SUBJECT: Authorizing line-of-credit advances under a reverse mortgage

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 6 ayes — Solomons, McCall, Flynn, Guillen, Orr, Riddle

0 nays

1 absent — Chavez

SENATE VOTE: On final passage, March 3 — 30-0

WITNESSES: For — Scott Norman, Texas Association of Reverse Mortgage Lenders; (*Registered, but did not testify:* Joey Bennet, Credit Union Legislative Coalition; Khelan Bhatia, AARP; Robert Doggett, Texas Low Income Housing Information Service; John Heasley, Texas Bankers Association; Mark Lehman, Texas Association of Realtors; Matt Matthews, Credit Union Legislative Coalition; Steve Scurlock, Independent Bankers Association of Texas; Larry Temple, Texas Mortgage Bankers Association)

Against — None

BACKGROUND: In 1997, Texas voters approved Proposition 8 (HJR 31 by Patterson), amending Texas Constitution, Art. 16, sec. 50 to allow homeowners to obtain loans and other extensions of credit based on the equity of their residence homestead. Equity is the difference between a home's market value and what is owed on the home. Home equity loans are paid in a lump sum or, as of 2003, by line of credit, and loan repayments begin immediately. If a homeowner fails to make a monthly installment, the lender may foreclose.

Reverse mortgage loans are fundamentally different from other home equity loans. Only homeowners who are or whose spouses are at least 62 years old may obtain reverse mortgages. The borrower receives loan advances based on the equity in the borrower's homestead. These advances may be provided in a lump sum or in monthly installments. However, repayments do not begin until the homeowner no longer occupies the property, transfers it to another owner, or passes away. At that time, the home often is sold, and the proceeds are used to pay off the loan. Any money remaining after the reverse mortgage is paid goes to the borrowers or their heirs. If the home is transferred to heirs, the loan balance is due at the time of transfer, regardless of whether the borrower still lives there. If the loan balance exceeds the value of the house, the estate or heirs are responsible only for the value of the home. The Federal Housing Administration insures the lender for any additional amounts.

In 1999, voters approved Proposition 2 (SJR 12 by Carona), specifying additional requirements for reverse mortgages, including increased consumer protections such as greater protection against foreclosure. The first federally backed reverse mortgages were offered in Texas in early 2001. In 2003, voters approved Propositions 16 and 6 (SJR 42 by Carona and HJR 23 by Hochberg and Solomons) enabling consumers to refinance home equity loans with reverse mortgages.

DIGEST:

CSSJR 7 would amend the methods by which advances could be made on reverse mortgage loans. Methods could include an initial advance at any time and future advances:

- at regular intervals;
- at regular intervals in which the amounts advanced could be reduced at the request of the borrower;
- at times and in amounts requested by the borrower until the credit limit was reached; or
- in amounts requested by the borrower until the credit limit established was reached, and subsequent advances at times and in amounts requested by the borrower according to the terms established by the loan documents to the extent that the outstanding balance was repaid.

A reverse mortgage would provide that a credit card, debit card, preprinted solicitation check, or similar device could not be used to obtain an advance. No transaction fees could be charged after the extension of credit in connection with any debit or advance. The lender or holder could not unilaterally amend the extension of credit.

The proposal would be presented to the voters at an election on Tuesday, November 8, 2005. The ballot proposal would read: "The constitutional amendment authorizing line-of-credit advances under a reverse mortgage."

SUPPORTERS SAY:

Many Texas seniors have begun to reap the benefits of using reverse mortgages, and CSSJR 7 would build upon this success by providing more options and protections for seniors seeking to live out their years in the comfort and security of their own homes. The manner in which advances currently may be obtained through reverse mortgages does not fulfill all seniors' needs, so providing the option to access funds as a line of credit would provide Texas seniors with a convenient option available in all 49 other states.

Many senior homeowners have considered reverse mortgages as a way to finance their housing and medical needs but did not want to take on more debt than they actually needed to at any particular time. Currently, if a borrower requests a lump sum advance in anticipation of the amount needed for the life of the loan, not only will interest begin accruing on the entirety of the loan, but that person may pay interest on money never even used. If the borrower instead chooses to receive installment payments, the payments may not be large enough to cover emergency expenses or to respond to changing, ongoing needs. A line of credit would allow seniors to draw out money only when it was needed in amounts great enough to cover necessary expenses without drawing out and paying interest on more than what they needed.

Seniors also seek the option of reducing their interest costs by repaying outstanding balances when circumstances permit, but they want the comfort of knowing they could redraw the amounts repaid if unforeseen circumstances required it. This flexibility would permit seniors to better conserve their estates for the benefit of themselves and their heirs by enabling them to control the amount and timing of their borrowing and significantly to reduce borrowing costs.

CSSJR 7 would maintain all of the consumer protections in current statute, including non-recourse liability, restrictions on events of default, and judicial process foreclosures, and would add several more, including preventing seniors from accessing their line of credit through credit cards, debit cards, or preprinted solicitation checks. This would help ensure the credit would be used for major life expenses like property taxes and insurance or medical bills. No transaction fees could be charged after the extension of credit in connection with any debit or advance, so it would protect seniors against hidden fees in contracts. Borrowers would know exactly what they were paying for in advance of finalizing the loan.

With the protections in Texas statute, reverse mortgages are virtually risk-free to the consumer, and this would not change with the addition of a line-of-credit alternative. Although it is obviously preferable for an individual to be debt-free, the fact remains that sometimes major expenses arise, and paying for them is not a question of whether or not a person needs some form of loan product to cover expenses but what sort of loan product is most appropriate. Other forms of home equity loans could require repayment to begin immediately, and the consumer would have fewer protections against foreclosure than those afforded by reverse mortgages. Also, consumers could use credit cards, but these typically carry a much higher interest rate than reverse mortgages, with the potential for higher fees and damaging impacts on credit scores if the consumer cannot make a payment every month.

Reverse mortgage lending does not provide an appealing market for unscrupulous lenders because to enter the market in general, lenders must keep their offers in line with the major competition. The line-of-credit plan is currently offered to 93 percent of borrowers by the Department of Housing and Urban Development (HUD) through its Home Equity Conversion Mortgages (HECM) and by Fannie Mae through its Home Keeper mortgages in all states other than Texas. Independent lenders would have to keep their numbers in step with the rules set up by these agencies in order to entice customers to use their loan product. Also, to be able to make these loans, an entity would need considerable funds on hand to sink into these loans for the long term, making it likely that it would be a large financial entity accountable to shareholders who would withdraw support if the lender engaged in unscrupulous practices to take advantage of seniors. These loans do not provide the lender with any up-front benefits because, by nature, they involve loaning funds for a very long term and not collecting any profits until the specified requirements are met for the loan to come due. Lenders could spend years waiting for any return, and unscrupulous lenders would not be interested in such an investment.

Many protections against foreclosure already are found in the Constitution and the circumstances under which this could occur are rare, so a lender could not take advantage of a senior by trying to open loans and then quickly foreclosing on homes. A judge would review each case of foreclosure and any unscrupulous lending practices would be too readily apparent for a bad actor to risk being caught engaging in such practices.

While having increased options for reverse mortgages could leave fewer assets for a homeowner or the homeowner's heirs, this is often a family decision. Family members often are the ones who introduce the idea of reverse mortgages to seniors because they are involved in elder family members' care and interested in seeing them remain in their homes and achieve financial security. Finally, borrowers are required to receive counseling on reverse mortgages and their financial alternatives, so they would be well informed in making this important financial decision.

OPPONENTS SAY:

CSSJR 7 could stimulate demand for a type of loan product that could in the end be more costly than traditional loans because the interest is added to the principal loan balance each month. The total amount of interest owed increases significantly with time as the interest compounds. The consumer involved is typically house rich and income poor, so the borrower’s fixed income would likely be insufficient for loan repayment. Because a consumer in compliance with the loan terms is not required to repay any of the debt until the home is sold or transferred, the borrower ceases to occupy the home for more than 12 months, or both borrowers have passed away, the consumer obligation can become significant. If another enticement existed to finance routine consumption spending through reverse mortgages, the consumer could quickly use up substantial amounts of equity in a home. That would leave fewer assets for the homeowner and his or her heirs.

Although most borrowers use HUD and Fannie Mae authorized lenders, other lenders still could offer such loans, and their fees and interest rates could be higher than the average market rate. If a consumer did not know what to watch for, that person could end up draining the equity in a home at an accelerated rate. For high-equity homes, lenders often look only at the equity in a home, not at the borrower’s repayment capacity. Someone who was house rich but cash poor quickly could spend down what had been sizeable equity in a home, leaving little remaining should they exhaust this equity.

NOTES:

As approved by the Senate, SJR 7 did not specify that subsequent advances to the extent that an outstanding balance on a reverse mortgage was repaid would have to be in accordance with the terms in the loan documents. It also would have allowed monthly fees to be charged after the extension of credit.