TAX & INSURANCE DEFAULTS

by Ryan LaRose

All Reverse MORTGAGE, INC.

...a serious dilemma for our industry.

Quite often we have had people come up to us and say, "Reverse mortgage servicers have it made. All you have to do is send money to borrowers when they request it and keep track of their accounts." Oh, if it were only that simple!

In early 2004, when we began researching the reverse mortgage market, our CEO attended his first National Reverse Mortgage Lender's Association (NRMLA) conference in Atlanta. It was there that he met people like Jeff Taylor, Dave Carey, Paul Franklin, Jim Cory, Sarah Hulbert and Shawna James, among many others.

Interestingly, at that time he also thought servicing reverse mortgages was quite simple. However, when he was finished listening to all of the industry experts and veterans, he was stunned at the breadth of work that was required. It was then that he ran into the "cold wall of reality": reverse mortgages are a highly sophisticated (and slightly esoteric) loan product. Further, they require not only a thorough understanding of HUD and Fannie Mae servicing guidelines, but also the ability to build a servicing platform from scratch, and of equal or greater importance, the ability to recruit and retain employees who have an almost "evangelical mission" to help and protect older adults.

As we began structuring systems, procedures, and processes, the one huge sticking point in our operational development was, "What in the world do we do with those borrowers who are unable to pay their taxes and/or insurance premiums?" Much to our initial dismay, the HUD servicing guidelines state that the servicer should request the loan be called due and payable on any tax or insurance (T&I) default, which sent us sideways. We simply could not imagine initiating foreclosure and eviction proceedings against an 85 year-old widow just because she was unable to make her $500 homeowner's insurance premium.

However, our fears were quickly abated when we learned that Fannie Mae, the only purchaser or investor of HECMs at the time, had decided not to pursue foreclosure on T&I defaults for the time being. Okay, we thought, not so bad after all.

In early 2007, we saw the entrance, albeit short-lived, of Wall Street investors to the reverse mortgage industry. This was the first time that a significant number of new reverse mortgages would very likely not be sold to Fannie Mae where the servicing policies and procedures were "time-tested." This did cause us a certain level of concern: would the non-Fannie Mae investors be as willing to adopt the "ride it out" philosophy concerning T&I Defaults as that followed by Fannie Mae? One, I might add, that we fully support.

Fortunately, so far they have.

Fast forward to the 4th quarter of 2008 and now that we are servicing close to 20,000 reverse mortgages, the T&I issue has become a lot more problematic for us, NRMLA, and in fact, the entire reverse mortgage industry.

Before I get into all of the intricacies and nuances of the T&I default dilemma, I would like to offer a little perspective. The vast majority of reverse mortgage borrowers are able to keep their taxes and insurance current. However, an ever-increasing number of borrowers require the proceeds from their reverse mortgage for immediate needs and in many cases, all available funds are either taken at closing or used up shortly thereafter.

Now factor into this "equation" the fact that a lot of older adult borrowers were (or are) accustomed to having their previous mortgage payments include escrows for taxes and insurance. Then, when they get the much-needed funds from their reverse mortgage, the thought of keeping reserves on hand for the tax or insurance bill, in many cases, doesn't occur to them or is simply not economically feasible.

When a servicer receives information that taxes are delinquent or a homeowner's policy has lapsed, the borrower is immediately contacted to discuss these potential "defaults" in the hopes that it was a simple oversight and the situation is easily and quickly rectified.

Oh, if it were only that easy!

All too often, the borrower is completely "tapped out" and is also unable to obtain funds from any other family members to help resolve the default. Somewhat surprisingly, it is not uncommon for a borrower to actually thank us for advancing the funds to pay their taxes or insurance premium with a rather revealing comment like, "Thank you so much for paying my tax bill. I honestly don't know what I would do without you." Even though servicers work diligently to impress upon the borrower that this is not a "free" advance and they need to pay it back, most efforts at recovery are generally not very productive. Yes, there are some folks on repayment plans, but the successful completion rate on these T&I workouts is dismally low.

With that said, the "pot is beginning to boil" once again as we are seeing a recent and rather dramatic increase in T&I defaults, with a significant percentage of those being fairly new loans. Quite frankly, we were completely amazed by the results of a recent data analysis that we conducted on new T&I defaults in our servicing portfolio. When we studied the underlying reasons behind these new defaults, one overwhelming "theme" emerged quickly: over 80% of the borrowers that recently defaulted on their taxes and/or insurance had selected a lump sum payment (full draw of all available funds) at the time of closing.

Further exacerbating this problem is the fact that secondary market investors of the HECM product compensate originators based upon the amount drawn at closing. This practice, whether or not it's intended, is an underlying factor causing the increasing number of fully drawn loans being originated.

Fannie Mae, reverse servicers, and HUD have been in communication with one another regarding this topic over the past several years. There have been T&I "brainstorming

sessions", work groups, and a sharing of ideas in an effort to provide the industry with a clear direction on how to move forward.

Many great ideas have been generated by all of the various participants as a result of these meetings and conversations, but roadblocks continue to be placed in the way of true progress. Guideline restrictions handcuff HUD from making any dramatic policy changes, without first seeking and obtaining congressional approval. Knowing how long it took to get the most recent housing bill passed, this is not a very encouraging solution.

Processes were introduced by HUD in the last 12 months as a tool to help investors mitigate foreclosures on T&I defaults. Essentially, the plan involves analyzing the current loan-to-value on the property, along with other factors, to determine if there could be a potential loss at some point in the future. If the borrower meets HUD's criteria, meaning there is no foreseeable danger of HUD incurring a loss, then they will allow the servicer to "defer" calling the loan due & payable until a future date, avoiding the requirement for an immediate foreclosure action. On the flip side, if the borrower's property value cannot support the potential future T&I advances, it is expected that the servicer/investor will seek approval from HUD to call the reverse mortgage due & payable, thereby moving towards foreclosure.

Thankfully, I am not aware of any foreclosures on HECM borrowers due to a default on taxes and insurance as of today. I do not know if this is due to the success of the HUD deferral program or the continued stance of HECM investors to not foreclose on T&I defaulted seniors, because it is not publicly shared information.

At a HUD training session for HECM servicers in August 2008, it was reaffirmed that HUD will continue to offer the T&I deferral program as an option for servicers and investors to reduce the requirement for foreclosures. However, there are still more questions than answers that remain on the right way to deal with borrowers who find themselves in this less-than-desirable predicament.

While the deferral process is a good first step, there has not been a HUD Mortgagee Letter issued which details this process and provides clear direction to servicers and investors. In addition, there are industry concerns over the criteria used when analyzing whether a loan passes or fails the HUD deferral guidelines. This lack of clear direction could lead to inconsistencies in servicing practices from one servicer to another, or one investor to another.

This difficult and sensitive situation leaves the primary HECM investor, Fannie Mae, with the unenviable role of advancing the necessary T&I advances year after year, after year. And it leaves the servicer with the haunting, potentially daunting, and even more unenviable task of initiating foreclosures if the investor decides that they cannot absorb any more advances. This becomes an even more challenging decision for investors to make as falling home prices and the overall housing crisis impacts the reverse mortgage industry.

As a final note, the reverse mortgage industry has seen many positive achievements over the past year: continued growth in the HECM program, more originators entering the marketplace, higher loan limits, and increased levels of consumer acceptance, to name just a few. But for servicers and investors, the "clock is ticking" and those of us at Celink, as well as any other servicer in the reverse mortgage industry, are hoping that a broad-based solution to the T&I default issue can be found – sooner rather than later.

If you have any questions, please contact our experts:
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