Option**

# Misunderstood Concepts

1. Line of Credit Growth
2. Guaranteed Growth
3. Tax-Free Cash
4. Partial Prepayments
5. Fixed Rate HECMs
6. The LESA
7. NBS Protection
8. The 95% Option

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# What if I told you...

**What if I told you that with a fixed rate HECM, there are ways to utilize more than 60% of the borrower's principal limit, even if they have very low mandatory obligations?**

- Would you say I'm crazy, ignorant of the guidelines, **OR** would you be curious to know how?

**What if I told you that despite what reverse mortgage marketing states, the HECM Line of Credit is NOT necessarily guaranteed to grow?**

- We'll tell you ten reasons the line of credit won't increase from month to month.

**What if I told you that adding heirs to title as non-borrowing owners could cost them money after the death of the last borrower?**

- We'll discuss the 95% option and when it can be used.

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# 1. Line of Credit Growth

*Hello, Mrs. Smith.*

*I understand you wanted clarification on the line of credit growth.*

*Think about the interest earnings you see on your CD right now.  
What are you getting...2%?*

*Well I can guarantee your HECM LOC will be earning you at least  
that much in interest and probably closer to 4% annually.*

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# The Compliant Explanation

- **No. The growth is NOT:**
  - Income,
  - Interest,
  - Earnings, or
  - Return on your home equity investment
- **The LOC is properly described as:**

***“A greater capacity to borrow more money  
in the future, regardless of home value”***

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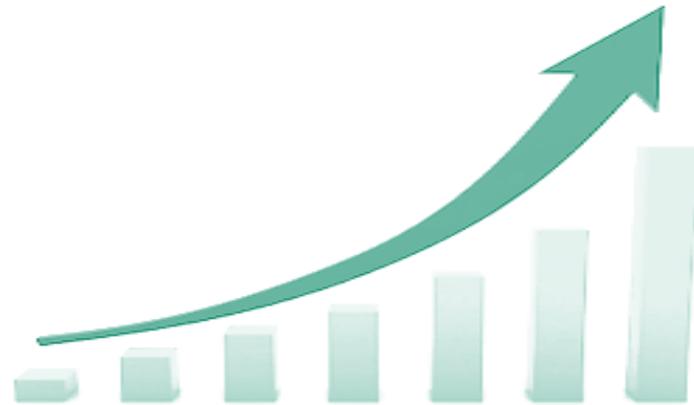
# How does the HECM LOC grow?

## Organic growth

Interest rate plus 0.50%  
(compounding)

## Prepayment growth

Reducing loan balance  
increases the LOC



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# Where does it say that?

- **HECM LOC Growth**
  - HUD 7610 Chapter 4 Part 5(C)

***"Counselors must not tell clients that HECM credit lines 'earn interest,' because credit line growth is simply increased access to borrowing power, comparable to an increase in a credit limit on a credit card."***





## 2. Guaranteed Growth

*Yes, Mr. Jones, you really do need a HECM Line of Credit.*

*Your traditional investments will generally go up during a bull market, and decline in a bear market. But the great thing about the HECM Line of Credit is that it is guaranteed to grow.*

*It always goes up, regardless of what is going on in the broader economy and regardless of your home's future value.*

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# When does a HECM LOC not grow?

- Borrower draws funds
- Loan is not in good standing
- Repair set-aside estimates are too low
- During the NBS Deferral Period
- During the initial disbursement limit in the first year
- Growth on zero is zero
- If the Maximum Mortgage Amount (MMA) is met
- If there are negative interest rates
- LESA is depleted
- Tenure interference on legacy loans

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# Where does it say that?

- **Maximum Mortgage Amount**
  - **24 CFR § 206.19(h)(1)**

**“No disbursements shall be made under any of the payment options... in an amount which shall cause the outstanding loan balance after the payment to exceed any maximum mortgage amount stated in the security instruments.”**





## 3. Tax-Free Cash

*Hi Mr. Moore,*

*The last time we spoke we were discussing the financial planning strategies of the reverse mortgage.*

*One of the key advantages we discussed is that the reverse mortgage offers you tax-free money.*

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# What taxes are potentially required?

- Property Tax
- Recording Tax
- Intangibles Tax
- Transfer Tax
- State Tax Stamps
- Tax on interest income from deposited funds
- Possible tax associated with a 1099-C (Cancellation of debt)
- Possible Capital Gains Tax

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# Where does it say that?

- **A Closer Look at Reverse Mortgage Marketing**
  - **2015 CFPB report**

***"Some consumers said advertisements claiming that reverse mortgage proceeds were 'tax free' made them believe they would not have to pay property taxes."***

***"Many consumers we spoke with did not understand that reverse mortgages are loans with fees, compounding interest, and repayment terms... This confusion is understandable where ads tout that reverse mortgages provide 'tax-free' money."***



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## 4. Partial Prepayments

*Hello, this is the HECM Servicing Department.*

*Oh, hello Mr. Wilson. Yes, I got your request for clarification on your recent payment of \$25,000. Yes, we processed your payment, and your loan balance was reduced by \$25,000.*

*However, partial prepayments are always applied to accrued mortgage insurance premiums first, and so we can't increase your line of credit until you've paid back all accrued mortgage insurance and accrued interest.*

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# Application of Prepayments

1. Mortgage insurance
2. Servicing fees
3. Accrued interest
4. Principal balance

**Note:** This is for tax and accounting purposes only. The LOC does not care what portion of the UPB was paid back.

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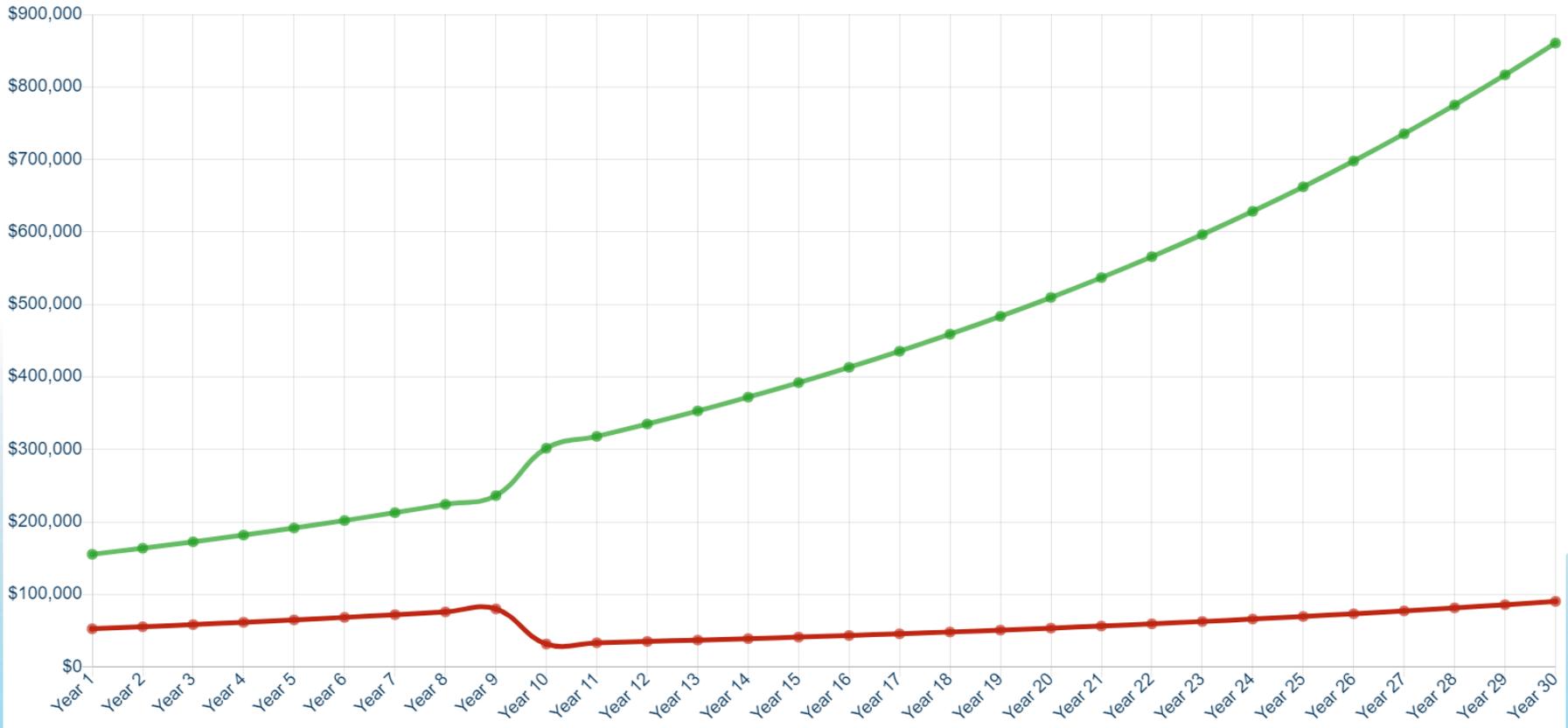
# See-Saw Explanation



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# Prepayment Growth



The illustration assumes a home value of \$450,000, a 62 year old borrower, a one-time payment of \$50,000, and a constant LOC growth rate of 4.99%. That rate can change based on interest rate adjustments as outlined in the terms of the loan.

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# Where does it say that?

- **Partial Prepayments**

- HUD 4235.1 CH 5-12C

**“By reducing the outstanding balance, the borrower increases the net principal limit.”**

- **Adjustable Rate Note**

**“Lender shall apply any partial prepayments to an existing line of credit.”**

- **Establish or Increase a Line of Credit**

- HUD 4330.1 CH 13-21B

**“A mortgagor may choose to make a partial prepayment to set up or to increase a line of credit.”**





## 5. Fixed Rate HECMs

*Hello, Bill.*

*Yes. I got your email about rates, and I understand you are very concerned about adjustable rate loans.*

*However, you don't have an existing mortgage, and with a fixed rate HECM, your proceeds are going to be capped at 60% of your principal limit.*

*I'm sorry, Bill, but I don't want you to miss out on the other 40% you'd be leaving on the table.*

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# Fixed Rate HECM

**Bill currently has no mortgage balance and has requested a fixed rate HECM.**

**How do you respond?**

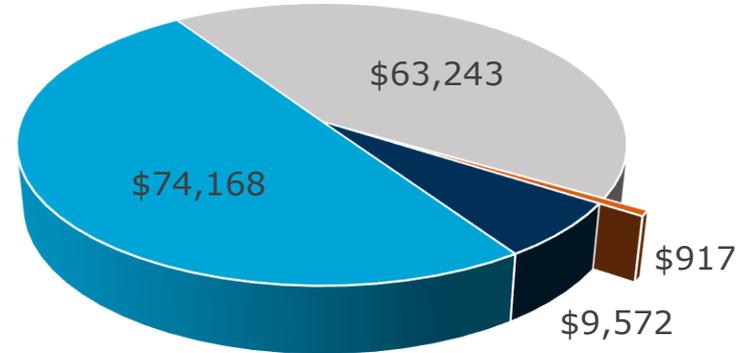
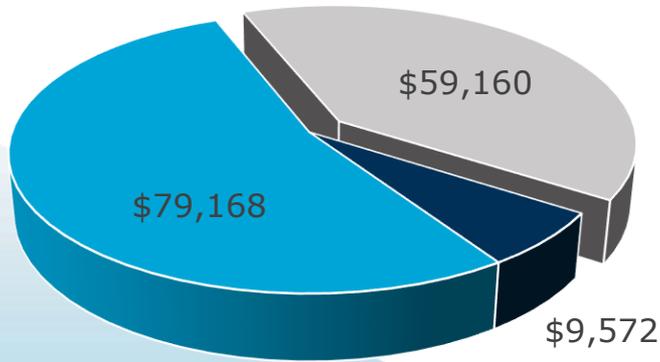
- A. Explain that he can only access 60% of the principal limit
- B. Encourage the ARM product because of its flexibility
- C. Discuss a fixed option utilizing more than 60%

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# Fixed Rate HECM with a LESA

These figures assume the borrower is age 70, has \$300,000 in value, a fixed rate of 4.56%, and taxes and insurance of \$5,000 annually.



■ Costs ■ Cash at Closing ■ Unavailable Principal

■ Costs ■ Cash at Closing ■ LESA ■ Unavailable Principal

**Note:** First year payment for property charges will be deducted from your available principal limit.

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# Who might be a good fit?

Borrowers who:

- Are rate-risk sensitive
- Want comfort and security
- Want to extinguish a mortgage, but have no interest in future draws

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# Where does it say that?

- **Voluntary LESA**
  - **24 CFR §206.205(b)2**

***"If, based on the results of the Financial Assessment, the mortgagee does not require the borrower to have a LESA, the borrower shall elect one of the following at closing:***

***[Option B] Borrower elects to have a Fully-Funded LESA for the payment of property charges."***





## 6. The LESA

*Hello Mr. Anderson,*

*Yes. I'm so sorry, but you failed financial assessment!*

*That means we'll need to withhold a portion of your principal limit, and set it aside to pay your property taxes and insurance.*

*This is really no different than an escrow account, but because you don't have a monthly payment, we'll need to deduct money upfront. At least you know your property charges will be paid.*

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# Proper Presentation of the LESA

## The LESA:

- Is not an escrow account
- Does not last the life of the loan  
**Note:** Not even an expected lifetime.
- Is in the best interest of the client
- Provides peace of mind
- Can be a positive experience, not punitive

## Also, provide:

- What happens when it runs out
- Concerns the heirs might have
- What impacts whether the LESA will last

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# Where does it say that?

- **Life Expectancy Table**
  - 2016 FA Guide 5.8

*"The figure used for life expectancy is taken from the U.S. Decennial Life Tables for 1979-1981 females"*

- **Not held in escrow**
  - 24 CFR §206.205(c)1

*"For a Fully-Funded LESA, the mortgagee shall (D) ensure that LESA funds are not held in an escrow account..."*

- **LESA is exhausted**
  - 24 CFR §206.205(c)4

*"If the LESA is exhausted and the borrower fails to make property charge payments, the mortgagee shall use any available principal limit to pay the outstanding property charge amount in full and charge the borrower's account."*



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## 7. Non-Borrowing Spouse

*Hello again, Mrs. Thomas.*

*No, Mrs. Thomas. You have nothing to worry about as a non-borrowing spouse. Since 2014, HUD has built-in provisions to protect you if Mr. Thomas pre-deceases you.*

*The reverse mortgage will still be there, and guarantees that you can remain in your home until another maturity event occurs.*

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# Non-Borrowing Spouses

- Caveats
  - 90-day requirement
  - Identified as a spouse in the documents
  - Continuous marriage
  - Continuous occupancy
- Death is the ONLY maturity event that opens a deferral option
- Deferral Period
  - LOC goes away
  - LESA goes away
- What is your plan?
  - What will you do to maintain the property?
  - Do you plan for long-term occupancy?

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# Where does it say that?

- **Death is the only maturity event that opens up a deferral option.**
  - **24 CFR §206.3**

***“Deferral Period means the period of time following the death of the last surviving borrower during which the due and payable status of a HECM is deferred for an Eligible Non-Borrowing Spouse provided that the Qualifying Attributes and all other FHA requirements continue to be satisfied.”***





## 8. The 95% option

*Hello again, Mr. Collins.*

*I'm glad the whole family was able to join us today. I just wanted reassure all of the heirs that y'all can remain on title as non-borrowing owners. Isn't that great?*

*Now, I know y'all have expressed an interest in keeping the home in the family. Of course, when that day comes, your payoff will be the lesser of the loan balance or 95% of the home's value.*

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# What will satisfy the HECM loan?

Scenario	HECM Loan Satisfaction
Traditional sale of the home (HUD 4330 Ch13-29A)	Debt or home value
Loan is due and payable (HUD 4330 Ch13-29B)	Debt or 95% home value
Heirs wish to keep the home <b>Note:</b> HUD considers any "post-death conveyance" or transfer of title to qualify as a "sale." (FHA Info #13-36) <ul style="list-style-type: none"><li>• If no post-death transfer</li><li>• If post-death transfer</li></ul>	<b>Full loan balance</b> Debt or 95% home value
Non-borrowing spouse wishes to keep the home (Mortgagee Letter 15-15)	Debt or 95% home value

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# Where does it say that?

- **Post-death conveyance of the property**
  - **FHA INFO #13-36**

***"If the mortgage is due and payable at the time the contract for sale is executed, the borrower may sell the property for at least the lesser of the mortgage balance or five percent under the appraised value. HUD interprets the word 'sale' to include any post-death conveyance of the mortgage property to the borrower's estate or heirs."***





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