Section D. Reverse Mortgage Loan Features and Costs

Overview

Contents

This section contains the following topics:

1. Types of Reverse Mortgage Products

Introduction

This topic contains information

- how a reverse mortgage differs from a forward mortgage, and
- types of reverse mortgages.

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PROTCL 5.D.1.a How a Reverse Mortgage Differs from a Forward Mortgage

In a forward mortgage, the borrower makes monthly payments to the lender, gradually building up his/her equity in the property.

In a reverse mortgage, the lender makes monthly payments to the borrower, gradually purchasing the equity in the home from the borrower. The borrower continues to hold title to the property, which is security for the loan.

PROTCL 5.D.1.b Types of Reverse Mortgages

The table below describes the three types of reverse mortgages.

Type of Reverse Mortgage	Description
Single purpose reverse mortgage	State and local government agencies usually offer this type of loan, in which the borrower may use the proceeds in only one specific way. This type of reverse is often restricted to homeowners with low or moderate income. ***Example***: The borrower may use the proceeds for home repairs or payment of taxes.
Proprietary reverse mortgage	Private lenders offer this type of reverse mortgage, which is not insured by the Federal government. Borrowers may use the loan proceeds for a variety of purposes. Propriety reverse mortgages may be more suitable for upper-income borrowers with high-value homes.

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1. Types of Reverse Mortgage Products, Continued

PROTCL 5.D.1.b Types of Reverse Mortgages (continued)

Type of Reverse Mortgage	Description
Reverse mortgage insured by the Federal Housing Administration (FHA)	The Home Equity Conversion Mortgage (HECM) is a reverse mortgage insured by the Federal government through FHA. FHA insures participating lenders against losses on HECM loans, and designs and administers the guidelines governing lender and borrower eligibility and use of HECM loans. Borrowers may use a HECM for any of the following purposes: • paying off any existing forward mortgage • accessing the home equity of a current residence (after satisfying any outstanding mortgage debt on the property) • refinancing an existing HECM, or • purchasing a new residence and obtaining a reverse mortgage in a single transaction.

2. Reverse Mortgage Loan Limits and Principal Limits

Introduction

This topic contains information on

- HECM loan limits
- the principal limit on a HECM, and
- leftover equity reserve on a HECM.

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PROTCL 5.D.2.a HECM Loan Limits

HECM loan limits are set by law. The maximum claim amount is used to determine the principal limit, defined as the lesser of the

- FHA national loan limit, or
- home's appraised value.

HECM for Purchase Loan Limit
The loan limit on a HECM for purchase is the least of the FHA loan limit, the appraised value, or the sales price.

Note: Proprietary reverse mortgages may have higher loan limits than HECMs, or no limits at all. Clients may want to consider proprietary products if they have a home with a high property value. Counselors must inform clients that proprietary products may have higher costs or substantially lower loan-to-value ratios than HECMs.

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2. Reverse Mortgage Loan Limits and Principal Limits,
Continued

PROTCL 5.D.2.b Principal Limit on a HECM

The principal limit is the amount of money that a borrower may access through a reverse mortgage. For HECM loans, the principal limit available to the homeowner is determined by multiplying

- the maximum FHA insurance claim amount (which is the lesser of the appraised value of the property or the FHA loan limit) *by*
- a factor based on the age of the youngest borrower and the expected interest rate, which may be no lower than 5.5 percent.

The principal limit is calculated at closing and increases each month by one-twelfth of the sum of the note rate and the annual mortgage insurance premium rate.

PROTCL 5.D.2.c Leftover Equity Reserve on a HECM

When a borrower takes out a reverse mortgage, there is a portion of the equity in the home that is reserved to reduce the lender's and FHA's risk. The amount reserved is determined by the ratio of the loan's principal limit to the home value.

3. Reverse Mortgage Payment Plan Options

Introduction

This topic contains information on reverse mortgage payment plan options, including

- types of reverse mortgage payment plan options
- a description of the reverse mortgage payment plans
- HECM borrower changes to payment plans
- changes to payment plans on proprietary reverse mortgages, and
- lender establishment of the monthly payment amount for term and tenure plans.

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PROTCL 5.D.3.a Types of Payment Plan Options

The lender disburses HECM loan proceeds to the borrower through the payment plan of the borrower's choice. The borrower may choose one of the following payment plan types:

- term
- tenure
- line of credit, or
- a combination of line of credit with term or tenure ("modified term" or "modified tenure," respectively).

Reference: For a description of each of these types of plans, see HECM Protocol 5.D.3.b.

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3. Reverse Mortgage Payment Plan Options, Continued

PROTCL 5.D.3.b Description: Reverse Mortgage Payment Plans

The table below describes each of the types of reverse mortgage payment plans.

Payment Plan Type	Description
Line of Credit	With a line of credit • the borrower may choose to receive the entire principal limit from the line of credit at closing in one up-front draw or lump sum, e.g., to pay off an existing mortgage (***Note***: This draw schedule is not a payment plan in itself but is simply an option with a line of credit.) • the borrower may choose to access the money at any time over a period of time until the line of credit is exhausted, and • the line of credit is exhausted when the loan balance equals the principal limit. As with any HECM payment plan, a borrower with a line of credit who uses up the entire principal limit may stay in the home as long as he/she continues to pay homeowners insurance and real estate taxes, and makes any necessary home repairs. ***Line of Credit Growth*** The unused portion of the line of credit grows at the “credit line growth rate,” which is equal to the compounding rate. This is the same rate at which the principal limit and the loan balance grow, which is the current interest rate plus 0.5 percent. Therefore, the amount of funds available to the borrower from a line of credit grows larger each month for as long as any funds remain. Counselors must *not* tell clients that HECM credit lines “earn interest,” because credit line growth is simply increased access to borrowing power, comparable to an increase in a credit limit on a credit card. Counselors should advise clients that proprietary reverse mortgages may have a lower credit line growth rate, or no credit line growth at all, which will affect the amount of cash available to the borrower over the life of the loan.

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3. Reverse Mortgage Payment Plan Options, Continued

PROTCL 5.D.3.b Description: Reverse Mortgage Payment Plans (continued)

Payment Plan Type	**Description**
	Caution: If the client has indicated that his/her lender is trying to cross-sell an annuity or other investment, the counselor must provide the client with the OIG Hotline number to report the violation.
Tenure	Under the tenure option, the borrower receives equal monthly payments as long as the borrower maintains his/her primary residence in the home. Even if the loan balance exceeds the principal limit of the loan, the borrower will continue to receive payments. ***Length of Term for Tenure Payments*** The length of the term for tenure payments is calculated by subtracting the age of the youngest borrower from 100 years, although the borrower will continue to receive payments if he/she lives past 100 years of age.
Term	Under the term option, the borrower chooses a fixed period of time during which he/she receives equal monthly payments. At the end of the term, the borrower may remain in the home as long as he/she fulfills the obligations under the terms of the mortgage by • paying property taxes, hazard insurance, and other property charges, and • maintaining the home.
Combination Payment Plans	The borrower may combine a line of credit option with term or tenure payment options. A combination plan known as a • *modified tenure plan* combines a line of credit with monthly payments as long as the borrower remains in the home, and • *modified term plan* combines a line of credit with monthly payments for a fixed period determined by the borrower.

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3. Reverse Mortgage Payment Plan Options, Continued

PROTCL 5.D.3.c HECM Borrower Changes to Payment Plans

A HECM borrower may request to change his/her payment plan at any time during the life of the loan. The lender may charge a fee, not to exceed $20.00, for changing the payment plan.

A borrower may

- change the term of payments
- receive an unscheduled payment
- suspend payments
- establish or terminate a line of credit, or
- receive the entire net principal limit (the difference between the current principal limit and the outstanding loan balance) in one payment.

PROTCL 5.D.3.d Changes to Payment Plans on Proprietary Reverse Mortgages

Proprietary reverse mortgages may not offer different payment options.

If the proprietary product offers different payment plans, the lender may

- prohibit the borrower from changing the payment plan, or
- require the borrower to pay a fee to change plans.

PROTCL 5.D.3.e Lender Establishment of the Monthly Payment Amount for Term and Tenure Plans

The lender establishes monthly payments to the borrower (term or tenure) by using the

- net principal limit
- length of the term in months (for the tenure option, 100 years minus the age of the current borrower), and
- expected rate.

For either of these plans, the borrower may choose to receive less than the maximum monthly payment allowed under the plan, in which case the remaining funds are placed into a line of credit.

4. Reverse Mortgage Note Rates/Interest Rates

Introduction

This topic contains information on

- the counselor's responsibility for explaining the reverse mortgage interest rate to the client
- reverse mortgage note rate
- interest rates for adjustable HECM loans
- eligible index types for adjustable rate HECMs
- a description of margin on an adjustable rate HECM
- a description of the interest rate cap on an adjustable rate HECM
- fixed interest rate HECMs, and
- the expected rate on a HECM.

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PROTCL 5.D.4.a Counselor Responsibility for Explaining the Reverse Mortgage Interest Rate to the Client

Counselors must ensure that the client understands the interest rate being charged by the lender for the reverse mortgage.

For either adjustable or fixed-rate loans, lower interest rates may be offset by higher origination costs, which the borrower may pay at closing or finance in the loan. If closing costs are financed, less cash will be available to the borrower. With HECMs, origination charges are rarely paid by increasing the interest rate because the higher rate results in a lower principal limit.

PROTCL 5.D.4.b Reverse Mortgage Note Rate

The note rate for a reverse mortgage is equal to the current interest rate (current index plus margin). The lender uses the note rate to calculate the

- loan balance
- credit line growth, and
- available loan funds at any given time.

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4. Reverse Mortgage Note Rates/Interest Rates, Continued

PROTCL 5.D.4.c Interest Rates for Adjustable HECM Loans

The interest rates for adjustable loans are comprised of an index rate plus a margin. Currently, HECM adjustable rate mortgages are based on either the

- Treasury Rates (adjusted to a constant maturity of one month or one year; also called the Constant Maturity Treasury [CMT] index), or
- London Inter-Bank Offered Rate (LIBOR).

Rates that adjust monthly tend to reflect economic conditions on a timelier basis. As economic conditions change, the adjustable rate may rise or fall, to its maximum cap or minimum floor. With an adjustable rate mortgage, the net principal limit will grow at the compounding rate, which will fluctuate monthly or annually, whichever the borrower chooses.

PROTCL 5.D.4.d Eligible Index Types for Adjustable Rate HECMs

The table below displays the eligible index types for adjustable rate HECM loans.

HECM ARMs	Periodic Adjustments-Note Rate	Expected Average Mortgage Interest Rate or Expected Rate (Determines Principal Limit)
Monthly Adjustable	1-Month CMT	10-Year CMT
	1-Year CMT	10-Year CMT
	1-Month LIBOR	10-Year LIBOR swap
Annually Adjustable	1-Year CMT	10-Year CMT
	1-Year LIBOR	10-Year LIBOR swap

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4. Reverse Mortgage Note Rates/Interest Rates, Continued

PROTCL 5.D.4.e Description: Margin on an Adjustable Rate HECM

The margin is an amount that the lender adds to the index to determine the note rate of the adjustable rate mortgage.

The note rate, which is a combination of the index and margin, affects how much a borrower pays on the loan balance, as well as the growth of the principal limit. The margin is also added to the expected rate, which affects the calculation of the initial principal limit. The higher the rate, the lower the principal limit.

Note: Margins may vary from lender to lender and from product to product.

PROTCL 5.D.4.f Description: Interest Rate Cap on an Adjustable Rate HECM

The interest rate cap is the maximum amount that the lender may add to the initial interest rate on an adjustable rate loan.

Annual adjustable rate HECM loans have a

- 2% annual cap, and
- 5% lifetime cap.

Note: Proprietary reverse mortgages often have interest rate caps, but these will vary from product to product.

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4. Reverse Mortgage Note Rates/Interest Rates, Continued

PROTCL 5.D.4.g Fixed Interest Rate HECMs

Some lenders offer HECMs with a fixed interest rate. With a fixed-rate reverse mortgage, the principal limit and the loan balance will grow at the interest rate determined at closing.

When discussing a fixed-rate reverse mortgage, the counselor must make the client aware that

- some lenders may set the interest rate at a level that makes the line of credit with a full, up-front draw at closing the only feasible option
- drawing the entire loan balance at closing exposes the borrower to many risks, including the lack of future availability of loan proceeds from credit line growth
- once the full amount is drawn, the borrower will pay interest on that large loan balance for the life of the loan
- drawing the entire loan balance may create a significant and unnecessary expense if the borrower does not need all the funds at closing, and
- over time, a fixed-rate loan which avoids the risk associated with an adjustable interest rate may be less advantageous to the borrower than an adjustable-rate loan which may maximize the amount over the life of the loan.

In most cases, the interest rate on a fixed rate will be initially higher than an adjustable rate, because a fixed rate brings greater risk to the lender. Because the interest rate on an adjustable rate loan may increase over time; for line of credit borrowers who do not plan to draw all of their funds at (or soon after) closing, an adjustable-rate loan may actually provide more available borrowing power.

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4. Reverse Mortgage Note Rates/Interest Rates, Continued

PROTCL 5.D.4.h Expected Rate on a HECM

The lender calculates the expected rate at origination and uses it to determine the principal limit and the servicing fee set-aside.

The table below describes the expected rate for

- fixed rate HECMs, and
- adjustable rate HECMs.

HECM Loan Type	Expected Rate
Fixed	The expected rate is • equal to the fixed rate, and • the same as the note rate.
Adjustable	The expected rate is the sum of • the lender's margin, and • the loan's index adjusted to a constant maturity of ten years (10-year CMT or 10-year LIBOR swap rates).

Note: The higher the expected rate, the lower the principal limit will be. When determining the principal limit, if the expected rate is less than 5.5 percent, then the lender will use 5.5 percent.

5. Retention of Title and Repayment of Debt

Introduction

This topic contains information on

- retention of title on a reverse mortgage, and
- the repayment of debt on a reverse mortgage.

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PROTCL 5.D.5.a Retention of Title on a Reverse Mortgage

Throughout the term of a reverse mortgage, the

- borrower retains ownership of the home, and
- title remains with the borrower or the borrower's estate until the home is sold.

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5. Retention of Title and Repayment of Debt, Continued

PROTCL 5.D.5.b Repayment of Debt on a Reverse Mortgage

A HECM loan becomes due and payable if the

- last surviving borrower passes away
- property is no longer the primary residence of the borrower
- last surviving borrower does not occupy the home for more than 12 consecutive months for health reasons
- borrower resides at another property for more than 6 months out of a year, or
- borrower fails to perform an obligation under the mortgage, such as paying taxes and hazard insurance or other property charges.

If the borrower sells the home, the outstanding loan balance is due. If the proceeds from the sale of the home are not sufficient to pay the loan balance, the lender will

- accept the proceeds from the sale of the home as payment in full, and
- file a claim with FHA to cover the difference.

If the borrower chooses to prepay the loan by liquidating assets while retaining ownership of the home, he/she must pay back the total outstanding loan balance.

Open-End versus Closed-End Credit Loans
Credit loans which are

- "open-end" allow for the repayment of some or the entire principal, which the borrower may re-borrow at some future date, and
- "closed-end" do *not* allow the borrower to re-borrow principal that is paid on the loan.

Note: Usually, fixed-rate HECMs are closed-end credit loans.

6. Reverse Mortgage Non-Recourse Feature

Introduction

This topic contains information on the reverse mortgage non-recourse feature, including

- a description of the non-recourse feature on a reverse mortgage, and
- the required timeframe for heirs or an estate to pay off a loan and extensions to the timeframe.

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PROTCL 5.D.6.a Description: Non-Recourse Feature on a Reverse Mortgage

"Non-recourse" means that if a lender takes legal action against the borrower for default on the loan, the lender can look only to the property to satisfy the loan, as opposed to holding the borrower personally liable for the debt. The lender can foreclose and recover as much as it can through proceeds of the foreclosure sale.

Note: This repayment standard also applies to the borrower's heirs or estate when the property is sold to repay the outstanding loan. The lender cannot hold the heirs or estate personally liable for the balance. However, if the heirs or the estate wish to keep the property, they are personally liable for the full balance of the loan.

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6. Reverse Mortgage Non-Recourse Feature, Continued

PROTCL 5.D.6.b Required Timeframe for Heirs or an Estate to pay Off a Loan and Extensions to the Timeframe

The lender is limited to providing 6 months to the heirs or the estate to pay off the loan.

The lender may request HUD approval for up to two 90-day extensions if the heirs or estate can demonstrate that they are actively marketing the property. Extension requests must

- be made before the initial 6 month, or previously extended timeframe has expired, and
- must promptly confirm the intention of the heirs or the estate to either
  - sell the property to a third party, or
  - keep the home and pay the balance of the loan in full.

Where no information has been provided, the lender will have no other option but to initiate foreclosure.

7. Mortgage Insurance/Insurance Premiums

Introduction

This topic contains information on

- mortgage insurance and principal limits on non-insured reverse mortgage products
- crossover risk for HECMs and non-insured reverse mortgage products
- mortgage insurance premiums on
  – standard HECMs, and
  – HECM Saver loans.

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PROTCL 5.D.7.a Mortgage Insurance and Principal Limits on Non-Insured Reverse Mortgage Products

Today, reverse mortgages that are not Federally insured

- do *not* have a mortgage insurance premium, and
- generally include other fees and pricing programs to protect lenders from risk.

On non-insured products that do not have mortgage insurance to protect them from losses associated with the loan balance growing larger than the property value, lenders take a conservative approach and set the principal limit much lower than a HECM, as discussed in HECM Protocol 5.D.7.b.

For this reason, typically the FHA-insured product gives the borrower access to more equity than non-insured reverse mortgage products. Counselors should make potential borrowers aware of the costs and available loan amounts on proprietary products that compensate for the absence of a mortgage insurance premium.

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7. Mortgage Insurance/Insurance Premiums, Continued

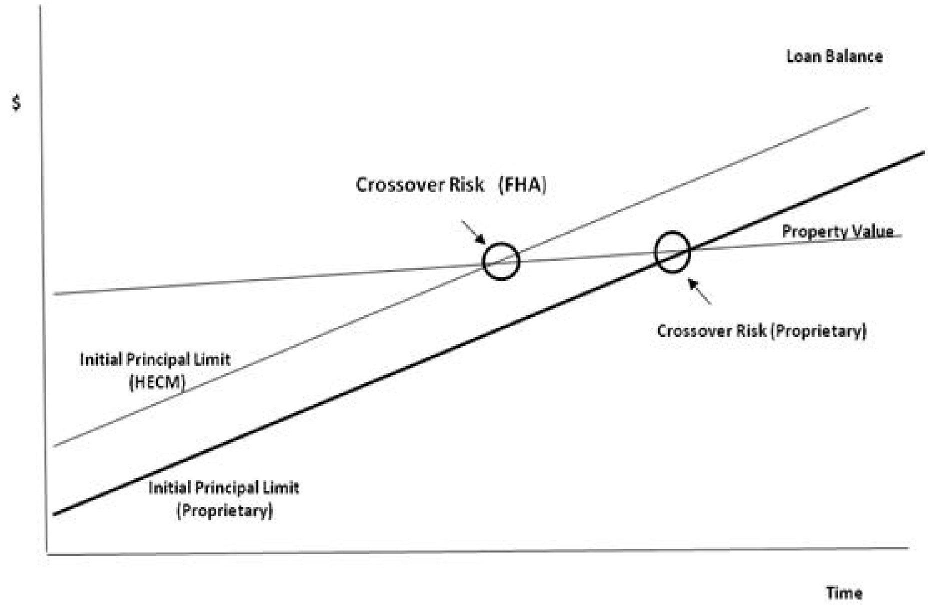
PROTCL 5.D.7.b Crossover Risk for HECMs and Non-Insured Reverse Mortgage Products

"Crossover" occurs when the loan balance exceeds the property value. FHA charges an insurance premium as protection against crossover risk.

With proprietary products for which the crossover exposure is greater than with a HECM, lenders protect themselves by setting the initial principal limit lower than they would on a HECM.

HECM loans

- generally offer
  - higher ratios of principal limit to equity in the home, and
  - lower costs as a result of the mortgage insurance program, and
- provide lenders and borrowers with the security of full backing by the Federal government.



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7. Mortgage Insurance/Insurance Premiums, Continued

PROTCL 5.D.7.c Mortgage Insurance Premiums on HECMs

For the insurance provided by FHA on a HECM, the borrower must pay both

- an up-front insurance premium, which is 2 percent of the maximum claim amount, and
- an annual premium, charged monthly at an annual rate of 1.25 percent of the outstanding loan balance.

These premiums are

- calculated at closing
- charged to the borrower throughout the life of the loan, and
- *not* refundable.

HECM Borrowers Who Refinance into Another HECM
A HECM borrower who refinances into another HECM is eligible for a reduction in his/her up-front mortgage insurance premium. The premium paid on the new HECM is calculated by multiplying the difference between the old maximum claim and the new maximum claim amounts by 2 percent.

Note: A HECM for purchase is not a refinance, and as such, there is no initial reduction in premium even if the borrower previously held a HECM mortgage.

PROTCL 5.D.7.d Mortgage Insurance Premiums on HECM Saver Loans

FHA designed HECM Saver as a second initial MIP option to lower upfront loan closing costs for borrowers who want to borrow a smaller amount than would be available with a standard HECM.

For HECM Saver, the initial MIP is

- 0.01 percent of the maximum claim amount, and
- collected at time of loan closing.

Note: A HECM Saver is available on the same loan and transaction types as a standard HECM.

8. Reverse Mortgage Loan Costs

Introduction

This topic contains information on

- servicing fees and servicing fee set-aside
- third-party closing costs
- application fee and origination fee
- financing closing costs
- payment plan change fees, and
- Total Annual Loan Cost (TALC).

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8. Reverse Mortgage Loan Costs, Continued

PROTCL 5.D.8.a Servicing Fees and Servicing Fee Set-Aside

Servicing fees are monthly fees paid to the lender for administering the loan, such as making monthly cash advances and processing payment plan changes. They are set aside from the principal limit at closing, but are only added to the loan balance as they are incurred on a monthly basis. For HECM loans that are

- annually adjusting and fixed rate, these fees may not exceed $30 a month, and
- adjust monthly, the fee cap is $35.

Lenders may charge less than the maximum set by FHA.

Servicing Fee Set-Aside
The servicing fee set-aside is the present amount of money that will be required to pay all of the monthly servicing fees until the borrower reaches age 100. This calculated amount

- ensures that sufficient loan proceeds are set aside so that the servicer may collect the monthly servicing fee, and
- is subtracted from the principal limit to arrive at the net principal limit that is available at closing.

Note: The amount reserved for these future payments
- is not part of the loan balance
- does not accrue interest, and
- is not a cost to the consumer until the fee is paid.

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8. Reverse Mortgage Loan Costs, Continued

PROTCL 5.D.8.b Third-Party Closing Costs

Third party closing costs include the usual and customary expenses associated with obtaining a mortgage, including the

- appraisal
- credit report
- title searches, and
- title insurance.

The costs depend upon the third parties who perform these activities for the lender, not on the type of mortgage. Clients must obtain a list of estimated closing costs from their lenders prior to closing.

Counselors

- *must not* quote any specific closing costs, but may discuss usual or customary ranges, and
- must inform the client that
  - none of the charges associated with these third-party origination activities may be paid before the counseling is completed, and
  - the client must not write a check or pay cash for the services until he/she completes counseling and has signed a reverse mortgage application with the lender.

PROTCL 5.D.8.c Application Fee and Origination Fee

Application and origination fees compensate the lender for processing, underwriting and preparing the loan documents.

Lender origination fees are 2 percent of the first $200,000 of the maximum claim amount, plus 1 percent of the balance above $200,000 to a maximum origination fee of $6,000.

Some lenders may charge lower origination fees, but they may charge higher interest rates. This practice may be more costly to the consumer.

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8. Reverse Mortgage Loan Costs, Continued

PROTCL 5.D.8.d Financing Closing Costs

A borrower may finance the mortgage insurance premium, origination fees, and third-party costs, using a draw at closing from the loan to cover these initial costs.

Borrowers may also pay closing costs with their own available funds.

PROTCL 5.D.8.e Payment Plan Change Fees

The fee that a lender may charge a borrower for changing a payment plan type is discussed in HECM Protocol 5.D.3.b.

PROTCL 5.D.8.f Total Annual Loan Cost (TALC)

Similar to an Annual Percentage Rate on a forward mortgage, the Total Annual Loan Cost (TALC) is the interest rate that shows the true cost of a HECM by including all costs of the loan.

It is a projection based on

- how long the borrower will have the loan
- how the borrower draws the loan proceeds, and
- an assumed property appreciation rate.

The TALC decreases the longer the borrower has the HECM, as the costs associated with the loan are averaged out over a longer period of time.

Reference: For sample TALC calculations, see HECM Protocol 7.B.6.