Unwinding Legacy HECM Issues

The Industry Leader Update by Reverse Focus l January 28th, 2019
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As a wise man once told me, “it’s easy to wind something up. It’s quite another thing to unwind it”. Since 2013 the FHA and HUD have taken a number of steps to try to unwind the components of the Home Equity Conversion Mortgage that have led to increased claims against FHA’s insurance fund and those that negatively impact its projected future economic value of the program.

Just how both agencies will continue to address this momentous challenge remains to be seen. While the increasing losses from HECMs are troubling, it should be noted that $73 billion of the $1.2 trillion of the insurance in-force in FHA’s MMI fund are HECMs. That is 6% of all loans insured by FHA are HECM loans according to a report last month from the Congressional Research Service. The problem is that even that small cohort of HECM loans can have a significant impact on the overall fund.

While most may agree the most problematic issues in the HECM warranted correction, many are concerned that future policy changes are based on actuarial reviews. Reviews that have historically shown significant volatility and wild swings in their valuation of the program. Much of that volatility can be attributed to the significant impact current interest rates and home appreciation growth play in the actuaries calculations and changes to the actuarial approach. To put it bluntly, expect more unpredictable projected economic values for the HECM.

While the projected economic values of the HECM remain uncertain, the FHA is committed to isolating the sources of continued losses. Last July, FHA Commissioner Brian Montgomery told members of the press that “We are digging deep in the portfolio to find out of the problem is on the front end or the back end, my sense is that it’s more on the back end in terms of the losses we are experiencing. Part of ‘triaging’ is [determining] why that is happening.” That triaging manifested itself first on the front end with the agency enacting a second appraisal requirement for HECM loans that did not meet the criteria of the Collateral Risk Assessment which compares submitted appraisals to a proprietary AVM to determine if the value has been inflated.

Yet larger issues may be lurking in the back end of the HECM portfolio which could be significantly contributing to continued insurance claims. Issues such as delayed foreclosures and conveyances to FHA, deteriorating property conditions and occupancy fraud in cases where the last borrower has died or moved. These require timely remedies.

As we reported last month, lenders are reporting widespread evidence of family members or renters occupying properties after the borrower's death or departure. However, occupancy fraud is not limited to reverse mortgages. It’s been one of the more common problems in traditional mortgage lending at the point of application in the effort secure a loan for an investment property under the guise of it being the primary residence.

Beyond principal limits or lending ratios lies the risk of ballooning HECM mortgage balances as properties sit vacant, are occupied by third parties, or the home falls into disrepair. Unwinding these vexing problems may require a cash-for-keys program to expedite the foreclosure of

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HECM properties in default, periodic inspections of HECM properties, and more stringent oversight and verification of the borrower's occupancy in the home.

While it may be difficult to unwind the complex problems facing the HECM program, the rewards are significant for both future borrowers and lenders alike.

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