Testimony

of

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before the

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Mr. Chairman and Members of the Subcommittee:

Thank you for convening this hearing to look into Long Term Sustainability for Reverse Mortgages: HECM's Impact on the Mutual Mortgage Insurance Fund. I am here today in my capacity as President & CEO of the National Reverse Mortgage Lenders Association (NRMLA), a trade association of over 300 companies involved in the origination, funding and servicing of reverse mortgages. Our organization has been serving the reverse mortgage industry as a policy advocate and educational resource since 1997. We also provide information about reverse mortgages to consumers and members of the press.

NRMLA member companies are responsible for over 90% of the reverse mortgages made in the United States. All NRMLA member companies commit themselves to our Code of Ethics & Professional Responsibility. Under that Code, placing the needs of the client takes precedence over all other considerations.

This Subcommittee, including members from both sides of the aisle, has been consistently sensitive to reverse mortgage issues and has continually taken steps to improve and enhance FHA's Home Equity Conversion Mortgage (HECM) program. For that, we are very appreciative, as are the three-quarters of a million senior households who have utilized the HECM program since its inception.

The issues surrounding reverse mortgages bring a key question into consideration:

How do we finance our longevity?

There were 4.2 million Americans over 85 years old in 2000; there will be over 9 million Americans over 85 years old in 2030. With life carrying on for decades beyond our earning years, we must manage assets and resources to sustain ourselves longer. Aging in place, remaining in one's own home for the duration of life or as long as physically possible, is simply the most cost-effective and financially sensible housing option for many. This requires the strategic use of home equity as a means of financial support.

Housing wealth, the equity accumulated in a home, represents the largest component of personal wealth for many American households. Typical retiree households might have Social Security income, a modest pension, limited income from low-yielding fixed-income instruments, and, perhaps, a diminished 401(k) account. The equity they have built up in their home is often their greatest asset, an important resource for funding their future.

The Bi-Partisan Policy Commission, in a report issued earlier this year, cited that half of homeowners 62 years of age or older had at least 55% of their net worth tied up in home equity. Furthermore, according to the Commission report, 9.5 million households headed by someone age 65 or older, spend more than 30% of their income for housing expenses, including mortgage payments; 5.1 million spend more than half their income on housing.

Congress recognized this when initially authorizing the HECM program as part of the Housing & Community Development Act of 1987.

I would like to thank the Subcommittee and its staff for making it relatively easy to prepare for this hearing by inviting me to address five specific items. I have organized my testimony accordingly. In addition to the testimony I am delivering today, I would urge the Subcommittee to review the testimony I presented before the full Senate Committee on Banking, Housing and Urban Affairs in a hearing on the financial condition of FHA convened on February 28, 2013. That testimony provides a background narrative on the history of the HECM program and current issues.

1.) Programmatic Challenges of HECM

HECM is a versatile personal financial management tool that was designed to empower older homeowners (over 62 years of age) with the ability to convert the wealth they have accumulated in the equity in their homes into cash to meet a variety of needs as they age.

Each and every borrower has particular needs and intended uses of the funds made available via a HECM; no two cases are the same. Consumer research of reverse mortgage borrowers, conducted last summer by ORC International, a global consumer opinion research firm engaged by NRMLA, revealed that most borrowers utilize the funds from their reverse mortgage to pay off existing mortgages and other consumer debt (59% of respondents); establish a "standby reserve" of cash for emergencies (53%) or uncovered health care expenses (24%); supplement monthly income (49%), repair or upgrade their home (33%) and/or provide financial assistance to a family member (14%). Most borrowers interviewed utilized funds from their reverse mortgage for a few of these categories.

The complex economic environment that followed the meltdown of the US housing market in recent years has had a significant impact on how and why U.S. homeowners utilize reverse mortgages. Individuals approaching retirement, whom had intended to work a few years longer, found themselves unexpectedly out of jobs prematurely and facing significant payments on their existing mortgages -- payments they could no longer afford to make. As a result, in a number of cases, HECMs were utilized to pay-off the underlying mortgage and eliminate the need to make monthly payments, preserving their ability to sustain themselves in their homes.

While this strategy has helped numerous older homeowners sustain themselves in their homes, it has also caused some stress to the HECM program. The combination of upfront lump sum draws for the entire amount of funds available -- often required to pay-off the existing mortgage loans -- and diminished income from job loss, has left some borrowers with a deep challenge in being able to continue to meet their obligations for paying taxes and insurance. With all of the funds from the HECM already spent to cover the prior mortgage balance and few additional financial resources left, some HECM borrowers have become delinquent on their property charges. When coupled with diminished home values, the HECM program has experienced new stresses, previously unforeseen, as a result of this confluence of factors.

To address this going forward, HUD staff, with input from the industry and other stakeholders, has been working on programmatic changes that would promote more prudent utilization of reverse mortgage funds. Restricting the amount of equity that would be available upon closing of a HECM and encouraging that funds be drawn down slowly over a longer period of time addresses the primary problem to some extent. When this concept of a "principal limit utilization" restriction is combined with a financial assessment of a prospective borrower's ability to meet their obligations, and a "set-aside" for taxes and insurance, the recently experienced stresses can be substantially mitigated.

2.) Need to Address and Improve Consumer Protections

The HECM program has several important consumer protections inherent in its design. First and foremost is the requirement that every prospective borrower must go through a HECM counseling session prior to submitting a formal application to a lender. The counseling sessions are conducted by "exam qualified" professional counselors, employed by HUD-approved nonprofit counseling agencies that have no business relationship with a lender or financial interest in the transaction. The counseling is conducted in accordance with a "counseling protocol" that has been developed by a multidisciplinary group of stakeholders, including senior advocacy organizations, counseling agencies, reverse mortgage specialists and HUD personnel. Counseling is continually monitored and improved periodically with additional aspects added to the protocol when deemed necessary.

Counseling is an area where an intensified approach might be beneficial for some prospective borrowers. However, it should be noted that while some observers outside of the industry have been critical of the efficacy of counseling, surveys of individuals who have actually gone through the counseling and then obtained reverse mortgages indicate a high degree of satisfaction with the process and information presented. While some critics question whether consumers actually understand reverse mortgages, those who have the loans feel that they do and have indicated such feelings on various surveys.

That being said, the three primary changes that FHA would like to quickly implement on the program, (a.) financial assessment of borrowers; (b.) principal limit utilization restrictions; and (c.) tax and insurance set-asides, would not only protect the FHA insurance fund, but simultaneously provide yet another level of safeguards for consumers. These additional provisions might preclude some needy borrowers from obtaining HECMs, thus forcing them to make the difficult decision to move out of their homes. However, these changes are intended to eliminate those prospective borrowers who are less likely to have a successful experience with their HECM loan.

The counseling protocol, of course, would have to be updated once these changes are implemented, so that these three items can be discussed as part of the counseling process.

In addition to the mandatory counseling for all prospective borrowers, the HECM program has other important consumer protections, including required disclosures and limits on fees that can be charged.

3.) Benefits of HECM Loans to Seniors Who Are Able to Age in Place

America faces a growing crisis in the years ahead. It is estimated that by 2030, there will be 72.1 million adults aged 65 and older, accounting for 19% of the population. People are experiencing longer lifespans with the 85+ becoming the fastest growing demographic group. Social Security replaces only 40% of pre-retirement earnings and most Americans have inadequate savings to sustain themselves through the retirement phase of their lives, a phase that is growing in duration as longevity increases.

Only 42% of retirees have pensions. Sixty per cent (60%) of US workers report that their total household savings and investments, excluding the value of their home and any defined benefit pension, is less than $25,000. Making those meager resources last over an unknown period of time is a primary stress factor for many older Americans. They are one mishap away from facing a personal financial disaster.

A HECM loan is not a complete solution to filling this retirement financial gap, but it is a valuable tool that has been utilized by nearly 800,000 older Americans to provide a degree of financial stability that helps them maintain their homes and age in place. In some cases, homeowners utilize a HECM to pay-off an existing mortgage, freeing up cash that has been going out the door every month for mortgage payments, so that it can be used for other expenses. In other cases, homeowners are establishing lines of credit to be used as a stand-by cash reserve for expenses that they might have trouble otherwise paying. These might include emergency repairs, taxes, insurance or unanticipated, uncovered health care expenses, such as in-home care. Others utilize the proceeds to make home improvements or modifications designed to create a home environment in which they can age in place. Some HECM borrowers choose to receive fixed monthly payments to supplement their other sources of income on an ongoing basis.

The HECM program offers enormous flexibility in how homeowners can draw down their equity allowing the program to be utilized in a number of different ways and enabling homeowners to plan and maximize the benefit of their HECM loan proceeds. The stories we hear from HECM borrowers are each individual and unique. What they share in common is that, in each and every case, it is the story of an individual homeowner, or a couple, who needs or wants to re-organize the way they manage their personal living and health care expenses to achieve a less stressful and more fulfilling life.

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

The HECM program was the product of much forethought and the program's designers at HUD did a tremendous job in blazing the trail and developing a very helpful and flexible loan product. The Department should be commended for this.

What could not be foreseen at the time the program was conceived was the deep diminution in home values that occurred in recent years, coupled with widespread loss of jobs. This tandem occurrence led to an increase in the number of HECM borrowers utilizing the program to simultaneously eliminate a mortgage for which they could no longer afford to make the payments and bolster their current cash flow..

Loans originated in the few years immediately before the housing crash, when property values were at a historical high, and before FHA reduced the amount of funds available under HECMs and increased the mortgage insurance premium (MIP), have had a deleterious impact on FHA's Mutual Mortgage Insurance (MMI) fund. Because a HECM loan relies solely on the future value of the home for repayment – no other source of payment from a borrower is expected -- the projected economic value of the HECM portion of the MMI fund has been disproportionately impacted by diminished home values. As home price appreciation reverts to its norm, some of the hypothetical projected loss will be mitigated.

Furthermore, FHA has taken steps to strengthen the HECM program with more recent books of business. These steps include reducing the "principal limit factors" (the reverse mortgage equivalent of loan-to-value factors) on two occasions and increasing the annual mortgage insurance premium. As a result of these steps, more recent books of business are projected to show a positive performance.

In addition to the steps previously taken to improve HECM program performance, FHA, with industry concurrence, would like to implement a few additional enhancements to the program. The changes under consideration would both help protect taxpayers and further safeguard consumers from entering into a loan transaction that might not be beneficial to them.

The three changes under discussion include:

A. Financial Assessment of Loan Applicants

This would be a form of underwriting, assessing each applicant's sources of funds and expenses to ascertain that the prospective borrower has sufficient resources and income to meet their obligation to pay property charges, including taxes and insurance, while having enough money left to cover normal living expenses.

Underwriting for a reverse mortgage would be different than for a forward mortgage. In a forward mortgage, underwriting essentially focuses on ascertaining that income will be sufficient for making loan payments and utilizes debt-to-income ratios to make this determination.

A reverse mortgage requires a slightly different approach. First of all, there are no monthly payments to be made on the mortgage. Secondly, a retiree might not have income per se, but instead might have assets to be spent down, as well as cash advances from the HECM loan. Accordingly, a "residual cash flow" analysis is an approach to underwriting for reverse mortgage borrowers.

Under this concept, a lender would evaluate a prospective borrower's income from all sources (Social Security, pensions, employment), their financial assets (being drawn down on a straight-line basis over their remaining life expectancy), and any cash available from the reverse mortgage. The cost of taxes and insurance would be subtracted from this available "cash flow'" leaving a "residual cash flow" that must be sufficient for covering all other normal living expenses. NRMLA suggests that FHA require lenders to utilize a residual income table created by the Veteran's Administration (VA) for its mortgage programs to determine if sufficient cash flow is available to make the HECM loan.

B. Principal Limitation Utilization Restriction

HECM loans perform best when funds are drawn down slowly over a longer period of time. Unfortunately, a confluence of factors over the past few years has resulted in a disproportionate number of HECM borrowers drawing down all available funds upfront at closing. This results in interest on the loan balance growing more quickly and loan balances growing larger than if funds are drawn over time.

FHA is considering implementing restrictions on the amount of funds that could be drawn down at closing. A Principal Limit Utilization (PLU) restriction would allow borrowers to only draw enough at closing to pay-off existing liens on the property, plus the costs associated with obtaining the loan and some modest "stipend" for paying other current expenses. The balance of loan proceeds available would either remain in a line of credit for future use or be paid out in fixed monthly payments.

NRMLA believes this is a sensible program improvement that will lead to a higher degree of success among HECM borrowers and reduce the risk to the MMI fund.

C. Set-Asides for Taxes and Insurance

There has been some experience with HECM borrowers utilizing all of their available resources and finding themselves eventually unable to meet their obligation to keep their property insured and pay real estate taxes. Under current program procedures, if the home owner fails to pay these items, the lender is required to advance its own funds to cover them. The lender must then work with the borrower to establish a repayment plan to be reimbursed for such advances. If the homeowner fails to follow through on the reimbursement plan, the loan is in default and the loan servicer must seek permission from HUD to call the loan due and payable.

To help avoid such situations in the future, FHA is planning to implement a requirement for a "set-aside" of some of the proceeds available from the HECM loan to be used as a source for covering taxes and insurance. A set-aside is essentially the reverse mortgage equivalent of an escrow in a forward mortgage.

5.) Other Opportunities to Improve the Home Equity Conversion Mortgage to Ensure Long-Term Sustainability for the Program, Consumers and the MMI Fund

The aforementioned changes to the HECM program that are under consideration by HUD and the reverse mortgage industry should address the shortcomings that have been identified with the program. The challenge is that, as of now, these types of changes can only be made by the full regulatory development process. This typically takes a year and a half or more to complete.

Therefore, the most productive action Congress can take is to provide HUD with the administrative authority to make changes on a more expeditious basis, so that it has the ability to respond in "real time" as it observes various trends in the economy and patterns of behavior among HECM borrowers and lenders.

Making the types of program changes outlined above, as well as continually updating and enhancing reverse mortgage counseling, should enable the Department to effectively manage the HECM program enabling it to remain a useful tool for elderly home owners, while minimizing risks to the taxpayers.

It is my understanding that some parties are concerned with vesting too much authority with FHA by granting them the ability to make program changes via Mortgagee Letter, in lieu of regulations. I do not share this concern.

I have worked with HUD on HECM program issues for nearly 15 years now and have always found the Department to be a responsible steward of the program. FHA has continually monitored performance, collected feedback both informally and through various studies, and consulted with many stakeholders before modifying any procedures.

I have no reason to doubt that such responsible leadership would continue if HUD is given the authority to fine-tune the HECM program as economic conditions and program performance require it to do so.

Thank you for the opportunity to appear here today. More importantly, thank you for the support that the HECM program has received over the years from members of this Sub-committee from both sides of the aisle.

Professional Biography for Peter H. Bell

Peter H. Bell is the President & CEO of National Reverse Mortgage Lenders Association (NRMLA), a Washington, D.C.-based trade association representing lenders, investors and loan servicers engaged in the origination, funding, administration and marketing of reverse mortgages, as well as vendors who provide services to those core members of the Association. NRMLA's primary functions include providing policy analysis and advocacy, public affairs outreach, professional education and networking opportunities for the reverse mortgage industry.

The Association has developed and sponsors the Certified Reverse Mortgage Professional (CRMP) designation for individuals involved in the reverse mortgage business. Its Ethics Committee fulfills an important responsibility ensuring that all member companies conduct their business in accordance with a stringent Code of Ethics & Professional Responsibility. Mr. Bell has served as NRMLA's CEO and chief ethics officer since its inception in 1996.

Mr. Bell has a long, deep background as a housing policy analyst in Washington for the past 37 years. In addition to his work on reverse mortgage and retirement finance issues, he is a nationally recognized authority on affordable housing development and finance issues and is frequently called upon to testify before Congress or advise federal agencies on housing matters. Mr. Bell serves on several civic and industry boards including the Board of Directors for Homes for America, an Annapolis, MD-based nonprofit developer of affordable housing active in the Mid-Atlantic region, and advisory boards for US Bank Community Development Corporation and The Related Companies Community Development Corporation.