COMMENTS
of the
National Consumer Law Center,
on behalf of its low income clients,
to the

Department of Housing and Urban Development

on
Changes to the Home Equity Conversion Mortgage Program Requirements:
Financial Assessments
Docket No. FR-5735-N-01

Submitted October 15, 2013.

On behalf of our low-income clients, the National Consumer Law Center[1] appreciates the opportunity to comment on the financial assessment requirements for the Home Equity Conversion Mortgage (HECM) program proposed by the Department of Housing and Urban Development (HUD).[2]

We support HUD's efforts to ensure that HECM borrowers have the ability to meet ongoing obligations for taxes, insurance, and other property charges—whether through income, assets, reverse mortgage proceeds, or an escrow set-aside. Ensuring that borrowers are able to meet these obligations comports with the program's goal of allowing elders to age in place and protects the Mutual Mortgage Insurance Fund. However, the detailed credit history analysis proposed is unnecessary to achieve these goals, and we strongly oppose the use of this credit history analysis to determine

[1] Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC publishes a series of consumer law treatises, including Mortgage Lending. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to prevent abusive financial practices, to help financially stressed families build and retain wealth, and to advance economic fairness. These comments were written by Tara Twomey, Of Counsel with NCLC.

[2] In the Notice published in the Federal Register, 79 Fed. Reg. 56576 (Sept. 12, 2013), the Department of Housing and Urban Development requested comments on the financial assessment requirements referenced in Mortgage Letter 2013-27 (Sept. 3, 2013). Mortgagee Letter 2013-27, in turn, refers to the *HECM Financial Assessment and Property Charge Guide* for details of the financial assessment required for prospective mortgagors as a condition of mortgage approval. As requested in the Notice, these comments address only the financial assessment and not other programmatic changes announced in Mortgage Letter 2013-27.

eligibility for a Home Equity Conversion Mortgage.

Detailed Credit Analysis is Inconsistent with the Purpose of the HECM Program.

The stated purpose of the recently proposed changes to the HECM program, including the financial assessment, is to "realign the HECM program with its original intent."[3] The original intent of the HECM program was "to meet the needs of older homeowners by reducing economic hardship that results from increasing costs of health, housing, and subsistence needs at a time of reduced income."[4] Recognizing that many seniors face economic hardship and that reverse mortgages are essentially equity-based lending, the HECM program has never used a detailed credit history analysis to determine eligibility for the HECM program.[5] It should not do so now.

The needs identified by Congress when it created the HECM program still exist today and are exacerbated by the economic downturn in recent years. Older adults, like the general population, are struggling to deal with job loss, reduced wages, erosion of retirement savings, and increased expenses, including those related to health care. [6] The economic distress among the senior population is evidenced by greater reliance on credit cards to bridge the gap between fixed incomes and escalating expenses.[7] It is not surprising then that potential reverse mortgage borrowers may have less than perfect credit. To deny a reverse mortgage to a senior because of a blemished credit history would be counter to the purpose of the HECM program. When used as designed, reverse mortgages allow seniors to tap home equity, often built up over a lifetime, to supplement

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[3] Mortgagee Letter 2013-27 (Sept. 3, 2013), at 2.

[4] 12 U.S.C. § 1715z-20(a).

[5] HECM borrowers must currently demonstrate a general credit standing that is satisfactory, 24 C.F.R. § 206.37, however, a detailed credit history analysis, such as that proposed, has never been required to satisfy this obligation. Instead, credit standing requirements are have been limited to (1) ensuring delinquent federal debts are brought current, satisfied, or a satisfactory repayment plan is established; (2) ensuring that the borrower is not suspended, debarred, or otherwise excluded from participation in HUD's programs; and (3) ensuring that HUD has not paid a claim within the previous three years on a loan made or insured by HUD, on the borrower's behalf (with certain exceptions). HUD HECM Handbook, 4235.1, § 4-3. Additionally, while credit reports are obtained for each borrower, the lender's review of those credit reports is limited to determining whether the borrower is delinquent or in default on any federal debts. *Id.* at § 4.7(B).

[6] *See, e.g.,* Fidelity Brokerage Services, *Retirees face estimated $240,000 in medical costs,* May 16, 2012 (a couple retiring in 2012 at age 65 would on average face $240,000 for medical care and health insurance expenses over their lifetimes, up from an estimated $160,000 in 2002), available at www.fidelity.com/viewpoints/retirees-medical- expenses.

[7] *See* John Pottow, *The Rise in Elder Bankruptcy Filings and Failure of U.S. Bankruptcy Law,* The Elder Law Journal, Vol. 19 (2012), rev. June 1, 2011; Amy Traub and Catherine Ruetschlin, *The Plastic Safety Net: Findings from the 2012 National Survey on Credit Card Debt of Low- and Middle-Income Households,* Demos, May 2012, available at http://www.demos.org/publication/plastic-safety-net.

their income or to retire existing debt, which in turn frees income previously devoted to debt service. That is, seniors may use reverse mortgages to break out of a cycle of debt that has negatively affected their credit history.

Bankruptcy Restrictions are Similarly Unnecessary and Inconsistent with Program Purposes. The credit history analysis proposes additional limitations on bankruptcy debtors seeking to purchase a home with a HECM loan. These restrictions, like the credit analysis in general, are inconsistent with the purpose of the HECM program and unnecessary. The proposed credit history analysis provides that a chapter 7 bankruptcy debtor is disqualified from obtaining a HECM for Purchase unless at least two years have elapsed since the date of the discharge in bankruptcy. In some cases, the required elapsed period of time may be reduced to twelve months. For chapter 13 debtors, the proposed credit history analysis requires that one year of the "pay-out period" has elapsed and that all payments have been made on time.[8]

The Housing and Economic Recovery Act of 2008 authorized a new reverse mortgage product that allows older consumers to purchase a principal residence with HECM loan proceeds.[9] The program was designed to enable older homeowners to relocate to other geographical areas to be closer to family members or downsize to homes that meet their physical needs. The details of the HECM for Purchase program are similar in most regards to the traditional HECM program. However, because borrowers do not have existing equity in the property, they are required to provide a monetary investment sufficient to bridge the gap between the principal limit and sales price.[10]

Bankruptcy followed by a reverse mortgage can afford seniors a true opportunity for a fresh start, by discharging most unsecured debt and allowing the debtor to use the reverse mortgage to address secured debts (such as mortgages on existing property or other property liens). Property that is considered exempt in the bankruptcy case may be used to satisfy the HECM for Purchase investment requirements. Denying borrowers the opportunity to age in place closer to family or in a residence that is more suitable for retirement living due to a prior chapter 7 bankruptcy or current chapter 13 bankruptcy serves no real underwriting purpose and is inconsistent with the goals of the HECM for Purchase program.

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[8] The proposed rule states that "one year of the pay-out period under the bankruptcy has elapsed." It is not clear what the "pay-out period" means, but it is assumed that it refers to payments under a confirmed chapter 13 plan. However, it should be noted that debtors generally begin making payments thirty days after filing the petition for relief even if a plan is not confirmed. *See* 11 U.S.C. § 1326.

[9] *See* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 2122 (July 30, 2008), *codified at* 12 U.S.C. § 1715z-20(m).

[10] HUD Mortgagee Letter 2009-11 (Nov. 6, 2009). Borrower may not obtain interim financing such as subordinate liens, personal loans, cash withdrawals from credit cards, or seller financing to meet the monetary investment requirement.

Detailed Credit History Analysis is Unnecessary in Light of Other Programmatic Changes

Limits on High Up-Front Draws

Currently, HECM borrowers may elect to escrow funds for property taxes and insurance by withholding amounts from monthly payments, charging amount to a line of credit, or holding back a portion of a lump sum distribution.[11] In cases when funds are not set aside to pay taxes and insurance and the borrower fails to make these payments, the lender may pay property taxes or hazard insurance premiums by withholding funds from monthly payments or by charging funds to a line of credit.[12] Defaults on taxes and insurance become more problematic when borrowers have drawn all the available loan proceeds up front, have not set aside any amounts for taxes and insurance, and do not have the income to pay these amounts on an ongoing basis. The problem is highlighted in HUD's 2012 Annual Report to Congress in which it stated that HECM loans with high up-front draws are twice as likely to have a tax-and-insurance default as are loans with initial draws of 60 percent, and four times as high as those with initial draws of 40 percent of the maximum allowed.[13]

Between 2008 and 2011, the reverse mortgage market experienced a dramatic shift in the type of HECM loans originated, with fixed-rate, full draw loans—also known as Standard HECM Fixed Rate loans—dominating the product mix by 2011.[14] These loans required lenders to advance the maximum amount available to the borrower at closing. The high up-front draw made this product more susceptible to tax-and-insurance defaults. In early 2013, HUD suspended the use of the Standard HECM Fixed Rate loans.[15]

Additionally, Mortgage Letter 2013-27, imposes Initial Disbursement Limits for loans assigned case numbers after September 30, 2013. Under these new rules, the maximum disbursement allowed during the first twelve months of the loan is the greater of sixty percent of the principal limit or the sum of mandatory obligations (e.g., initial mortgage insurance premium, loan origination fees, HECM counseling, amounts to discharge existing property liens) plus ten percent of the principal limit. While not altogether eliminating high up front draws, the new rules will curb their use. Consequently, tax-and-insurance defaults can be expected to drop as well.

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[11] 24 C.F.R. § 206.205.
[12] *Id.*
[13] U.S Department of Housing and Urban Development, Annual Report to Congress Fiscal Year 2012 Financial Status FHA Mutual Mortgage Insurance Fund, at 29 (Nov. 16, 2012).
[14] In 2008, fixed-rate HECMs made up less than 2% of the HECM market, and in 2011 they made up more than 69% of the HECM market. Consumer Financial Protection Bureau, Reverse Mortgages: Report to Congress, at 30 (June 28, 2012); Federal Housing Administration's Home Equity Conversion Mortgage Update, NRMLA Eastern Regional Conference (March 19, 2013).
[15] Dep't of Hous. & Urban Dev., Mortgagee Letter 2013-01 (Jan. 30, 2013).

Cash Flow/Residual Income Analysis

Within the proposed financial assessment, HUD has proposed a Cash Flow/Residual Income Analysis in addition to the Credit History Analysis. In general, NCLC supports the use of a residual income analysis to determine borrowers' ability to meet future tax and insurance obligations (as well as other obligations). Sufficient residual income demonstrates that the borrower can not only meet their property-related obligations, but also that the borrower will have sufficient additional income to meet basic living expenses.

We believe that the Residual Income Analysis along with the new limits on high up-front draws are sufficient to ensure borrower compliance with tax, insurance and other property charge obligations in the vast majority of cases.

The Harm of Credit Reporting Errors Outweigh Any Benefits to the Program

Despite the importance of accurate credit reports, systematic errors are common in the credit reporting system. For example, the Federal Trade Commission recently undertook a comprehensive study of errors in credit reporting, using expert consultants to help study participants order and review their credit reports. The FTC concluded that 26% of consumers had at least one potentially material error on at least one of their three credit reports.[16] Problems such as mixing the identities of consumers,[17] errors caused by debt collectors, creditors and other furnishers of information,[18] and the fallout caused by identify theft[19] continue to plague the system. Additionally, fixing credit report errors can be an odyssey for consumers.

Because tax-and-insurance defaults can be sufficiently mitigated through the reduction in high up-front draws and the residual income analysis, the unreliable credit reporting system should not be used as a mechanism to deprive homeowners of the ability to access equity in their homes.

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[16] Federal Trade Commission, Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003, at i (December 2012). Confirmed error rates ranged from 10-21% depending on the definition used for confirmed error.

[17] *See* Michael Wagner and Jill Reipenhoff, *Credit Scars: Mixed and Marred,* Columbus Dispatch (May 7, 2012).

[18] *See* Consumer Financial Protection Bureau, *Key Dimensions and Processes in the U.S. Credit Reporting System: A review of how the nation's largest credit bureaus manage consumer data,* December 2012, at 14, 29, available at http://www.consumerfinance.gov/reports/key-dimensions-and-processes-in-the-u-s-credit-reporting-system.

[19] *See* Javelin Strategy & Research, 2010 Identity Fraud Survey Report: Consumer Version 5 (2010).

Extenuating Circumstances and Compensating Factors Do Not Sufficiently Mitigate the Cost and Harms of Requiring a Detailed Credit History Analysis

We acknowledge that HUD has attempted to lessen the impact of the Credit History Analysis by proposing that lenders may take into account extenuating circumstances and compensating factors. In particular, the guidance provides that "[w]here the credit history raises concerns about the mortgagor's capacity or willingness to meet their financial obligations, mortgagees should consider whether there are extenuating circumstances that led to the credit/financial issues." These issues may include the loss of income due to death of a spouse, unemployment, reduced work hours and emergency medical treatment. Additionally, the lender may consider compensating factors such as low draws at closing, residual income of 150% or higher than the figures in the residual income analysis, and history of good credit, mortgagor is retiring mortgage debt.

These subjective factors will create uncertainty in the origination process and make an already complex product more complex (and as a result more costly). The better solution is to forgo expansion of the credit history analysis beyond what is currently required.

Residual Income Analysis

While NCLC generally supports the use of the residual income analysis, we believe that it should be tailored to the HECM context and should consider the borrower's anticipated income and expenses after closing. We also support the use of regional residual income figures. The use of such figures account for living expenses that are more costly in some geographic areas of the country. There are a few items in the residual income analysis that we believe need to be addressed.

Tailor analysis to HECM borrower's situation immediately after closing. In many cases, HECM loans are used to supplement income or retire debt. Either of these uses affects a residual income analysis. However, the proposed analysis does not consider these effects within the analysis itself. Instead, supplemental income or the impact of retired debt is left to the "compensating factors" that the lender "may" consider. Because the purpose of the HECM program is to allow seniors to supplement income or retire debt by converting equity to cash, the HECM residual income analysis should account for these changes in the borrower's financial situation.[20]

Address mismatches between income and expenses when there is a non-borrowing spouse. The current proposed analysis states that income from non-borrowing spouses or other household members not obligated on the mortgage may "not be considered as part of the cash flow residual income analysis, either directly or as a compensating factor." While excluding a non-borrowing spouse's income, the non-borrowing spouses expenses

[20] By comparison, the ability-to-pay test for forward mortgages under Dodd-Frank is determined as of the consummation of the loan, not prior to consummation. 15 U.S.C. § 1639c(a)(1).

are included in the analysis in community property states (such as California). This creates an obvious mismatch in the calculation that must be addressed.

Address or clarify potential mismatch between income and family size. Non-borrowing spouses are counted in the household when determining the minimum amount of residual income required, but their income is excluded. That is, a married couple in the Northeast region must have a monthly residual income of $906 in order to demonstrate sufficient financial capacity to meet their financial obligations. If both are mortgagors, then the income of both borrowers will be considered in reaching the $906. However, if only one spouse is the borrower, then only that borrower's income will be counted toward the minimum requirement. Again, this is a mismatch in what is considered household income (only one spouse) versus what is needed to satisfy the residual income test (enough residual income for both). Though the proposal notes an exception for "a spouse not obligated on the note who has stable and reliable income sufficient to support his or her living expenses," the proposal also states that the one person family size may only be used where "tax returns confirm that the mortgagor files tax returns as a single person." Thus, it is unclear whether a borrowing spouse may claim a family size of one, if he or she files joint tax returns with his or her non-borrowing spouse.

Conclusion

Reverse mortgages provide real benefits to many older homeowners struggling financially. It is important that borrowers be evaluated for their ability to pay tax, insurance and other property charges, but a detailed credit history analysis is unnecessary and inconsistent with the purpose of the HECM program. We recommend that the credit history review not be expanded beyond the existing requirements related to federal debts, previous claims, and suspensions or exclusions from HUD programs. Additionally, while we support the residual income analysis, we believe that it must be specifically tailored to the HECM program and account for changes in income or expenses that result from the use of reverse mortgage proceeds.