Reverse Mortgage Update

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Overview

- Reverse mortgage basics
- Financial Assessment
- Property charge default – loss mitigation
- Occupancy issues
- Avoiding foreclosure for non-borrowing spouses
Reverse Mortgage Basics

- FHA-insured Reverse Mortgages – the Home Equity Conversion Mortgage (HECM) - for seniors age 62+
- No monthly payments; must pay taxes and insurance
- Interest and servicing fees added to the loan balance each month
- Loan comes due upon a triggering event: death, sale, non-occupancy, or non-payment of property charges
- Loan proceeds can be taken as a lump sum, equity line, or annuity.

Reverse Mortgage Basics

- Initial principal amount loaned is based on:
  - Appraised value of home
  - Prevailing interest rates
  - Age of the youngest borrower (or spouse after 8/2015); older = higher loan proceeds
  - "Principal Limit Factor"
    - Percentage of loan value that can be borrowed
    - PLF tables published at portal.hud.gov
- Loan balance may grow to exceed the value of the house
- Nonrecourse loan (no personal liability for the debt)
- FHA insurance (assignment to HUD when the loan balance reaches 98% of the Maximum Claim Amount)
Can we give an example that people can use with clients so they'll understand how interest compounds on a loan-- e.g., if you have a 100,000 loan at 4 percent interest (plus 1.25% MIP added to the loan), in 10 years it will be almost $167,000. A lot of people think they can take out a small amount and still have a lot of equity left, and they won't.

Craig Briskin, 11/5/2015
General Requirements

- Borrower must be 62 or older
- Must own and have equity in the property
- Occupy property as principal residence
- No delinquency on federal debt (or in repayment plan)
- Financial resources to pay property charges (taxes, insurance, HOA), or enough equity to pay this from loan proceeds
- Home can’t have significant repair issues that affect health/safety or that exceed 15% of property value

HECM Loan Documents

- 2 liens filed on property – one in favor of the lender, one in favor of HUD
  - Each lien is recorded for 150% of the Maximum Claim Amount
    - “Maximum Claim Amount” = appraised value at the time of closing, up to $625,500
  - Lender will be in first position, HUD in second
“Due and Payable” Events

- The last surviving borrower dies
- The last surviving borrower sells the home or conveys title (however, borrowers can convey title after closing as long as they retain at least a life estate interest in the property)
- The borrower changes their principal residence
  - A borrower may be away from the home for up to 12 months if the absence is due to medical reasons
- Borrower fails to pay property charges or maintain the property in “saleable” condition

High Costs

- Application costs
  - Reverse mortgage counseling required = approx. $125
  - Appraisal required = approx. $450-475
- Closing and servicing costs
  - Origination costs = $6,000 max (2% of prop value up to $200K, 1% of remaining value)
  - Mortgage insurance premiums (.5% or 2.5% upfront, then 1.25% per year over life of the loan)
  - Servicing fee ($30-35 per month)
  - Costs compound monthly – exponential growth!
Helpful Uses for Reverse Mortgage as a “Last Resort”

- Allows seniors to access home equity to pay expenses when income has decreased, but expenses may have increased.
- Use for increased medical expenses or other increased costs
- Payoff of existing mortgage
  - Client has equity but existing loan is unaffordable
  - Short-payoff to settle legal claims
  - Balloon payment, or balance remaining at maturity
- Pay other property debts
  - Back property taxes or HOA (assuming fees are affordable now)
  - Judgment lien (threatening foreclosure)

Helping Client Weigh Factors

**Good Option:**
- Equity in the home
- Client can afford taxes, insurance, and other household expenses
- Home in good repair
- Client isn’t worried about leaving home to heirs free of a mortgage (or need for RM outweighs this concern)
- **No good alternatives** and no other assets/resources

**Bad Option:**
- Client has little or no equity
- Client wouldn’t be able to afford taxes & insurance even with RM proceeds
- Home needs significant repairs that affect health/safety or that exceed 15% of property value
- Client wants family to inherit the home (family living in the home? – big red flag)
- Alternatives available, other retirement funds or assets
- SSI?
Financial Assessment

New Financial Assessment Requirements

- HUD announced the policy in Mortgagee Letters 2014-21 and 2014-22, but then delayed the effective date until April 27, 2015

- Borrower must satisfy a property charge review:
  - Gross income minus monthly cost of taxes, insurance, minimum installment payments (car, credit cards), and $0.14/sq ft for est utilities/maintenance
  - Must have surplus remaining of $529-580 single or $886-998 couple, depending on region.

- Must also satisfy a credit review:
  - No default on housing and installment payments in past 12 mos
  - No more than 2 30-day late payments in past 2 years
  - May explain defaults based on extenuating circumstances
Financial Assessment: Life Expectancy Set Aside

- Failing either review = fully funded life expectancy set-aside
- Insufficient residual income = partially funded set-aside
- Seniors will likely pay more for HECM counseling; some will not be able to access a RM Loan because of insufficient proceeds after LESA

Property Charge Defaults & Occupancy Issues
**Servicers Claim Non-Occupancy**

- Servicers send annual occupancy recertification, borrower is supposed to return it under HUD regs
- Sometimes servicers claim the home is not occupied and seek to foreclose, even though borrower is still living there
  - Did borrower return occupancy verification? Did servicer take any additional steps to verify occupancy (e.g. calls, inspection)?
- Security deed says failing to occupy as principal resident is a due and payable event, not failing to return the occupancy verification
- Proof of occupancy should “cure” any default under the mortgage (utility bills, ID listing property address, etc).
- If borrower was out of the home for less than 12 months (such as in nursing home), this is permitted.

**Property Charges**

- The reverse mortgage borrower must continue to cover “property charges,” including:
  - Property taxes
  - Homeowner’s insurance
  - HOA fees
- About 10% of RMs are in default for failure to pay property charges
- Taxes and insurance can be escrowed (rare)
- Sometimes lender starts out by paying them out of funds available, though a “set aside”—may create confusion
- In some cases, property charges are incorrect; e.g. borrower had insurance when lender took out forced-place policy and charges can be refunded upon borrower’s proof of coverage
The New Rules: ML 2015-11

- Eff. April 23, 2015; loss mitigation is permissive (not mandatory)
- Property Charge Delinquency Letter (as soon as Servicer knows of default); Must inform borrower of these options:
  - Refinancing the defaulted HECM if possible
  - Local assistance programs (e.g., Hardest Hit Funds program)
- Or, if neither of these two options will work, servicer may offer:
  - Repayment plan
  - Extension of foreclosure timelines for “At Risk” Mortgagor age 80+
- Due and Payable Notice (Within 30 days of default unless Loss Mitigation extension)
  - Must reference any available loss mit, mention option to sell or execute deed in lieu, and refer to HUD counseling agency
  - May not accelerate the loan until 30 days after Due & Payable Notice

ML 2015-11: Repayment Plans

Servicer should:

- Determine the total amount due for unpaid property charges and property charges coming due in the next 90 days
  - Minus HOA fees, which cannot be included in the repayment plan
- Determine the borrower’s ability to repay the charges through a repayment plan
  - No longer than 5 years
  - Payment no more than 25% of monthly surplus income
  - Or such shorter period so as to ensure repayment before the loan hits 98% of the Maximum Claim Amount
- Per ML 2016-07, may offer a repayment plan that will go beyond 98% of the MCA, but claim amount cannot exceed MCA
Loss Mitigation After Foreclosure Initiated?

- **ML 2015-11:** *Payment plan not available after foreclosure initiated*

- **ML 2016-07:** for loans that were in foreclosure when ML 2015-11 was issued (April 23, 2015), a repayment plan is allowed

- **NEW FAQ 5/26/16:** “Mortgagees may evaluate a HECM borrower for permissive loss mitigation after first legal action has been taken [to initiate foreclosure].”

New ML 2016-07

- **Issued March 30, 2016**

- New option: Servicer may delay foreclosure if the arrearage is less than $2,000 and the borrower has expressed willingness to pay and is attempting to pay, or lender has not yet been able to reach the borrower

- New option: “Mortgagee Funded Cure”
  - Mortgagee may advance the funds to pay property charges
  - May not include the advanced funds in a claim to HUD
  - May not assign the loan for 3 years has passed where borrower has paid the T&I on time
F/C Extension for “At Risk” Mortgagors (ML 2015-11)

Mortgagee may request foreclosure extension if:

- Youngest living mortgagor is at least 80 years old, and
- Critical circumstances such as terminal illness or long-term physical disability of borrower or family member living in the home
- Submit written request with supporting medical records or doctor’s letter
- Must resubmit supporting documentation on an annual basis for ongoing extension each year
- NEW FAQ says the “at risk” extension is not available if loan is already in foreclosure; seek a waiver from HUD?

Can ch. 13 bankruptcy help?

- Servicer refuses to offer repayment plan or offers a shorter repayment plan than what the borrower can afford
- Cure the taxes and insurance through chapter 13 plan
  - Unlike a typical mortgage creditor, no P&I will be included in Proof of Claim
  - Attorney’s fees and foreclosure fees should not be included in Proof of Claim (just property charges)
Problem: Servicers paying property taxes early

- Some low-income and elderly homeowners have special arrangements with the taxing authority – payment plan, grace period, etc.
- Servicers cause problems by paying the taxes before they are due, then saying the loan is in default and borrower must qualify for a repayment plan to pay back the advances.
- HECM Loan Agreement:
  - "2.10.5 If Borrower fails to pay the property charges in a timely manner, and has not elected to have Lender make the payments, Lender shall pay the property charges as a Loan Advance as required under Section 2.16. If a pattern of missed payments occurs, Lender may establish procedures to pay the property charges from Borrower’s funds as if the Borrower elected to have Lender pay the property charges."

After the Borrower’s Death:
Options to Prevent Foreclosure

- Sale
- Refinance
- Surviving Spouse – Special Provisions
Guidelines: after Death of Borrowers

- Loan balance comes due and payable (exception: optional deferral for surviving spouse)

- Estate or personal representative can:
  - Allow lender to foreclose
  - Sell the home
  - Short sale/purchase for 95% of appraised value

- Timeline
  - Estate has an initial 6-month period to try to purchase, sell, or refi
  - Can request up to two 90-day extensions if additional time needed (but need to show progress, such as probate, sale listing, etc).

Option to Sell or Refinance at 95% of FMV if Home Underwater

Estate can sell the property to an heir/family member (to pay off RM) for the lesser of:
- the current loan balance or
- 95% of the Fair Market Value, whichever is less.

Practical considerations:
- Can heir qualify for a loan (credit, income)?
- $$ for down-payment (look at assistance programs if insufficient savings)
Non-Borrowing Spouse Problem

- Until Aug. 2014, reverse mortgages only protected the borrower from foreclosure, even if there were a non-borrowing spouse;
- Lenders regularly remove a (usually younger) spouse from a deed when closing a RM;
  - Spouse not yet 62;
  - Higher loan proceeds (and origination fees) if remove younger spouse.
- Although lenders often told non-borrowing spouse they could be added back onto the deed later, loan docs called the loan due and payable upon the death of the borrower;
- HUD regs/loan docs did not protect non-borrowing spouse, contrary to language in HECM statute that protects homeowners (not only HUD–defined “borrowers”)

Statutory Protection for Spouses

In a section titled, “Safeguard to Prevent Displacement of Homeowner,” the statute provides:

The Secretary may not insure a home equity conversion mortgage under this section unless such mortgage provides that the homeowner’s obligation to satisfy the loan obligation is deferred until the homeowner’s death, the sale of the home, or the occurrence of other events specified in regulations of the Secretary. For purposes of this subsection, the term "homeowner" includes the spouse of a homeowner.

12 U.S.C. § 1715z-20(j)
HUD’s Regulation

- Only protected the borrower, not the spouse:

“The mortgage shall state that the mortgage balance will be due and payable in full if a mortgagor dies and the property is not the principal residence of at least one surviving mortgagor...” 24 C.F.R. § 206.27(c)(1)

- Lenders forced to foreclose on non-borrowing spouse once the borrower passed away.

- This changed for new loans originated after August 4, 2014. See Mortgagee Letter 2014-07

Bennett and Plunkett litigation

- Bennett v. Donovan: Initially, district court dismissed for lack of standing

- Bennett v. Donovan, 703 F.3d 582 (D.C. Cir. 2013) (holding that surviving spouses had standing to sue HUD because HUD could redress the harm)

- Bennett v. Donovan, 4 F.Supp.3d 5 (D.D.C. Sept. 30, 2013) (holding that HUD’s regulation allowing for foreclosure while surviving spouse still lived in the home was invalid; remanding to HUD to fashion a remedy)
Mortgagee Letter 2014-07

- Issued April 25, 2014

- For all HECM’s originated after August 4, 2014, the loan will not come due and payable until the death of the borrower and any spouse

- Loan terms must be calculated factoring in any non-borrower spouse (so if the non-borrower spouse is younger, loan proceeds will be lower)

- A prospective fix – but nothing regarding loans originated prior to August 4, 2014

Mortgagee Letter 2015-15

- At first, HUD issued a policy saying that servicers could elect to assign the loan to HUD (who would allow the widow(er) to remain in the home until death) if loan balance was no higher than it would have been had spouse been factored in (this was called the “Principal Limit test.”)

- On June 12, 2015, HUD issued ML 2015-15, giving servicers the option to assign the loan to HUD through the MOE (Mortgagee Optional Election) without satisfying the Principal Limit test.

- On the whole, this was a significant leap forward from HUD’s previous position

- Still a number of criteria that must be met for the loan to be eligible for assignment

- Deadlines
ML 2015-15: MOE Criteria

1. Spouse must have been legally married to the borrower at time of the loan (with an exception for same sex couples who could not legally marry) and must have been legally married at the time of borrower’s death;

2. Spouse must currently reside in the home as his/her principal residence, and must have done so at time of origination and throughout the borrower’s life;

3. Loan not due and payable for any other reason - If there has been a default on property taxes or homeowner’s insurance, spouse must cure any such default before the loan can be eligible for assignment.
   - Loans in the MOE “deferral period” cannot get a repayment plan for T&I default; spouse must cure the default within 30 days

4. Spouse must have, or be able to obtain within 90 days of the death of the borrower, “good, marketable title to the property” or a legal right to stay in the home until his/her death.
   - Timing: within 90 days of the death (but what about deaths that occurred years ago and you are now trying to meet conditions for the MOE? Argue that so long as spouse can arrange it now, in time to meet MOE deadlines, should be OK)
   - What is “good, marketable title”?*
   - Legal right to stay until death
     - Long-term lease
     - Court order
     - Partial ownership interest? (one of several heirs)
**ML 2015-15: MOE Deadlines**

1. By the later of 120 days after the death of the borrower or 120 days after issuance of the Mortgagee Letter (June 12, 2015), Mortgagee must elect to take the MOE or exercise its contractual rights;

2. Within 30 days after the election, Mortgagee must notify the spouse and the borrower’s estate of what election it made;

3. Within the 60 day period after an election of the MOE, Mortgagee must review all criteria to ensure that the loan is eligible - and if it isn’t, the deferral period will end (and Mortgagee will foreclose);

4. Within 120 days after making the election, Mortgagee must initiate the assignment to HUD (+60 day extension recently, in ML 2016-05)

**Planning Ahead for Non-Borrowing Spouse While Borrower Still Living!**

- Make sure spouse will take title to the property immediately, or as quickly as possible, after borrower’s death:
  - Transfer on death deed (statute?)
  - Joint tenancy/quitclaim deed
  - Trust

- Same-sex couples need to marry if they haven’t already

- Keep taxes and insurance current – if lender advances funds for these expenses, ideally couple should repay immediately as opposed to repayment plan (b/c spouse will have to bring current quickly after borrower’s death)
Litigation Options

- If your non-borrower spouse client still cannot satisfy the requirements of MOE 2015-15...

- Consider bringing legal claims:
  - Administrative Procedure Act
  - Reformation or breach of contract claims
  - Fraud/misrepresentation (against original lender and assignee)

Did the Non-borrowing Spouse Sign the Security Instrument?

- *Celia Smith v. Reverse Mortgage Solutions*, 2015 WL 4257632 (Fla. 3 DCA 2015), Unpublished Opinion-Not Final

- *Smith* Court determined that the “plain and unambiguous” language of the mortgage defined both spouses as “borrower” and therefore that a condition precedent for foreclosure (namely the death of the last surviving borrower) had not occurred. Judgement of foreclosure was reversed.

Using Bankruptcy to Stop a Foreclosure?

- Basic principle in bankruptcy that a “claim” includes a debt secured by the debtor’s home, even if debtor has no personal liability on the note.

- Non-borrowers must be allowed to de-accelerate the note and cure arrearage in a chapter 13 plan.

- Can the debtor (non-borrower spouse) propose a viable chapter 13 plan? Plan to refinance; sell; litigate against HUD?

“Cramdown” of reverse mortgages in bankruptcy

- Using the chapter 13 plan to modify the balance owed on a mortgage to the fair market value of the home and reduce the interest rate to prime + a margin for risk


- Normally, a homeowner cannot “cramdown” a first mortgage that is secured by the homeowner’s principal residence, however...

- An exception to the rule exists under 11 U.S.C. 1325(a)(5) for mortgages that mature (i.e. become fully due and payable) prior to the filing of the bankruptcy petition.
HECM Developments

- HUD Proposed rules
  - Codify Mortgagee Letters which
  - Limit up-front disbursements
  - Financial assessment
  - Defer due & payable status for non-borrowing spouses
  - Other requirements
  - 81 Fed. Reg. 31770 (May 19, 2016)
  - Comments Due July 18, 2016

- Litigation
  - Excessive & unnecessary property inspections
    - “Drive by” inspections
  - Generate default related fees
  - Floyd v. Nationstar Mortgage

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