REVERSING COURSE: STEMMING THE TIDE OF REVERSE MORTGAGE FORECLOSURES THROUGH EFFECTIVE SERVICING AND LOSS MITIGATION

*Sarah B. Mancini**
*Odette Williamson***

The government-backed reverse mortgage program provides a crucial safety net for older adults, allowing them to close the gap between their income and expenses by converting their home equity to cash. But in recent years, the program has been threatened by surging insurance claims, on the one hand, and a rising tide of defaults on the obligation to pay property taxes and insurance, on the other. The Department of Housing & Urban Development (HUD) has responded to both of these crises by implementing new origination rules that limit access to the reverse mortgage product for the low-income borrowers most in need of the financial relief that reverse mortgages can provide. Rather than curtailing the program for those that need it most, more focus

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Sarah B. Mancini is of counsel at the National Consumer Law Center.

Odette Williamson is a staff attorney in the National Consumer Law Center's Boston office.

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on reverse mortgage servicing and on implementing robust loss mitigation could reduce property charge foreclosures while also preserving the core mission of the Home Equity Conversion Mortgage program (HECM) to allow vulnerable elders to tap into home equity while aging in place.

Introduction

Charlotte Lowe was struggling to find a way to pay for the repairs needed on her modest home in Cambridge, Massachusetts. After working a lifetime, she was now living off of Social Security benefits and a small amount of extra cash from babysitting neighborhood children. She and her husband bought this home in the 1960s when they were expecting their fourth child and they needed more room. They did a lot of work on the house at the beginning. She worked as a switchboard operator connecting telephone calls and a host of other jobs after that. When they divorced after twenty-three years of marriage, she stayed in the home. But in 2003, at sixty-eight years old, she was faced with the need to make significant modifications and repairs. She had no other savings besides the equity in her home. It was significant equity because the mortgage on her home of thirty-eight years was paid off.[1]

The federally-insured reverse mortgage program, also known as the Home Equity Conversion Mortgage (HECM) program, was designed for Charlotte and those like her—house rich, but cash poor. As originally conceived, HECMs were supposed to meet the special needs of elderly homeowners by providing a mechanism for them to liquidate their home equity without having to sell and move out of their houses. It allowed these seniors to bridge the financial gap between income and expenses and to remain in their homes and communities.

The foundations of the HECM program are laudable, and for many years the program successfully achieved its goals by allowing hundreds of thousands of elderly homeowners to stay in their homes. But reverse mortgages are complex financial products and some financial industry players have engaged in less scrupulous lending practices.

1. Telephone interview with Charlotte Lowe (Jan. 5, 2018 at 4:55 p.m.) (on file with authors); Email from Todd Kaplan, Senior Attorney with Greater Boston Legal Services (Jan. 8, 2018 at 9:55 a.m.) (on file with authors). Charlotte Lowe is typical of a number of older borrowers who have taken out reverse mortgage loans and later experienced a property charge default. *See Examples of Senior Homeowners Struggling with Ineffective and Inconsistent Servicing of HECM Loans*, NAT'L CONSUMER LAW CTR. (Oct. 26, 2017), https://www.nclc.org/images/pdf/foreclosure_mortgage/reverse-mortgages/ib-hecm-examples-loss-mitigation.pdf [hereinafter NCLC Examples of HECM Servicing Problems].

Some lenders have encouraged borrowers to invest reverse mortgage proceeds in annuities or other financial products that provided the borrowers with little benefit and left them in a more precarious financial position. Other lenders have enlisted silver-haired celebrities to tout the benefits of reverse mortgages, but the sales pitches rarely have described the borrowers' obligations under the loans, such as the obligation to pay property taxes and insurance. Mortgage brokers' assurances that reverse mortgages are "payment free" and that non-borrowing spouses can live in the property for their lifetime have raised the specter of foreclosure for tens of thousands of seniors in their twilight years.

At age eighty, Charlotte Lowe was one such reverse mortgage borrower facing foreclosure. When she took out her reverse mortgage in 2003 she understood that there were no payments required. The majority of her reverse mortgage proceeds were paid out for the significant work that had to be done on her home. Unbeknownst to Charlotte, at some point, the reverse mortgage servicer began paying property charges owed on her house. Charlotte believed her property taxes were in abatement and did not realize they had become delinquent and been paid by the servicer. She entered into a repayment plan, but her servicer terminated that agreement and was unwilling to offer her any other options when another year's property taxes fell delinquent. In 2015, Charlotte received a letter from a law firm that had been retained to carry out a foreclosure of her home. Unfortunately, Charlotte's situation is not unique. Foreclosures of reverse mortgages for failure to pay property taxes have grown at an alarming rate. It is now projected that approximately 18% of currently outstanding federally-insured reverse mortgages will experience a property charge default.

The federal government's response to rising reverse mortgage foreclosures, and resulting increased losses for the insurance fund, has been to reduce the proceeds available through a reverse mortgage and to impose an underwriting protocol for new loans. Little, however, has been done to ensure the program has a robust loss mitigation program that will prevent avoidable foreclosures.

This is because the Department of Housing and Urban Development (HUD) has errantly promoted changes in origination as the primary solution to two distinct problems related to HECM loans. The first problem is the solvency crisis in which the government fund that insures payment of reverse mortgage claims has been operating in the red. The pressure on the insurance fund has been caused in large part

by lender policies, which peaked in 2009-2012, favoring loans where all available funds were drawn at origination, and the subsequent crash in home prices. This combination led to many HECM loan balances exceeding the property value and therefore more insurance claims. The second problem is the large and growing number of reverse mortgage borrowers defaulting on property charges, such as property taxes and hazard insurance. Although the repercussions of these two problems have been felt largely at the same time, they are two distinct issues, and the policy response to the problems should be considered separately.

This Article posits that a greater focus on reverse mortgage servicing and loss mitigation would be a more effective means of addressing the second crisis, that of property charge foreclosures, while also preserving the program's core mission of helping financially strapped older adults. Part I sets out the scope of the problem of elders aging with reduced income but also with significant home equity and provides an overview of the government-insured reverse mortgage program that was crafted to address this problem. Part II frames the first reverse mortgage crisis: rising demands on the insurance fund caused by market forces and the recent housing market crash. Part III discusses the second crisis, the growing wave of property charge defaults, and Part IV examines HUD's principal response to date—the implementation of a financial assessment at loan origination. Part IV argues that the constraints of the financial assessment limit access to reverse mortgages for low- and moderate-income seniors who most need access to the product. Part V concludes by arguing that instead of stricter underwriting, a comprehensive approach to reverse mortgage servicing and loss mitigation would better address the property charge default crisis while maintaining the core goals of the program. Finally, specific policy recommendations for implementing such an approach are provided.

We believe strongly in the importance of reverse mortgage loans as a tool for older consumers to maintain independence and stable housing while relieving financial strain. We hope this Article advances the cause of the continuing viability, and sound growth, of a reverse mortgage product that does not threaten older borrowers with an unnecessarily high risk of foreclosure.

I. Background: The Need for a Government-Insured Reverse Mortgage Program

A. Reverse Mortgages Offer Older Adults a Means to Bridge the Resource Divide

Approximately 80% percent of adults age sixty-five or older own a home.[2] A home is the most common financial asset owned by Americans, eclipsing ownership of retirement accounts and other forms of savings and assets.[3] Moreover, for most homeowners, their home is their most valuable asset.[4] Reverse mortgages, conventional home equity loans, and a developing industry of so-called "equity release products" are targeted at an increasing population of older homeowners who are often described as "cash poor, but equity rich." Older consumers use reverse mortgages to supplement income, pay off debt, and repair or otherwise modify homes to accommodate physical disabilities. Unlike other options, reverse mortgages allow older adults to access the equity in their home without selling and moving from the home or taking on a traditional loan with its correspondent monthly payment.

Using reverse mortgages to liquidate home equity has been promoted recently as a financial planning tool, often as a strategy to delay receiving Social Security benefits or draws from retirement accounts, or as a standby line of credit. Yet survey results show that most HECM borrowers sought the loan for more conventional reasons.[5] Nearly half the respondents sought a reverse mortgage to pay for basic necessities and essential expenses.[6] Survey respondents that were most likely to seek reverse mortgages to deal with necessities were those over eighty

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2. ANNUAL HOMEOWNERSHIP RATES FOR THE UNITED STATES BY AGE GROUP, 1982-2016, U.S. CENSUS BUREAU, FIGURE 7 (Feb. 21, 2017), https://www.census.gov/housing/hvs/data/charts/fig07.pdf (finding that for those sixty-five and older, the percentage is 79.5% as of the fourth quarter of 2016).

3. Jesse Bricker et al., *Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances*, 103 FED. RESERVE BULLETIN, NO. 3, at 18 (Sept. 2017), https://www.federalreserve.gov/publications/files/scf17.pdf (noting that 63.7% of Americans own a home; this percentage exceeds other forms of saving and assets, including retirement accounts (52.1%), cash-value life insurance policies (19.4%), stocks (13.9%), and savings bonds (8.6%)).

4. *See id.*

5. *See* Donald Redfoot, Ken Scholen & S. Kathi Brown, *REVERSE MORTGAGES: NICHE PRODUCT OR MAINSTREAM SOLUTION? REPORT ON THE 2006 AARP NAT'L SURVEY OF REVERSE MORTGAGE SHOPPERS*, AARP PUB. POL'Y INST. (Dec. 2007), https://assets.aarp.org/rgcenter/consume/2007_22_revmortgage.pdf.

6. *See id.*

years old, in poor or fair health, women, and those who were divorced or widowed.[7] For younger borrowers, reducing household debt, typically by paying off a forward mortgage, was the primary motivation for obtaining a reverse mortgage.[8]

Only a tiny fraction of eligible homeowners have taken out a reverse mortgage. But, as the baby boomer population ages, it is likely that a growing number of elders will need a reverse mortgage to make ends meet. More homeowners are entering retirement with mortgage debt than in prior generations.[9] Older adults are also carrying more non-mortgage debt, including credit card and student loan debt, into retirement than in past decades.[10] While debt is rising for seniors, fewer have traditional pension plans and a lack of retirement savings adds to the financial strain of growing older.[11]

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7. *Id.*

8. *See* Donald Haurin et al., *Reverse Mortgage Motivations and Outcomes: Insights from Survey Data*, 19 CITYSCAPE: J. POL'Y DEV. & RES. 73 (2017) [hereinafter Haurin et al.]; *Changing Attitudes, Changing Motives: The MetLife Study of How Aging Homeowners Use Reverse Mortgages*, NAT'L COUNCIL ON AGING & MET LIFE MATURE MKT. INST. (Mar. 2012), https://www.metlife.com/assets/cao/mmi/publications/studies/2012/studies/mmi-changing-attitudes-changing-motives.pdf.

9. CONSUMER FIN. PROT. BUREAU, OFF. FOR OLDER AMERICANS, SNAPSHOT OF OLDER CONSUMERS AND MORTGAGE DEBT at 8 (May 2014), http://files.consumerfinance.gov/f/201405_cfpb_snapshot_older-consumers-mortgage-debt.pdf [hereinafter CFPB Snapshot 2014] (analyzing Census data and concluding that the percentage of homeowners age sixty-five and older carrying mortgage debt increased from twenty-two to thirty-percent); *see also* JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., PROJECTIONS AND IMPLICATIONS FOR HOUSING A GROWING POPULATION: OLDER HOUSEHOLDS 2015-35 (Dec. 2016).

10. *2016 Survey of Consumer Finances Chartbook*, FED. RESERVE BD., 837 (Sept. 20, 2017), https://www.federalreserve.gov/econres/files/BulletinCharts.pdf (49.8% of families headed by someone seventy-five or older were in debt in 2016 compared to 21% in 1989; 70.1% of families headed by someone aged sixty-five to seventy-four were in debt in 2016 compared to 49.6% in 1989); *see also* Craig Copeland & Employee Benefit Res. Inst., *Debt of the Elderly and Near Elderly*, 1992-2013 36 EBRJ.ORG NOTES (Jan. 2015) (the percentage of American families with heads ages fifty-five or older that had debt increased from 53.8 percent in 1992 to 65.4 percent in 2013); CFPB Snapshot 2014, *supra* note 9, at 6 (increasing percentage of older Americans owe a mortgage on their home); Emily Bradon, *Fidelity: Couples Need $240,000 For Retirement Health Costs*, U.S. NEWS & WORLD REP. (May 10, 2012), http://money.usnews.com/money/blogs/planning-to-retire/2012/05/10/fidelity-couples-need-240000-for-retirement-health-costs (indicating a couple retiring in 2012 at age sixty-five would face, on average, $240,000 for medical care and health insurance expenses over their lifetimes, up from an estimated $160,000 in 2002).

11. *See* Annamaria Lusardi et al., *Debt and Financial Vulnerability on the Verge of Retirement*, NBER WORKING PAPER NO. 23664 (Aug. 2017).

Some homeowners have turned to reverse mortgages to bridge the resource divide; more are likely to do so in the future. As the financial fragility of this population increases, and as they continue to live longer, more older consumers will tap into home equity to fund current consumption, to modify homes to account for physical disabilities, or to pay for in-home care.

B. Overview of the FHA-Insured HECM Reverse Mortgage Loan Program

Home Equity Conversion Mortgages are federally-insured reverse mortgage loans that allow older homeowners to convert a portion of their home equity into cash. The Federal Housing Administration (FHA), under the umbrella of HUD, administers the HECM program and issues regulations and Mortgagee Letters (policy documents) governing HECM loans. HUD-approved private lenders originate HECM loans subject to the agency's regulations.[12]

Congress established the HECM program in 1988, following years of public and private initiatives to create reverse mortgages or other equity conversion products.[13] Advocates were concerned about the financial plight of older adults who were struggling to meet daily expenses, including housing and health related expenses.[14] Elder advocates pushed policymakers to create an equity conversion product that would be widely accepted by the lending industry and that would provide basic consumer protections for vulnerable older homeowners.[15]

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12. HUD guarantees that the lender will be compensated, up to specified limits, for any losses after default on the loan. 12 U.S.C. § 1715z-20(i)(C) (2018). The homeowner is also protected by HUD in the event the lender is unable to fulfill its payment obligation. 12 U.S.C. § 1715z-20(i)(A) (2018).

13. Housing and Community Development Act of 1987, Pub. L. No. 100-242, § 417, 101 Stat. 1815 (1988). The program was made permanent in 1998.

14. Advocates highlighted the desire of elders to remain in their community and age in place despite the economic strain caused by rising taxes, utility costs and home maintenance. *See* SUBCOMM. ON HOUS. AND CONSUMER INT. OF THE H. SELECT COMM. ON AGING, REP. ON 79TH 1981 WHITE HOUSE CONFERENCE ON AGING, REPORT OF THE MINI-CONFERENCE ON AGING FOR THE ELDERLY, (Comm. Print 1981) https://babel.hathitrust.org/cgi/pt?id=pur1.32754066676069;view=1up;seq=18 (prepared by the NAT'L COUNCIL OF SENIOR CITIZENS EDUC. AND RES. (TR.).

15. *See id.* (finding both the 1981 White House Conference on Aging and the President's Commission on Housing recommended that the federal government take a more active role in the creation of a reverse mortgage program); *see also* STAFF OF THE S. SPECIAL COMM. ON AGING, 97TH CONG., 2D SESS., TURNING HOME EQUITY INTO INCOME FOR OLDER HOMEOWNERS: AN INFORMATION PAPER (Comm. Print

The HECM program was designed specifically "to meet the special needs of elderly homeowners by reducing the effect of the economic hardship caused by the increasing costs of meeting health, housing, and subsistence needs at a time of reduced income," while also preventing the risk of displacement from the home.[16]

To be eligible for a HECM, the borrower must be at least sixty-two years old.[17] The property serving as collateral for the loan must be the borrower's principal residence.[18] Borrowers are required to keep the property in good repair and pay property-related charges, including property taxes and hazard insurance premiums, referred to as "property charges," in a timely manner.[19]

The amount that the borrower receives from the HECM loan is based on the maximum amount HUD will insure or the property value (whichever is less), the age of the youngest borrower (or non-borrowing spouse), and the expected interest rate.[20] Borrowers can receive mortgage proceeds through a lump sum, a line of credit, a monthly disbursement for life of loan or a fixed term, or a combination of these options.[21]

Interest, mortgage insurance, and servicing fees accrue and are added to the principal balance monthly. Thus, unlike traditional forward mortgages, for which the amount owed decreases and the borrower's equity increases, reverse mortgage debt increases over time as

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1982), https://www.aging.senate.gov/imo/media/doc/reports/rpt682.pdf (noting that accessing equity has the potential to raise elders' monthly income above the poverty line; elders can repair homes or make changes to accommodate disability; and pay for medical or health related expenses).

16. 12 U.S.C. § 1715z-20 (2018).

17. 12 U.S.C. § 1715z-20(b)(1) (2018); 24 C.F.R. § 206.33 (2018).

18. 24 C.F.R. § 206.35 (2018) (mortgagors may include holders of a future interest in the property, such as a life estate); 24 C.F.R. § 206.39 (2018) (stating property is considered the principal residence of any borrower who is temporarily or permanently in a health care institution as long as the property is the principal residence of at least one other borrower who is not in a health care institution). "Temporary" is defined as a period of less than twelve months.

19. 24 C.F.R. §§ 206.3, 206.205 (2018).

20. 24 C.F.R. § 206.3 (2018).

21. *See* 12 U.S.C. § 1715z-20(d)(9) (2018); 24 C.F.R. §§ 206.17, 206.19 (2018). A line of credit plan permits the borrower to draw amounts as needed until the line of credit is depleted. Under the tenure plan, borrowers receive equal monthly payments from the lender for as long as borrowers live and continue to occupy the property as a principal residence. Term plans also provide for equal monthly payments, but payments are disbursed for a fixed period of time. Though HECM term plans provide monthly payments only for a fixed number of months, they do not mature until the borrower dies, relocates, or sells the home. The modified tenure and modified terms plans allow borrowers to combine these various features.

the loan proceeds are disbursed, and interest and fees are added to the loan balance. HECMs are "non-recourse" loans, which means that the borrower (or his or her estate) will not owe more than the loan balance or the value of the property, whichever is less.

HECMs become due and payable when the last surviving borrower dies, the home is sold, or the borrower fails to occupy the home for at least a year or comply with other terms of the mortgage.[22] When the loan comes due, the home can be turned over to the lender or the loan may be paid off through a sale or refinance. After a loan has entered due and payable status, the loan may be satisfied by paying the lesser of the loan balance or 95% of the appraised value of the property.[23] If the HECM loan becomes due and payable because the borrower has failed to comply with other terms of the mortgage, the borrower has the right to cure the default, restoring the HECM loan to a current status.

C. Servicers and the Servicing of Reverse Mortgages

The servicing of reverse mortgages is performed by a relatively small number of companies.[24] As with forward mortgages, reverse mortgage servicers collect the amount due, monitor the payment of property-related charges, and communicate with borrowers, heirs, and family members. Servicers are also required to monitor the property to determine whether a borrower still occupies the property,[25] and to work with heirs to sell or otherwise dispose of the property after the borrower's death.[26] Companies may perform the day-to-day servicing in-house or outsource all or part of the servicing of reverse mortgage loans to a subcontracted servicer.[27]

22. *See* 24 C.F.R. § 206.27 (2018).

23. *See* 24 C.F.R. § 206.125(c) (2018).

24. Some servicing companies also originate or purchase loans and issue HECM-backed Ginnie Mae securities. Most advances on HECM loans are securitized into Ginnie Mae HECM Mortgage Backed Securities, also know as HMBS.

25. *See* 24 C.F.R. § 206.211 (2018).

26. *See* 24 C.F.R. § 206.125(a)(2) (2018).

27. Among the largest servicers are RMS (Reverse Mortgage Solutions), Celink and Nationstar. Nationstar Mortgage is one of the largest mortgage servicers in the United States; Champion Mortgage is a division of Nationstar that specializes in servicing reverse mortgages. Celink performs some servicing functions for Nationstar and other companies. In addition to servicing reverse mortgages, RMS is an originator and one of the top ten issuers of HMBS.

The actions of reverse mortgage servicers are limited by HUD's regulations and Mortgagee Letters, as well as by responsibilities outlined in the note and security instrument.[28] But servicers are not financially incentivized to invest in strong loss mitigation programs or clear communication with borrowers. This is why HUD's role as insurer and regulator is crucial if unnecessary HECM foreclosures are to be avoided. Effective servicing, and steps HUD could take to improve HECM servicing, are discussed in Part V. First, Parts II-IV explore HUD's current approach to the two crises in the reverse mortgage market.

II. The First Crisis: Market Changes and the Housing Crash Threaten the Fiscal Soundness of the HECM Program

In recent years, the HECM program has experienced a crisis of solvency—a growing number of insurance claims and insufficient capital in light of the outstanding obligations of the FHA Mutual Mortgage Insurance ("MMI") fund.[29] Although the accounting method used in annual actuarial reports to Congress overstates the severity of this crisis,[30] the state of the MMI fund has led to concern about the fiscal soundness and sustainability of the HECM program. The reverse mortgage program's negative impact on the insurance fund was caused primarily by two factors: industry-driven demand for "full-draw" HECMs, and the subsequent housing market crash. In late 2009, the year with the highest volume of HECM originations on record, a significant number of HECM loans involved the withdrawal of all available loan proceeds at origination, with no funds reserved for monthly payments or in a line of credit.[31] These so-called "full-draw" HECMs have

28. *See* 24 C.F.R. Part 206; U.S. DEP'T HOUS. URBAN DEV., HOME EQUITY CONVERSION MORTGAGES HANDBOOK (4235.1), https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsgh/4235.1 .

29. The MMI Fund insures mortgages guaranteed by the Federal Housing Administration. The fund covers both traditional forward FHA loans and HECMs.

30. Edward Golding & Laurie Goodman, *To better assess the risk of FHA programs, separate reverse and forward mortgages*, URBAN INST. (Nov. 29, 2017), https://www.urban.org/urban-wire/better-assess-risk-fha-programs-separate-reverse-and-forward-mortgages.

31. *See* CONSUMER FIN. PROT. BUREAU, REPORT TO CONGRESS ON REVERSE MORTGAGES 81 (June 28, 2012), https://www.consumerfinance.gov/data-research/research-reports/reverse-mortgages-report/ [hereinafter CFPB Report to Congress 2012].

resulted in faster growing loan balances, with interest compounding on the larger principal balances over time. By 2011, 69% of HECMs made were fixed-rate, full-draw loans.[32] Crashing home values followed by a slow or stagnant rebound in many areas have exacerbated the problem, with a significant number of insurance claims made necessary by home prices not covering the full balance due on the loan at the time of an eventual foreclosure. These shifts, the resulting impact on the fund, and HUD's response are addressed in this section.

A. Market Shifts

Prior to 2009, nearly all HECMs were adjustable-rate loans, and most borrowers took the loan proceeds at least in part through an open-end line of credit.[33] Beginning in late 2009 and continuing through 2012, roughly 65% to 75% of HECMs originated were fixed-rate, full-draw loans.[34] This shift occurred after HUD clarified, in early 2008, that the fixed-rate HECM could be structured as a closed-end loan, with all proceeds taken in a single lump-sum disbursement.[35] During the early days of HECM securitization, closed-end loans were preferred by the secondary market. At the time, advances made with open-end products were more difficult to securitize.[36] The widespread market adoption of the full-draw product coincided with a 32% increase in the number of borrowers taking 90% or more of the available loan proceeds at closing.[37]

Consumers did not suddenly develop an appetite for fixed-rate, full-draw loans. Indeed, just a year earlier, prior to the explosion of fixed-rate HECMs, almost 90% of HECM reverse mortgage borrowers chose to receive their money *solely* as a line of credit.[38] Rather, consumer

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32. *Id*. at 30.
33. *Id*. at 80.
34. *Id*. The numbers have shifted again due to recent policy changes, with adjustable-rate HECMs outnumbering fixed-rate HECMs in 2014 and 2015. *See also* Christopher Feather et al., *Financial Sustainability and the Home Equity Conversion Mortgage: Advancing Fiscal Soundness and Affordable Financing for Senior Homeowners*, 19 CITYSCAPE: J. POL'Y DEV. & RES., No. 1, at 47, 54 (2017).
35. CFPB Report to Congress 2012, *supra* note 31, at 80.
36. *Id*. at 80–86.
37. *Id*. at 61.
38. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, REVERSE MORTGAGES: PRODUCT COMPLEXITY AND CONSUMER PROTECTION ISSUES UNDERSCORE NEED FOR IMPROVED CONTROLS OVER COUNSELING FOR BORROWERS 8 (June 2009), http://www.gao.gov/new.items/d09606.pdf [hereinafter Reverse Mortgages: Product Complexity].

behavior changed as reverse mortgage lenders waived origination fees and other charges on full-draw loans, and not for other options. Consumers were incentivized to withdraw all the proceeds up front, whether they needed it or not.[39] Aggressive marketing, pricing and product availability, rather than overwhelming consumer demand, drove this trend. Reverse mortgage counselors reported to the CFPB that some clients were *only* presented with the fixed-rate loan by their lender.[40] The Bureau noted that "some originators may be recommending the fixed-rate product more strongly than—or even to the exclusion of—the adjustable-rate product to prospective borrowers."[41] In the nine months between March and December 2009, for example, the percentage of fixed-rate, lump-sum loans went from less than 3% to approximately 70%.[42]

The push for fixed-rate, full-draw HECMs was driven in large part by investor demand. Originators receive exceptionally high compensation from the secondary market for originating fixed-rate HECMs.[43] Originator compensation from the secondary market is structured as a percentage of the loan balance at closing, and during this time period the premium paid to originators was higher for full-draw loans than for lines of credit, or term or tenure loans. Investors in Ginnie Mae HMBS were willing to pay a 10% to 12% premium on fixed-rate loans, compared with a 6% to 9% premium on adjustable-rate loans.[44]

Of course, some HECM borrowers during this period had larger existing mortgage balances,[45] and were drawn to the lump-sum payout

39. *See* Rachel L. Sheedy, *Reverse Mortgage Lenders Cut Fees*, KIPLINGER (July 13, 2010), http://www.kiplinger.com/features/archives/krr-reverse-mortgage-lenders-cut-fees.html; *see also* Tara Siegel Bernard, *Reverse mortgages Still Costly, but Less So*, N.Y. TIMES (Apr. 16, 2010), http://www.nytimes.com/2010/04/17/your-money/mortgages/17money.html.

40. *See* CFPB Report to Congress 2012, *supra* note 31, at 95.

41. *Id.* at 97.

42. Donald L. Redfoot, *How Recent Changes in Reverse Mortgages Impact Older Homeowners*, AARP PUB. POL'Y INST. (Feb. 2011), https://assets.aarp.org/rgcenter/ppi/ltc/fs211-economic.pdf.

43. *See* CFPB Report to Congress 2012, *supra* note 31, at 81 (noting that a portion of the premiums issuers receive have been passed on to brokers, retail loan officers and correspondent lenders; the premium is structured as a percentage of the loan balance at closing, and the percentage paid is higher for fixed-rate loans than for variable rate loans).

44. *Id*.

45. *Id.* at 48.

of loan proceeds because they needed the full HECM proceeds to satisfy their existing loans.[46] But many older consumers were steered toward fixed-rate, full-draw reverse mortgages because this option was more profitable for lenders and brokers, and not because of a net benefit to the borrower. For borrowers who did not need all of the available proceeds immediately, full-draw loans were more expensive than other options. Borrowers paid compounding interest and ongoing mortgage insurance premiums on the full amount of available loan proceeds over the life of the loan. With lines of credit or term or tenure payments, in contrast, interest accumulates only on the funds that have been advanced to the borrower.[47] In addition, HECM reverse mortgages have a credit line growth feature that allows the unused portion of the line of credit to grow at a specified interest rate, increasing the amount available in the line of credit over time.[48] For these reasons, borrowers who do not need the full loan proceeds at origination are better off selecting a line of credit and withdrawing only the amount needed.

The shift toward full-draw HECMs led to loan balances that have grown at a rapid pace. At the same time, the housing market crash began to take its toll. The meltdown coincided with longer loan tenures for HECM borrowers.[49] Longer loan tenures meant loan balances continued to grow through compounding interest, while at the same time property values plummeted in many areas, failing to grow at the expected rates. HECM loan proceeds are based on the assumption that property values will grow at an average of 4% per year over time; this assumption has not been borne out over the past ten years.[50] The combination of a long period of declining home values, longer loan tenure,

46. *Id.* at 57.

47. *Id.* at 93.

48. Home Equity Conversion Mortgage Insurance, 24 C.F.R. §§ 206.3, 206.25(d) (2018); *see* CFPB Report to Congress 2012, *supra* note 31, at 93. (stating the remaining funds in the line of credit grow at the same rate as the interest rate on the mortgage, plus 0.5%).

49. *See* CFPB Report to Congress 2012, *supra* note 31, at 61.

50. Edward J. Szymanoski, *Risk and the Home Equity Conversion Mortgage*, 22 J. AM. REAL ESTATE & URBAN ECON. ASS'N, 347, 365 (June 1994); *see also* Jack M. Guttentag, *How Senior Homeowners Can Hedge Property Value Risk*, HUFFINGTON POST: THE BLOG (Nov. 28, 2016, 9:59 AM), https://www.huffingtonpost.com/jack-m-guttentag/how-senior-homeowners-can_b_13280790.html; *see also After 8 Years, the Real Estate Market is Finally Looking Normal Again*, FORTUNE, (Mar. 31, 2014), http://fortune.com/2014/03/31/after-8-years-the-real-estate-market-is-finally-looking-normal-again/ (showing the Case-Shiller Housing Index lost thirty-three percent from its peak in 2006 to its trough in 2012).

and a significant number of borrowers having taken all available proceeds at closing led to significant and growing losses for the MMI fund over recent years.[51] HUD's Annual Report to Congress on the financial status of the MMI fund for Fiscal Year 2012 projected the economic value of the HECM portfolio to be negative $2.8 billion.[52] By Fiscal Year 2016 the fund's estimated actuarial value was negative $7.7 million, even with the resurgence of the housing market.[53] Although this valuation is skewed by a requirement to consider only existing loans and assume no future originations, HUD still has responded to the actuarial numbers with alarm.[54]

B. HUD's Response to the First Crisis

In response to this crisis, HUD focused its regulatory efforts on origination changes designed to limit funds advanced to borrowers and to shore up the fiscal underpinnings of the HECM program. The program is designed to be self-supporting through its premium revenue.[55] In its attempts to maintain that status, HUD lowered principal limits and charged higher insurance premiums. In Fiscal Year 2012, for example, HUD reduced the available principal limits by 10% to 15%.[56] In addition to changing the amount available from the loan, HUD limited the amount that could be disbursed during the first twelve months of the loan to 60% of the initial principal limit, unless more was needed to

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51. *See* U.S. DEP'T OF HOUS. & URBAN DEV., MORTGAGEE LETTER 2013-27 (Sept. 3, 2013) [hereinafter Mortgagee Letter 2013-27].

52. *Annual Report to Congress Fiscal Year 2012: Financial Status FHA Mutual Mortgage Insurance Fund*, U.S.DEP'T OF HOUS. & URBAN DEV. 1, 35 (Nov. 16, 2012), https://archives.hud.gov/news/2012/F12MMIFundRepCong111612.pdf.

53. *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund HECM Loans For Fiscal Year 2016*, INTEGRATED FIN. ENG. 1, 19 (Nov. 15, 2016), https://www.hud.gov/sites/docments/ACTUARIALMMIFHECM2016.pdf [hereinafter FY 2016 Actuarial Review].

54. Laurie Goodman, *A Review and Critique of the 2014 actuarial assessment of FHA's Mutual Mortgage Insurance Fund*, URBAN INST. (2015) https://www.urban.org/sites/default/files/publication/33581/2000060-The-2014-Actuarial-Report-on-the-FHA-Mutual-Insurance-Fund.pdf; Laurie Goodman, *We're not accurately assessing the Federal Housing Administration's solvency* URBAN INST. (Nov. 30, 2015), https://www.urban.org/urban-wire/were-not-accurately-assessing-federal-housing-administrations-solvency.

55. *Hearing Before the House Financial Services Comm., Subcomm. on Insurance, Housing and Community Opportunity*, 112th Cong., 2d Sess. (2012) (written testimony of Charles Coulter, Deputy Assistant Secretary for Single Family Housing, U.S. Dep't of Hous. & Urban Dev).

56. *Id.*

make mandatory payoffs.[57] At the same time, HUD implemented a two-tier pricing structure for mortgage insurance based on the amount disbursed at closing or during the first twelve months.[58] These changes focused on severely restricting the full-draw HECM loan that dominated the market in previous years and on improving the fiscal status of the fund.

In early 2017, HUD finalized rules that primarily amended the origination and claims process.[59] The final regulations also codified previously announced changes including a financial assessment as part of the underwriting process, limits on disbursement of proceeds during the first year of the loan, and deferral of the due and payable status of the loan for eligible non-borrowing spouses.[60] The servicers' responsibilities largely remained the same under the amended rules. But, HUD did emphasize a swift foreclosure timeline.[61] The amendments added protections for the agency through the claims process and enhanced standards and penalties related to the assignment of the property to HUD.[62] While tightening the claims processing procedure, HUD did not shore up oversight of servicers with respect to their interaction with borrowers and heirs.[63] The agency also opted not to increase penalties for non-compliance with the servicing regulations.[64]

The agency relied heavily on an economic rationale for the 2017 rule changes, acknowledging that the HECM portfolio of loans continued to experience volatility.[65] HUD focused on stabilizing the fund and stemming the economic losses, and less on improving consumer protections, though the two are not mutually exclusive. The agency noted that the impact of program changes was hard to predict but that it did expect a gradual positive effect on the insurance fund.[66]

Further, changes announced in August 2017 have significantly reduced the amount of loan proceeds borrowers can access through a re-

57. Mortgagee Letter 2013-27, *supra* note 51.
58. *Id.*
59. FED. HOUS. ADMIN., Strengthening the Home Equity Conversion Mortgage Program, 82 Fed. Reg. 7094 (Jan. 19, 2017) (to be codified at 24 C.F.R. pt. 30, 206).
60. *Id.*
61. *Id.* at 7136.
62. *Id.* at 7140.
63. *Id.* at 7136–38.
64. *See* 24 C.F.R. § 206.201 (2018).
65. *See* 82 Fed. Reg. 7094.
66. *See id.*

verse mortgage. The principal limits have again been adjusted downward, further reducing the proceeds that older adults can receive from the loans.[67] The changes include a further increase in the upfront mortgage insurance premium and a decrease in the annual mortgage insurance premium,[68] which, on balance, make most reverse mortgages more expensive for the borrower.

III. The Second Crisis: The Rising Tide of Property Charge Defaults

Since the program's inception, the HECM loan documents have required the borrower to pay property charges and stated that the failure to do so may result in the loan being called due and payable, followed by foreclosure.[69] But before 2011, HUD was not generally requiring servicers to initiate foreclosure when HECM borrowers defaulted on property charges. Instead, many borrowers went years without paying these charges and never received a foreclosure notice from their servicer. Servicers simply paid the delinquent property taxes and homeowners insurance and added those amounts to the outstanding loan balance.

During the time period of rising home values and significant equity cushions protecting HECM loans, a borrower's failure to pay taxes or insurance, and the lender's decision to advance these funds and add them to the loan balance, did not pose a significant risk to the insurance fund.[70] Thus, between 2007 and April 2009, HUD instituted a policy of

67. *Id.*
68. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2017-12 (Aug. 29, 2017).
69. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2017-11 (Aug. 24, 2017).
70. *Oversight of the Fed. Hous. Admin's Reverse Mortgage Program for Seniors: Hearing Before the House Financial Services Comm., Subcomm. on Insurance, Housing and Community Opportunity*, 112th Cong., 53–54 (2012) (written testimony of Charles Coulter, Deputy Assistant Secretary for Single Family Housing, U.S. Dep't of Hous. & Urban Dev.).

granting foreclosure deferrals rather than instructing servicers to foreclose due to property charge defaults.[71] This informal policy was announced via e-mail rather than any public issuance or rulemaking.[72] Then, on May 20, 2009, HUD sent an e-mail to servicers advising them that HUD would no longer accept deferral requests from servicers related to property charge defaults.[73] But, many servicers interpreted this guidance from HUD to mean that they no longer needed to report the property charge defaults to HUD but that they still were not required to initiate foreclosure based on these defaults.[74] A number of servicers indicated that they were awaiting further guidance from HUD regarding what they were supposed to do with respect to these defaulted loans.[75]

The significant number of HECM loans in default on property charges and the lack of clear guidance from HUD regarding these loans were brought to light by an Office of the Inspector General (OIG) audit and report issued on August 25, 2010.[76] The purpose of the audit was to determine whether HUD's policies regarding property charge defaults were negatively impacting the insurance fund. The report revealed that at least 20,000 HECMs were in default on property charges at that time and that HUD had absolutely no handle on the scope of the problem.[77] HUD's internal records suggested that 7,673 loans were in default, but the OIG report identified an additional 12,958 defaulted loans, of which HUD had no knowledge. The OIG discovered these additional defaulted loans based on data obtained from four out of sixteen HECM servicers nationwide, and thus reported that its findings still might not fully capture the scope of the problem.[78] The OIG report stated that servicers had advanced more than $35 million in property tax and insurance payments on the nearly 13,000 loans auditors discovered to be in

71. U.S. DEP'T OF HOUS. & URBAN DEV., OFFICE OF INSPECTOR GENERAL AUDIT REPORT, HUD WAS NOT TRACKING ALMOST 13,000 DEFAULTED HECM LOANS WITH MAXIMUM CLAIM AMOUNTS OF POTENTIALLY MORE THAN $2.5 BILLION, 1, 6 (Aug. 25, 2010) [hereinafter HUD OIG AUDIT REPORT] ("HUD routinely deferred foreclosure through an informal policy because it indicated that it was unwilling to foreclose on senior citizen borrowers.").

72. *Id.* at 6 n.9 ("HUD's policy was issued via e-mail. HUD was unable to provide a copy.").

73. *Id.* at 7.

74. *Id.*

75. *Id.*

76. *See generally id.*

77. *Id.* at 2.

78. *Id.*

default, and servicers were expected to advance another $35 million in payments on these loans over the next year if no action was taken by HUD. The report estimated that the claims that might need to be paid out of the insurance fund might total $1.47 billion for the roughly 20,000 total HECMs in default as of March 2010.[79]

As of February 2012, approximately 54,000 HECM borrowers were at risk of losing their homes to foreclosure due to property charge defaults.[80] That number has continued to grow. In November 2016, a HUD actuarial report by an independent accounting firm showed that 89,064 HECMs were in default on property charges with at least twelve months having passed since the borrower's last attempted payment on property charges.[81] This represents about 14% of currently active HECM loans.[82] The report projected that roughly 18% of HECMs currently outstanding would experience a property charge default at some point in time.[83]

There are a number of reasons why so many HECM borrowers have gone into default on property charges. To be sure, some borrowers defaulted due to a lack of sufficient income and savings with which to meet their ongoing expenses, after having exhausted their home equity through the HECM. But the most significant factor for many HECM borrowers was a lack of understanding that they were required to pay these charges after closing on their reverse mortgages.[84] False advertising of reverse mortgage terms contributes to this lack of understanding. Older adults being solicited for a reverse mortgage are often told that this loan is "payment free."[85] If they previously had a forward mortgage

79. *Id.* at 11.

80. CFPB Report to Congress 2012, *supra* note 31, at 132.

81. FY 2016 Actuarial Review, *supra* note 53, at D-6.

82. Jennifer McKim, *More Seniors are Taking Loans Against Their Homes - and It's Costing Them*, WASH. POST (Aug. 25, 2017) [hereinafter McKim].

83. FY 2016 Actuarial Review, *supra* note 53, at D-7.

84. *See* CFPB Report to Congress 2012, *supra* note 31, at 130.

85. In November 2012, the FTC, in coordination with the CFPB, issued warning letters to companies regarding potentially misleading mortgage advertisements. *See* Press Release, Fed. Trade Comm'n, FTC Warns Mortgage Advertisers that Their Ads May Violate Federal Law (Nov. 19, 2012); Press Release, Consumer Fin. Prot. Bureau, Consumer Financial Protection Bureau Warns Companies Against Misleading Consumers with False Mortgage Advertisements (Nov. 19, 2012); Letter from Consumer Fin. Prot. Bureau, to company ABC (Nov. 19, 2012), https://files.consumerfinance.gov/f/201211_cfpb_generic_warning_letter_older_Americans.pdf. (One misrepresentation singled out by the agencies was the claim that "consumers who enter into a reverse mortgage will have 'no payments,' notwithstanding that such consumers may continue to be responsible for tax and insurance payments.").

loan, as is the case for most HECM borrowers, consumers were used to having the funds for these large, annual or semi-annual obligations escrowed by their mortgage company as part of their monthly housing payment.[86] As recently as late 2016, the CFPB took action against three reverse mortgage lenders for deceptive advertising practices, including misrepresenting that HECM borrowers would have no payments and could not lose their homes.[87] Advertisements for reverse mortgages typically discuss borrower obligations like tax and insurance payments only in the fine print, if at all, and many older adults cannot read the fine print used in advertisements.[88]

Required pre-loan counseling has been inconsistent at informing borrowers of the requirement to pay property charges.[89] Concerns have been raised periodically about the overall effectiveness of required pre-loan counseling.[90] Even when HUD counseling protocols are followed, a telephone counseling session that may last less than one hour is not going to correct most consumers' misconceptions about the reverse mortgage terms.[91] HECM servicers have not effectively communicated the necessity to pay property charges to borrowers after the loan closing. Thus, many HECM borrowers have no idea that they are obligated to pay their property taxes and hazard insurance annually, did not know how much it would cost them, and did not realize they needed to plan ahead for this expense. Taxing authorities are not set up to provide customer service, and some do not even send a bill in advance of the due date.[92]

86. *See* CFPB Report to Congress 2012, *supra* note 31, at 129 (citing to complaints received by the CFPB and the FTC revealing that HECM borrowers did not realize they were obligated to pay these charges).

87. Press Release, Consumer Fin. Prot. Bureau, CFPB Takes Action Against Reverse Mortgage Companies for Deceptive Advertising (Dec. 7, 2016).

88. CONSUMER FIN. PROT. BUREAU, OFFICE FOR OLDER AMERICANS, A CLOSER LOOK AT REVERSE MORTGAGE ADVERTISEMENT AND CONSUMER RISKS 7 (June 2015), https://www.consumerfinance.gov/data-research/research-reports/a-closer-look-at-reverse-mortgage-advertisements-and-consumer-risks/.

89. *See* CFPB Report to Congress 2012, *supra* note 31, at 123 (explaining that confusion about taxes and insurance persisted after pre-loan counseling).

90. *See generally* Reverse Mortgages: Product Complexity, *supra* note 38, at 8.

91. *See* CFPB Report to Congress 2012, *supra* note 31, at 124; *see also* Fed. Hous. Admin.: Strengthening the Home Equity Conversion Mortgage Program, 82 Fed. Reg. 7094, at 7112 (to be codified at 24 C.F.R. pts. 30, 206) (public comment noting that counseling is ineffective at correcting misconceptions advanced by unscrupulous mortgage brokers).

92. Email from Sarah White, Connecticut Fair Housing Center (Feb. 9, 2018 at 12:38 p.m.) (on file with authors).

This lack of understanding has been compounded for some borrowers who received HECM loan proceeds through a line of credit by the fact that, if the borrowers failed to pay property charges, servicers were directed to pay the charges out of the line of credit.[93] Some borrowers in this situation never realized that they were supposed to be paying the property charges themselves.[94] When the credit line was exhausted and servicers began to advance the funds to pay these charges, many of these borrowers did not understand that their loans had gone into default.[95] Under HUD's policy from 2007 through 2011, these borrowers would not have been notified of a potential foreclosure related to such a default.[96] Even though these borrowers were aware that they did not make property charge payments, the servicer's payment of those charges led them to believe that everything was fine. They had no reason for alarm, and therefore slipped further and further into default without realizing it.

As described above, until 2011, HUD allowed servicers to advance funds for property charges without seeking repayment from the borrower. Servicers instead added these advances to the loan balance, with the expectation of being repaid eventually through foreclosure or a claim on the HUD insurance. Many borrowers did not realize they were in default on their loans, while the tax and insurance payments made by the servicer reached levels that would be untenable for any low-income borrower to repay.

Then, in the midst of the foreclosure crisis, HUD's handling of the HECM program was called into question by the 2010 OIG Audit Report.[97] That report brought to light the fact that HUD had not been requiring lenders to foreclose based on property charge defaults and had no appreciation for the scope of the problem.[98] The report pointed out that HUD would be better able to address the issue and improve the HECM program's ability to prevent defaults on property charges if it could obtain accurate information about the existing loans in default.[99]

93. CFPB Report to Congress 2012, *supra* note 31, at 129.
94. *Id.* at 130.
95. *Id.*
96. *Id.*; *see also* HUD OIG Audit Report, *supra* note 71, at 6–7.
97. *See generally* HUD OIG Audit Report, *supra* note 71.
98. *Id.* at 6.
99. *Id.*

In response to the OIG report, in January 2011, HUD significantly shifted its policy regarding property charge defaults.[100] First, HUD required mortgagees to immediately report any property charge delinquencies and to report future delinquencies on a monthly basis.[101] Servicers were directed to notify HECM borrowers of property charge defaults within thirty days and offer loss mitigation options to such borrowers to cure the default.[102] HUD established the following loss mitigation options to be considered: establishing "a realistic repayment plan," contacting a housing counseling agency to seek out local resources to help cure the default, and refinancing into a new HECM if there is sufficient equity to do so.[103] Repayment plans that servicers could offer to HECM borrowers varied in length depending on the amount of money owed, but could not extend beyond twenty-four months.[104]

If the borrower failed to cure the delinquency and loss mitigation options had been exhausted, HUD instructed servicers to request permission to accelerate the loan and foreclose.[105] Upon approval, servicers were mandated to initiate foreclosure within certain timeframes.[106] The move to require a loss mitigation review prior to foreclosure was a positive step, but HUD's limited loss mitigation options during this time (for example, only allowing repayment plans of up to twenty-four months) prevented many struggling borrowers from curing their default.

In April 2015, HUD made another significant change in its policy on property charge defaults. It announced that mortgagees must make a request to accelerate the loan within thirty days of a property charge default.[107] In contrast to HUD's previous policy, exhaustion of all applicable loss mitigation options was not a prerequisite to requesting permission to accelerate and foreclose. HUD's new position was that servicers *may* offer loss mitigation, but would have to seek an extension of

100. U.S. Dep't of Hous. & Urban Dev. Mortgagee Letter 2011-01 (Jan. 3, 2011) [hereinafter Mortgagee Letter 2011-01].
101. *Id*. at 2.
102. *Id*.
103. *Id*.
104. *Id*. at 3.
105. *Id*. at 4.
106. *Id*.
107. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2015-11 at 2 (Apr. 23, 2015).

the foreclosure timeframes to do so.[108] In addition, HUD barred servicers from offering even permissive loss mitigation options to any HECM borrower once foreclosure had been initiated.[109] Although the latter policy was later reversed by HUD, confusion persisted about this rule for months.[110] After HUD clarified that loss mitigation was permissible after the initiation of foreclosure, many servicers still declined to offer it because of HUD's aggressive position on foreclosure deadlines.[111]

Servicers' incentives surrounding loss mitigation are heavily dependent on HUD's policing of the foreclosure timeline. HUD's regulations require that servicers initiate the foreclosure process within a certain time period after a loan becomes eligible to be called due and payable owing to a failure to pay property charges or occupy the property.[112] If servicers do not initiate foreclosure in a timely manner, HUD may impose a financial penalty known as interest curtailment—refusing to allow the mortgagee to include any interest that accrues on the loan after the missed deadline in its eventual insurance claim.[113] For any HECM where the loan balance has grown to exceed the market value of the home, the possibility of losing out on recovery of the interest accruing on the debt is a significant disincentive to engaging in loss mitigation.

While making loss mitigation permissive, HUD also expanded the loss mitigation options for borrowers with property charge defaults. For example, it generally allowed servicers to offer repayment plans with a term as long as sixty months, up from a previous maximum of twenty-four months.[114] HUD created an informal repayment plan option for arrearages below $2,000, a mortgagee-funded cure wherein the

108. *Id.* at 3.
109. *Id.*
110. *See generally* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2016-07 (Mar. 30, 2016); *see also* U.S. DEP'T OF HOUS. & URBAN DEV., *Frequently Asked Questions*, https://hudgov.prod.parature.com/link/portal/57345/57355/ArticleFolder/26/Reverse-Mortgage-Programs (last visited Feb. 26, 2018).
111. *See generally* NCLC Examples of HECM Servicing Problems, *supra* note 1.
112. 24 C.F.R. § 206.125(d) (2018).
113. 24 C.F.R. § 206.129(d)(3)(x) (2018).
114. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2015-11, at 6–7 (Apr. 23, 2015). HUD later revised its policy to allow a servicer to offer a repayment plan that will extend beyond ninety-eight percent of the Maximum Claim Amount, but reiterated that HUD will not pay any amount above the Maximum Claim Amount at the time of assignment, and the loan may not be assigned in an active repayment plan. *See* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2016-07 (Mar. 30, 2016). In practice, this policy still means servicers are extremely unlikely to offer a

mortgagee may simply pay off the arrearage, and an "At-Risk Extension" of the foreclosure timelines for borrowers who are over age eighty and face critical circumstances, such as a terminal illness or long-term physical disability.[115] Yet, the change from mandatory to permissive loss mitigation, strict enforcement of foreclosure timelines, and prohibition on loss mitigation after foreclosure has been initiated overwhelmed these positive changes and led to a spike in HECM foreclosure due to property charge defaults.

Approximately 24,000 HECM borrowers received "due and payable" notices in the 2015 federal fiscal year, which ended September 2015.[116] That was triple the number for 2014, according to HUD.[117] In fall of 2016, HUD reported that nearly 90,000 HECMs were in default on property charges with no payment in the past twelve months.[118]

Despite this public data, HUD has been unwilling to acknowledge the fact that property charge defaults are driving the stark increase in HECM foreclosures. In recent public responses to the release of data on the uptick in reverse mortgage foreclosures in 2016,[119] HUD has claimed that the vast majority of HECM foreclosures are due to the death of the borrower.[120]

Consumer advocates from around the country have reported that HUD's lack of robust loss mitigation policies and strict foreclosure timelines, and servicers' business decisions influenced by these policies, make it extremely difficult for HECM borrowers to cure property

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repayment plan that extends beyond ninety-eight percent of the MCA, which may mean that a borrower is capped at a shorter term plan, making the payment unaffordable.

115. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2015-11, at 2 (Apr. 23, 2015); U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2016-07 (Mar. 30, 2016).

116. Jennifer McKim & Koby Levin, *Seniors Face More Foreclosures as Reverse Mortgages Bite Back*, NEW ENGLAND CTR. FOR INVESTIGATIVE REPORTING (May 1, 2016), https://www.necir.org/2016/05/01/seniors-face-foreclosures-reverse-mortgages-bite-back/.

117. *Id.*

118. *See* FY 2016 Actuarial Review, *supra* note 53; *see also* McKim, *supra* note 82.

119. *New FOIA Response from HUD Reveals 646% Increase in Foreclosures Against Seniors in 2016* CAL. REINVESTMENT COALITION (Nov. 15, 2017), *available at* http://www.calreinvest.org/news/new-foia-response-from-hud-reveals-646-increase-in-foreclosures-against-seniors-in-2016.

120. *See* Brian Collins, *Calls Intensify to Separate Reverse Mortgages from FHA Fund*, NAT'L MORTGAGE NEWS, (Nov. 22, 2017), https://www.nationalmortgagenews.com/news/calls-intensify-to-separate-reverse-mortgages-from-fha-fund (citing HUD's contention that ninety-nine percent of reverse mortgage foreclosures are the result of the death of the last borrower or the borrower moving out of the home).

charge defaults and avoid foreclosure.[121] Certain servicers refuse to offer repayment plans at all after foreclosure has been initiated, if the arrearage balance exceeds $5,000, or if other conditions exist.[122] Yet, to date, HUD has failed to seriously consider strengthening its servicing regulations to deal with the significant problem of property charge defaults. In the following section we examine HUD's response to the crisis of property charge foreclosures, focusing almost exclusively on origination-side policies.

IV. HUD's Response to High Rates of Property Charge Defaults: The Financial Assessment

Historically, the HECM program has never involved an assessment of the borrower's creditworthiness, because the borrower was not required to make monthly payments on the loan.[123] But in September 2013, HUD proposed a new financial assessment to ensure that borrowers have the ability to meet ongoing obligations for property charges—whether through income, assets, reverse mortgage proceeds, or by setting aside reverse mortgage funds.[124] The financial assessment, which lenders were required to implement beginning April 27, 2015, includes residual income and credit history analyses.[125] Depending on the results of the financial assessment, the lender may be required to set aside funds for payment of property charges over the life expectancy of the borrower. This is required when the lender determines that the bor-

121. *See* NCLC Examples of HECM Servicing Problems, *supra* note 1; *see also* Courina Yulisa & Caroline Nagy, *Protecting Senior Homeowners from Reverse Mortgage Foreclosure*, CTR. FOR N.Y.C. NEIGHBORHOODS 2–3 (Aug. 2017), *available at* http://cnycn.org/reverse-mortgage-policy-brief/ (revealing that for one company that services 10,000 reverse mortgage loans in New York state, fully one third of their loans were in default; and foreclosure attorneys in New York City and Long Island report that one quarter to one third of their cases now involve reverse mortgage foreclosures).

122. *See generally* NCLC Examples of HECM Servicing Problems, *supra* note 1.

123. *See* CFPB Report to Congress 2012, *supra* note 31, at 129–30.

124. *See* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2013-45 (Dec. 20, 2013) (delaying effective date of financial assessment requirements); U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2013-28 (Sept. 3, 2013) (financial assessment and property charge guide); Dep't of Hous. & Urban Dev., Mortgagee Letter 2013-27 (Sept. 3, 2013) (announcing the proposed financial assessment).

125. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2014-21 (Nov. 10, 2014); *see also* Dep't of Hous. & Urban Dev., Mortgagee Letter 2015-06 (Feb. 26, 2015) (extending the financial assessment implementation date to April 27, 2015).

rower has not demonstrated the ability or willingness to meet their financial obligations."[126] If dictated by HUD's financial assessment, the lender will create a Life Expectancy Set-Aside ("LESA") for the payment of property charges.[127] This set-aside may be fully or partially funded by the HECM proceeds, depending on the outcome of the financial assessment.[128] The set-aside is deducted from the amount that would otherwise be available in loan proceeds. Therefore, the amount of HECM proceeds available for distribution to the borrower can be significantly reduced if a set-aside for taxes and insurance is required.

The lender must conduct an extensive evaluation of the borrower's credit history and residual income to determine whether a LESA should be required.[129] The borrower's credit is deemed satisfactory if the borrower has made all housing and installment debt payments on time for the previous twelve months, had no more than two thirty-day late mortgage or installment payments in the past twenty-four months, and has no major derogatory credit on revolving accounts in the past twelve months.[130] Satisfactory credit also means an absence of collections or charged-off accounts, from any time period covered by the credit report, according to some lenders' interpretation of HUD's rules. If the borrower's credit is not "satisfactory," meaning an account has been reported in collection or there have been late payments on mortgage or installment debt, the lender must require a LESA unless the negative credit events can be explained by extenuating circumstances. The prospective borrower must gather documentation of any extenuating circumstances and show the lender that they were directly related to the negative events reflected on the borrower's credit report.[131]

If the borrower's credit history is satisfactory, the lender conducts a review of residual income. Residual income is the amount left for household expenses, such as food, clothes, medicine, and transportation after deducting the payments for all debts that will not be paid off by the HECM, expected property charges, and an allowed amount for

126. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2014-21 (Nov. 10, 2014).
127. *Id.*
128. *Id.*
129. U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2014-22, at 22 (Nov. 10, 2014) (Revised HECM Financial Assessment and Property Charge Guide) .
130. *Id.*
131. *Id.* at 71.

utilities and maintenance.[132] The lender may consider only the borrower's income from documented sources.[133] The borrower's residual income, after subtracting these expenses, must meet or exceed a certain threshold based on household size and geographic region.[134] For example, a household of one in Arizona must have $589 in residual income remaining after deducting these expenses.[135] If the borrower's residual income falls below the required amount, compensating factors may justify a decision not to require a LESA.[136] Otherwise, a satisfactory credit history that lacks sufficient residual income will require at least a partially-funded LESA, and a lender may deem the fully-funded LESA appropriate. According to some in the reverse mortgage lending industry, partially-funded LESAs are rare; lenders are more likely to err on the side of requiring the fully-funded LESA.[137]

In its final rule announced January 2017, effective September 19, 2017, HUD formalized the policy changes adopted in these 2013 and 2014 mortgagee letters.[138] HUD acknowledged a reduction in borrower choice for those who do not meet new credit or residual income requirements.[139]

There are a number of issues with HUD's current financial assessment and property charge set-aside policies. First, the rules require an exhaustive review of credit history that can be burdensome for loan originators to do. Especially for the most financially vulnerable elders, who are most likely to need a reverse mortgage for its intended purpose of easing financial strain at a time of reduced income, doing the assessment well is time consuming. These older adults are extremely likely to have at least one collection account—either a medical debt, an old phone or cable bill, etc.—and to have a history of paying mortgage or installment debt late within the past twenty-four months. In that event, "passing" the financial assessment and avoiding the requirement to impose a set-aside will require the borrower, with the help of the loan

132. *See id.* at 31–69.
133. *Id.* at 31.
134. *Id.* at 69.
135. *See id.*
136. *Id.* at 72–73.
137. Telephone and in-person interviews with HECM counselors and loan originators (May 11, 2017 at 10 a.m., 2 p.m., and 4 p.m.; Sept. 15, 2017 at 1:30 p.m.), [hereinafter HECM Telephone Interviews].
138. *See Strengthening the Home Equity Conversion Mortgage Programs*, FED. HOUS. ADMIN. (Jan. 19, 2017), https://www.gpo.gov/fdsys/plg/FR-2017-01-19/pdf/2017-01044.pdf.
139. *Id.* at 5.

originator to gather documentation of extenuating circumstances. Some lenders require the hardship that constitutes "extenuating circumstances" to have occurred immediately before the default or collection in order to deem it sufficiently causally connected to disregard the negative event. Many homeowners might use up their savings before defaulting on a mortgage, for example, after a job loss. But an underwriter might reject an explanation of extenuating circumstances if the event, such as a job loss or medical hardship, happened eight or nine months before the default. If a HECM applicant points to a major hardship that post-dated the default, it might not be deemed connected; it is often the case that homeowners experience a series of hardships, and it can be hard to pinpoint the right precise event from the right time period to satisfy the rules as some lenders interpret them.[140]

The requirements for showing "compensating factors" to get past a residual income shortfall are similarly burdensome for potential borrowers and loan officers. Moreover, there is so much ambiguity in HUD's rules surrounding the credit review and residual income analysis that an array of lenders interpret them differently. There is significant variation in lenders' interpretation of the import of a residual income shortfall. For example, if a HECM applicant has less than the required amount of residual income, even when the lender removes the taxes and insurance from the equation (because they will be covered by a LESA), there is some dispute over whether the loan should be approved, even with a LESA.[141] If the residual income analysis results in negative residual income (less than zero), most lenders will not approve the loan.[142] It can be difficult for reverse mortgage brokers to keep up with the different interpretations of HUD's policy applied by different lenders.[143]

Information obtained from industry participants suggests that processing costs have increased significantly as a result of the financial assessment.[144] One broker estimated that he can process only about half as many HECM loans per year as he did before the assessment rules took effect.[145] Reverse mortgage lenders likely are having to hire more

140. HECM Telephone Interviews, *supra* note 137.
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*

processors and more loan officers to handle comparable volume, resulting in increased overhead per loan.

Perhaps most significantly, failing the financial assessment and being required to include a LESA will make the loan unfeasible for some HECM borrowers. This is true because the available proceeds may be insufficient to pay off existing liens and make any required repairs. This is especially likely in geographic areas where property values are lower and for borrowers who are younger (resulting in a larger LESA, due to longer life expectancy, and a lower principal limit for the same reason).[146] For example, a sixty-three-year-old borrower with a home that appraises for $72,000 and existing liens totaling $15,000 would not be able to close on the HECM if a LESA is required.[147] Such a borrower would have to bring funds to the closing table, which, as research has shown, is not possible for most interested HECM applicants.[148]

Of course, the goal of the financial assessment was to exclude some borrowers from accessing a reverse mortgage. The borrowers who cannot afford to pay ongoing taxes and insurance (even after obtaining the HECM) and cannot afford a set-aside out of available loan proceeds are intentionally being denied for the program. Most would agree that a HECM loan is not a good option for a person who is going to default on property charges in the near term and face foreclosure as a result.[149] Such a person would be better served, typically, by selling the home without incurring the closing costs for a HECM. The question, though, is whether the pendulum has swung too far—whether HUD has imposed rules that are more strenuous than necessary to achieve the desired result, namely rules which may be excluding potential borrowers that could maintain tax and insurance payments and would benefit a great deal from accessing a reverse mortgage.

For example, is it necessary to require a fully-funded property tax set-aside for an applicant due to a medical debt that went into collection six years ago? A significant number of older adults have experienced

146. Haurin et al., *supra* note 8, at 93.
147. This example is based on estimated interest rates as of April 2017.
148. Haurin et al., *supra* note 8, at 93.
149. Indeed, consumer advocates called for HUD to require underwriting to determine borrowers' ability to pay taxes and insurance. *See* NAT'L CONSUMER LAW CTR., COMMENTS TO THE CONSUMER FIN. PROT. BUREAU ON NOTICE AND REQUEST FOR INFO. REGARDING CONSUMER USE OF REVERSE MORTGAGES (July 2, 2012), https://www.nclc.org/images/pdf/foreclosure_mortgage/reverse-mortgages/comments-cfpb-reverse-mortgages-2012.pdf.

medical hardships. It is not uncommon for consumers to have medical bills that go unpaid due to a belief that insurance should have paid for certain treatments, and to unwittingly end up with a bill in collection. Similarly, is it necessary to require a full set-aside based on an applicant having paid late on his or her mortgage within the past twelve months? Arguably, such a person would face significantly less financial strain if he or she can obtain a HECM and no longer have the obligation to pay the principal and interest on a forward mortgage. Of course, the set-aside is not automatically required for individuals who have these events on their credit—but some lenders interpret HUD's policy very strictly, and some loan officers will not have the time or inclination to help a borrower explain and document a closely connected hardship that can serve as "extenuating circumstances."

Research suggests that poor credit history is one of the most predictive factors for future property charge defaults.[150] Yet, of individuals with imperfect credit, not all of them would go on to default on property charges. Some percentage would, and some would not. Even the research supporting HUD's approach shows that a certain percentage of people who would not have gone into default will be excluded based on the assessment rules.[151] Stephanie Moulton, Donald R. Haurin, and Wei Shi modeled HUD's proposed policy interventions using data from HECM counseling sessions from 2006-2011 mapped onto HECM loan data from HUD.[152] Their results showed that capping the upfront draw and requiring a LESA for borrowers with poor credit would reduce HECM defaults by 50% and reduce uptake (the number of counseled individuals able to proceed with a HECM loan) by 12%.[153] The researchers assumed a baseline default rate of 15.6%. This means that the proposed intervention they found most effective, capping upfront draws and requiring a LESA for borrowers with poor credit, would result in approximately 7.8% of HECM borrowers going into default (half of the baseline rate of 15.6%), but 12% of borrowers not proceeding with the loan. Assuming annual origination volume of 60,000 loans (which has been roughly average volume in recent years), this 12% reduction

150. Donald R. Haurin et al., *Reducing Default Rates of Reverse Mortgages*, CTR. FOR RETIREMENT RES. AT B. C. 3 (July 2016), http://cpr.bc.edu/brifs/reducing-default-rats-of-reverse-mortgages/ [hereinafter *Reducing Default Rates*].

151. *See generally id.*

152. *Id.*

153. *Id.*

would mean 7,200 fewer households able to access a HECM loan and 5,242 fewer HECM borrowers expected to default.[154]

Unfortunately, there is no good publicly available data regarding the number of individuals who have, in fact, been unable to move forward with a HECM due to a LESA requirement making the loan unfeasible. Most of these individuals will be advised by a loan officer that they cannot close on the loan without bringing a certain amount of money to the table, and will not ever make a formal application.[155] The number of people who fit this description is not known. AAG, the largest reverse mortgage originator in recent years, reports that in 2016 it received 500,000 inquiries from individuals interested in learning about the reverse mortgage option, but only 9,000 of these individuals went on to obtain a HECM loan.[156] It is not clear how this 2016 data from AAG compares to that of previous years. Some in the industry estimate that roughly 25% of interested individuals who would have qualified for a HECM previously are locked out by the financial assessment and LESA rules.[157] This is double the number estimated by researchers Moulton, Haurin, and Shi in the study discussed above. HUD received a number of comments in response to its codification of the financial assessment from individuals who were concerned about the burdensome documentation requirements for avoiding a LESA and the extent to which these rules restrict access to HECM loans, but opted not to make any adjustments in the 2017 final rule.[158]

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154. Only 4,118 borrowers would be expected to default (7.8% of the smaller number of originations, 52,800), as opposed to an estimated 9,360 borrowers who would have defaulted without the restrictions (15.6% of 60,000 borrowers).

155. HECM Telephone interviews, *supra* note 137.

156. *See* Alex Spanko, *AAG Expands Beyond Reverse Mortgages with Real Estate Launch*, REVERSE MORTGAGE DAILY (Sept. 11, 2017), https://reversemortgagedaily.com/2017/09/11/aag-expands-beyond-reverse-mortgages-with-real-estate-launch/.

157. *See* Susan Tompor, *Reverse mortgages shake loan-shark image, fight for respectability*, DETROIT FREE PRESS (Aug. 15, 2016), https://www.freep.com/story/money/personal-finance/ssatompor/2016/08/14 /reverse-mortgages-retirement/87701012/ (noting one reverse mortgage broker estimated a comparable percent of interested and otherwise eligible consumers blocked from obtaining a HECM based on reviewing his inquiries received in 2016); *see also* Email from Matt Neumeyer, Premier Reverse Mortgage (Jan. 4, 2018 at 7:07 p.m.) (on file with authors) (noting that out of 69 elders he prequalified in 2016, 38 failed the financial assessment, and 12 of those, or 17% of the total, would have proceeded with the loan otherwise).

158. Rules and Regs. Dep't of Hous. And Urban Dev., 82 Fed. Reg. 7094, 7103 (Jan.19, 2017); *see also* Mark Olshaker, *Outside Looking In: Industry Advocates' Perspectives on Reverse Mortgages*, REVERSE MORTGAGE (2017) (quoting Meg Burns, former

Whatever the number, some percentage of these older adults who will be barred from obtaining a HECM due to the financial assessment results could have paid the property charges, especially if they had access to effective communication from a loan servicer and the opportunity to make monthly payments into escrow rather than being hit with large, one-time expenses.

The combination of the LESA rules and the other fiscally conservative changes to the HECM program in recent years, such as lower principal limit factors and increased insurance premiums, are a one-two punch that will knock out a significant number of low-income elders who are likely to be most in need of the relief a HECM loan could provide. These struggling homeowners were among those Congress intended to help when it authorized HUD to create a program of reverse mortgage insurance. But, the reverse mortgage industry now seems bent on rebranding the product to attract affluent consumers—to market it as a financial planning tool to hedge a variety of sources of retirement income against each other.[159] Articles lauding the success of the financial assessment at reducing tax and insurance defaults have also noted that the HECM borrowing in the post-financial-assessment world involves larger loan balances—meaning more expensive homes and likely higher-income borrowers.[160]

V. The Need for a Focus on HECM Servicing and Loss Mitigation in Response to Property Charge Defaults

As discussed above, HUD's primary response to the tsunami of property charge defaults has been to require faster foreclosure on existing loans in default and to impose strict underwriting requirements up front for new HECM originations. These rules, although well-intentioned to protect the solvency of the program, will limit access to the product for low-income seniors who have less home equity. Lower-income elders with lower property values and higher existing mortgage balances are the homeowners most likely to be blocked from obtaining

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program director with FHA, opining that the financial assessment is overly cumbersome and has contributed to a "significant reduction in volume of this business").

159. *See 7 Ways to Use a Reverse Mortgage as a Financial Planning Tool*, AAG, https://www.americanadvisorsgroup.com/news/featured-article-7-ways-to-use-a-reverse-mortgage-as-a-financial-planning-tool (last visited Feb. 26, 2018).

160. *See, e.g.*, *Financial Assessment Looks Better and Better*, NEW VIEW ADVISORS LLC (May 24, 2017), http://newviewadvisors.com/commentary/financial-assessment-looks-better-and-better/.

a reverse mortgage due to the combination of lower principal limits and a required property charge set-aside.[161]

On the other hand, shifting to focus on effective servicing would protect the fund while also preserving the core mission of the HECM program. Because many of the homeowners who have defaulted due to nonpayment of property charges can in fact afford to repay the missed amounts, making repayment plans available would avoid unnecessary foreclosures. HUD has never developed a comprehensive approach to HECM servicing—requiring servicers to do a better job of communicating with borrowers and evaluating them for a wide range of loss mitigation when necessary. To do so would better address the immediate property charge crisis and protect the long-term viability of the fund, while also maintaining the HECM program as a part of the social safety net for older adults who are equity rich but cash poor.

A. The Importance of Effective Servicing

HUD's sudden policy shifts from allowing property charges to build up indefinitely, to requiring servicers to attempt to recover the charges through loss mitigation, to making loss mitigation optional and requiring swift foreclosure, have put HECM borrowers in a precarious position. Many have accumulated large default balances over the years of non-enforcement that are now very difficult to repay on limited retirement income.[162] The problem has been exacerbated by the fact that when servicers now contact borrowers about the obligation to repay these funds, the notice letters sent are typically confusing and intimidating.[163]

HECM servicers have not developed effective protocols for communicating with borrowers about the need to repay delinquent property charges or the loss mitigation options available to help them do so. HUD created a model property charge delinquency letter, but the letter is not as clear or reader-friendly as it could be.[164] Among other problems, it uses terms like "your loan may be declared due and payable"

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161. *See generally* Matt Neumeyer, *Reverse Mortgage Property Charge Set Asides*, PREMIER REVERSE MORTGAGE (June 1, 2015), http://premierreverse.com/reverse-mortgage-life-expectancy-set-asides/ (last visited Mar. 29, 2018).

162. *See generally Reducing Default Rates*, *supra* note 150.

163. *See* NCLC Examples of HECM Servicing Problems, *supra* note 1.

164. *See* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2011-01, (Model Property Charge Delinquency Letter) (Jan. 3, 2011), https://www.hud.gov/program_offices/administration/hudclips/letters/mortgagee/2011ml.

rather than clearly stating that foreclosure may result, and the option to enter into a repayment plan is buried below a demand to repay the full arrearage amount by a certain date.[165] A review of examples of property charge default letters sent by servicers in recent years reflects many of the same problems—a failure to use plain English, a failure to clearly warn borrowers about the serious consequences that may occur, and a failure to set forth all of the available options for resolving the default.[166] HUD received a number of public comments in its most recent public rulemaking regarding difficulties communicating with servicers and obtaining loss mitigation.[167]

Servicers' behavior is understandable in light of HUD's policy directives regarding property charge defaults. Lenders may not want to foreclose on older borrowers, but are concerned about being penalized by HUD for not following strict foreclosure timelines. At the same time, HUD places no emphasis on effective, clear communication with HECM borrowers. HUD requires only the recitation of certain contractual and regulatory language in the property charge default letters and "due and payable" notices that are sent to borrowers. The language used to convey this required content is opaque. Moreover, letters are not the best means of addressing the property charge default with the vulnerable population of older HECM borrowers—a combination of written, phone, and in-person communication would be much more effective.

Aside from issues regarding property charges, borrowers have complained about the servicing of reverse mortgages. Poor servicing practices are rampant in the HECM market. Most reverse mortgage servicing complaints center on the failure to provide adequate loss mitigation options to cure a default prior to initiating foreclosure.[168] Borrowers also complain that servicers institute foreclosure based on alleged non-occupancy of the home even when the elder is still living in the

165. *See id.*

166. Letters from servicers submitted to NCLC by consumer advocates from around the country (on file with the authors). Some of the letters regarding property charge default do clearly explain that a repayment plan may be available. Most do not notify borrowers about the At-Risk Extension.

167. Fed. Hous. Admin.: Strengthening the Home Equity Conversion Mortgage Program, 82 Fed. Reg. 7094, 7102 (the need for proactive communication with non-borrowing spouses), 7111 (difficulty communicating with servicers), 7112 (counseling not sufficient to counteract miscommunications from loan brokers), 7114 (need for a standard letter informing heirs of repayment options), 7115 (need for improved loss mitigation options).

168. *See* NCLC Examples of HECM Servicing Problems, *supra* note 1.

home.[169] Some complaints mirror the frustrations that consumers face with forward mortgages, including servicers providing incorrect and inconsistent information to borrowers and heirs; general poor communication and unresponsiveness; and losing paperwork and other documents submitted to apply for loss mitigation or other options. These servicing problems have resulted in loans being improperly called due and payable and have led to unauthorized foreclosures.[170]

These servicing problems were also documented by the CFPB in its *Snapshot of Reverse Mortgage Complaints: December 2011-December 2014*.[171] The report highlighted frustrations with loan servicers in the process of attempting to repay the loan, including the lack of a clear process to repay the loan; problems with the appraisal process, including lengthy delays; multiple requests for the same documents when attempting to remedy defaults; failure to keep accurate records of critical documents, including tax records; and servicers who provide inconsistent instruction or are unresponsive.[172] Borrowers and heirs complained that servicers often delay and impede attempts to cure HECM defaults and avoid foreclosure.[173] The unresponsiveness of loan servicers was a particular challenge for grieving family members trying to settle the estate of a loved one.

Violations of HECM servicing obligations expose homeowners to a risk of foreclosure and impose significant financial and emotional harm. Such noncompliance should expose the servicer to stiff financial penalties.[174] But servicers are not denied insurance benefits for failure to comply with servicing responsibilities.[175] Rather, financial penalties in the form of a denial or delay of insurance benefits are reserved for noncompliance with those rules that bear on assignment or the condition of the property when accepted by HUD.[176] HUD has not adequately enforced its existing guidelines to challenge servicing errors

169. *Id.*
170. *Id.*
171. *Snapshot of Reverse Mortgage Complaints*, CONSUMER FIN. PROT. BUREAU, OFFICE FOR OLDER AMERICANS, 15 (Feb. 2015), http://files.consumerfinance.gov/f/201502_cfpb_report_snapshot-reverse-mortgage-complaints-december-2011-2014.pdf.
172. *See id.* at 12–14.
173. *See id.* at 14.
174. *See* 24 C.F.R. § 206.137 (2018).
175. *See* 24 C.F.R. § 206.201 (2018).
176. *See* 24 C.F.R. § 206.137 (2018).

and abuses. Moreover, there are significant legal hurdles for older borrowers attempting to enforce HECM program requirements against their servicers.

Effective servicing of HECM loans, and clear borrower communication regarding property charges, could go a long way toward stemming the tide of property charge foreclosures. Older adults who have taken out reverse mortgages are particularly resource-constrained.[177] They tend to take out these loans as a last resort, motivated by a lack of sufficient income to cover rising medical costs and other essential expenses.[178] Over time, the typical HECM borrower has trended towards taking out the loan at a younger average age and with higher existing mortgage debt that needed to be paid off through the reverse mortgage.[179] This means that as they continue to age, the typical HECM borrower of recent years will not have the ability to further tap into home equity when they face financial struggles. Many HECM borrowers might be eligible for tax relief without realizing it.[180] A number of state and local property tax exemptions become available at age sixty-five, and housing counselors might not notify borrowers of these options during the pre-loan counseling, especially if it was conducted before the borrower turned sixty-five.[181] Strong servicing might include notifying seniors about additional tax exemptions or referring them to post-closing housing counseling services for assistance identifying and seeking such exemptions.

Moreover, the HECM loan product is complex and confuses many borrowers. Even though borrowers are required to undergo pre-loan counseling, the counseling must cover a wide range of topics, including some as complex as whether to take the loan proceeds as a lump sum, a line of credit, or a term or tenure disbursement. Research indicates that on certain topics, including property charge requirements, confusion persists even after required pre-loan counseling.[182] In addition,

177. *Snapshots of Older Consumers and Mortgage Debt*, CONSUMER FIN. PROT. BUREAU 17 (May 2014), https://files.consumerfinance.gov/f/201405_cfpb_snapshot_older-consumers-mortgage-debt.pdf.

178. *See* CFPB Report to Congress 2012, *supra* note 31, at 45–46.

179. *Id.* at 48.

180. *See* Silda Nikaj & Joshua J. Miller, *HECM and Property Tax Relief for Seniors*, 19 CITYSCAPE J. POL'Y DEV. & RES. 29, 32–37 (2017) [hereinafter Nikaj & Miller].

181. *See id.* at 30. However, the HECM program does not permit participation in tax "deferral" programs where the deferred taxes will take priority over the reverse mortgage – so a senior that was previously eligible for tax relief might have lost certain relief options by virtue of the reverse mortgage.

182. *See* CFPB Report to Congress 2012, *supra* note 31, at 123, 126.

many HECM borrowers will begin to experience cognitive disabilities or memory loss as they reach their seventies and eighties.[183] All of these factors suggest an even more important role for effective loan servicing and clear, frequent communications from loan servicers regarding property charges from the outset. HUD can and should require effective servicing of HECM loans. In the next section, we discuss HUD's authority to require servicers to review HECM borrowers in property charge delinquency for loss mitigation.

B. HUD Has the Authority to Require Servicers to Engage in Loss Mitigation

In 2015, HUD made a sudden shift from requiring that mortgagees consider all loss mitigation options prior to initiating a property charge foreclosure, to making all loss mitigation permissive. Although servicers are required to send a property charge delinquency notice setting out any options that may be available, HUD now takes no position on what options the servicer is required to offer.[184]

The shift to permissive loss mitigation has greatly reduced the availability of foreclosure avoidance options that servicers provide to borrowers for curing a property charge default. When combined with HUD's much more aggressive policing of foreclosure deadlines, and the very real possibility of HUD cutting off the interest accruing on a claim if foreclosure is determined to have been initiated in an untimely way, these policy changes have done more to drive the surge in avoidable HECM foreclosures than any other factor. Some servicers refuse to offer repayment plans after a foreclosure has been initiated.[185] Others will not extend a repayment plan if the amount owed exceeds $5,000. These unnecessary limitations have led to significant numbers of HECM borrowers losing their homes.

HUD has the authority to require servicers to engage in loss mitigation prior to commencing foreclosure, and making loss mitigation mandatory would help older borrowers as well as the insurance fund.

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183. Rates of cognitive disability increase with age. Over twenty percent of the population of people over age eighty have a cognitive disability. *See Housing America's Older Adults*, JOINT CTR. FOR HOUSING STUD. OF HARV. U. 3 (2011), http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchshousing_americas_older_adults_2014.pdf.

184. *See* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2015-11 (Apr. 23, 2015).

185. *See* NCLC Examples of HECM Servicing Problems, *supra* note 1.

The HECM statute, implementing regulations, and loan documents all give HUD the ability to require mortgagees to conduct a loss mitigation review before declaring a loan due and payable based on a property charge default. The National Housing Act authorizes HUD to insure eligible HECMs "upon such terms and conditions as the Secretary may prescribe," provided that the mortgages made under this program have promise for improving the financial situation of older homeowners, include safeguards to protect borrowers from attendant risks of these loans, and have the potential for acceptance in the marketplace.[186] The Act also states that for any FHA-insured mortgage that is in default or imminent risk of default, the mortgagee "shall engage in loss mitigation actions for the purpose of providing an alternative to foreclosure."[187]

HUD's regulations govern the manner and timing of foreclosing and submitting a claim on the insurance after a foreclosure sale is conducted.[188] Prior to foreclosing, the mortgagee is required to notify both the commissioner and the borrower when a loan becomes due and payable, and must give the borrower at least thirty days from the date of the notice to take one of a number of actions, including "[c]orrect[ing] the condition which resulted in the mortgage coming due and payable."[189] Even after foreclosure is initiated, the mortgagee is required to permit the borrower to correct the condition that resulted in the mortgage becoming due and payable—which should include curing a default through a repayment plan.[190] According to the HECM mortgage documents, the loan does not become due and payable based on a failure to pay property charges until the commissioner gives approval.[191] The commissioner has the authority to give or withhold that approval, according to the mortgage documents and the HECM regulations,

186. *See* 12 U.S.C. § 1715z-20(c) (2018).

187. 12 U.S.C. § 1715u(a) (2018). The requirement to engage in loss mitigation applies to all mortgage loans insured under Subchapter II of the National Housing Act, which includes both forward mortgages and the HECM program (authorized in 12 U.S.C. § 1715z-20 (2012)).

188. *See* 24 C.F.R. § 206.123 (2018).

189. 24 C.F.R. § 206.125(a)(2)(iv) (2018).

190. *See* 24 C.F.R. § 206.125(a)(3) (2018). Although this section goes on to talk about reinstatement, and states that a mortgagee is not required to accept a reinstatement more than once in a two-year period, it does not exclude other methods of correcting a condition that led to due and payable status, such as beginning to pay property charges going forward and/or repaying corporate advances for property charges through a repayment plan.

191. *See* 24 C.F.R. § 206.27(c)(2) (2018).

which set forth the terms of the insurance contract between HUD and the mortgagee.[192]

In HUD's most recent amendments of the HECM regulations, which were announced in January 2017 and took effect on September 19, 2017, HUD added the following language related to property charge defaults: "The mortgagee may provide any permissible loss mitigation made available by the Commissioner through notice."[193] HUD's decision to add this sentence, which makes clear that a mortgagee may engage in loss mitigation, in no way cabins HUD's ability to issue a policy requiring loss mitigation before approving a due and payable request.

Further support for HUD's authority to require mortgagees to engage in loss mitigation prior to foreclosing based on a property charge default is found in regulations that apply broadly to mortgages insured by HUD. The loss mitigation regulation provides, "Mortgagees *must* consider the comparative effects of their elective servicing actions, and *must* take those appropriate actions which can reasonably be expected to generate the smallest financial loss to the Department."[194] The regulation goes on to list a number of loss mitigation options that must be considered by the servicer, and states that "HUD may prescribe conditions and requirements for the appropriate use of these loss mitigation actions."[195]

Servicers are so concerned about being penalized by HUD for not initiating foreclosure in a timely manner that the decision by HUD not to require loss mitigation has led to a significant number of servicers declining to extend loss mitigation at all. Servicers claim they have made this "business decision" not to offer permissive loss mitigation because of the risk of being somehow penalized by HUD if loss mitigation efforts are not ultimately successful in curing the property charge default.[196] Above all, it is crucial that HUD communicate clearly to servicers that they will not be penalized if they are engaging in good faith loss mitigation efforts.

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192. *See id.*; HECM Loan Agreement: Fixed Interest Rate, FHA (Feb. 12, 2015), https://www.hud.gov/sites/docments/HECM_MODEL_FIXED_LOAN_AGR.pdf.

193. 24 C.F.R. § 206.205(e)(2)(ii) (2018).

194. 24 C.F.R. § 203.501 (2018) (emphasis supplied). 24 C.F.R. § 203.500 (2018) explains that this subpart identifies acceptable servicing practices for mortgage insured by HUD– and should therefore apply to both the forward and reverse mortgage programs.

195. *Id.*

196. *See* NCLC Examples of HECM Servicing Problems, *supra* note 1.

In the long run, effective loss mitigation policies will produce benefits not just for borrowers who want to save their homes, but for the insurance fund. The purpose of loss mitigation is to allow the borrower to repay the property charges that have been advanced by the servicer—meaning that if successful, these amounts will not be included in an eventual insurance claim with HUD. At present, it is true that some loans in property charge default are also upside down, with each passing month before loan termination translating into a growing deficiency that will eventually be covered by HUD. But that upside-down status was caused by the first crisis discussed in this Article—lender policies and the housing crash—and not by the borrower failing to pay the property charges. An appropriate policy response must deal with these issues separately, and must recognize that a successful outcome for a HECM loan is the borrower remaining in the home until the borrower moves for their own reasons or passes away.

As the insurer of HECM loans, HUD has the ability to set the rules regarding the circumstances under which it will pay an insurance claim and the circumstances under which it may reject or limit the amount of a claim. Indeed, HUD has exercised this authority over HECM mortgagees by policing the deadlines after which it will curtail the accrual of interest for purposes of claim payment if foreclosure has not been timely initiated. HUD could use the same authority, as insurer, to instead impose rules regarding mandatory loss mitigation prior to foreclosure that would reduce the number of avoidable property charge foreclosures. The HECM statute, regulations, and loan contract all give HUD the authority to require loss mitigation as a precondition to declaring a HECM due and payable based on a property charge default. From 2011 until April of 2015, HUD took the position that it could require mandatory loss mitigation before a foreclosure based on a property charge default; HUD's sudden shift on this issue in 2015 has not been explained. In 2011, HUD directed HECM mortgagees, indicating: "It is <u>only</u> after all applicable loss mitigation strategies have been exhausted <u>that the mortgagee may submit</u> a due and payable request to HUD."[197] HUD still recognizes that it has authority to make loss mitigation mandatory for forward mortgages insured by the FHA.[198] HUD

197. Mortgagee Letter 2011-01, *supra* note 100, at 1 (emphasis added).
198. *See* 24 C.F.R. § 203.605 (2018) (requiring mortgagees to evaluate delinquent borrowers for loss mitigation and take appropriate action); 24 C.F.R. § 203.500 (2018) (authorizing HUD to impose a penalty if servicers fail to evaluate loss mitigation options).

was right about the need for loss mitigation for HECMs in 2011: "Foreclosure [. . .] must remain a method of last resort for the resolution of unpaid property charges."[199]

C. HUD Could Require Servicers to Escrow for Property Charges.

In addition to requiring loss mitigation when a default has already occurred, a new focus on effective loan servicing could involve asking servicers to make available the option of prospectively escrowing for taxes and insurance. A significant number of homeowners who would be unable to obtain a HECM loan if a LESA is required would have the ability to make a monthly escrow payment for property charges if that option were made available. Most of this segment of lower-income homeowners is currently paying on a forward mortgage,[200] and obtaining a HECM would remove their obligation to pay principal and interest. In many cases the monthly escrow payment for taxes and insurance would be only a few hundred dollars per month. With a severe shortage of subsidized rental housing, most seniors would be hard pressed to find cheaper housing than that available for several hundred dollars per month. Most would prefer to stay in their home, in a familiar community, rather than being displaced.

Servicing costs must be considered in relation to this change as well as those described below. But, HECM servicers are currently paying property taxes and insurance out of fully-funded LESAs, making payments to borrowers for these expenses where there is a partially-funded LESA, and paying delinquent property charges when needed. Handling a prospective escrow account is not likely to demand significantly more servicing resources than these functions that are already being carried out.

199. Mortgagee Letter 2011-01, *supra* note 100, at 1 (Jan. 3, 2011).
200. *See* Nikaj & Miller, *supra* note 180.

D. Better Servicing Would Also Reduce the Incidence of Improper Non-Occupancy Foreclosures and Help Non-Borrowing Spouses Remain in Their Homes.

There are two other significant causes of avoidable reverse mortgage foreclosures that would be helped by a greater focus on effective servicing: improper claims of non-occupancy and failures to extend foreclosure protections to a non-borrowing spouse. Consumer advocates report a large and growing problem with reverse mortgage servicers initiating foreclosure based on baseless allegations that the borrower has ceased to occupy the home as his or her principal residence.[201] The elders who have fallen victim to this sloppy servicing practice have typically been living in their home continuously, with utility service on and no evidence of abandonment, and were often actually served with a foreclosure lawsuit in their home—an action completely inconsistent with any suggestion they were not residing in the home.[202]

One of the primary reasons servicers seem to initiate foreclosure wrongfully when a home is occupied by the borrower is an over-reliance on one single source of information regarding occupancy: whether the borrower returns an annual occupancy certification request card.[203] Although such request cards are a reasonable starting point for checking the status of the home, the number of problems that can lead them not to be returned suggest that this cannot be the sole basis for concluding that an elder is no longer living in the property. Requiring servicers to affirmatively call the borrower (and any designated third-party contact) and make at least two attempts at an in-person contact prior to initiating foreclosure would avoid most of the improper non-occupancy foreclosures taking place today.

Although beyond the scope of this Article, the problems surrounding spouses of reverse mortgage borrowers left off the loan (and

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201. *See, e.g.*, NCLC Examples of HECM Servicing Problems, *supra* note 1; Jillian H. Wilson, Reverse Mortgage Concerns: Occupancy Determination, USFN (Aug. 7, 2016), http://www.usfn.org/blogpost/1296766/253585/Reverse-Mortgage-Concerns-Occupency-Determination [hereinafter Wilson].

202. *See* NCLC Examples of HECM Servicing Problems, *supra* note 31.

203. *See* NCLC Examples of HECM Servicing Problems, *supra* note 1; Wilson, *supra* note 201.

taken off title) have been well documented.[204] After litigation, HUD finally adopted a policy that was capable of helping at least some non-borrowing spouses stay in their homes. Known as the Mortgagee Optional Election, or MOE, the solution HUD developed was to allow mortgagees to assign the loan to HUD so that HUD could allow an eligible non-borrowing spouse to remain in the home until his or her death. To be eligible to have the loan assigned, a spouse must meet a series of criteria, the most troublesome of which has been proving good and marketable title or the legal right to remain in the home within ninety days of the borrower's death. A significant number of non-borrowing spouses have been blocked from obtaining the MOE assignment because, first, the servicer failed to effectively communicate with them about their rights and options, and second, HUD has imposed unrealistic and arbitrary deadlines for seeking the MOE in a given case.

If HUD required servicers to provide information about the rights and options of non-borrowing spouses affirmatively, even prior to the death of the borrowing spouse, many spouses could make arrangements in advance that would better enable them to stave off the risk of an unnecessary foreclosure. And more importantly, clear and prompt communication after the death of the borrower is essential if non-borrowing spouses are to be given a true opportunity to stay in their homes. These steps, and others described below, could make a huge difference to the non-borrowing spouses currently facing the threat of foreclosure and eviction. These steps would not be difficult for servicers to take and are not even terribly costly; but due to servicers' financial incentive structure, they will not be taken absent a clear directive from HUD.

VI. Policy Recommendations

If HUD is to best preserve the HECM program as a tool to allow older adults to age in place, with stable and affordable housing, it must undertake a comprehensive reform of its approach to reverse mortgage servicing. Specifically, the following actions should be part of any review of reverse mortgage servicing practices.

204. *See* Plunkett v. Castro, 67 F. Supp. 3d 1 (D.D.C. 2014); *see also* Sarah Bolling Mancini & Alys Cohen, *Surviving the Borrower: Assumption, Modification, and Access to Mortgage Information After a Death or Divorce*, 43 PEPP. L. REV. 345 (2016).

1) CLARIFY SERVICER COMMUNICATIONS WITH BORROWERS

Too often, the letters sent to HECM borrowers by loan servicers use opaque language and legal terms of art. Servicing letters should be written in plain English. Servicers should reach out to borrowers immediately after closing, to begin to establish a rapport and an expectation of dialogue. As much as possible, written communications should be accompanied by a phone call and when possible, in-person communication.

2) INCREASE ACCESS TO POST-CLOSING HOUSING COUNSELING.

Certain actions, such as helping a borrower apply for the senior homestead exemption or shop around for cheaper homeowner's insurance, are most suited for HUD-certified housing counselors. HUD should increase funding for HECM counseling after closing, including counselors who are available to assist with property charge defaults. If servicers begin a practice of referring borrowers to HUD-certified counselors early in the loan term, borrowers may build a relationship of trust and gain financial tools that may prevent property charge defaults proactively. Among other things, HUD-certified counselors may be able to assist borrowers in identifying additional property tax homestead exemptions or relief that may be available from the taxing authority or from other sources, finding resources for free or low-cost home repairs, and dealing with unforeseen medical expenses or other budget issues. A recent report from a housing counseling network with a special project on post-default HECM counseling found that out of 162 HECM borrowers facing default or foreclosure, 70% were able to cure the default and remain in their homes with the help of experienced counselors.[205]

3) REQUIRE LOSS MITIGATION.

HUD has the authority to require servicers to evaluate borrowers for loss mitigation prior to declaring a loan due and payable owing to a property charge default. Making loss mitigation mandatory would help HECM borrowers while also protecting the insurance fund. Reasonable loss mitigation is likely to result in borrowers paying back the past-due property charges, rather than having those charges passed

205. Housing Options Provided for the Elderly, Grant Report to Retirement Research Foundation (Feb. 2018) (on file with authors).

along to HUD through the insurance claim. Loss mitigation also furthers the central purpose of the HECM program, preventing displacement of elderly homeowners.

4) EXPAND LOSS MITIGATION OPTIONS.

HUD's current options for reverse mortgage loss mitigation are far too limited. HUD allows an extension of foreclosure timelines for borrowers with critical health circumstances, such as long-term illness, only if all borrowers are over age eighty. The borrower has the burden of reapplying annually to continue the extension. This "at-risk extension" option should be available to all borrowers with critical circumstances, regardless of age, and without the need for a burdensome annual recertification. Further, HUD's repayment plan rules are too restrictive. Servicers are directed to offer repayment plans that extend no longer than sixty months (or less if the loan is nearing the Maximum Claim Amount) and to approve a plan only if the borrower can make the required payment with 25% of their available surplus income.[206] If a borrower defaults on a repayment plan and owes more than $5,000, they are not eligible for another repayment plan.[207] HUD needs to make repayment plans more flexible and to offer options akin to a partial claim for borrowers who are unable to make a serious dent in the arrearage but can begin to pay property charges going forward.[208]

5) ACCOMMODATE DISABILITIES.

A significant number of older adults are disabled, or become disabled as they reach a more advanced age. These disabilities may involve physical limitations, such as hearing loss or visual impairment, or may be cognitive in nature. Regardless, effective servicing of reverse mortgage loans must involve an awareness of disabilities and a sensitivity to the need for reasonable accommodations of those disabilities.

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206. Mortgagee Letter 2015-11, *supra* note 107, at 6–7.
207. *Id.* at 8.
208. A partial claim is a loss mitigation option made available by HUD on forward mortgages, in which HUD advances the amount of the arrearage and takes a silent second mortgage for the amount advanced. This option allows the borrower to start fresh going forward, even if they are not able to come repay the existing arrearage.

6) REMOVE UNREASONABLE DEADLINES.

Deadlines that are too strict are most problematic for disabled borrowers, but contribute to avoidable displacement of older borrowers across the board. HUD should make it clear that servicers are permitted, even encouraged, to extend loss mitigation after a foreclosure has been initiated. HUD should remove some of the pressure on servicers by lengthening foreclosure deadlines and also making it clear that if complying with HUD's requirements, loss mitigation efforts toll the running of any deadline to foreclose. Moreover, servicers faced with the death of the last surviving borrower who leaves behind a non-borrowing spouse should be able to make the election to assign the loan to HUD up until a foreclosure sale has been completed.

7) IN ADDITION TO A PROPERTY CHARGE SET-ASIDE, REQUIRE LENDERS TO OFFER THE ALTERNATIVE OF A MONTHLY ESCROW FOR TAXES AND INSURANCE.

Borrowers who can afford to pay the property taxes and insurance on a monthly basis should have the option to do so. This option is especially important for low-income homeowners who might benefit from a HECM, but might be priced out of the loan if a LESA were required. Borrowers are significantly less likely to default on property charges if they are paying into a monthly escrow, rather than paying a large lump sum annually or semi-annually. Especially if the escrow option is combined with clear communication and access to post-closing housing counseling, it has the potential to work well for a significant number of low-income homeowners who might be boxed out by HUD's current financial assessment and LESA rules. Creating a prospective escrow option would help further Congress's intent in creating the HECM program with minimal risk to the insurance fund, since a payment default would be small in amount and noticed immediately, allowing plenty of time for loss mitigation or, if necessary, foreclosure. HUD could authorize a demonstration program, allowing a limited number of HECM borrowers with several different servicers to pay property charges through a monthly escrow.

CONCLUSION

Charlotte Lowe was forced to get help from family members in order to avoid imminent foreclosure and the loss of her home of over fifty years. The mortgage servicer refused to allow her to enter into a

repayment plan, despite the efforts of a very capable attorney advocating on her behalf. Charlotte's granddaughter and grandson-in-law drained their savings to help her pay off the significant property charge arrearage in order to prevent Charlotte from being put out on the street. Other older borrowers in this situation are forced into bankruptcy to save their homes from foreclosure. And still others have no viable option to prevent the loss of their homes.

The changes described above would make a significant difference for the vulnerable older homeowners most in need of the benefits of a HECM loan. As the number of older adults with significant home equity and insufficient retirement savings continues to grow, it is essential that HUD address the servicing problems discussed in this Article and adopt the policies recommended above. Our ability to provide safe and stable housing for a growing population of older Americans hangs in the balance.