Statement of

Laurie S. Goodman*

Vice President for Housing Finance Policy, Urban Institute

before the

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Committee on Financial Services

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PROTECTING SENIORS: A REVIEW OF THE FHA'S HOME EQUITY CONVERSION MORTGAGE (HECM) PROGRAM

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*The views expressed are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

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500 L'Enfant Plaza SW
Washington, DC 20024
urban.org

Chairwoman Waters, Ranking Member McHenry, and members of the subcommittee, thank you for the opportunity to testify today. My name is Laurie Goodman, and I am the vice president for housing finance policy at the nonprofit Urban Institute, a leading research organization dedicated to developing evidence-based, nonpartisan insights that improve people's lives and strengthen communities. Urban's Housing Finance Policy Center provides timely, impartial data and analysis on public policy issues affecting the housing and housing finance markets. The views expressed are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

I spent close to 30 years as a Wall Street mortgage-backed securities analyst. I left Wall Street to found the Housing Finance Policy Center about six years ago. Although we publish research on a wide range of housing finance issues, we go further to understand how those issues affect key segments of the US population, by age, race or ethnicity, gender, geography, and other characteristics. Over these past six years, we have published a sizeable body of research to examine the housing and housing finance needs of senior homeowners. A key question we have studied is how to make it easier for seniors to responsibly access home equity for a comfortable retirement.

Home equity is the most important asset for most homeowners, and the homeownership rate for seniors ages 65 and older is close to 80 percent. Moreover, in the next decade, the senior population share will grow, and a greater portion of these younger seniors will have forward mortgages, which will consume a large share of their limited retirement income. For these borrowers, tapping into home equity to pay off the forward mortgage will be even more important to ensuring a comfortable retirement, as it removes the burden of a monthly payment. Reverse mortgages are a critical home equity extraction vehicle for such borrowers, particularly less affluent ones. The Federal Housing Administration's (FHA's) Home Equity Conversion Mortgage (HECM) program is the dominant program in this space. In this testimony, I will discuss challenges in retirement financing, quantify the importance of home equity in the net wealth profile of US homeowners, discuss available equity extraction vehicles, and explain the HECM program's role. I will then suggest improvements to the program.

Challenges in Retirement Financing

Retirement has already begun for baby boomers, the largest generation of seniors to date and a generation expected to live longer than previous generations. Yet, many of these retired and soon-to be-retired Americans lack the financial assets for a comfortable retirement. The most commonly held and valuable asset for most American families is their home. For many, home equity may be the only resource that ensures they have food, medicine, and other basics for a comfortable retirement. Tapping into home equity could also allow millions of seniors to age in place, rather than move into senior living facilities paid for by taxpayer dollars.

Older adults are less well set up for retirement than they believe. They overestimate their ability to earn income in retirement. A recent survey by the Employee Benefit Research Institute (EBRI) showed that 8 in 10 workers expect to work in retirement, but in reality, only 28 percent of retirees work for pay. In addition, many adults expect to work until age 65, but the median retirement age is 62. EBRI found that 4 in 10 workers retire earlier than expected because of health or disability issues or a change in the structure of their organization, both of which are impossible to predict and plan for.[1]

In addition to earned income, there are three sources of retirement funding: personal savings, employer-sponsored pensions or retirement savings plans (including individual retirement accounts), and entitlement programs such as Social Security. A 2017 Government Accountability Office study found that 43 percent of seniors would have incomes below the federal poverty level absent Social Security.[2] The personal savings rate is down over the past four decades, from more than 13 percent in the early 1970s to 5.3 percent in 2017, and the shift from defined benefit to defined contribution plans has given workers less certainty about how much income they will have in retirement.

Although aging in place may not be optimal for everyone,[3] encouraging this solution—which is less costly than aging in a nursing home or long-term care facility—benefits seniors and taxpayers. A US Department of Housing and Urban Development (HUD) report estimates that nursing homes are more than three times as expensive as noninstitutional long-term care.[4] Tapping into home equity to make home repairs or pay off a forward mortgage can allow seniors to age in place.

Home Equity Is the Largest Component of Net Worth for Most Families

More US households own their home than own financial assets such as retirement accounts, life insurance, stocks, and bonds. According to the Federal Reserve's 2016 Survey of Consumer Finances, 63.7 percent of households owned their primary residence, but only 52.1 percent had retirement accounts, 19.4 percent had cash-value life insurance policies, 13.9 percent had stocks, and 8.6 percent had savings bonds.[5] For most Americans, their principal residence is their most valuable asset, dwarfing the value of other assets. Per the 2016 Survey of Consumer Finances, the median value of the primary residence for homeowners was $185,000. In contrast, the median value was $60,000 for retirement accounts, $8,500 for cash-value life insurance, $25,000 for stocks, and $1,000 for savings bonds.

Moreover, home equity is the largest source of net worth (assets minus debt) for most homeowners. According to the 2016 Survey of Consumer Finances, the median value of total assets (including housing) owned by homeowners of all ages was $341,580. Median net worth was $231,420. Net worth is a better measure of household financial health because it considers debt. Median home equity for homeowners was $100,000 and was the largest component of median net worth. This reflects the fact that home prices have risen. Nationwide, even borrowers who purchased a home at the 2006 peak,

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[1] Employee Benefit Research Institute (EBRI), *2019 Retirement Confidence Survey Summary Report* (Washington, DC: EBRI, 2019).

[2] Government Accountability Office (GAO), *The Nation's Retirement System: A Comprehensive Reevaluation Is Needed to Better Promote Future Retirement Security* (Washington, DC: GAO, 2017).

[3] Karan Kaul, "American Seniors Prefer to 'Age in Place'—But What's the Right Place?" *Urban Wire* (blog), Urban Institute, June 3, 2019, https://www.urban.org/urban-wire/american-seniors-prefer-age-place-whats-right-place.

[4] "Measuring the Costs and Savings of Aging in Place," US Department of Housing and Urban Development, Office of Policy Research and Development, accessed September 20, 2019, https://www.huduser.gov/portal/periodicals/em/fall13/highlight2.html.

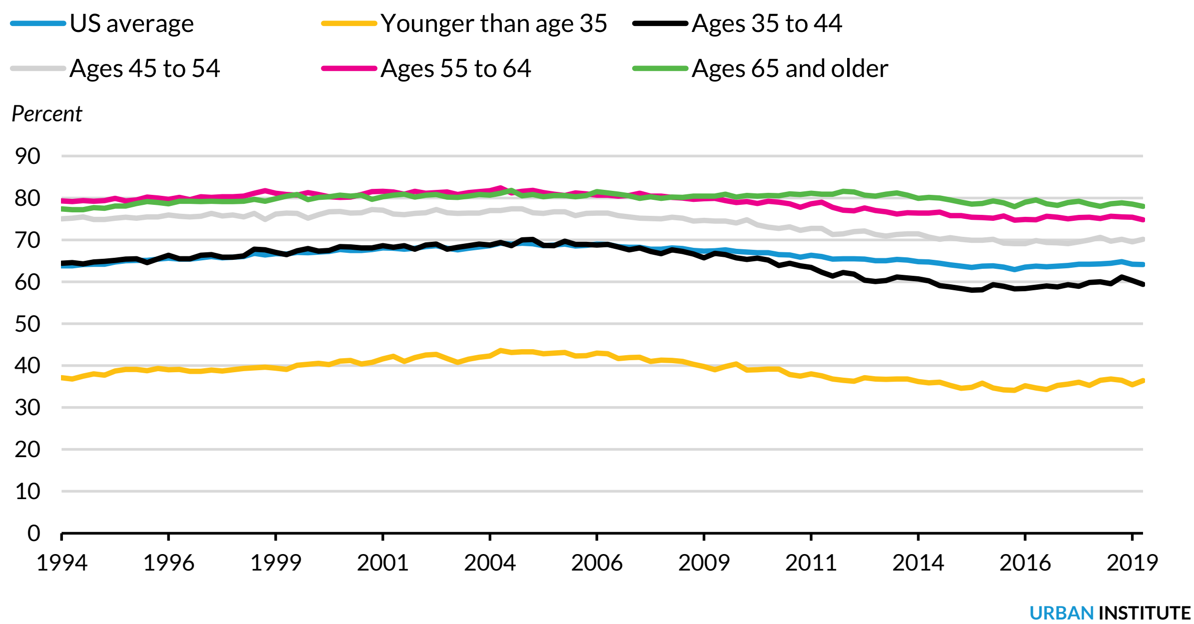
[5] Jessee Bricker, Lisa J. Dettling, Alice Henriques, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, Sarah Pack, John Sabelhaus, Jeffrey Thompson, and Richard A. Windle, *Changes in US Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances* (Washington, DC: Board of Governors of the Federal Reserve System, 2017).

before the financial crisis, have seen a 14.9 percent increase in home prices. And mortgages amortize over time, allowing homeowners to build equity by paying down principal.

Seniors are apt to have more home equity than younger people, in part because their homeownership rate is higher (figure 1). The homeownership rate in the second quarter of 2019 was 78 percent for seniors and 59.4 percent for 35-to-44-year-olds. Moreover, over the past 15 years, the homeownership rate has declined substantially for everyone younger than 65 but has declined only marginally for seniors. The homeownership rate is down 3.1 percent for seniors but is down 10 percent for 35-to-44-year-olds. And, on average, senior homeowners have more home equity than the rest of the population (figure 2), as they have benefited from home price appreciation and have built equity by paying down their mortgage for a longer time. Senior homeowners have a median net worth of $319,250, 38 percent higher than the $231,400 for all homeowners, and the median home equity for senior homeowners was $143,400, 43 percent higher than the $100,000 for all homeowners.

FIGURE 1

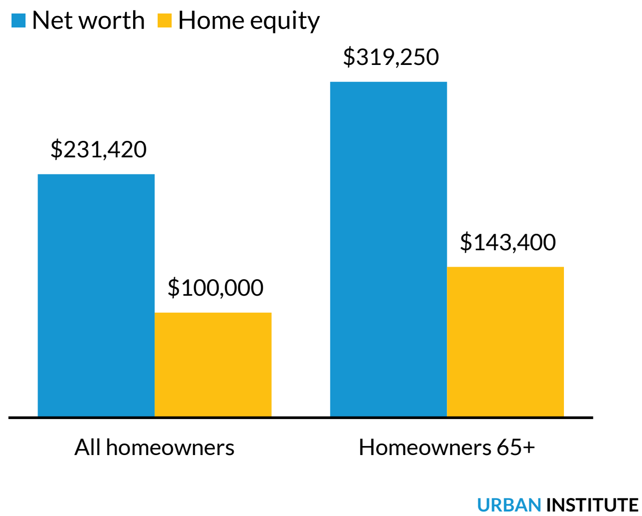
Homeownership Rates, by Age



Source: US Census Bureau.
Note: Data as of the second quarter of 2019.

FIGURE 2

Net Worth for Homeowners

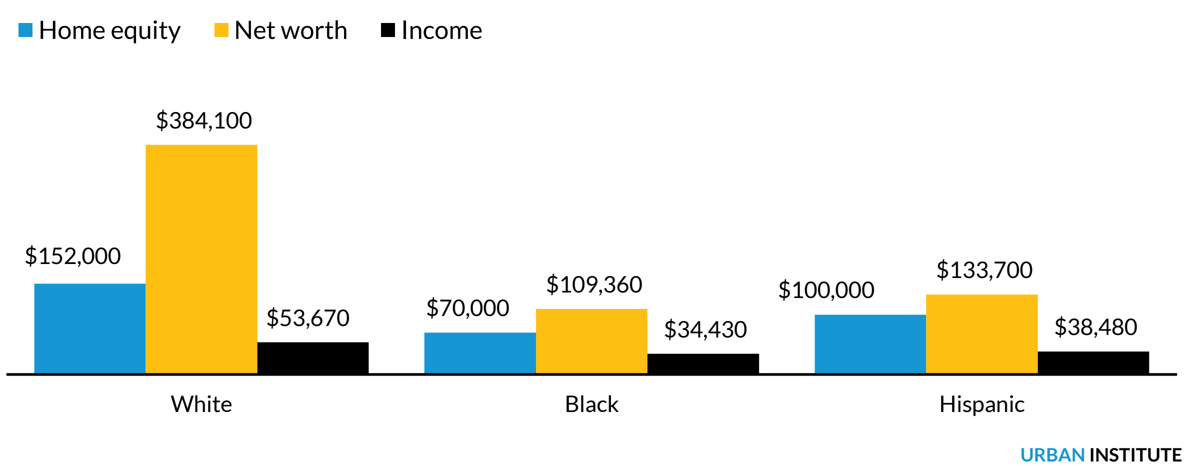


Source: Urban Institute calculations based on the 2016 Survey of Consumer Finances.
Note: Renters have a net worth of $5,200.

Home equity accounts for a larger share of net worth among black and Hispanic seniors than among white seniors.[6] Figure 3 shows median home equity, net worth, and income, by race or ethnicity, among seniors. Black and Hispanic households are behind on all three measures, but median home equity is a larger share of median net worth than it is for white households. The ratio of median home equity to median net worth is 40 percent for white households but is 64 percent for black households and 70 percent for Hispanic households.

FIGURE 3

2016 Wealth Measures for Senior Households, by Race or Ethnicity



Source: Urban Institute calculations based on the 2016 Survey of Consumer Finances.

[6] In this analysis, "white" refers to non-Hispanic white and "black" refers to non-Hispanic black.

The Importance of Tapping into Home Equity

We estimate that 2.5 million to 4.5 million senior households, or 10 to 17 percent of the 26 million senior homeowning households, could benefit from a reverse mortgage or other vehicle to tap into home equity.[7] We assume that households with the greatest need to extract equity would be those with limited incomes and limited liquid assets but sizeable home equity. We further assume that before extracting equity, homeowners would spend down their liquid net worth.[8] Collectively, 3.3 million households (or 13 percent of the 26 million senior households) earn up to $60,000 a year and have liquid net worth of less than $50,000 and home equity of more than $100,000. The combined home equity wealth of these households is more than $775 billion. Even if we assume that households earning $40,000 to $60,000 a year are less likely to need to tap into home equity, that still leaves 2.5 million homeowning households earning less than $40,000 (or 10 percent of the 26 million senior households), with a combined home equity wealth of more than $600 billion. And if we assume only $50,000 of home equity rather than $100,000, the number of potential borrowers increases to 4.5 million (table 1).

TABLE 1

Estimating the Number of Senior Households with Home Equity but Limited Income

Number of households

	Home Equity		
Income	**> 100,000**	**> $50,000**	**> $25,000**
≤ $20,000	920,580	1,897,676	2,376,474
≤ $40,000	2,482,032	4,546,126	5,992,042
≤ $60,000	3,292,709	5,716,358	7,495,296

Aggregate home equity in billions of dollars

	Home Equity		
Income	**> 100,000**	**> $50,000**	**> $25,000**
≤ $20,000	$208	$283	$303
≤ $40,000	$562	$724	$781
≤ $60,000	$773	$964	$1,034

Source: Urban Institute calculations based on the 2016 Survey of Consumer Finances.

Even if the numbers in table 1 were adjusted downward for borrowing limits under the HECM program, which limits borrowing to 50 to 60 percent of a home's value, extracting this home equity could make a big difference in retirement quality for many seniors.

[7] This analysis was taken from Laurie Goodman, Karan Kaul, and Jun Zhu, *What the 2016 Survey of Consumer Finances Tells Us about Senior Homeowners* (Washington, DC: Urban Institute, 2017).

[8] Liquid net worth is a measure of on-hand cash or savings that can be converted to cash quickly. Liquid net worth is financial assets minus student loans, installment loans, credit card debt, and other debt.

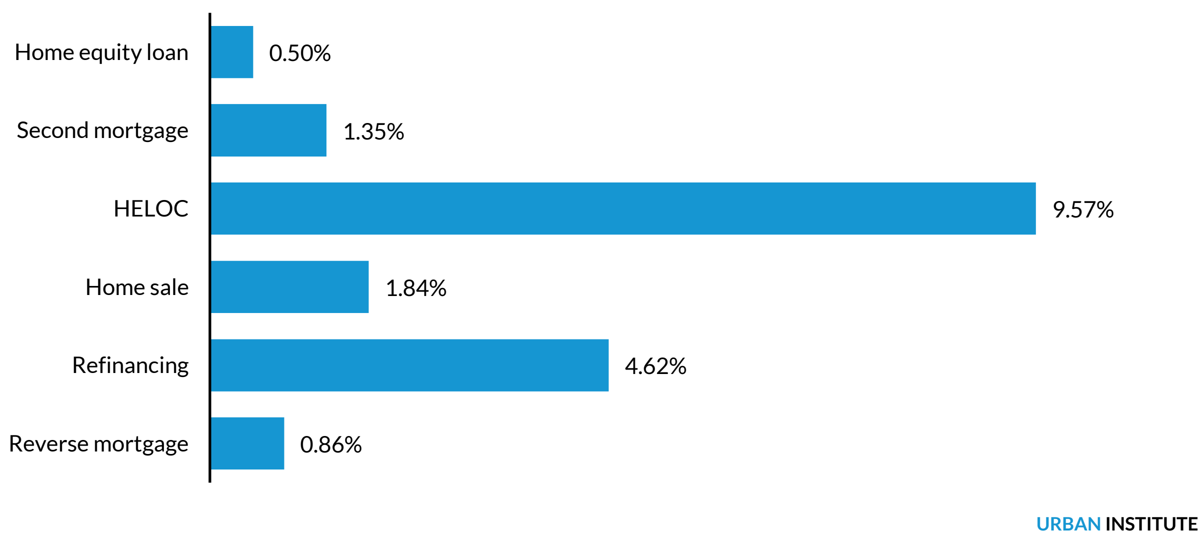
Vehicles to Tap Into Home Equity

The five main vehicles for extracting home equity, in order of popularity, are as follows:

- **A home equity line of credit, or HELOC,** is a line of credit, collateralized by the home, that the borrower draws as needed up to a set limit. The interest rate is generally adjustable rate, indexed to market interest rates.
- **A cash-out refinance** is a forward mortgage taken out on a home with an existing mortgage that replaces the existing mortgage and is larger than the remaining balance on the mortgage, so the borrower receives a cash payout of the difference between the old and new mortgages.
- **A home sale.**
- **A second mortgage** is a mortgage subordinated to the first mortgage. The money is taken out in a lump sum and repaid each month.
- **A reverse mortgage** is a loan in which the borrower has borrowed against the home's value. The borrower can receive a single up-front payment, a fixed monthly payment, or a line of credit. Unlike a forward mortgage, the borrower does not make monthly payments.

Despite the potential for home equity extraction to help millions of seniors in retirement, home equity extraction rates are low. According to the 2014 Health and Retirement Study, a biennial study of Americans ages 51 and older conducted by the University of Michigan, only 11.4 percent of owner-occupied households ages 65 and older had an active home equity loan, second mortgage, or HELOC at the time of the survey. In addition, during the two years before the 2014 survey, only 4.6 percent tapped into home equity by refinancing their mortgage (cash-out refinance), 1.8 percent accessed equity by selling their home, and 0.9 percent extracted equity through a reverse mortgage.

FIGURE 4
Share of Homeowners Ages 65 and Older Who Extracted Home Equity, by Strategy



Source: 2014 Health and Retirement Study.
Notes: HELOC = home equity line of credit. For home equity loans, home equity lines of credit, and second mortgages, the shares correspond to respondents reporting having one of these three products active at the time of the survey. For the other categories, this period of coverage was the prior two years.

The financial characteristics of borrowers in the Survey of Consumer Finances dataset who extracted home equity indicate that HELOC borrowers are more affluent than borrowers who extract equity through a cash-out refinance or a second mortgage. The average net worth of a HELOC borrower age 65 or older is $561,450, versus $142,750 for a borrower who uses a cash-out refinance or a second mortgage. The annual income of a HELOC borrower is $73,922 versus $39,493 for a borrower using cash-out refinancing and $47,594 for a borrower taking out a second or third mortgage.

The financial characteristics of borrowers taking out HECMs are weaker than those of borrowers who use any of the other equity extraction vehicles. Moulton and coauthors do a deep dive into the characteristics of borrowers taking advantage of HECMs, HELOCs, cash-out refinances, and home equity loans. They show that reverse mortgage borrowers tend have much lower incomes, less than half of those who took advantage of other equity extraction vehicles. HECM borrowers have considerably lower credit scores, more credit card debt, and more debt more than 60 days past due.[9]

Low-income borrowers rarely qualify for HELOCs or other loans that require a monthly payment. Moreover, HECMs were historically not underwritten from a credit perspective. In 2015, a financial assessment was introduced for the first time, and its purpose was to determine whether the borrower had the "willingness and ability" to meet the loan's financial obligations, specifically the obligations to make tax and insurance payments. Borrowers who do not meet the minimum credit requirements are not turned away from the program, but they are required to have a set-aside to meet these tax and insurance payments.

Tapping Into Home Equity Will Become More Important Going Forward

The importance of tapping into home equity will grow because of large increases in the number of seniors and the higher share of younger seniors who will have a mortgage at retirement.

Thus far, I have focused on the finances of today's seniors (and relied heavily on 2016 data). Demographic trends suggest that the number of seniors will grow considerably over the next decade. The 2017 Census Bureau population projections has the number of seniors increasing from 71 million in 2016 to 106 million by 2030.[10] The senior population share will rise from 22 percent in 2016 to 30 percent by 2030. If we look only at adults, ages 20 and older, the senior population share rises from 29 percent in 2016 to 39 percent in 2030. These are individual projections, not household projections, and include both homeowners and renters, but they illustrate a massive increase in the number of seniors. In earlier projections, Rolf Pendall, Jun Zhu, and I show that seniors should make up 33 percent of total

[9] See Stephanie Moulton, Donald R. Haurin, Samuel Dodini, and Maximilian Schmeiser, "How Home Equity Extraction and Reverse Mortgages Affect the Credit Outcomes of Senior Households," Working Paper 2016-351 (Ann Arbor: Michigan Retirement Research Center, 2016).

[10] "2017 National Population Projections Tables, Table 3: Detailed Age and Sex Composition of the Population," US Census Bureau, last updated September 6, 2018, https://census.gov/data/tables/2017/demo/popproj/2017-summary-tables.html.

households by 2030, up from 22 percent in 2010. They will make up about 39 percent of all homeowning households by 2039, up from 26 percent in 2010.[11]

In addition to the increased number of seniors and the increased senior population share, younger seniors are more apt to enter retirement with a mortgage than older seniors. In 2016, 41 percent of homeowners ages 65 and older had a mortgage on their primary residence, compared with 21 percent in 1989. The median outstanding debt has risen from $16,793 to $72,000, adjusted for inflation. Figure 5 shows the breakdown by age for these metrics. Many households carrying mortgage debt into retirement will likely not be able to afford monthly payments and could access liquidity and smooth consumption with a reverse mortgage.

FIGURE 5A

Share of Senior Homeowners with a Mortgage

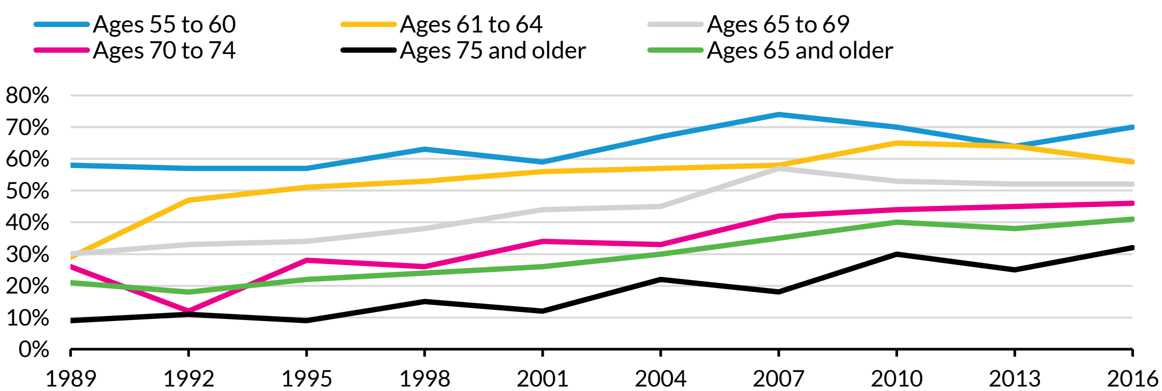
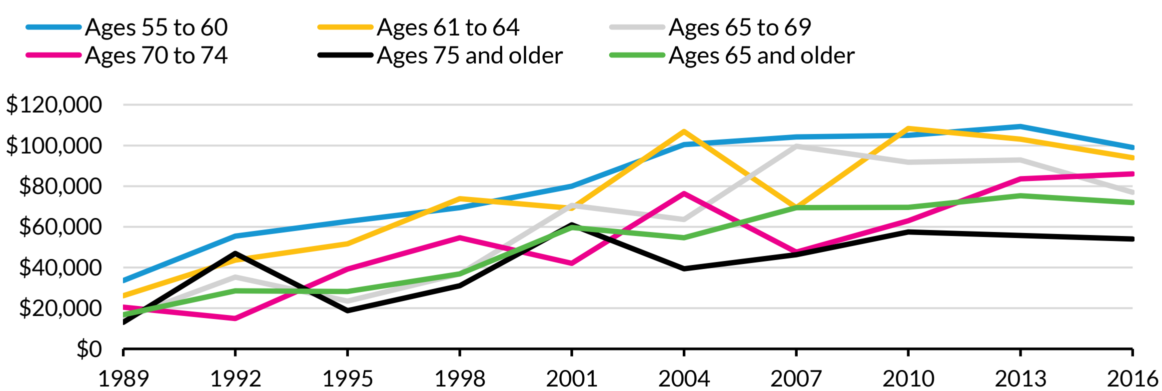


FIGURE 5B

Median Mortgage Amount for Senior Homeowners with a Mortgage



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Source: Urban Institute calculations based on the 2016 Survey of Consumer Finances.
Note: Data are in 2016 constant dollars.

[11] Laurie Goodman, Rolf Pendall, and Jun Zhu, *Headship and Homeownership: What Does the Future Hold?* (Washington, DC: Urban Institute, 2015).

Insights from Fannie Mae Survey Data

With so many low- and moderate-income households retiring with mortgage debt and limited savings, one would expect reverse mortgage products to be used more frequently. Why is this not the case? In the second quarter of 2016, the Fannie Mae National Housing Survey surveyed seniors ages 55 and older on familiarity and willingness to use various methods to tap into home equity. The nearly 1,000 respondents were 55 and older, and responses were weighted to make them reflective of census population data by gender, race or ethnicity, income, and education.

Thirty-seven percent of respondents were very concerned or somewhat concerned about their personal financial situation in retirement. This share was 43 percent among homeowners with a mortgage. Fifty-two percent of 55-to-64-year-olds with a mortgage were concerned about their personal financial situation in retirement.

Even so, close to 90 percent said they we not very interested or not at all interested in taking equity out of their home. Nineteen percent wanted to save it to give to their children or heirs, 10 percent wanted to save it for an emergency, 30 percent did not need the money, 36 percent did not want to have debt, and 7 percent did not have enough income to quality for additional debt.

When asked what home equity extraction methods people are familiar with, 49 percent said they were familiar with a reverse mortgage, 62 percent were familiar with a home equity loan or line of credit, 36 percent were familiar with a cash-out refinance, and 23 percent were familiar with none of these.

When asked what method they would use if they were going to extract equity, 35 percent said they would sell their home and purchase a less expensive one, and 16 percent said they would take out a home equity loan or home equity line of credit. Only 6 percent said they would use a reverse mortgage.

When those familiar with reverse mortgages were asked about their concerns, 20 percent said they were afraid of getting scammed, 12 percent thought they were too costly, 11 percent were worried their family would not be able to stay in the home, and 9 percent thought reverse mortgages were too difficult to understand.

Recommendations to Improve the HECM Program

Given the financial shortfall many will experience in retirement and the enormous amount of existing home equity, increasing the use of and addressing concerns about reverse mortgages is important. Our policy recommendations fall into three categories:

- improve reverse mortgage financial literacy
- simplify reverse mortgage product design, lower costs for safer products, and encourage innovation
- redesign programs to reduce foreclosure frequency and loss severity

Improve Reverse Mortgage Financial Literacy

Reverse mortgages are complex, but so are many other financial products, such as stocks, bonds, and insurance. These other financial instruments do not suffer the same financial literacy issues that reverse mortgages do. Why?

First, the complexity of reverse mortgages has been exacerbated by fraud and misinformation. A Consumer Financial Protection Bureau review of reverse mortgage advertisements and focus group impressions of those advertisements revealed that consumers did not even know that reverse mortgages were loans because ads either did not include interest rates and repayment terms or included them in the fine print. Other consumers pointed out that such phrases as "government insured" and "government-backed program" led them to believe reverse mortgages are a federal government benefit (similar to Medicare).[12] And in the Fannie Mae survey cited above, the top answer for avoiding reverse mortgages was a fear of being scammed.

Second, consumers typically do not think about tapping into home equity in general, or reverse mortgages in particular, until retirement or later. As a result, the level of knowledge about these products is low before retirement. In contrast, the public is more familiar with banking, investment, and insurance products, as they have been exposed to them from a younger age.

Suggestion 1: Include Home Equity in Financial Planning

Financial planning has historically included only financial wealth and ignored housing wealth, even though most people have more of their assets in housing wealth than in financial assets. Financial planners and advisers are not trained in and often do not know much about products that allow the client to tap into home equity, making them more reluctant to endorse them. In addition, financial advisers cannot be legally compensated for recommending reverse mortgages because the Real Estate Settlement Procedures Act prohibits people without a mortgage license from being paid on a mortgage transaction.[13] Even if financial advisers know about reverse mortgages, it does not make sense for them to take the risk that one of their associates uses a client's home equity inappropriately when there is no compensation.

Addressing this is complicated. We certainly do not want financial planners getting compensated to put seniors into inappropriate products. But if information about tapping into home equity were included in the financial planning certification procedure, rules were put in place about what the financial planner can and cannot say, and compensation were limited, it would be advantageous to the customer. First, the information would help people think more holistically about retirement. Reverse mortgages could be an alternative to selling stocks in a bad market. They could be more favorable than incurring penalties on withdrawing assets from individual retirement accounts. If an older adult is selling one home and buying another, financing the new home partially with a reverse mortgage can free up cash for daily living expenses. Moreover, the more homeowners know about their options, the less susceptible they are to scams.

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[12] Consumer Financial Protection Bureau (CFPB), "A Closer Look at Reverse Mortgage Advertisements and Consumer Risks" (Washington, DC: CFPB, 2015).

[13] Real Estate Settlement Procedures Act, 12 U.S.C. §2601–617 (1974).

A short-term fix may be for the Social Security Administration to provide education and outreach to seniors. The Social Security Administration, which touches most seniors and retirees, could disseminate information on how reverse mortgages could work with Social Security benefits to improve financial security. For example, for a person who would elect early Social Security benefits, tap into home equity at age 62, and elect a later Social Security draw could be better off in the long run.

Suggestion 2: Improve Reverse Mortgage Counseling
Currently, counseling by an independent third-party counselor approved by HUD must be completed before a lender processes a reverse mortgage application. The counseling includes information about how reverse mortgages work, including payment options, benefits and drawbacks, and tax implications. But the counseling happens late in the process, after the homeowner has decided to obtain a reverse mortgage. Mandatory counseling could be enhanced by requiring lenders to refer borrowers to HECM counseling as their first step after initial contact.

In addition, counseling could be targeted to allow for different types of counseling for different types of borrowers. Borrowers could be sent down one of several tracks depending on their creditworthiness, needs, income, and assets. For instance, a borrower with a high credit score and significant household wealth may be better suited for a forward home equity product such as a HELOC. These borrowers might benefit from counseling that compares the pros and cons of HECMs with the forward equity extraction products. On the other hand, low-income borrowers with limited means could benefit from counseling that focuses more on appropriate use of HECMs and how to select the amount they need to borrow. A few different counseling tracks would make the counseling more valuable to the diverse customer base.

Finally, HUD could require that the reverse mortgage servicer provide a follow-up phone call after closing, reenforcing the program's functionality and reviewing the amount the borrower would receive each month and their unused line of credit. During this onboarding call, the borrower could ask any questions and receive the servicer's contact information.

Simplify Reverse Mortgage Program Design, Lower Costs for Safer Products, and Encourage Innovation

There are several ways to simplify the reverse mortgage program structure, and there is potential to introduce streamlined programs for specific purposes.

Suggestion 3: Eliminate Infrequently Used Options
Simplifying the number of reverse mortgage choices could reduce borrower expense and make the product less confusing. In a forward mortgage, borrowers have two choices: they can choose a fixed- or adjustable-rate mortgage and they can choose the mortgage term (30 or 15 years). In contrast, the HECM offers many more options: fixed versus adjustable rate, lump-sum disbursement, line of credit, term annuity, tenure annuity or a combination of payment options, and the timing and pace at which funds will be withdrawn. The plethora of options makes the product more difficult for the borrower to comprehend and more difficult for secondary investors to value.

Eliminating less frequently used features could simplify the product structure. Few borrowers tend to use the HECM annuities. According to the 2018 HUD annual report to Congress, 2 percent of borrowers opted for a term or tenure annuity, and another 4 percent opted to combine a term and tenure annuity with a line of credit.[14] These numbers have been reasonably constant over the past decade. Tenure annuities are particularly problematic for the Mutual Mortgage Insurance Fund, as they combine a life insurance feature (yet another option) with the reverse mortgage, essentially giving the borrower a payment for the rest of his or her life.

Another simplification would be to place a time limit on the line of credit disbursement option. Currently, the borrower can tap into this unused line of credit at any time, and the untapped portion of the line does not accrue interest. The line of credit stays open as long as the borrower remains in the home. Enforcing a time limit, such as 10 years, would provide more certainty to lenders (who must maintain liquidity) and to investors and the FHA.[15]

Proprietary reverse mortgage products—which serve borrowers who have home prices above FHA loan limits, or near the high end of these limits, suggesting they capture a more affluent market sector—have a simpler structure than the HECM product. Most are single draw or have a fixed draw for four years, although the lines of credit are starting to grow. In the proprietary programs, the lines of credit have a 10-year draw period.

Suggestion 4: Streamline the Conversion of a Forward Mortgage into a Reverse Product

More older adults have a mortgage in retirement and are making monthly payments on the forward mortgage. HECM rules require that borrowers pay off a forward mortgage if they have one, and more than 60 percent of HECM borrowers use at least a portion of their proceeds to pay off a forward mortgage.[16] Allowing for a program to convert the forward mortgage into a reverse mortgage in a streamlined fashion makes sense for many but not all of these borrowers.[17] It may not make sense for a borrower with a small outstanding balance on a first mortgage who wants to borrow an additional amount. But the one-time draw would make for a simpler structure with a fixed interest rate, potentially making the product more attractive to investors and, in a competitive market, reducing the rate charged to borrowers. It could also save on sales and marketing costs, which are the largest HECM cost after the up-front mortgage insurance premium. If the borrower already has an FHA forward mortgage, the process could be further expedited.

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[14] US Department of Housing and Urban Development (HUD), *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund* (Washington, DC: HUD, 2018).

[15] Putting a term limit on the line of credit disbursement option would also protect HUD from a "ruthless strategy" under which a borrower obtains a line of credit that opportunistically draws funds only if the value of the house falls below the approved line. In other words, borrowers can theoretically use the HECM as an insurance policy against falling home prices, creating losses for HUD. See Deborah Lucas, "Hacking Reserve Mortgage" (unpublished paper, Massachusetts Institute of Technology, 2015) for a description of the "ruthless strategy" and estimates of the impact. Thomas Davidoff and Jake Wetzel (unpublished manuscript, University of British Columbia, Sauder School of Business, 2014) show this strategy is rarely used.

[16] Stephanie Moulton and Donald Haurin, "Unlocking Housing Wealth for Older Americans: Strategies to Improve Reverse Mortgages," in *New Approaches to Retirement Security* (Washington, DC: Brookings Institution; Evanston, IL: Northwestern University, Kellogg School of Management, forthcoming).

[17] Moulton and Haurin, "Unlocking Housing Wealth."

Suggestion 5: Reintroduce a Modified Version of the HECM Saver Program
In September 2010, HUD introduced the HECM Saver program as a low-cost vehicle for seniors who wanted a small disbursement and found the standard HECM premiums too expensive. This program eliminated the up-front premium, but the annual premium was the same as the standard HECM. Despite its low up-front cost, this program was discontinued in 2013 because of low demand. Reintroducing a version of this, with both lower up-front costs and lower annual fees, makes sense. Product features would include only an up-front draw and a strict cap on the loan-to-value ratio, which eliminates the risk to the Mutual Mortgage Insurance Fund. The underwriting could be streamlined to include an automated valuation model rather than a full home appraisal, further lowering expenses.

This is a simplified version of the tiered pricing recommendation suggested in the recent housing finance reform plan HUD presented to President Trump in September 2019, pursuant to the March 27, 2019, directive.[18]

Suggestion 6: Encourage the Development of Proprietary (non-HUD) Alternatives
The market for proprietary products is small but growing. The development of the market, however, has been limited by two obstacles. First, most borrowers qualify for the government program; loan limits are $726,525 nationwide.[19] Second, some states have rules that do not allow nongovernmental alternatives. These states are Iowa, Massachusetts, Maryland, Minnesota, Tennessee, Wisconsin, and West Virginia.

Reducing loan limits from the current level of $726,525 would encourage the development of alternative products, promoting competition and innovation. These non-HECM products will not offer borrowers the same flexibility as the government products, but they may do a better job meeting the needs of this segment of the market. And if HECM loan limits were reduced, it would likely force states who do not allow proprietary products to reevaluate their rules. Over time, the importance of the second obstacle would recede.

But a policy change like this should be made with eyes wide open. HUD should calculate if and by how much these high-balance mortgages cross-subsidize the lower-balance loans and make sure the financial impact is manageable.

Redesign Programs to Reduce Foreclosure Frequency and Loss Severity

There are several changes that can lower foreclosure frequency and loss severity. We examine two apiece in suggestions 7 and 8.

Suggestion 7: Implement Changes That Reduce Foreclosure Frequency
Reverse mortgages can enter into foreclosure if a borrower fails to pay taxes and insurance. Borrowers who skip a tax or insurance payment have two years to bring it current before the loan can be foreclosed upon; meanwhile, the servicer advances the funds, adding the amount advanced to the

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[18] US Department of Housing and Urban Development (HUD), *Housing Finance Reform Plan: Pursuant to the Presidential Memorandum Issued March 27, 2019* (Washington, DC: HUD, 2019).

[19] This is derived as 150 percent of the Federal Housing Finance Agency's conforming loan limit of $484,350; Fannie Mae and Freddie Mac can lend up to $726,525 in a limited number of high-cost areas.

borrower's HECM balance. The simplest way to avoid tax and insurance defaults is to escrow the funds. There are several opportunities for program improvements that would result in lower foreclosure frequencies and lower loss severities.

This is hardly a new insight. In April 2015, HUD changed the program to include a borrower financial assessment. If the borrower's financial condition falls below a certain level, taxes and insurance must be escrowed. This has reduced the default rate. Research by NewView Advisors shows that the tax and insurance default rates, at 37 to 45 months, have declined from 6.9 percent before the financial assessment was implemented to 2.1 percent after the assessment was implemented.[20]

This process can be improved further by making an escrow account the default through the inclusion of a life expectancy set-aside (LESA). For fiscal year 2018, about 14 percent of HECM borrowers have fully funded LESAs. In a fully funded LESA, the servicer pays the property taxes and insurance.[21] The borrower could ask for a waiver of this requirement by completing a detailed financial assessment (currently required for all borrowers). Meeting the hurdle in this assessment would waive the LESA requirement.

Second, if the taxes and insurance are not escrowed, reminding borrowers of their obligations can reduce foreclosure frequency. Moulton and coauthors showed that simple automated quarterly mail reminders to HECM borrowers about future property tax and insurance payments reduced tax and insurance default rates by as much as half.[22] Requiring this of servicers is an easy change.

Suggestion 8: Implement Program Changes to Reduce Loss Severity

In the forward market, foreclosure is the worst alternative for both the borrower and the holder of the risk. Foreclosure alternatives (e.g., short sales, deed in lieu of foreclosure) are preferable. The Cash for Keys program, announced in 2017, was an attempt to transfer this process to the reverse market.[23] Currently, the servicer can pay a borrower (and be reimbursed by HUD) for relocation expenses up to $3,000, in exchange for the borrower granting the servicer the legal right to dispose of the property via a deed in lieu of foreclosure. But this applies only to HECMs originated after September 2017. This program could be improved by (1) allowing the servicer to use Cash for Keys on HECMs originated before 2017 and (2) giving the servicer the flexibility to make a payment greater than $3,000. In many states, particularly judicial foreclosure states, it takes years to foreclose, during which time the property deteriorates. Allowing for a larger payment would be cost-effective. In addition, servicers should have the flexibility to make larger payments if the servicer can show it is in HUD's financial interest.

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[20] "Financial Assessment Is Working (Part V)," NewView Advisors blog, June 27, 2019, https://www.newviewadvisors.com/commentary/financial-assessment-is-working-part-v/.

[21] Cheryl Walker, Kasey Watson, and John Olmstead, "HECM Update," presentation given at the 2018 National Reverse Mortgage Lending Association Annual Conference and Expo, San Diego, CA, October 29, 2018, https://www.nrmlaonline.org/wp-content/uploads/2018/10/FHA-HECM-Update.pdf.

[22] Stephanie Moulton, J. Michael Collins, Cäzilia Loibl, Donald R. Haurin, and Julia Brown, *Reminders to Pay Property Tax Payments: A Field Experiment of Older Adults with Reverse Mortgages* (New York: SSRN, 2019).

[23] Dana T. Wade (general deputy assistant secretary for housing), "Implementation of HUD's January 2017 Home Equity Conversion Mortgage (HECM) Final Rule," mortgagee letter to all FHA-approved mortgagees and all HUD-approved housing counselors, August 24, 2017, https://www.hud.gov/sites/documents/17-11ML.PDF.

Finally, changing servicing protocol could make a big difference. HECM loans are generally pooled into Ginnie Mae securities and sold to investors. Currently, when the value of the loan reaches 98 percent of the initial claim amount, the servicer must pull the loan out of the Ginnie Mae pool; the loan is either (1) assigned to the FHA or (2) held by the reverse mortgage servicer on the servicer's balance sheet. Loans that qualify are generally assigned, as holding these loans on the servicer's balance sheet is expensive.

A loan cannot be assigned (it does not qualify) if it has tax or insurance delinquencies or if the servicer is working with the borrower on loss mitigation, the home is being foreclosed upon, the borrower is in bankruptcy, or the loan is inactive because the borrower has died or has moved out. If the loan cannot be assigned to the FHA, the servicer will hold and service the loan through resolution. Actuarial studies indicate that close to 60 percent of the loans are not assigned because they do not meet the FHA's assignment eligibility criteria.[24]

It is evident when comparing the losses on loans that are assigned versus those that are not assigned that the loss severity is higher on the loans that are assigned. Assigned loans have a loss rate of roughly 42 percent—which includes the difference between the estimated value and the sales price, the costs of the sale, and the costs of maintaining the property until it is sold—versus 12 percent on loans that are not assigned.[25]

The fact that loss severities are so much lower on unassigned loans reflects two realities:

- FHA policies do not maximize the value of the properties
- servicer incentives, in combination with their specialized knowledge, reduces losses

For example, the FHA does not foreclose on properties with tax and insurance defaults, even though it is entitled to do so. If servicers are not paying taxes and insurance, they might not be maintaining the home, resulting in the need for more proactive servicing to mitigate losses. Moreover, in many cases, the taxes and insurance are unpaid, as the home is vacant, which can be detrimental to its value. It is not clear how closely the FHA monitors vacancies.

Servicers are better at monitoring the properties, often reminding the borrower to make the tax and insurance payments to avoid foreclosure. They also dispose of properties faster, as servicers usually lose money if the house is vacant and deteriorating. In contrast, contractors employed by HUD are often less experienced than the original servicers. The contract terms they operate under often lack strong performance measures, positive incentives for positive outcomes, and penalties for negative outcomes, which hamper the FHA's ability to take action for poor execution.

Losses can be reduced in several ways. First, HUD could continue to accept assignment of the HECM loans but allow servicing to be performed by the current servicers. That is, the FHA would hold

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[24] Integrated Financial Engineering, *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund HECM Loans for Fiscal Year 2016* (Washington, DC: US Department of Housing and Urban Development, 2016).

[25] For more on the loss calculations, see Laurie Goodman and Edward Golding. "The FHA Can Improve Its Reverse Mortgage Program by Changing Servicing Protocol," *Urban Wire* (blog), Urban Institute, May 31, 2019, https://www.urban.org/urban-wire/fha-can-improve-its-reverse-mortgage-program-changing-servicing-protocol.

the mortgage in its portfolio and pay the current servicer to continue to service the loan. Servicer performance could be monitored by comparing the loss severities on the loans assigned by the servicers with those that are not assigned. Servicers could be compensated on a fee-for-service basis or a negotiated servicing fee. The compensation should include incentives that minimize loss severity.

If HUD chooses to go a different route, it should find an experienced servicer, compensate that servicer in a way that encourages cost-effective loss mitigation, and allow the servicer to follow program rules. There may be circumstances in which HUD decides not to enforce foreclosure rules, but it should be done on a case-by-case basis rather than as a matter of policy. Anecdotal evidence suggests the most common cause of tax and insurance defaults is death or a move into a senior living facility, not a 95-year-old simply forgetting to pay.

Finally, continued program improvements should be every program's goal in both the government and private sectors. Providing data on HECM performance would be helpful to this process. Origination data are available from both HUD and the Home Mortgage Disclosure Act, but performance information is not. Performance data used to be available but were discontinued in 2011.[26] Restoring and enhancing these data would make the program more transparent and provide the evidence to guide future program enhancements.

Summary

The HECM program is a valuable vehicle to tap into home equity and is the sole option for many low-income senior households to extract equity. It will become even more valuable and more necessary as the senior population increases and the proportion of those seniors with a mortgage (and limited retirement savings) increases. Helping more seniors age comfortably in their homes is an issue that should generate bipartisan support, as the alternative for many would be a nursing home or other facility paid for with taxpayer dollars.

But there are ways to improve the HECM program to better meet the needs of senior borrowers and to be more cost-effective. I have made seven suggestions in three areas:

- improve reverse mortgage financial literacy
- simplify reverse mortgage product design, lower costs for safer products, and encourage innovation
- redesign programs to reduce foreclosure frequency and loss severity

I hope the committee focuses on these suggestions for improvement and allows this valuable program to realize its full potential.

[26] To see the discontinued data, see "Home Equity Conversion Mortgage Data," US Department of Housing and Urban Development, accessed September 20, 2019, https://www.hud.gov/program_offices/housing/rmra/oe/rpts/hecmdata/hecmdatamenu.