FHA's Office of Single Family Housing Training Module

Office of Single Family Program Development

HECM Financial Assessment and Property Charge Set Asides

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Todays' Agenda

- Introduction and Welcome
- *Temporary Procedures – FHA Connection Data Entry - HECM with Negative Residual Income*
  - Published on August 28, 2015
- Review of Financial Assessment Basics
  - Calculating Residual Income
  - Compensating Factors
  - Making Sustainable HECM Decisions
- Set-Aside Calculation Formulas
- Case Studies
- Questions

Introduction

- Financial Assessment requirements became effective for HECMs with case numbers issued on or after April 27, 2015.
- Through August 31, 2015, HUD had issued 23,246 HECM case numbers since the effective date.
- Of these case numbers, 3,918 loans have closed and 1,749 have been endorsed.

FHA INFO # 15-68

On August 28, 2015, FHA INFO #15-68 announced two sets of Temporary Procedures and FAQs.

- FHA Connection Data Entry related to HECMs with Negative Residual Income:
  - Allows entry of a negative residual income number; and
  - Provides process for requesting refunds of late charge and interest for delay in submitting Initial MIP where FHA Connection did not allow data entry to be completed.

- HECM Calculator:
  - Data entry when a value is entered in the Cash from Borrower/Cash from Lender fields.

HECM Temporary Procedures and FAQs

- Temporary Procedures and FAQs are available on the HECM Lenders Site at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm.

- HECMs requiring use of these temporary procedures must meet all requirements in Mortgagee Letters 2014-21 and 2014-22 and HECM Financial Assessment and Property Charge Guide.

- All criteria stated in Section 4.2 of the Guide must be met if a compensating factor is cited where residual income does not meet the standard.

HECM Temporary Procedures and FAQs (cont.)

- Income from other sources must meet documentation standards in the Guide.
- As stated in 4.3 of the Guide, mortgagees must identify in writing on the Financial Assessment Worksheet all extenuating circumstances and compensating factors it relied upon to make its favorable determination.
- Supporting documentation must be included in the origination binder.

Review of HECM Financial Assessment Basics

Applicable Mortgagee Letters:

- 2014-21:
  - Provides the regulatory basis for the HECM Financial Assessment
- 2014-22:
  - Transmits the HECM Financial Assessment and Property Charge Guide
- 2015-06 :
  - Extended effective date of financial assessment requirements to 4/27/15
- 2015-09 :
  - Revised Section 3.98 of Guide and provided new model HECM Financial Worksheet

Review of HECM Financial Assessment Basics (cont.)

- Financial Assessment requirements apply to all HECMs:
  - Traditional;
  - Refinance; and
  - Purchase.

- Complete Financial Assessment must be performed for <u>every</u> HECM mortgagor:
  - No “fast track” procedures; and
  - Borrower request, or mortgagee requirement, for Life Expectancy Set-Aside does not mean that the full financial assessment requirements do not have to be met.

Review of HECM Financial Assessment Basics (cont.)

Credit and Property Charge Payment History:

- Determine if mortgagor "…has demonstrated the willingness to timely meet his or her financial obligations"; Section 2.1

- When evaluating credit history and property charge payment history—analysis is not limited to principal residence only;

- Mortgagees must also document credit history and property charge payment history for any other real estate owned;

Review of HECM Financial Assessment Basics (cont.)

Credit and Property Charge Payment History (cont.)

- Where the mortgagor has a credit and/or property charge payment history that does not demonstrate this willingness, consider any extenuating circumstances;
- Where there are documented extenuating circumstances, credit or property charge history may be deemed acceptable;

Review of HECM Financial Assessment Basics (cont.)

Financial Capacity Analysis

- Calculation of residual income to determine if the mortgagor has the financial capacity "…to meet his or her documented financial obligations with his or her documented income." **Section 3.1**; and
- If mortgagor does not meet residual income standard, consider any documented compensating factors.

Review of HECM Financial Assessment Basics (cont.)

Negative Residual Income

- Why revise FHA Connection to permit the entry of a negative number for mortgagor residual income?
- FHA Connection cannot currently capture the amount of income from permissible sources other than the mortgagor.
- While a mortgagor may have negative residual income, when income from another source is taken into account, the residual income standard may be met.

Review of HECM Financial Assessment Basics (cont.)

Example of Negative Residual Income

Residual Income Standard	$ 886
Gross Monthly Income	$1,581
Monthly Expenses	- $1,385
Monthly Property Charges	-$ 305
Residual Income	-$ 109
Non-Borrowing Spouse Income	+$1,100
Total Residual Income	$ 991

- When Non-Borrowing Spouse income is included, mortgagor meets residual income standard.

Review of HECM Financial Assessment Basics (cont.)

Extenuating Circumstances and Compensating Factors

- You cannot cite extenuating circumstances to support loan approval where the residual income standard is not met.
- You cannot cite compensating factors to support loan approval where the credit or property charge history standard is not met.
- Extenuating Circumstances are not limited to those in the Guide.
- Compensating Factors are limited to those listed in the Guide.

Extenuating Circumstances

Four criteria must be met:

- There is a connection between the problem and the measurable impact on finances;
- Actions of the mortgagor did not contribute to the problem;
- The problem is not likely to recur; and
- The mortgagor has access to financial resources that enhance the ability to meet future financial challenges.

Compensating Factors

- Four compensating factors require that income from another source combined with the mortgagor's income equals or exceeds the applicable residual income standard:
  - Non-Borrowing Spouse Income;
  - Overtime, Seasonal, Part-time, or Bonus Income;
  - Expected SSI or Pension Income; and
  - Imputed Income from HECM.

- All required criteria for the applicable compensating factors must be met to cite the compensating factor;

Compensating Factors (cont.)

- Property Charge Payment History Requires that:
  - Mortgagor has paid his or her own property charges directly for past 24 months;
  - All property charge payments have been made without incurring penalties for last 24 months;
  - Current income is not less than that of the previous 24 months; <u>and</u>
  - Residual income is 80% - 99% of the applicable standard.

- If all four criteria are not met, you cannot cite this compensating factor;

Compensating Factors (cont.)

- Assets Equal to Life Expectancy Property Charges Requires that:
  - Assets are at least equal to Projected Life Expectancy Property Charges; and
  - Assets were not dissipated or considered in residual income calculation.

- If both criteria are not met, you cannot cite this compensating factor

Compensating Factors (cont.)

- Access to Other Income or Resources Requires that:
  - Mortgagors have access to revolving credit; or
  - Other sources that provide the mortgagor with financial liquidity that would enhance ability to endure a financial crisis.

- There must be a relationship between the amount of the residual income shortfall and the amount of credit or other resources available;

Compensating Factors (cont.)

- HECM Sufficient to Pay Off Debts Requires that:
  - HECM proceeds remaining during[1] First 12 Month Period are sufficient to pay off outstanding obligations (revolving and installment debt); and
  - HECM proceeds were not dissipated or considered in residual income calculation.

- If both criteria are not met, you cannot cite this compensating factor; and

- There must be a relationship between the amount of the residual income shortfall and the benefits of paying off obligations.

1. Correction made on 11/19/15 to replace the word "after" with the word "during" in this location. Please note that this correction is not reflected in the webinar recorded on 9/23/15.

Is a Life Expectancy Set-Aside Required?

Life Expectancy Set Asides (LESA), are for the purpose of setting HECM funds aside for payment of property charges.

- Fully Funded LESA required based on mortgagor's credit or property charge history.
- Partially Funded LESA required based on the mortgagor's residual income shortfall.
- Fully Funded LESA when "projected Partially Funded LESA is greater than 75% of the Projected Life Expectancy Property Charges". **Section 5.7**

Is a Life Expectancy Set-Aside Required? (cont.)

If a Fully Funded Set-Aside is Required:

- Does the mortgagor meet the residual income standard?
- Does the mortgagor meet the residual income standard if compensating factors are taken into account?
- Does the HECM represent a sustainable solution to the mortgagor's financial circumstances?

Is a Life Expectancy Set-Aside Required? (cont.)

If a Partially Funded Set-Aside Is Required:

- Does the mortgagor meet the credit and property charge history standards?
- Does the mortgagor meet the credit and property charge history standard if extenuating circumstances are taken into account?
- Does the HECM represent a sustainable solution to the mortgagor's financial circumstances?

Projected Life Expectancy Property Charges

- Must calculate even if Set-Aside is not required.
- Must be entered in FHA Connection on the HECM Financial Assessment Update screen.
- To calculate, you need the formula in Section 5.3 of the Guide, and three data elements:
  - Monthly real estate taxes, hazard and flood insurance (annual amounts ÷ 12);
  - Monthly compounding rate (expected rate + annual MIP rate ÷ 12); and
  - Life expectancy in months of youngest mortgagor (annual life expectancy x 12).

Projected Life Expectancy Property Charges (cont.)

- Formula for calculating Projected Life Expectancy Property Charges:
  $(1.2 \text{ x PC} \div 12) \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^{m}\}$

- Where:
  - **PC = annual property charges**
    (based on current charges or known rates for next year for real estate taxes, hazard and flood insurance)
  - **m = life expectancy in months of youngest mortgage**
    (life expectancy in years from Appendix 2 in Guide x 12)
  - **c = monthly compounding rate**
    (expected rate + 1.25% annual MIP rate ÷ 12)

Projected Life Expectancy Property Charges (cont.)

Let's look at an example:

- Assume:

Taxes	$2,000
Hazard Insurance	600
Flood Insurance	400
Property Charges	$3,000

Youngest mortgagor is 77 years old	
Expected rate is	4.16%
MIP rate is	1.25%
Monthly Compounding Rate is	0.004508
(expected rate + annual MIP rate ÷ 12)	

Projected Life Expectancy Property Charges (cont.)

Remember the formula:

$$(1.2 \text{ x } PC \div 12) \times \{(1+c)^{m+1} - (1+c)\} \div \{c \times (1+c)^m\}$$

• $(1.2 \text{ x } PC \div 12)$	$1.2 \text{ x } 3{,}000 \div 12$	300
• $(1+c)^{m+1}$	1.004508^{121}	1.723371
$-(1+c)$		- 1.004508
		0.718863
• $(1+c)^m$	1.004508^{120}	1.715636
x c	0.004508	x 0.004508
		0.007734

Projected Life Expectancy Property Charges (cont.)

Remember the formula:

$$(1.2 \text{ x } PC \div 12) \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^{m}\}$$

$$300 \times 0.718863 \div 0.007734 = 27{,}884$$

Projected Life Expectancy Property Charges = $27,884

Projected Life Expectancy Property Charges FHA Connection Data Entry Requirement

For the Projected Life Expectancy Property Charge field, you will need the calculation and instructions from Sections 5.2 and 5.3 of HUD's HECM Financial Assessment and Property Charge Guide.

Multiply Monthly Property Charges Subtotal *(from the Monthly Property Charges page section)* by 1.2

Projected Life Expectancy Property Charges

Monthly Property Charges Subtotal x 1.2	600.00
TALC Life Expectancy (in Months)	156
Expected Rate	6.175
Compounding Rate (Expected Rate + 1.25%)	7.425
Projected Life Expectancy Property Charge	62400.00

Multiply the life expectancy of the youngest borrower in years by 12

Add the Expected Rate *(entered directly above)* plus 1.25% *(annual mortgage insurance premium rate)*

See calculation information in Sections 5.2 and 5.3 of the HECM Financial Assessment and Property Charge Guide

Life Expectancy Set-Asides

- If a Fully Funded Life Expectancy Set-Aside is required, it is calculated using the formula for Projected Life Expectancy Property Charges.

- In our example, the amount of $27,884 is projected to be sufficient to pay monthly property charges of $300 for 10 years – the life expectancy of the youngest mortgagor.

- Note that the set-aside amount of $27,884 is less than the figure you would get by simply multiplying the monthly amount by 120 months - $36,000.

Partially Funded Life Expectancy Set-Aside

- Formula for calculating Partially Funded Life Expectancy Set-Aside:

  $(1.2 \text{ x MRIS} \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^{m}\}$

- Where:
  - **MRIS = Monthly Residual Income Shortfall**

    (based on the amount by which the mortgagor falls short of the applicable residual income standard for family size and geographic region)
  - **m = life expectancy in months of youngest mortgagor**

    (life expectancy in years from Appendix 2 in Guide x 12)
  - **c = monthly compounding rate**

    (expected rate + 1.25% annual MIP rate ÷ 12)

Partially Funded Life Expectancy Set-Aside (cont.)

Let's look at an example.

- Assume:

Residual Income Standard		\$589
Monthly Residual Income		469
Monthly Residual Income Shortfall	=	\$120
Youngest mortgagor is		77 years old
Expected rate is		4.16%
MIP rate is		1.25%
Monthly Compounding Rate is (expected rate + annual MIP rate ÷ 12)		0.004508

- This is all we need to calculate the Partially Funded Life Expectancy Set-Aside.

Partially Funded Life Expectancy Set-Aside (cont.)

Remember the formula:

$$(1.2 \times \text{MRIS}) \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^{m}\}$$

• (1.2 x MRIS)	1.2 x 120	144
• $(1 + c)^{m+1}$	1.004508^{121}	1.723371
- (1 +c)		- 1.004508
		0.718863
• $(1 + c)^{m}$	1.004508^{120}	1.715636
x c	0.004508	x 0.004508
		0.007734

Partially Funded Life Expectancy Set-Aside (cont.)

Remember the formula:

$$(1.2 \text{ x MRIS}) \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^{m}\}$$

$$144 \quad \times \quad 0.718863 \quad \div \quad 0.007734 \quad = \$13{,}384$$

- Partially Funded Life Expectancy Set-Aside = $13,384.
- Mortgagor will receive semi-annual payments of $720 (120 x 6).

Partially Funded Life Expectancy Set-Aside (cont.)

- Partially Funded Life Expectancy Set-Aside — $13,384
  ÷
  Projected Life Expectancy Property Charges — $27,884
  = 48%

- Since Partially Funded Set-Aside amount is less than 75% of Projected Life Expectancy Property Charges, Fully Funded Life Expectancy Set-Aside is not required.

CASE STUDIES

What Did We Learn Today

- Negative Residual Income may be entered in FHA Connection, but only where there are other documented sources of income (compensating factors).
- To cite a compensating factor you must document that all criteria have been met .
- Projected Life Expectancy Property Charges must be calculated for every HECM and entered into FHA Connection.
- Published policy requires mortgagees to make loan decisions that represent a sustainable solution for the mortgagor's financial situation.

QUESTIONS?

THANK YOU!