The HECM Program State of Health:
And Why It Matters

NRMLA Southern Region Conference

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FHA HECM Insurance: How the Program Works

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- The Federal Housing Administration ("FHA") insures the Home Equity Conversion Mortgage ("HECM") program
- FHA collects an initial and ongoing Mortgage Insurance Premium ("MIP") from every HECM originated. FHA pays claims in the form of realized losses ("Type I") and repurchases ("Type II")
- Type I Claims are pre-assignment claims in which FHA insures against cross-over loss and certain loss-related expenses. Cross-over loss results from loan liquidations in which the HECM loan balance exceeds property value
- Type II Claims are assignment claims in which the HECM investor assigns an active loan to HUD once the loan balance reaches 98% of the Maximum Claim Amount ("MCA")
- FHA's capital position is equal to its cumulative capital from premiums and claims over time *plus* the Net Present Value ("NPV") of future Mortgage Insurance Premium ("MIP") *minus* future claim payments

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The Trouble With HECM 2008 - 2019

- As of the end of FY 2008, FHA was showing about a 2% capital ratio surplus, representing a "negative subsidy", or profit to FHA
- Within 4 years, this changed to a -3.5% deficit
- For the next 6 years, FHA reported a generally deteriorating position, including nearly -12% at the end of FY 2016 and –18.83% (or nearly -$14 billion) at the end of FY 2018
- The FY 2018 number shocked the industry and led for a call by some observers to end the HECM program
- Within the last 4 years, the fortunes of the HECM program improved dramatically, improving to -9.2%, -0.8%, 6.1% and 22.8% (or +$15 billion) at the end of FYs 2019, 2020, 2021, and 2022, respectively
- What happened?

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Risk Fact: What Determines the Health of the HECM Program?

- Loan-to-Value Ratio ("LTV"), or Principal Limit Factor ("PLF")
  - Original PLF and Initial Utilization %
  - Current
- Home Prices
- Default Rates (Tax and Insurance, Occupancy, etc.)
- Payoff Rates (Too slow, too fast or whipsaw)
- Interest Rates
- Production level
- Servicing: by Original Servicer and Servicer of Secretary's Notes
- Other Factors include: Draw Rates, Production Level, Servicing, Loan Size, Property Type

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The Trouble with HECM: 2009

- In May 2009, New View Advisors published its first blog entry: “The Trouble with HECM”
- We made the following basic points:
  - Initial PLFs/LTVs are too high
  - Home Values are falling, defaults are rising
  - The HECM program will experience significant cross-over loss
  - The combination of these factors will lead to future losses for FHA
  - Our base case scenario predicts an $8 billion loss for FHA

Excerpt: “… a large portion of outstanding HECMs of recent vintage will generate losses, with more and more loans crossing over into loss territory each year. … That translates into nearly $8 billion dollars of loss in present value terms … The extremely high loan amounts, with Loan-to-Value ratios as high as 80% to 90% for older borrowers, are creating "crossover" losses as property values decline and loan balances increase. As a result, the HECM program faces a potential death spiral scenario, in which senior borrowers are faced with ever increasing costs to fund the subsidy required to continue its existence, an existence made more tenuous by the high costs to the borrower and the taxpayer.”

A Decade of Reform: 2009 - 2019

- Two Years Later: " … This fact is reflected in FHA's estimate of a Loan Loss Liability of $8.692 billion (for HECMs originated through FY 2008) in their most recent (2010) Annual Management Report. This is consistent with the $8 billion crossover loss New View Advisors predicted in July 2009. (FHA has continually made upward revisions to their loss estimates for HECMs originated through FY 2008, from their $4.8 billion estimate at the end of FY 2009 and $1.5 billion the year before.)

- Over the next ten years:
  - FHA revises PLF tables (generally significantly downward) at the beginning of Fiscal Years 2010, 2013, 2014, and 2017.
  - FHA requires for Financial Assessment for all HECM borrowers
  - FHA reduces the Minimum Expected Rate to 3%.
  - Home Prices increase significantly: (73% during FY 2017 – FY 2022)
  - FHA increases Lending Limit (Maximum Principal Limit) significantly

- **HECM Principal Limit Factor Changes: 2010 - 2017**

PLF Regime	72 year old	82 year old	90 year old
Original @5.5% Expected Rate	70.6%	79.4%	85.9%
FY 2010 @5.5% Expected Rate	61.6%	68.0%	74.0%
FY 2013 @5.5% Expected Rate	52.4%	57.8%	62.9%
FY 2014 @5.5% Expected Rate	52.9%	61.6%	69.9%
FY 2017 @5.5% Expected Rate	44.1%	53.3%	63.6%
FY 2017 @3.0% Expected Rate	58.8%	65.8%	73.0%

A Decade of Reform: Financial Assessment to the Rescue

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- Defaults rose steadily during the financial crisis and remained a thorn in the side of the program. T&I and other defaults can lead to foreclosure and result in significant losses to FHA, HMBS issuers, and other HECM investors. To address this issue, FHA released Mortgagee Letter 2014-22

- FHA's objective for its Financial Assessment regulations was to reduce the persistent defaults, especially Tax and Insurance (T&I) defaults, plaguing the HECM program in 2009-2014

- FHA: "… an increasing number of tax and hazard insurance defaults by mortgagors led FHA to establish … a requirement for a Financial Assessment of a potential mortgagor's financial capacity and willingness to comply with mortgage provisions"

- Financial Assessment requirements became effective for HECMs with case numbers issued on or after March 2, 2015. Since then, HECM lenders make a financial assessment of borrowers' ability to meet their obligations, including property taxes and home insurance

A Decade of Reform: Financial Assessment to the Rescue

- **HECM Defaults Rates, Post-FA and Pre-FA**

FA Regime	T&I Defaults	Serious Defaults	Cutoff Date
Pre-FA	7.1%	10.5%	3/31/15
Post-FA	0.9%	2.3%	3/31/23

Serious Defaults defined as: T&I Defaults plus Called Due to Default (other than Mortality) plus Foreclosure related.

Why It Matters

- Program Survival
- Public Relations
- Investor Support:
  - Corporate Level
  - Venture Capital/Private Equity
  - Capital Markets
  - Specialized Lenders
- Industry Health
  - Financing Cost
  - Cash Flow
  - Servicing Cost
  - Loan Loss Reserves
- Consumer Benefits

Appendix: Selected HECM-Related Mortgagee Letters

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- 2023-09 Adjustable-Rate Mortgages (ARM): New Secretary-Approved Interest Rate Indices and Requirements for Transitioning from London Interbank Offered Rate (LIBOR) Index
- 2021-08 Home Equity Conversion Mortgage (HECM) Program - Changes to Interest Rate Requirements Including Removal of the London Interbank Offered Rate (LIBOR) Index
- 2017-12 Home Equity Conversion Mortgage Program: Mortgage Insurance Premium Rate and PLFs
- **2014-22 HECM Financial Assessment and Property Charge Requirements**
- 2014-21 Comprehensive Changes Including MIP Structure and Initial Disbursement Limits
- 2014-12 New HECM Principal Limit Factors
- 2014-07 HECM Non-Borrowing Spouse
- 2013-33 HECM Mandatory Obligations, Life Expectancy Set-Aside Calculation, and Purchase Transactions
- 2013-28 Financial Assessment and Property Charge Guide
- 2013-01 Consolidation of Pricing Options and PLFs for Fixed Interest Rates
- 2010-34 HECM Saver; MIP and PLFs
- 2007-13 ARMs Addition of LIBOR Index

Appendix: Financial Assessment

- Purpose
  - Financial Assessment is used to evaluate the borrower(s) willingness and capacity to meet his or her financial obligations; Determine if the HECM is a sustainable solution for the borrower(s) financial situation.

- Underwriter Responsibility
  - Perform an analysis of the borrower(s) current financial situation.
  - Complete the Financial Assessment Worksheet;
    - Property charge payment history
    - Credit history
    - Assets
    - Calculation of Imputed Income
    - Calculation of Maintenance and Utility Expenses
    - Monthly Effective Income
    - Monthly Property Charges
    - Other Monthly Expenses
    - Residual Income Calculation/Shortfall
    - Monthly Property Taxes Calculation as % of Monthly Income
    - Extenuating Circumstances
    - Compensating Factors
    - Financial Assessment Results

- Documentation
  - Mortgagees must include documentation used to conduct the Financial Assessment in the Case Binder; and
  - Mortgagees must ensure that all required information for income, expense, assets and liabilities is captured on the 1009 Application, and capture additional required information using Parts IV, V and VI of the FNMA form 1003, Uniform Residential Loan Application, or an alternative form developed to capture the same information

Thank You

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