

HECM, reverse mortgage, HUD, AARP, non-borrowing spouse

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A New Challenge to the HECM Reverse Mortgage Program

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The United States today faces a retirement funds crisis: a rapidly growing number of persons who are retiring without the financial capacity to support themselves during ever-increasing life spans. The HECM reverse mortgage program, which allows older homeowners to convert some or all of the equity in their homes into cash, ought to be a major policy tool for dealing with the crisis. It is a well-designed program that allows seniors to draw funds in a variety of ways to meet a wide range of problems, but it has been hobbled by major challenges that have kept it small. These include excessive complexity that leaves many seniors befuddled, negative media reports by befuddled journalists, deceptive merchandising by some loan providers, and hostility by AARP to which many seniors look for guidance on financial products.

Effective August 4, more sand will be thrown in the HECM gears, thanks to a misguided lawsuit by AARP against HUD, and a misguided change in HECM rules by HUD in response to the lawsuit. Here is the backdrop.

The amount of cash or monthly payments that a senior can draw under the HECM program depends, among other things, on the senior's current age. The older the senior, the larger are the draw amounts. If the house is owned jointly by married seniors and both are covered by the HECM, the age of the younger one is used, which lowers the draw amounts.

But seniors have had a choice under the program to include their younger spouses as HECM co-borrowers, or not. If the spouse is included, the amounts that can be drawn under the program are lower but the surviving spouse can remain in the house and draw whatever funds were available before the death. Alternatively, the older spouse can draw larger amounts by leaving the younger spouse out of the HECM, but that means that she must vacate the property when the borrower dies.

Because not all younger spouses need the protection provided by a HECM, this is a valuable option, comparable to choosing between a single and a joint annuity. But effective August 4, the option disappears.

The problem is that some seniors wanted it both ways and abused the privilege. They left their younger spouse off the HECM so that they could draw larger payments, sometimes deceiving their spouse, sometimes rationalizing that the government would not allow a senior to be thrown out on the street. And when it appeared that in fact the government was

allowing the eviction of non-borrowing spouses, the AARP sued HUD to prevent it.

AARP's claim, which in my view has very little credence, is that the seniors who had left their spouses out of the HECM did not make an informed choice but were deceived by the loan officers and mortgage brokers with whom they dealt. It argued further that HUD was obliged under the law to protect the tenure of spouses who are not included in a HECM agreement.

The response of HUD to the lawsuit was to put a hold on all cases involving non-borrowing spouses that were on the path toward eviction following the death of the borrower, and to develop a new set of rules applicable to all HECMs written after August 4, 2014. The new rules are designed to protect non-borrowing spouses (NBSs) from being evicted following the death of HECM borrowers. If the surviving NBS assumes ownership of the house and meets other obligations of ownership including payment of property taxes, she can remain there indefinitely. Further, an NBS can be any age when the HECM is taken out, but the younger she is, the less the amount that the HECM borrower can draw.

Under this new rule, all spouses will have their tenure protected. If they are 62 or older, they are co-borrowers, and if they are younger than 62 they are NBSs with protected tenure. But note that the rule does not protect the tenure of dependent children resident in the house, or spouses who marry HECM borrowers after the HECM is taken out.

The new rules carry two major costs. One is that seniors with younger spouses are required to purchase tenure protection for them, whether they need it or not. The cost will depend on the age of the NBS. As an example, the borrowing power of a senior of 80 married to a NBS of 40 will be reduced by 36%. If the NBS is only 25, the reduction becomes 47%.

The second cost will appear later and is more insidious. While NBSs have their tenure protected, they cannot draw funds under the HECM, only the borrower can do that. A borrower in anticipation of death, however, can draw the full amount of any unused credit line, including the line obtained from conversion of monthly payments, which then becomes accessible to the NBS. This is a horror show waiting to happen that will seriously endanger the integrity of the program.

None of this is necessary. Abuses associated with the option that seniors have had, to include or exclude a younger spouse in a HECM, could be eliminated by better disclosures that leave the basic structure of the program in place. The abuses would go away if spouses not covered by the HECM contract were required to acknowledge in writing that they are fully aware that they must vacate the property if their spouse predeceases them or moves out of the house permanently. The simplest remedies should be tried first.

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