



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING
FEDERAL HOUSING COMMISSIONER

Date: March 11, 2021

Mortgagee Letter 2021-08

To: All Direct Endorsement Underwriters
All FHA Roster Appraisers
All FHA Roster Inspectors
All FHA-Approved 203(k) Consultants
All HUD-Approved Housing Counselors
All HUD-Approved Nonprofit Organizations
All Governmental Entity Participants
All Real Estate Brokers
All Closing Agents

Subject Home Equity Conversion Mortgage (HECM) Program – Changes to Interest Rate Requirements Including Removal of the London Interbank Offered Rate (LIBOR) Index

Purpose This Mortgagee Letter (ML):

- Removes approval for use of the London Interbank Offered Rate (LIBOR) index for adjustable interest rate HECMs;
- Establishes the acceptance of the Secured Overnight Financing Rate (SOFR) index and permits mortgagees to commingle index types for newly originated annual adjustable interest rate HECMs when establishing the expected average mortgage interest rate using the U.S. Constant Maturity Treasury (CMT) and using the Secured Overnight Financing Rate (SOFR) index to establish the initial mortgage interest rate (Note rate) and periodic Note rate adjustments; and
- Sets zero as the “floor” for the index value used to determine the Note rate.

This ML also provides new model Note language that incorporates the changes described above.

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Effective Date The policy requirements in this Mortgagee Letter are effective as follows:

Section of ML	Effective Date
Definition of Expected Average Mortgage Interest Rate § 206.3	HECMs closed on or after May 3, 2021
Interest Rate Index for Annual Adjustable Interest Rate HECMs §206.21(b)(1)(ii)	HECMs closed on or after May 3, 2021
Monthly Adjustable Interest Rate HECMs § 206.21(b)(2)	HECMs closed on or after May 3, 2021
LIBOR Pipeline Loans	LIBOR-based HECMs must close on or before May 3, 2021, to be eligible for FHA insurance.
Interest Rate Index Floor	HECMs closed on or after May 3, 2021
Changes to Model Note	Mortgagees may immediately begin use of the revised model note for all CMT indexed HECMs. Mortgagees must use the revised model note for all SOFR indexed HECMs. Mortgagees must use the revised Model Note for all HECMs closed on or after July 1, 2021.

Public Feedback HUD welcomes feedback from interested parties for a period of 30 calendar days from the date of issuance. To provide feedback on this policy document, please send feedback to the FHA Resource Center at answers@hud.gov. HUD will consider the feedback in determining the need for future updates.

Affected Programs This guidance applies to the HECM program.

Affected Regulations and Mortgagee Letters Pursuant to the authority granted in the Reverse Mortgage Stabilization Act of 2013 (Pub. L. No. 113-29; Section 255(h)(3) of the National Housing Act (12 U.S.C. 1715z-20(h)(3)) (RMSA), the requirements in this Mortgagee Letter revise and, where they conflict, supersede the HUD regulations cited in the table below. Additionally, HUD is utilizing its general authority to impose administrative requirements to revise and supersede, where they conflict, with the Mortgagee Letters in the table below. The table below highlights current policy and regulatory items that are affected in whole or in part by these changes.

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Affected Regulations and Mortgagee Letters (cont.)

Code of Federal Regulations (CFR)
§ 206.3 Definitions; Expected Average Mortgage Interest Rate
§ 206.21(b)(1)(ii) Interest Rate Index
§ 206.21(b)(2) Monthly Adjustable Interest Rate HECMs
MLs
ML 2007-13, Adjustable Rate Mortgages – Addition of LIBOR Index
ML 2016-16, Source for 10-Year Swap Rate

Authority

Reverse Mortgage Stabilization Act of 2013, 12 USC 1715z-20(h)(3); National Housing Act Section 255(d)(2) and (5), 12 U.S.C. § 1715z-20(d)(2) and (5).

Background

On July 27, 2017, the Chief Executive of the United Kingdom’s Financial Conduct Authority (FCA), the regulator of LIBOR, publicly questioned the sustainability of LIBOR, supported transition away from LIBOR to alternative reference rates.¹ While publication of LIBOR rates will not necessarily end after June 30, 2023, the anticipated withdrawal of banks from the LIBOR panel and the absence of the underlying market supporting LIBOR makes the future of LIBOR beyond mid-2023 uncertain.²

To address this, the Board of Governors of the Federal Reserve and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (ARRC) to identify a set of alternative reference interest rates that are more firmly based on transactions from a robust underlying market and comply with emerging standards, such as the International Organization of Securities Commissions’ Principles for Financial Benchmarks, and to identify an adoption plan with means to facilitate the acceptance and use of these alternative reference rates.³ The ARRC engaged in a several-year process to evaluate a range of potential comparables to U.S. dollar LIBOR, and on June 22, 2017, the ARRC identified the SOFR as the rate that represents best practice for use in certain new U.S. dollar derivatives and other financial contracts.

In response to the LIBOR transition and the ARRC’s identification of SOFR, on September 21, 2020, Ginnie Mae issued *All Participants Memorandum* (APM) 20-12 and extended by APM 20-19 announcing that LIBOR-based adjustable interest rate HECMs that are not securitized as of March 1, 2021, will be ineligible for the HECM mortgage-backed securities (HMBS) program. APM 20-12 also stated that Ginnie Mae is prepared to facilitate the creation of a new Single-Class MBS collateralized pool for SOFR adjustable interest rate mortgages and HECMs.

¹ <https://www.fca.org.uk/news/speeches/the-future-of-libor>

² <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf>

³ See *The Interim Report and Consultation* prepared by the Alternative Reference Rates Committee. <https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2016/arrc-interim-report-and-consultation.pdf?la=en>

Background (cont.)

Currently, adjustable interest rate HECMs are based on the LIBOR or CMT indexes. In fiscal year 2020, 97.4% of new endorsements were adjustable interest rate HECMs; the majority of which use the LIBOR index.⁴

The unreliability of the LIBOR index has posed issues for calculating the expected average mortgage interest rate for LIBOR-based adjustable interest rate HECMs. The 10-year LIBOR Swap rate is used to calculate the amount of HECM proceeds available to the borrower. From February 27, 2020, to May 27, 2020, the 10-year LIBOR Swap rate remained “frozen” at the last published rate. During this “frozen” period, the 10-year LIBOR Swap rate did not reflect market conditions. When publication of the 10-year LIBOR Swap rate finally resumed, the rate dropped dramatically from 1.22% to 0.68%.

Given the risks of originating adjustable interest rate HECMs using an increasingly uncertain LIBOR index and that Ginnie Mae will no longer securitize LIBOR-based adjustable interest rate HECMs as of March 1, 2021, HUD is implementing program changes to remove approval of the LIBOR index and approve the SOFR index for adjustable interest rate HECMs. With the viability of the LIBOR index in jeopardy and the current dominance of LIBOR-based HECMs in the marketplace, HUD is announcing these program changes to mitigate future disruption to the market by transitioning away from the LIBOR index and offering an alternative SOFR index option.

HUD does this, in part, based on the RMSA authority in Section 255(h)(3) of the National Housing Act (12 U.S.C. 1755(h)(3)), which grants the Secretary authority to “establish, by notice or mortgagee letter, any additional or alternative requirements that the Secretary, in the Secretary’s discretion determines are necessary to improve the fiscal safety and soundness of the program.” The Secretary has determined that the changes announced in this ML are necessary to proactively protect against the potential risks that an increasingly unreliable LIBOR index poses to the Mutual Mortgage Insurance Fund (MMIF) and HECM borrowers. As previously indicated, the unreliability of the LIBOR index results in unpredictable changes in interest rates which leads to unpredictable changes to the principal balance that is ultimately insured by FHA. Permitting the utilization of the SOFR index protects the safety and soundness of the MMIF by providing an index that is fundamentally sound, stable, broadly adopted and highly marketable in the securities market. The addition of the SOFR index is widely seen as the growing consensus solution for indexing adjustable interest rate mortgages in the absence of LIBOR. FHA’s adoption of the SOFR index ensures the demand of a viable HECM product.

⁴ See *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund*. <https://www.hud.gov/sites/dfiles/Housing/documents/2020FHAAnnualReportMMIFund.pdf>

Background (cont.)

Currently, HUD's regulation at 24 CFR § 206.3 requires mortgagees to calculate the expected average mortgage interest rate by calculating the sum of the mortgagee's margin plus the weekly average yield for the 10-year CMT rate or the 10-year LIBOR Swap rate. The same index type, CMT or LIBOR, must be used to establish the initial Note rate and to calculate future adjustments, as commingling of index types is not allowed. By removing approval of the use of the LIBOR index, the CMT index would remain as the only index approved to establish the expected average mortgage interest rate.

The CMT index has remained reliable and consistently published in a publicly available source since the inception of the HECM program. FHA is permitting an additional index option beyond the CMT index in an effort to sustain the current marketability and liquidity of the HECM product in the secondary market by introducing SOFR, which is considered a comparable replacement index to LIBOR. Additionally, an equivalent 10-year SOFR Swap rate does not exist in a robust and publicly available format. This ML modifies the requirements set forth in 24 CFR § 206.3 by removing LIBOR and including SOFR as an available index and permit the commingling of index types, so that CMT could be used to establish the expected average mortgage interest rate, and the SOFR index could be used to establish the Note Rate of newly originated HECMs under 24 CFR § 206.21.

HUD's regulation at 24 CFR § 206.21 provides for adjustable interest rate HECMs to be either adjusted annually based on the 1-year LIBOR or the 1-year CMT or adjusted monthly based on the 1-month CMT index, 1-year CMT index, or 1-month LIBOR index. This ML removes LIBOR and includes SOFR as an available index under 24 CFR § 206.21.

HUD is also taking this opportunity to set zero as the "floor" for the index value used to determine the Note rate. Under 24 CFR § 206.21(b)(1)(ii), HUD requires that changes in the Note rate must correspond to the upward and downward change in the index. Under the current HUD regulation, the Note rate could go below zero in a negative interest rate environment. The current low interest rate environment, which the Federal Reserve signaled would persist through 2023, is unprecedented for the HECM program.⁵ The possibility of a negative interest rate environment poses uncertain market risks and programmatic impacts to the HECM program. Permitting negative index rates would severely restrict the marketability of HMBS and therefore liquidity. Lenders, servicers, and investors did not contemplate or develop systems to accommodate the reversal of cash flows. Further, permitting negative index rates would be inconsistent with GSEs and the Treasury's (CMT) statement that establishing a floor of zero more accurately reflects borrowing costs. Establishing an interest rate index floor protects the fiscal safety and soundness of the HECM program by mitigating against the uncertain impacts of negative index rates and the reasons discussed above.

⁵ <https://www.ft.com/content/827302da-4257-4bbc-a0fa-9bc98f65d661>

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Background (cont.)

HUD is also revising the model loan documents to include the requirements defined in this ML. The revisions include fallback language that is based on the ARRC recommended fallback language for residential adjustable rate mortgages to handle transitions with respect to adjustable mortgage interest rate indices.⁶

Summary of Changes

The ML revises, and where it conflicts, supersedes the requirements in 24 CFR § 206.3 and 24 CFR § 206.21, and MLs 2007-13 and 2016-16.

Mortgagees may no longer originate adjustable interest rate HECMs using the LIBOR index but may use the CMT or SOFR indexes.

For all adjustable interest rate HECMs, the mortgagee must use the 10-Year CMT to establish the expected average mortgage interest rate.

For annual adjustable interest rate HECMs using the SOFR index, the mortgagee must use the 30-day average SOFR, as published by the Federal Reserve Bank of New York. The Federal Reserve Bank of New York publishes the 30-day average SOFR on their website at: <https://apps.newyorkfed.org/markets/autorates/sofr-avg-ind>.

HUD has now established zero as the minimum for the index value used to determine the Note rate for all HECMs to prevent against below-zero interest rates in a negative interest rate environment.

HUD has provided model loan documents to include the requirements defined in this ML, including the fallback language for future adjustable interest rate index transition events.

Definition of Expected Average Mortgage Interest Rate § 206.3

Expected average mortgage interest rate means the interest rate used to calculate the principal limit established at closing. For fixed interest rate HECMs, the expected average mortgage interest rate is the same as the fixed Note rate and is set simultaneously with the fixed interest rate. For adjustable interest rate HECMs, the expected average mortgage interest rate is the sum of the mortgagee's margin plus the weekly average yield for U.S. Treasury securities adjusted to a constant maturity of 10 years. For adjustable interest rate HECMs, the Note rate is calculated using either the CMT or Secured Overnight Financing Rate (SOFR) index. The index type (CMT or SOFR) used to calculate the initial Note rate must be the same index type used to calculate Note rate adjustments - commingling of index types for the Note rate and adjustments is not allowed, unless otherwise approved by the Secretary. The margin is determined by the mortgagee and is defined as the amount that is added to the index value to compute the expected average mortgage interest rate. The mortgagee's margin is the same margin used to determine the initial Note rate and the periodic adjustments to the Note rate.

⁶https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARM_Fallback_Language_Press_Release.pdf

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Definition of Expected Average Mortgage Interest Rate § 206.3 (cont.)

Mortgagees, with the agreement of the borrower, may simultaneously lock in the expected average mortgage interest rate and the mortgagee's margin prior to the date of loan closing or simultaneously establish the expected average mortgage interest rate and the mortgagee's margin on the date of loan closing.

Interest Rate Index for Annual Adjustable Interest Rate HECMs §206.21(b)(1)(ii)

Changes in the Note rate charged on an adjustable interest rate mortgage must correspond either to changes in the 30-day average SOFR or to changes in the weekly average yield on U.S. Treasury securities, adjusted to a constant maturity of one year. Except as otherwise provided in this section, each change in the Note rate must correspond to the upward and downward change in the index, except that the index value shall not be less than zero.

Monthly Adjustable Interest Rate HECMs § 206.21(b)(2)

If a mortgage meeting the requirements of paragraph § 206.21(b)(1) of this section is offered, the mortgagee may also offer a mortgage which provides for monthly adjustments to the interest rate such that changes in the interest rate charged on an adjustable interest rate mortgage correspond to changes in the weekly average yield on U.S. Treasury securities, adjusted to a constant maturity of one year (except as otherwise provided in this section, each change in the Note rate must correspond to the upward and downward change in the index, except that downward changes in the index will not result in a Note rate that is less than zero), or to the one-month CMT index, and which sets a maximum interest rate that can be charged.

Table of Eligible Adjustable Interest Rate Index Types

Mortgagees must comply with the index requirements in the table below.

Eligible Index Types		
Adjustable Rate Types	Expected Average Mortgage Interest Rate	Note Rate and Periodic Adjustments
Annually Adjustable	10-Year CMT	1-Year CMT
		30-Day Average SOFR
Monthly Adjustable	10-Year CMT	1-Year CMT
		1-Month CMT

LIBOR Pipeline Loans

Mortgagees may use the 30-Day Average SOFR for annually adjustable HECMs where the HECM will close on or after May 3, 2021, provided that the 10-Year CMT is used to determine the expected average mortgage interest rate.

Mortgagees must conform their mortgage documents to satisfy the requirements of this ML.

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Interest Rate Index Floor	For all HECMs, the index value used to determine the Note rate must not be below zero. In the event the current index for an adjustable interest rate HECM falls below zero, the current index will be deemed to be zero for purposes of calculating the borrower’s Note rate.
Changes to Model Note	<p>FHA is revising the model loan documents for the first and second HECM Adjustable Interest Rate Notes to incorporate the fallback language and other requirements of this ML. The revised model loan documents will be accessible from the following website prior to the effective date of the ML:</p> <p>https://www.hud.gov/program_offices/housing/sfh/model_documents</p> <p>As a reminder, mortgagees are responsible for adapting model documents to ensure compliance with other federal, state, and local laws, and may do so without HUD approval.</p>
Existing LIBOR-based HECMs	Existing LIBOR-based HECMs closed prior to May 3, 2021, remain unaffected by this ML. FHA will issue policy regarding existing LIBOR contracts at a future date.
Paperwork Reduction Act	The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB Control Numbers 2502-0524 and 2502-0611. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB Control Number.
Questions	Any questions regarding this Mortgagee Letter may be directed to the FHA Resource Center at 1-800-CALL-FHA. Persons with hearing or speech impairments may reach this number by calling the Federal Relay Service at 1-800-877-8339. For additional information on this Mortgagee Letter, please visit www.hud.gov/answers .
Signature	

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