HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 845 Reverse Mortgage Loans to Senior Individuals
SPONSOR(S): Legg
TIED BILLS: **IDEN./SIM. BILLS:**

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1)	Insurance, Business & Financial Affairs Policy Committee		Marra	Cooper
2)	Policy Council			
3)	General Government Policy Council			
4)				
5)				

SUMMARY ANALYSIS

A reverse mortgage is a type of loan that allows a senior homeowner to convert a portion of his or her home equity into cash. The lender advances money as a lump sum, in monthly payments or as a line of credit. The homeowner does not have to make monthly payments; rather, the total loan amount comes due upon certain occurrences, such as the homeowner's death or a sale of the home.

The Federal Housing Administration (FHA) insures reverse mortgages through the Home Equity Conversion Mortgage (HECM) program, which places certain requirements on disclosure, fees and counseling on lenders. Loans available under the HECM program are capped at $625,500. Homeowners seeking loans for amounts beyond that amount turn to proprietary reverse mortgage programs, which account for approximately 5 to 10 percent of the market. These loans are not subject to the HECM regulations and are only subject to general fair practice and disclosure requirements.

Consumer advocates have expressed concern that some borrowers may not fully understand the complexities of the terms and costs of a reverse mortgage loan. Additionally, reverse mortgages have given rise to claims of abuse. Such claims range from marketing reverse mortgages as “free money,” or government programs for seniors, to aggressively cross-selling annuities or other insurance or financial products.

The bill would subject proprietary reverse mortgages to many of the same requirements that HECMs must meet, including those requiring counseling and disclosure of certain terms and limiting cross-selling.

The bill also provides that failure to comply with the requirements does not invalidate the loan agreement. Furthermore, it provides that the application of any other existing civil remedies at law is precluded.

A lender who fails to make required loan advances, and fails to cure such default, must pay the borrower triple the amount wrongfully withheld plus interest.

The bill precludes the application of any state laws or rules that would “frustrate the purpose” of reverse mortgages.

The bill may have an insignificant fiscal impact on the Office of Financial Regulation, which licenses and regulates non-depository mortgage lenders.

The bill provides an effective date of July 1, 2010.

HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

<u>Current Situation</u>

A reverse mortgage is a type of loan that allows a homeowner to convert a portion of their home equity into cash. The lender advances money as a lump sum, in monthly payments or as a line of credit. The homeowner does not have to make monthly payments; rather, the total loan amount comes due upon certain occurrences, such as the homeowner's death or a sale of the home.

Generally, to be eligible for a reverse mortgage, a homeowner must be older than 62 years of age and must own his or her home with little to no outstanding liens. Because the transaction is equity-based, there are seldom income or credit qualifications.[1] Reverse mortgages are generally non-recourse loans, meaning that the borrower will never owe more than the value of the property.[2]

Equity conversion products, including reverse mortgages, have been around since the early 1960s and grew in popularity during the 1980s. In 1988, Congress created the Home Equity Conversion Mortgage (HECM) program, allowing the Federal Housing Administration (FHA) to insure reverse mortgages.[3] While HUD was originally limited to insuring 2,500 mortgages, the number of insured reverse mortgages had reached 425,000 by 2008.[4]

HECMs are only available through an FHA-approved lender and are subject to certain regulations; including:[5]

Borrower Eligibility Requirements:

- Be 62 years of age or older
- Own the property outright or have a small mortgage balance
- Occupy the property as principal residence
- Not be delinquent on any federal debt
- Participate in a consumer information session given by an approved HECM counselor

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[1] Tara Twomey, Subprime Revisited: How Reverse Mortgage Lenders Put Older Homeowners' Equity at Risk. National Consumer Law Center 2 (Oct. 2009).

[2] *See* Mortgage Letter 2008-38. If an estate or homeowner wishes to maintain ownership of the home, however, it must pay the loan balance, regardless of the home's value.

[3] 12 U.S.C. 1715z–20 and 24 C.F.R. 206.

[4] Twomey, *supra* n. 1 at 4-5.

[5] *See* U.S. Dept. of Housing and Urban Development. FHA Reverse Mortgages (HECMs) for Consumers. *Available at* http://www.hud.gov/offices/hsg/sfh/hecm/hecmabou.cfm.

Eligible Properties (must meet FHA requirements)
- Single family home or 1-4 unit home with one unit occupied by the borrower
- Manufactured home
- HUD-approved condominium

Financial Requirements:
- No income or credit qualifications
- No repayment as long as the property is the principal residence
- Closing costs may be financed in the mortgage

Mortgage Amount Based On:
- Age of the youngest borrower
- Current interest rate
- Lesser of appraised value or the HECM-FHA mortgage limit, currently $625,500.

Repayment – The loan becomes due and payable in full if:
- Borrower dies or sells home
- Borrower fails to live in the home for 12 consecutive months
- Borrower permanently moves to a new principal residence
- Borrower allows the property to deteriorate and fails to make necessary repairs
- Property taxes or hazard insurance are not paid or borrower violates other obligations

However, not all reverse mortgages are HECMs. Homeowners seeking loan amounts beyond the HECM maximum turn to proprietary programs. An accurate assessment of the number of proprietary reverse mortgages made does not exist. However, it is widely believed that proprietary reverse mortgages account for 5-10% of all reverse mortgages made. With the recent developments in the housing market and economy in general, this percentage may be smaller.[6]

These programs are not subject to the same restrictions as HECMs. They are, however, subject to basic federal creditor protection laws, including:

- Truth in Lending Act (TILA), as implemented by Regulation Z[7]
  - Requires disclosure of overall costs of credit.
  - Requires a disclosure of the "total annual cost" using three scenarios.

- Real Estate Settlement Procedures Act (RESPA)[8]
  - Requires disclosure of fees and charges in the real estate settlement process.
  - Prohibits kickbacks between settlement service providers.

- Fair Lending (Equal Credit Opportunity & Fair Housing acts)[9]
  - Prohibits discrimination in all aspects of credit transactions on certain prohibited bases.

- Unfair and Deceptive Acts or Practices (UDAP)[10]
  - Generally prohibits unfair or deceptive acts or practices in all aspects of the transaction.
  - Provides legal parameters for determining whether a particular act or practice is unfair or deceptive.

In Florida, the Office of Financial Regulation (OIR) is responsible for the licensure and regulation of loan originators, mortgage broker businesses, and non-depository, mortgage lender businesses. State and federally chartered depository institutions and other specified entities are exempt from state

[6] Twomey, *supra* n. 1 at 4-5.
[7] 15 U.S.C. 1601 *et seq*. and 12 C.F.R. 226.1.
[8] 12 U.S.C. 2601 *et seq*., Regulation X, 24 CFR 3500.
[9] 15 U.S.C. 1691 et *seq*., Regulation B, 12 CFR 202, and 42 U.S.C. 3601 *et seq*.
[10] Section 5(a) of the Federal Trade Commission Act, 15 U.S.C. 45(a)

licensure. A person licensed or required to be licensed under parts I-III of ch. 494, F.S., is subject to administrative fines and penalties for violating any provision of parts I-III of ch. 494, F.S., RESPA, TILA, or any regulations adopted under such acts.[11]

Consumer advocates have expressed concern that some borrowers may not fully understand the complexities of the terms and costs of a reverse mortgage loan.[12] Additionally, reverse mortgages have given rise to claims of abuse.[13] Such claims range from marketing reverse mortgages as "free money," or as a government program for seniors, to aggressively cross-selling annuities or other insurance or financial products.

Financial service providers may encourage borrowers to invest the reverse mortgage proceeds in an annuity, sometimes earning less than the interest mounting on the reverse mortgage and restricting the borrower's access to much-needed funds. The federal Housing and Economic Recovery Act of 2008 prohibits lenders from conditioning the extension of an HECM loan on a requirement that borrowers purchase any other financial or insurance product, except those that are usual and customary in mortgage lending, such as hazard or flood insurance.[14] However, this prohibition does not apply to proprietary reverse mortgage lenders.

<u>Proposed changes</u>

The bill provides that the purposes of the act include
- meeting seniors' special needs by permitting the conversion of home equity into liquid assets;
- encouraging lender participation in reverse mortgages;
- protecting senior homeowners from fraud and abuse; and
- encouraging the use of the federal Home Equity Conversion Mortgage program and proprietary reverse mortgages;

The bill provides definitions applicable to the act, including 'reverse mortgage,' which is defined as:

A nonrecourse loan secured by real property that meets the following criteria:
1. The loan provides a lump sum, periodic cash advances, and lines of credit to a borrower based on the equity or the value in a borrower's owner-occupied
2. The loan requires no payment of principal or interest until the entire loan becomes due and payable.

The act is applicable to both reverse mortgages written through proprietary and the HECM programs.

The bill provides the following requirements for reverse mortgages:

- Prepayment must be allowed without penalty.
- Interest rates may be fixed or variable, and may include interest contingent on the property's value at the time of the loan, payment or changes in value between the dates.
- Periodic advances to a borrower may not be reduced based on adjustments in the interest rate.
- The reverse mortgage may become due upon:
  - Sale or transfer of the home;
  - Any fixed maturity date agreed upon;
  - Any event specified in the loan documents which jeopardizes the lender's security; or
  - The borrowers' failure to occupy the home as a principal residence.
    - This does not include temporary absences of less than 60 days; or
    - Extended absences, between 60 days and 1 year, if the borrower secures the home in a manner satisfactory to the lender, per the loan agreement.

[11] Section 494.00255, F.S.
[12] *See, e.g.,*Twomey, *supra* n. 1 at 1.
[13] *See, e.g.,* Sid Kirchheimer, Scam Alert: Reverse Mortgage Seduction, AARP Bulletin Today. (Feb. 9, 2009); Twomey, *supra* n. 1.
[14] 12 U.S.C. 1715z–20.

- The reverse mortgage loan may include costs and fees, subject to federal and state laws.
- The lender must provide disclosures to the borrower before the loan closing, including information regarding the Interest rate, term of the loan, schedule of advancements, and conditions under which repayment is triggered.
- The lender may not condition the reverse mortgage on the applicant purchasing an insurance annuity or other financial product, excluding those customary for mortgages. This includes offering such financial product to the borrower, or referring the borrower to anyone else for such purchase, before closing or the borrower's right to rescind the loan agreement.
- The borrower must receive financial counseling regarding reverse mortgages.
  - The lender must refer prospective borrowers to a HUD-approved counseling agency and provide them with a list of 5 agencies, including at least 2 offering counseling by phone.
  - Counseling may be face to face or by phone.
  - Counseling must include financial and other implications of reverse mortgages and alternative options.
  - The borrower may be charged a fee for the counseling, which may be financed under the loan.
  - The lender may not accept a final application or collect any fees without receiving a certification that the applicant has received the requisite counseling.

The bill also provides that failure to comply with the requirements does not invalidate the loan agreement. It also provides that the application of any other existing civil remedies at law is precluded. From the context of the paragraph, it seems likely that the preclusion of applicability of all civil remedies was a drafting error.

A lender who fails to make required loan advances, and fails to cure such default, must pay the borrower triple the amount wrongfully withheld plus interest.

The bill precludes the application of any state laws or rules that would "frustrate the purpose" of reverse mortgages.

The bill provides an effective date of July 1, 2010.

B. SECTION DIRECTORY:

Section 1 creates a new, unnumbered section to provide purposes, definitions, and requirements for reverse mortgage loans.

Section 2 provides an effective date.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   The bill may have an insignificant fiscal impact on the Office of Financial Regulation, which licenses and regulates non-depository mortgage lenders.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill provides additional disclosure requirements that may help consumers choose a more cost-effective reverse mortgage.

The bill may impact proprietary reverse mortgage lenders not currently following HECM guidelines for disclosure.

D. FISCAL COMMENTS:

The bill may have an insignificant fiscal impact on the Office of Financial Regulation, which licenses and regulates non-depository mortgage lenders.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   This bill does not appear to require counties or municipalities to take an action requiring the expenditure of funds, reduce the authority that counties or municipalities have to raise revenue in the aggregate, nor reduce the percentage of state tax shared with counties or municipalities.

2. Other:

   Federal Preemption

   The bill applies its requirements to both proprietary reverse mortgages and loans through the federal Home Equity Conversion Mortgage program. To the extent that the bill's requirements conflict with federal law governing such loans, the bill's requirements will be preempted by federal law.

   The Supremacy Clause of the U.S. Constitution applies when state law is inconsistent with federal law. State law directly conflicting with federal law is invalid.[15] State laws not in direct conflict may also be invalidated if a court finds Congress intended to occupy the entire field regulated, even if the state law seems to reinforce or compliment the federal law.[16] Courts will determine whether the scheme of federal regulation is comprehensive.[17] If a federal agency has been established, courts will likely deem preempted all matters within the jurisdiction of the agency.

   The bill's attempt to apply its requirements to loans insured through the federal Home Equity Conversion Mortgage program could be preempted by the federal regulations. However, the bill's requirements closely track those of the federal program, so a conflict is unlikely.

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[15] *See Perez v. Campbell*, 402 U.S. 637 (1971); *McCulloch v. Maryland*, 17 U.S. 316 (1819).
[16] *Campbell v. Hussey*, 368 U.S. 297 (1961).
[17] *Pennsylvania v. Nelson*, 350 U.S. 497 (1956).

The bill's regulation of proprietary reverse mortgages is less likely to conflict with federal regulation, as Congress has not regulated these mortgages beyond the fair practice acts applicable to all loans. Furthermore, it may be argued that these loans exist beyond the jurisdiction of the FHA.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The definition of 'reverse mortgage loan,' at lines 76-82, is limited to those nonrecourse loans providing "a lump sum, periodic cash advance, <u>and</u> lines of credit." Because reverse mortgages often use any one of those methods of payment or a combination of them, the word 'or' may be more accurate than 'and.'

Lines 262-266 provide that failure to comply with the act is not grounds for invalidation of any agreement. It goes on to provide:

> However, this section <u>does preclude</u> the application of any other existing civil remedies provided by law.

Under this provision, a borrower would have no civil remedies. This provision would undoubtedly be preempted by federal laws providing private causes of action for unfair lending practices. From the context of the paragraph, it seems likely that the term, 'not' was inadvertently omitted from line 265 between 'does' and 'preclude.'

Lines 272-280 provide that applicable state laws or rules that "<u>frustrate the purpose</u> of reverse mortgage loans [do] not apply to reverse mortgage loans." How this provision will be interpreted and applied is difficult to ascertain. The bill provides purposes for the act, including (1) to meet seniors' special needs by permitting the conversion of home equity into liquid assets; (2) To encourage lender participation in reverse mortgages; (3) To protect senior homeowners from fraud and abuse; and (4) To encourage the use of the federal Home Equity Conversion Mortgage program and proprietary reverse mortgages. But these are not necessarily the purpose of reverse mortgage loans, and even if a court relies on these purposes, it is unclear what sort of state laws or rules would be ruled inapplicable to reverse mortgages.

IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES