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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Date: **June 18, 2014**

MORTGAGEE LETTER 2014-11

To: **ALL APPROVED MORTGAGEES**

Subject: Home Equity Conversion Mortgage (HECM) Program: Limit on Insurability of Fixed Interest Rate Products under the HECM Program

Purpose

This Mortgagee Letter uses the authority granted to HUD in Sections 202(a) and 255(c) of the National Housing Act and in the Reverse Mortgage Stabilization Act of 2013 to amend the Federal Housing Administration's (FHA) HECM program to limit the insurability of fixed interest rate mortgages under the HECM program to mortgages with the Single Disbursement Lump Sum payment option.

Effective Date

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

Policy Description	Effective Date
Limitations on Fixed Interest Rate HECMs	Case numbers assigned on or after June 25, 2014
Limitations on Adjustable Interest Rate HECMs	Case numbers assigned on or after June 25, 2014
Unused Repair Set-Aside Funds	Case numbers assigned on or after June 25, 2014
FHA Connection Updates	Case numbers assigned on or after June 25, 2014
Loan Documents	
Mortgagees may use the Model Fixed Interest Rate HECM Loan Documents for case numbers assigned on or before August 3, 2014, to update fixed interest rate loan documents for new mortgages and pending mortgages that did not close prior to the Effective Date of this Mortgagee Letter.	
Mortgagees must begin using the Model Fixed Interest Rate HECM Loan Documents for case numbers assigned on or after the Effective Date of Mortgagee Letter 2014-07, HECM Program: Non-Borrowing Spouse.	

Continued on next page

Mortgagee Letter 2014-11, Continued

Affected Topics

The policies set forth in this Mortgagee Letter impact the operation of Section 255(d) (9) and (10) of the National Housing Act in the context of fixed interest rate HECMs.

Additionally, the policies set forth in this Mortgagee Letter supersede, where they conflict in the following:

- 24 CFR §§ 206.3, 206.19, 206.25, 206.26
- Mortgagee Letters 2014-07, 2013-33, 2013-27, and 2008-08;
- Handbook 4235.1 REV-1, Paragraphs 1-6, 5-4, 5-11 and Appendices 2 & 5; and
- Handbook 4330.1 REV-5, Chapter 13.

Background

After the Fiscal Year 2013 Annual Report to Congress on the FHA Mutual Mortgage Insurance Fund (MMIF) identified serious risks in the HECM program and the additional capital required to fund future losses, FHA began making significant programmatic adjustments. Under the National Housing Act, the Secretary has a fiduciary responsibility to protect the MMIF, to minimize the risk of default, and to insure HECMs, upon terms and conditions that the Secretary may prescribe, only to the extent that the Secretary determines such mortgages have a potential for acceptance in the mortgage market. In addition, the Reverse Mortgage Stabilization Act of 2013, which amends Section 255(h) of the National Housing Act, authorized the Secretary 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." These authorities permit, and in fact require, the Secretary take actions necessary to protect the fiscal integrity of the HECM program and the MMIF.

While the program adjustments implemented to date are reducing risk and contributing to the sustainability of the HECM program, new risks are emerging in connection with certain fixed interest rate HECM strategies that are being introduced in the market. One of the recent programmatic adjustments introduced by FHA limited the amount of the principal a mortgagor may draw within the first twelve-month disbursement period. This change was introduced to address an industry practice of requiring large initial draws on fixed interest rate HECMs. Factors contributing to this industry strategy included mortgagees' inability to effectively hedge the interest rate risk of providing mortgagors with the ability to draw fixed interest rate funds in unknown amounts at future dates. By limiting initial disbursements

Continued on next page

Mortgagee Letter 2014-11, Continued

Background (continued)

and increasing the initial mortgage insurance premium for draws in excess of 60% of the principal limit, FHA addressed a significant risk to the MMIF.

One new market option strongly encourages the mortgagor to take the maximum amount available during the first twelve-month disbursement period and to take the remaining amount shortly after the expiration of the first twelve-month disbursement period whether they need it or not. This is done through various pricing options, marketing and advertising. This practice would continue to undermine FHA's objective of reducing large upfront draws and providing mortgagors with access to equity over time as well as jeopardize the sustainability of the program. The existing HECM program does not permit mortgagees to require the timing or amount of draws. At present, should the mortgagor so choose, he or she can convert the remaining available principal under the HECM to a line of credit or other term or tenure payment option that remains available for access for years into the future.

Another "fixed interest rate" option in the market, which creates a different type of risk, emphasizes mortgagor options for future draws at the fixed interest rate set at origination. As noted above, prior to introduction of the limited draw policy during the first twelve-month disbursement period, mortgagees were requiring full disbursements at loan closing on fixed interest rate HECMs. A fixed interest rate option with future draws is untried and unproven in the mortgage market and it is likely that mortgagees will continue to encourage large draws early in the life of the loan to reduce potential hedging risk. A forward mortgage equivalent of a fixed interest rate line of credit is generally not available in the market for reasons similar to those outlined in this document. Mortgages that allow future draws are generally adjustable interest rate mortgages products or a combination of an initial fixed interest rate draw with future draws based on adjustable interest rate mortgage pricing or a fixed rate in effect at the time the future draw is taken. The hedging and interest rate risk posed by continued future availability of funds at a fixed interest rate set at origination is significant, and FHA believes, excessive.

FHA believes that these new variants of fixed interest rate HECM products pose a threat to the future financial soundness of the HECM program, to the Department's ability to operate the HECM program, and to Ginnie Mae's ability to operate a financially sound securitization program. Mortgagee default would shift risk to the Federal Government through FHA. FHA may succeed to the obligations and risk exposures of HECM mortgagees on HECM notes either by assignment when the mortgagor's obligation reached 98% of the maximum claim amount or the triggering of FHA's obligation to make

Continued on next page

Mortgagee Letter 2014-11, Continued

Background (continued)

payments under the HECM to the mortgagor. FHA's obligations in these circumstances would include servicing costs and advancing additional funds as may remain under the loan contract.

The HECM mortgagee may attempt to mitigate interest rate risk by shifting the burden to other parties through interest rate swaps or use of interest rate derived options. Such hedging materially erodes profitability such that some portion of the mortgagees may choose to accept the risk rather than hedge it. Hedging requires sophisticated financial skills to execute and manage, and does not guarantee the intended outcome.

FHA is not authorized to require HECM mortgagees to mitigate interest rate risk and is not positioned to monitor HECM mortgagee's methods for doing so. Dissimilar to institutional mortgagees, the Federal Government in general is not positioned to mitigate or absorb interest rate risk or to accept losses in situations where the opportunity to mitigate risk exposures has passed.

Ginnie Mae also reached a similar conclusion and issued an *All Participants Memorandum (APM)*, on April 1, 2014, announcing that fixed interest rate HECM loans with future draws will be ineligible for securitization on or after June 1, 2014. The only fixed interest rate HECM product that will be eligible for securitization will be mortgages with the Single Disbursement Lump Sum payment option selected at loan closing, which was an option that was introduced with the September 30, 2013 program changes.

As a result, FHA must now take steps to address these risks and protect the HECM program and the financial soundness of the MMIF. The financial impact and operational difficulties posed by this statutory guarantee of payment by FHA on these products has led FHA to conclude that it can no longer insure fixed interest rate reverse mortgages that provide the mortgagor with any options for future payments.

Continued on next page

Mortgagee Letter 2014-11, Continued

Limitations on Fixed Interest Rate HECMs

FHA will only insure fixed interest rate reverse mortgages where the mortgage limits the mortgagor to:

- A single, full draw to be made at loan closing; and
- Does not provide for future draws by the mortgagor under any circumstances.

Borrower's Advance means the funds advanced to Borrower at closing as set forth in the HECM Loan Agreement.

As there will be no risk of the Secretary having to pay future advances to the mortgagor, the HECM Second Security Instrument and HECM Second Note are no longer required for fixed interest rate HECMs.

Mortgagees shall use the Single Disbursement Lump Sum payment option for all fixed interest rate HECMs.

Mortgagors will be responsible for the payment of all property charges and no longer have the option to elect to require the mortgagee to pay such property charges on their behalf as provided in §206.205(b).

If a mortgagor fails to pay property charges, mortgagees shall proceed with the loss mitigation requirements announced in Mortgagee Letter 2011-01, as if the mortgagor has no remaining funds available under the mortgage.

Limitations on Adjustable Interest Rate HECMs

FHA will only insure adjustable interest rate reverse mortgages where the payment plan option is either:

- Tenure;
- Term;
- Line of Credit;
- Modified Tenure; or
- Modified Term.

The Single Disbursement Lump Sum payment option shall not be used for adjustable interest rate HECMs.

All other HECM program requirements remain unchanged for adjustable interest rate HECMs.

Continued on next page

Mortgagee Letter 2014-11, Continued

Determining the Principal Limit Amount

Mortgagees will continue to determine the principal limit according to existing policy guidelines by multiplying the maximum claim amount by the principal limit factor corresponding to the age of the youngest mortgagor, and the expected average mortgage interest rate, until further notice. The expected average mortgage interest rate must be the same as the fixed mortgage (note) interest rate and set simultaneously.

The principal limit for a fixed interest rate mortgage will "increase" each month by one-twelfth of the sum of the mortgage note interest rate plus the annual mortgage insurance rate, but no further funds may be made available for the mortgagor to draw against after the Borrower's Advance.

Future disbursements from set-aside accounts can be made by the mortgagee for purposes defined for the specific set-aside.

Mortgagees may continue to add accrued interest, mortgage insurance premiums, servicing charges and disbursements from repair or servicing fee set-aside accounts to the outstanding mortgage balance for fixed interest rate HECMs in accordance with existing FHA requirements. All other HECM program requirements remain applicable to fixed interest rate mortgages.

Determining the Borrower's Advance

At loan closing, mortgagees will determine the Borrower's Advance, which may not exceed the greater of:

- 60% of the principal limit; or
- Mandatory obligations as defined by Mortgagee Letter 2013-33, plus 10% of the principal limit.

As a reminder, the additional 10% of the principal limit is available when the mortgagor's mandatory obligations exceed 50% of the principal limit. The mortgagor may take a partial amount or all of the 10% provided the Borrower's Advance does not exceed the principal limit.

The sum of all advances permitted under the mortgage cannot exceed the principal limit. The mortgagor may bring other available funds to closing to bring the sum of all anticipated advances within the principal limit.

Continued on next page

Mortgagee Letter 2014-11, Continued

Unused Repair Set-Aside Funds

No unused repair set-aside funds for a fixed interest rate HECM shall be made available to the mortgagor under any circumstance.

Partial Pre-Payments and Repayments from Insurance and Condemnation Proceeds

If the mortgagor makes a partial repayment of the outstanding mortgage balance any time after loan closing and before the contract of insurance is terminated, the mortgagee must increase the available principal limit by the amount applied toward the outstanding mortgage balance, up to an amount not to exceed the principal limit amount established at origination; however, such amount shall not be available to the mortgagor to draw against.

Single Disbursement Lump Sum Payment Option Pipeline Processing of Loans

HECM fixed and adjustable interest rate pipeline mortgages that already have an active case number for a Single Disbursement Lump Sum payment option and meets the requirements defined in Mortgagee Letter 2013-27, and all other HECM program and property eligibility requirements, continue to be eligible for FHA insurance.

Closed Fixed Rate Pipeline Processing

FHA will insure all fixed interest rate transactions, i.e., traditional, refinance, and purchase, that closed on or before the publication date of this Mortgagee Letter, and that meet the following requirements:

- The mortgage provides for or does not provide for future draws after loan closing;
- The mortgage has one of the six available payment plan options; and
- All other FHA program and property eligibility requirements have been met for the mortgage.

Mortgagees must follow existing guidelines for submitting the FHA case binder to the local Homeownership Center.

Continued on next page

Mortgagee Letter 2014-11, Continued

Fixed Rate Traditional and Refinance Transaction Pipeline Processing for Pending Loans

Where mortgagees have initiated the origination of a fixed interest rate traditional or refinance transaction that allows the mortgagor to access mortgage proceeds after loan closing, but did not close on or before the Effective Date of this Mortgagee Letter, the mortgagee must ensure the following requirements are met for the mortgage to be eligible for FHA insurance:

- The FHA case number is requested on or before July 2, 2014;
- HUD systems will reflect the mortgagor's payment option of either Term, Tenure, Line of Credit, Modified Term or Modified Tenure;
- All other HECM program and property eligibility requirements are met; and
- Loan closing is completed on or before September 30, 2014.

Fixed Rate Purchase Transaction Pipeline Processing of Pending Loans

Currently, FHA only permits a mortgagee to order a purchase transaction FHA case number in FHA Connection for a mortgage on a property that has been issued a Certificate of Occupancy and the required HECM counseling has been completed. However, to avoid any negative impact to any mortgagor who had previously entered into a bona fide sales contract and made an earnest money deposit on a property before the Effective Date of this Mortgagee Letter, FHA will allow mortgagees to request a purchase transaction FHA case number with a fixed interest rate where:

- The mortgagee requests the case number on or before July 2, 2014;
- The mortgagee obtains a copy of the mortgagor's bona fide sales contract and evidence of the earnest money deposit that were executed and paid by the mortgagor before the publication date of this Mortgagee Letter;
- HUD systems will reflect the mortgagor's payment options of either Term, Tenure, Line of Credit, Modified Term or Modified Tenure;
- The required HECM counseling will be completed prior to the date of loan closing;
- The Certificate of Occupancy will be issued prior to the date of loan closing; and
- These mortgages must comply with existing case number expiration requirements. See Mortgagee Letter 2011-10 for guidance on case numbers.

Continued on next page

Mortgagee Letter 2014-11, Continued

Fixed Rate Purchase Transaction Pipeline Processing of Pending Loans (continued)

Documentation supporting that these requirements have been met must be included in the FHA case binder.

All other requirements remain applicable and the mortgagee must ensure the mortgage, the mortgagor, and the property meets all other FHA eligibility requirements.

HECM Loan Documents

In order to ensure that the provisions of this Mortgagee Letter are properly implemented, FHA has revised the model loan documents listed below to incorporate these changes.

- Model Fixed Interest Rate Note,
- Model Fixed Interest Rate Mortgage,
- Model Fixed Interest Rate HECM Loan Agreement, and
- Model Repair Rider to the HECM Loan Agreement.

These revised documents, attached to this Mortgagee Letter as Exhibit 1, may be used for case numbers assigned on or prior to August 3, 2014, to update fixed interest rate loan documents for new mortgages and pending mortgages that did not close prior to the Effective Date of this Mortgagee Letter.

Mortgagees must begin using the model loan documents, attached as Exhibit 2, for case numbers assigned on or after the Effective Date of Mortgagee Letter 2014-07, HECM Program: Non-Borrowing Spouse. These revised model loan documents supersede the fixed interest rate loan documents issued with Mortgagee Letter 2014-07.

- Model Fixed Interest Rate Note (Post-Mortgagee Letter 2014-07 Non-Borrowing Spouse);
- Model Fixed Interest Rate Mortgage (Post-Mortgagee Letter 2014-07 Non-Borrowing Spouse);
- Model Fixed Interest Rate HECM Loan Agreement (Post-Mortgagee Letter 2014-07 Non-Borrowing Spouse); and
- Model Fixed Interest Rate Repair Rider to the HECM Loan Agreement (Post-Mortgagee Letter 2014-07Non-Borrowing Spouse).

Mortgagees remain responsible for any alterations to these documents necessary to comply with state law.

Continued on next page

Mortgagee Letter 2014-11, Continued

FHA Connection Updates

Mortgagees must use the instructions below to enter a fixed interest rate HECM, with a Single Disbursement Lump Sum payment option, in FHA Connection.

System Field	Lender Entry
ADP Code	Select the correct ADP Code, either: 961 – HECM Fixed or 967 – HECM Condominium Fixed
Amortization Type	Select: Fixed
Payment Plan	Select: Lump Sum Disbursement

Information Collection Requirements

Paperwork reduction information collection requirements contained in this Mortgagee Letter are pending approval 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 2502-0059, 2502-0524, and 2502-0429. 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 should be directed to the FHA Resource Center at 1-800-CALLFHA (1-800-225-5342). Persons with hearing or speech impairments may reach this number by calling the Federal Information Relay Service at (800) 877-8339. For additional information on this Mortgagee Letter, please visit www.hud.gov/answers.

Signature

Carol J. Galante
Assistant Secretary for Housing - Federal Housing Commissioner

Attachments
Exhibit 1-Model Fixed Interest Rate Loan Documents Pre-ML 2014-07 Non-Borrowing Spouse
Exhibit 2-Model Fixed Interest Rate Loan Documents Post-ML 2014-07 Non-Borrowing Spouse