

PUTTING EQUITY BACK IN REVERSE MORTGAGES: HOW STATE LEGISLATURES CAN BRING FAIRNESS TO HOME EQUITY CONVERSION MORTGAGES

Andrew C. Helman*

"We should provide for our age, in order that our age may have no urgent wants of this world to abstract it from the meditations of the next. It is awful to see the lean hands of Dotage making a coffer of the grave!" – Edward Bulwer, Lord Lytton¹

INTRODUCTION

For many of today's seniors, life began in the shadow of the Great Depression, and life will end in the shadow of the Great Recession.² Meanwhile, seniors' incomes tend to be stagnant, especially with the recent economic downturn, and the problem is compounded by rising expenses for basic needs such as gas, oil, and groceries, as well as all-important medical expenses.³

* J.D. University of Maine School of Law, 2010. The author is employed by the firm Bernstein, Shur, Sawyer, and Nelson, in Portland, Maine. The author would like to thank Prof. Thom Ward and Prof. Lois Lupica for their insightful criticisms.

1. 2 EDWARD BULWER (LORD LYTTON), MISCELLANEOUS PROSE WORKS 30 (London, Richard Bentley 1868).

2. See, e.g., Valerie Bauman, *Recession Sends Older Americans to Food Pantries*, HUFFINGTON POST (Nov. 28, 2009), http://www.huffingtonpost.com/2009/11/28/recession-sends-older-ame_n_372665.html.

3. Lynn O'Shaughnessy, *Rising Prices Hammer Seniors on Fixed Incomes; Food, Fuel, Medical Costs Go out of Reach for Some*, USA TODAY, July 2, 2008, at B1; Deanne Loonin & Elizabeth Renuart, *The Life and Debt Cycle: The Growing Debt Burdens of Older Consumers and Related Policy Recommendations*, 44 HARV. J. ON LEGIS. 167, 171 (2007); PEW RESEARCH CTR., REcession TURNS A GRAYING OFFICE GRAYER, Sept. 3, 2009, available at <http://pewresearch.org/pubs/1330/american-work-force-is-graying> (38% of seniors and 63% of those ages 50 to 61 are delaying retirement due to the economic downturn); RICH MORIN & PAUL TAYLOR, PEW RESEARCH CTR., NOT YOUR GRANDFATHER'S RECESSION – LITERALLY, May 14, 2009, available at

This trend is particularly problematic in a state like Maine, which is the grayest state in the nation.⁴ Coupled with the ever-increasing number of baby-boomers approaching retirement,⁵ Maine and many other states are at a crossroad: How do policy-makers ensure seniors can retire with dignity, in spite of a down economy, evaporating wealth, and diminished resources for social welfare programs?⁶

Answering that question is not easy, and there are two major directions to take – either relying on the public sector or turning to the private sector. Many states have tried to marshal public sector resources to help seniors with rising property taxes. For example, the Maine Legislature created a program to provide targeted relief to some seniors by calling on the state government to pay municipal property taxes in exchange for priority liens enforceable upon the transfer or death of the property owner.⁷ But the public sector proved unable to bear this financial burden, and the program was phased out as the Maine Legislature struggled with budgetary matters in the wake

<http://pewresearch.org/pubs/1223/not-your-grandfathers-recession-literally> (presenting survey data showing that during the prior year 36% of seniors cut back on spending, 43% lost money on investments, 56% had a harder time meeting retirement needs, and 38% reported the recession caused family stress).

4. Kevin Miller, *Census: Maine Oldest, Whitest State's Census Data Likely Have Policy Implications*, BANGOR DAILY NEWS, May 14, 2009, at 1.

5. Annie E. Nelson, *Reverse Mortgages: Changes Brought About by the Housing and Economic Recovery Act*, 13 N.C. BANKING INST. 337, 360-61 (2009).

6. While the federal government may be uniquely suited to address this problem due to its extensive involvement in seniors' lives through Medicare and Social Security, Congress is often slowed by gridlock. Cf. Evan Bayh, Op-Ed., *Why I'm Leaving the Senate*, N.Y. TIMES, Feb. 21, 2010, at WK9. As a result, there may be greater room for political success at the state level.

7. ME. REV. STAT. ANN. tit. 36, §§ 6250-67 (2010). See, e.g., H. 114-1088, 1st Sess., at 4 (Me. 1989); H. Amendment H to Comm. Amendment A to H.P. 776, H. 114-1088, 1st Sess. (Me. 1989); Elderly Householders Tax Relief Act, ch. 503, 1971 Me. Laws 1015; Act of March 3, 2010, ch. 489, 2010 Me. Laws 1121 (providing municipal property tax deferrals for senior citizens) (codified at ME. REV. STAT. ANN. tit 36 § 6271 (2010)). In addition to efforts to provide targeted relief for Maine seniors, the Legislature also enacted two other programs of note. The Maine Residents Property Tax Program provides rebates based on the proportion of a taxpayer's income that goes to pay property taxes or rent to income. ME. REV. STAT. ANN. tit. 36, §§ 6201-20 (2010). The Maine Resident Homestead Property Tax Exemption provides discounts the valuation of homestead property up to \$13,000. §§ 681-689.

of a shutdown of state government in 1991.⁸

Given the stark economic realities facing the state and federal governments, it is worth asking whether the private sector might be better-equipped to bear this burden, and if so, to what extent government can channel private sector resources to help seniors? The private sector presents several options for senior homeowners – for example, sale, sale-leaseback, retaining a life-estate, a support mortgage, or a reverse mortgage – and there are pros and cons to each, ranging from financial feasibility for sales or sale-leasebacks to the need to curb abusive and misleading practices for reverse mortgages.⁹ But in light of emerging data showing that the vast majority of seniors would prefer to age in place and the difficulty many seniors would face generating substantial income from limited equity freed in a sale, sale-leaseback, or sale of all but a life-estate, a reverse mortgage may present a promising option.¹⁰

However, significant reforms are needed to make reverse mortgages safe and secure for seniors – though that still leaves as a separate question whether entering into a reverse mortgage transaction makes smart financial sense in any given situation. Many of the needed reforms can be addressed at the state level without the need for Congressional action. For example, seniors would benefit from rules ensuring fair transactions by boosting consumer protections, such as enhanced counseling

8. Me. Exec. Order No. 1 FY 91/92 (July 1, 1991); Elderly Householders Tax Relief Act, ch. 707, § G-6, 1993 Me. Laws 251 (codified at ME. REV. STAT. ANN. tit. § 6267 (2010)) (“New taxpayer claims for participation in the deferral program provided pursuant to this chapter are not allowed regarding an application filed on or after April 1, 1991.”); Telephone Interview with David Ledew, Dir. of Prop. Tax Div., Me. Revenue Serv. (June 17, 2009).

9. Celeste M. Hammond, *Reverse Mortgages: A Financial Planning Device for the Elderly*, 1 ELDER L. J. 75, 77-92 (1993) (discussing sale, sale-leaseback, retaining a life-estate, special purpose home equity conversion programs, and reverse mortgages); GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 20-22 (3d ed. 1994) (discussing support mortgages); *Thompson v. Glidden*, 445 A.2d 676, 678 (Me. 1982) (holding that a support mortgage should be construed liberally in favor of the senior needing support).

10. For a discussion and example of whether a reverse mortgage makes sense in a particular situation, see Tara Siegel Bernard, *Costs Fall for Reverse Mortgages*, N.Y. TIMES, Apr. 17, 2010, at B1.

requirements and prohibitions against inappropriate cross-selling of annuities and other financial or insurance products; a ban on yield spread premiums; a suitability analysis; a "lite" product geared toward property taxes; and a private right of action for damages plus attorney's fees for violations of program rules. Legislators could induce lenders to agree to these protections by offering to place them on a list of preferred lenders maintained by the appropriate state agency, such as a state housing authority. Seniors would benefit from safe and secure borrowing options, while lenders would benefit from the imprimatur of the state government when accessing this largely untapped market.¹¹

Discussion of this proposal will begin in Part II by describing the scope of the economic problems facing seniors – and by extension some baby boomers. Part III will look to Maine and its last major programmatic effort to help seniors to demonstrate why the public sector is ill-equipped to tackle this problem. Instead, as discussed in Part IV, the private sector is better-suited to shoulder this burden. While there are several options available, creating a program to induce lenders to offer reverse mortgage products that are safe and secure may present the best way for seniors to gain liquidity from the equity trapped in their homes. Finally, Part V will conclude by calling on state legislatures to take action to curb abusive practices associated with reverse mortgage products, so that seniors can more easily free locked-up equity to help during retirement.

DESCRIBING THE PROBLEM

Throughout the recent recession our country has largely, though not entirely, avoided breadlines; however, that has not been the case for many seniors, who "are particularly affected by shrinking income, increased expenses, easier access to credit, and erosion of the economic safety net."¹² The reality for many

11. Nelson, *supra* note 5, at 360-61.

12. Loonin & Renuart, *supra* note 3, at 170. See, e.g., O'Shaughnessy, *supra* note

seniors is that “prices of essentials — notably, gas and food — have galloped beyond reach,” while at the same time seniors are “living on fixed incomes” and “just getting crushed on food and medicine that they can’t do without.”¹³

To begin with, the median income tends to be lower for households headed by those who are over 65-years-old,¹⁴ and about 75% of all seniors have incomes below \$33,000.¹⁵ While a smaller percentage of seniors live in poverty than other age groups,¹⁶ that is largely due to the support offered by Social Security.¹⁷ Additionally, today’s seniors have not saved enough for retirement, which can be deduced from the fact that “the percentage of people over the age of sixty-two who receive more than half of their income from sources other than Social Security is shrinking.”¹⁸ Yet at the same time, the vast majority of today’s seniors expect and hope to remain at home during their retirement.¹⁹

The problem is compounded by rising expenses for housing costs, health care costs, energy costs, and property taxes, which, taken together, put the squeeze on seniors.²⁰ For example, “[o]lder adults devote a larger share of their expenditures to housing than to any other category of goods or services, including health care.”²¹ At the same time, older Americans are more likely to be homeowners; more than 80% of all heads of

3; Bauman, *supra* note 2.

13. O’Shaughnessy, *supra* note 3.

14. CARMEN DENAVAS-WALT ET AL., U.S. CENSUS BUREAU, P60-236, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2008, 6 (2009), available at <http://www.census.gov/prod/2009pubs/p60-236.pdf>.

15. PATRICK PURCELL, CONG. RESEARCH SERV., 7-5700, INCOME AND POVERTY AMONG OLDER AMERICANS IN 2008 Summary (2009), available at http://benefitslink.com/articles/guests/RL32697_Oct_2009.pdf (interpreting census data in a report prepared for Congress).

16. DENAVAS-WALT ET AL., *supra* note 14, at 18, Figure 5.

17. Loonin & Renuart, *supra* note 3, at 170.

18. *Id.*

19. ADA-HELEN BAYER & LEON HARPER, AARP, FIXING TO STAY: A NATIONAL SURVEY OF HOUSING AND HOME MODIFICATION ISSUES 25 (2000), available at http://assets.aarp.org/rgcenter/il/home_mod.pdf.

20. Loonin & Renuart, *supra* note 3, at 171.

21. *Id.*

households over 65 are homeowners, in comparison to the homeownership rate for all households of 68.8%.²² That pattern holds true for households living below the federal poverty line as well, with seniors living below the poverty line having higher homeownership rates than the general population.²³

And the rise (and recent fall) in housing prices has not helped matters, because there is a correlation between the increase in housing prices and rising property taxes.²⁴ Unfortunately for those with low incomes, especially seniors, rising property taxes are especially difficult to cope with because their incomes usually do not rise correspondingly.²⁵ For example, scholarly journals and newspapers have reported instances of seniors in New England who are living well below the poverty line and who are unable to pay their property tax bills after their home values sky-rocketed.²⁶

These trends are particularly problematic in Maine. To begin with, recent census data show that Maine is the oldest state in the nation.²⁷ Even before 2009's update to the 2000 Census data, Maine was the grayest state: "[T]he median age in Maine – already the nation's oldest state – is growing as the number of Mainers who are 45 or older swells and the number of residents under age 18 declines."²⁸ According to the most recent data, "Maine and Vermont also share the distinction of having the smallest percentage of the population under age 5."²⁹

22. U.S. CENSUS BUREAU, SERIES H150/05, AMERICAN HOUSING SURVEY FOR THE UNITED STATES: 2005, 42 (2006), available at <http://www.census.gov/prod/2006pubs/h150-05.pdf>.

23. *Id.* at 42, 414 (reporting the home-ownership rate among seniors living below the poverty line was 63.3%, while the rate for the entire sample was 42.6%).

24. See Loonin & Renuart, *supra* note 3, at 173. However, it is worth pointing out that increase valuations alone do not lead to higher taxes, and this is merely a correlation. What drives property taxes are the needs of a municipality and the amount of money to be raised. When higher property values result from a revaluation, the local tax rate is typically reduced downward by a proportional amount.

25. *Id.*

26. *Id.* at n.48.

27. Miller, *supra* note 4.

28. *Id.*

29. *Id.*

Unfortunately, there is every reason to believe that we are looking at the tip of the iceberg when it comes to seniors' financial health and ability to gather the financial resources – between private savings and public social welfare programs – to retire with dignity. For starters, about 10,000 baby boomers a day turn 62.³⁰ Put a slightly different way, approximately 78.2 million baby boomers were born between 1946 and 1964.³¹ “With the aging of the baby boomers, it has been estimated the population of seniors will increase 36 percent to nearly 55 million by 2020.”³² Given the current economic reality – a down stock market, falling home prices, and decreasing job prospects – boomers may very well be in a difficult position when it comes time to retire.³³ For example, from October 2007 to October 2008:

[R]etirement accounts have lost \$1.6 trillion or 18.3 percent of their value, according to Urban Institute calculations. The Congressional Budget Office puts the figure at \$2 trillion [from July 2007 to October 2008]. Individual 401(k) participants' average losses ranged from 7.2 percent to 11.2 percent in the first nine months of 2008, according to an Employee Benefit Research Institute analysis of 2.2 million participants. These losses disproportionately affect baby boomers because they have less time to recover before retirement.³⁴

On top of that, many boomers face the real prospect of decreased wealth transfer from the generation before them, which is living longer and also has been hit hard by the current

30. Nelson, *supra* note 5, at 360-61.

31. Patricia E. Salkin, *A Quiet Crisis in America: Meeting the Affordable Housing Needs of the Invisible Low-Income Healthy Seniors*, 16 GEO. J. ON POVERTY L. & POL'Y 285, 292 (2009).

32. *Id.*

33. Emily Brandon, *3 Ways the Economic Crisis is Destroying Baby Boomer Retirement*, U.S. NEWS & WORLD REP. (Oct. 14, 2008), <http://money.usnews.com/money/retirement/articles/2008/10/14/3-ways-the-economic-crisis-is-destroying-baby-boomer-retirement>. *But see* Carlos Lozada, *Go Ahead and Book Those Travel Plans*, THE WASHINGTON POST (Nov. 29, 2009), <http://www.washingtonpost.com/wpdyn/content/article/2009/11/27/AR2009112702473.html> (discussing a recent study postulating that the current economic downturn will only delay retirement by an average of a month and a half).

34. Brandon, *supra* note 33.

financial crisis.³⁵ And that does not take into consideration the fact that many boomers expect retirement to be more active than the preceding generation, hopefully filled with travel and activity.³⁶ As one writer said:

For us, retirement is more a lifestyle transition than an end in itself. To maintain our standard of living in retirement, conventional wisdom has held that retirees need roughly 65-75 percent of their pre-retirement income, and this figure is likely to increase to 80 or 90 percent as people are living longer and staying more active than in generations past.³⁷

Even before the recent economic downturn, the American Association of Retired Persons' (AARP) policy institute projected that baby boomers should not count on inheritances to survive during retirement.³⁸ "[I]nheritances, despite wishful thinking and optimistic projections, are not likely to bail out the boomers."³⁹ In part, that is because the median value of inheritances received by boomers by 2004 was \$64,000.⁴⁰ However, before the economic downturn, in 2004, only about fifteen percent of boomers actually expected any inheritance, "suggesting that for most boomers, inheritances will remain an elusive or small, contributor to their retirement security."⁴¹ Taking a broader look, AARP said:

In general, inheritances are unlikely to make a significant contribution to the retirement savings of most boomers. Nor are inheritances likely to have

35. Dean Burns, *Can Baby Boomer Generation Expect Inheritance for Retirement?*, BABY BOOMER MAGAZINE (May 20, 2010), <http://www.babyboomer-magazine.com/news/119/ARTICLE/1108/2009-02-10.html>; See also JOHN GIST & CARLOS FIGUEIREDO, AARP PUBLIC POLICY INSTITUTE, IN THEIR DREAMS: WHAT WILL BOOMERS INHERIT? 9 (May 2006), available at http://assets.aarp.org/rgcenter/econ/dd139_inherit.pdf; Meghan Sharp, *Downturn Takes its Toll on Senior Citizens*, FOXBUSINESS (March 6, 2009), http://www.wowonline.org/ourprograms/eesi/documents/Downturntakesitstollonseniorcitizens_3609.pdf.

36. Burns, *supra* note 35.

37. *Id.*

38. GIST & FIGUEIREDO, *supra* note 35, at 9.

39. *Id.*

40. *Id.* at 5.

41. *Id.* at 9.

much of an effect on labor supply. For those nearing retirement, a large inheritance might be a factor in the timing of their retirement, but only the most affluent are likely to receive such inheritances. In general, inheritances are not likely to rescue most boomers if they have failed to prepare for retirement on their own.⁴²

Taken together, the problem stands in stark relief. The current group of seniors is “sitting on a large amount of home equity” but face trouble making ends meet.⁴³ The baby boomers, who are rapidly approaching retirement, are facing diminished retirement savings due to the economic downturn and no substantial hope of being bailed out by inheritances from their parents.

Given this perfect storm, the current crop of seniors is increasingly turning to credit.⁴⁴ For example, even before the recent economic downturn, between 1992 and 2001 “[a]verage credit card debt for Americans between the ages of sixty-five and sixty-nine rose a staggering 217% . . . to \$5,844.”⁴⁵ And from 2005 until 2009, credit card debt for older Americans increased by 26%, which was the second highest for any age group.⁴⁶ Similarly, the number of older Americans holding mortgages has also increased.⁴⁷ At the same time, it seems that predatory lenders have been “target[ing] the equity in elders’ homes by offering loans to pay for long-neglected home repairs, credit card bills, property and municipal taxes, or even medical bills.”⁴⁸

42. *Id.*

43. Loonin & Renuart, *supra* note 3, at 180.

44. *Id.* at 168.

45. *Id.*

46. JOSÉ GARCÍA & TAMARA DRAUT, DĒMOS, THE PLASTIC SAFETY NET: HOW HOUSEHOLDS ARE COPING IN A FRAGILE ECONOMY 4 (2009), available at <http://www.demos.org/pubs/psn.pdf>.

47. Loonin & Renuart, *supra* note 3, at 168.

48. *Id.* at 180.

THE PUBLIC SECTOR IS NOT THE ANSWER

Like many state policy-makers, the Maine Legislature explicitly recognized the financial problems faced by seniors, especially regarding property taxes.⁴⁹ As a result, the Legislature enacted the Elderly Tax Deferral Program in 1989, requiring the state government to pay local property taxes for certain low-income seniors in exchange for liens on the seniors' homestead property that were enforceable if the senior died, sold the property, moved, or moved the property from the state.⁵⁰ But the program proved to be unsustainable.⁵¹ While the state has recouped virtually all of the money invested in the program, it tied up scarce resources that could have been directed to other programs, and it essentially put the state in the business of lending, when the private sector may be better equipped to do so more efficiently.

The details of the program are fairly simple and in line with the Legislature's stated purpose when enacting it, which was to "alleviate[] property tax burdens on persons, age 65 years and older, by establishing provisions for a property tax deferral program."⁵² The program allowed seniors who met eligibility criteria to defer property taxes on their principal residence, in exchange for the state government paying their local property taxes.⁵³ In exchange for accepting the state's help, seniors agreed to repay the amount of money advanced plus interest, which

49. H. 114-1088, 1st Sess., at 4 (Me. 1989); H. Amendment H. to Comm. Amendment A. to H.P. 776, H. 114-1088, 1st Sess. (Me. 1989). During floor debate in which the Senate accepted the House's action to adopt Committee Amendment A, one senator said the following: "I do plan to vote for this, understanding that there is some property tax relief for the individuals throughout this state, including the elderly[,] who wish to stay in their homes . . . and this will allow many of them that choice." 114 Legis. Rec.1989 (statement of Senator Kany).

50. ME. REV. STAT. ANN. tit. 36, § 6259 (2010).

51. Elderly Household Tax Relief Act, ch. 707, § G-6, 1993 Maine Laws 251 (codified at ME. REV. STAT. ANN. tit. § 6267 (2010)); Telephone Interview with David Ledew, *supra* note 8.

52. H. Amendment H to Comm. Amendment A to H.P. 776, H. 114-1088, 1st Sess. (Me. 1989).

53. ME. REV. STAT. tit. 36, §§ 6250(3), 6251 (2010).

was set at six percent per annum.⁵⁴ Four major classes of events triggered a repayment obligation: death of the claimant; sale of the property; the claimant moved for reasons other than health; or the property, such as a mobile home, was removed from the state.⁵⁵

The state secured its interest by recording a lien on the property.⁵⁶ When one of the four repayment-triggering events took place, seniors, their heirs, or their devisees, had until April 30th of the following year to repay the state the amount of money advanced to cover local property taxes plus interest.⁵⁷ If the state did not recoup its money by that time, the Legislature authorized the State Tax Assessor to record a tax lien certificate in the registry of deeds, which created a "mortgage on the real estate to the State" that had "priority over all other mortgages, liens, attachments and encumbrances of any nature and [gave] to the State all rights usually instant to a mortgage, except that the mortgagee d[id] not have any right of possession of the real estate until the right of redemption expire[d]."⁵⁸ If the senior, their heirs, or devisees, did not repay the state within twelve months from when the tax lien was filed in the registry of deeds, "the mortgage [was] deemed foreclosed and the right of redemption expired."⁵⁹ As a practical matter, however, the state only foreclosed on one property in nineteen years.⁶⁰

To be eligible to participate, seniors and their property had to meet certain requirements. First, participating taxpayers had to be sixty-five or older on April 1 of the year in which they filed

54. §§ 6255(3), 6259.

55. § 6259.

56. § 6254(1).

57. *Id.*

58. *Id.* It is not entirely clear what impact, if any, this program had on residential borrowing. Because enrollment in the program was relatively short-lived, it is difficult to gauge the impact on lending. However, if the Legislature does seriously consider reviving the program, then it would be worth analyzing this issue in more depth.

59. § 6254(2).

60. E-mail from David Ledew, Dir. of Prop. Tax Div., Me. Revenue Serv. (April 15, 2010) (on file with author).

a tax deferral claim, and they had to earn less than \$32,000 in the previous year.⁶¹ Second, the state only provided tax deferral assistance on homestead property, which included a senior's "owner-occupied principal dwelling," such as a house, apartment, or mobile home.⁶² Third, seniors had to hold the property in fee simple estate.⁶³

Despite the program's modest enrollment – for example, 73 claimants in year one, 90 in year four, and about 175 at the program's height – the Legislature quickly became concerned about the cost of the program and authorized the State Tax Assessor to pay less than the total amount due to municipal taxing authorities.⁶⁴ If the taxpayer could not pay the difference, then the municipality was left holding the bag, and its only recourse was a tax lien for the amount of uncollected taxes.⁶⁵ As a practical matter, though the program was destined to grow, the Legislature's decision to allow pro-rated distributions to municipalities triggered a lack of confidence in the program.⁶⁶

However, the real death knell came a few short years later, in the wake of a fiscal crisis that led to a shutdown of state government in 1991.⁶⁷ In 1994, as part of a supplemental budget bill, the Legislature established a retroactive moratorium on new claims under the Elderly Tax Deferral Program that were filed on or after April 1, 1991.⁶⁸ The prohibition will likely never be lifted. There was no floor debate or discussion in the press of this issue.

A handful of properties remain in the program – eight in

61. § 6251(1).

62. §§ 6250(3), 6251.

63. § 6252.

64. § 6257(1-A). At one point in time, the program had more than 175 participants. E-mail from David Ledew, *supra* note 60.

65. § 6257(1-A).

66. Telephone Interview with David Ledew, *supra* note 8.

67. *Id.*; Me. Exec. Order No. 1 FY 91/92 (July 1, 1991).

68. Elderly Householders Tax Relief Act, ch. 707, § G-6, 1993 Maine Laws 251(codified at ME. REV. STAT. ANN. tit. § 6267 (2010) ("New taxpayer claims for participation in the deferral program provided pursuant to this chapter are not allowed regarding an application filed on or after April 1, 1991.").

2009 – and Maine Revenue Services expects to collect fully for all of the taxes owed.⁶⁹ As mentioned above, throughout the program's life, the state government has only had one collection issue, which was for a property that deteriorated due to lack of care.⁷⁰ However, the state recovered its money at auction.⁷¹

Recently, a state legislator attempted to breathe new life into the Elderly Tax Deferral Program,⁷² but she was unable to win support from the Legislature's Taxation Committee because of the cost of the program, even though she proposed raising the minimum age for participation to seventy.⁷³ However, Rep. Chase's effort was not entirely without success. The Taxation Committee amended her proposal to allow municipalities to establish tax deferral programs based on guidelines that are similar to the Elderly Tax Deferral Program.⁷⁴ As enacted, municipalities are authorized to establish programs for seniors at least seventy years or older, who occupy their homestead property, have lived in the property for at least ten years, and have an income of 300% of the federal poverty level or less.⁷⁵ But even this modest proposal is a poor use of public resources; it would tie up millions in scarce public resources,⁷⁶ it could give lenders cold feet and add to borrowing costs,⁷⁷ and would likely add to administrative costs for enforcement proceedings.

69. Telephone Interview with David Ledew, *supra* note 8.

70. *Id.*

71. *Id.*

72. Senior Property Tax Deferral Program, ch. 908, (codified at ME. REV. STAT. ANN. tit. §§ 6250-6267 (2010)).

73. *Id.*; Telephone Interview with David Ledew, *supra* note 8.

74. Comm. Amendment A., 124-1121, 2nd Sess., (Me. 2010).

75. *Id.*; Act of March 3, 2010, ch. 489, 2010 Maine Laws 1121 (codified at ME. REV. STAT. ANN. tit. 36 § 6271).

76. Telephone Interview with David Ledew, *supra* note 8.

77. If the program gained widespread acceptance, it is not entirely clear what impact it would have on residential lending because the state is able to place its liens first in line, which jeopardizes the position of any private lienholder. As originally enacted, the program voided contractual language barring liens of this sort. ME. REV. STAT. tit. 36, § 6265 (2010). There is no data on the program's impact on lending.

A PRIVATE SECTOR SOLUTION

THE OPTIONS

Given the relatively high rates of homeownership and stagnant or declining incomes among seniors, many "face the dilemma of being 'house rich, but cash poor.'"⁷⁸ Often, for the vast majority of seniors, their "wealth is tied up in the equity of their homes, a nonliquid, non-income-producing asset."⁷⁹ Turning to the private sector, seniors will find several ways to help them tap into their locked-up equity: sale; sale-leaseback; retaining a life estate; a support mortgage; or a reverse mortgage.⁸⁰ And there are distinct advantages and disadvantages to each, especially for homeowners in states with housing costs similar to Maine, where the median sale price for a home in 2008 was \$178,000, and the average monthly rent for a two bedroom apartment in the same year was \$846.95.⁸¹

For example, a sale is "the most obvious way for the elderly homeowner to convert home equity to an income-producing use."⁸² A homeowner can then invest the proceeds to generate income, or simply live off of the sale proceeds and buy or rent

78. Hammond, *supra* note 9, at 76. While Hammond offers an interesting perspective on alternatives to reverse mortgages, it is worth noting that in her article she said her express goal was "to increase availability of reverse mortgages and to encourage their wider use." *Id.* at 77.

79. *Id.* at 77-78.

80. See generally *id.* at 77-92 (discussing sale, sale-leaseback, retaining a life-estate, special purpose home equity conversion programs, and reverse mortgages); NELSON & WHITMAN, *supra* note 9, at 20-22 (discussing support mortgages); *Thompson v. Glidden*, 445 A.2d 676, 678 (Me. 1982) (holding that a support mortgage should be construed liberally in favor of the senior needing support). Traditional forward financing is also an option, and seniors could try to obtain a credit line, lump sum mortgage with amortized payments, or a balloon mortgage. But the senior may face difficulty making payments on these options. Even a loan with a balloon payment could pose problems if the borrower lives longer than expected and the estate is unavailable to be liquidated. See Hammond, *supra* note 9, at 80.

81. *Maine Economics & Demographics*, MAINE STATE PLANNING OFFICE, <http://econ.maine.gov/index/sheet> (last visited Feb. 21, 2011) (The website provides access to Census data and allows users to build spreadsheets for particular data sets. This data comes from the Housing data set for 2008.).

82. Hammond, *supra* note 9, at 79.

less expensive housing.⁸³ However, unless a homeowner has substantial wealth tied up in their home, this option may not provide enough income and could also prove to be risky if investments do not pan out.⁸⁴ Basic investment strategies look to a person's risk tolerance and time horizon for reaping gains.⁸⁵ Given that seniors have a relatively short time horizon, their corresponding risk tolerance probably should be low because they will not have much time to recoup losses.⁸⁶ That raises serious questions about the appropriate mix of assets in a wealth management plan for seniors and whether stocks, generally considered high-risk, high-return investments, make sense when compared to bonds and cash or cash equivalents.⁸⁷

Sale-leaseback presents another option, though the transactions are often complex to navigate.⁸⁸

The basic transaction involves the homeowner selling the house to an investor who leases it back to the elderly person under a lifetime lease. Typically, the owner/seller gets some down payment from the buyer and then receives a monthly principal and interest payment from the buyer The owner/seller, now a tenant/lender, also pays monthly rent to the

83. *Id.*

84. Assuming a senior could earn three percent interest with low-risk investments, such as cash, cash equivalents, or bonds, it seems doubtful that selling a house in Maine would generate enough income to pay the median rent. Ignoring transaction costs, the income that could be generated from the median price of a home in Maine, approximately \$178,000, is \$5,340. Even before income taxes, that would only be \$445 per month, which is far less than the approximately \$846 per month needed for a two bedroom apartment at the median price. Even using some county-specific data, the numbers do not improve much. For Cumberland County, the median home price for 2008 was \$225,000, and the median price for a two bedroom apartment was about \$1,031. *Maine Economics & Demographics*, *supra* note 81. The picture is even more bleak for residents of Washington County, where the median home value was \$107,000 in 2008 and the median rent for a two bedroom apartment was about \$813. *Id.*

85. *Beginners' Guide to Asset Allocation, Diversification, and Rebalancing*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/investor/pubs/assetallocation.htm> (last modified Aug. 28, 2009).

86. *See id.*

87. *See id.*

88. Hammond, *supra* note 9, at 80-81.

buyer/landlord/borrower.⁸⁹

In addition to the complexity of such a transaction, there are a few other challenges. Seniors would need to find an investor, possibly a family member. Lessees may be in a more precarious position than owners in fee simple when it comes to maintaining possession in the face of legal action. Seniors would be vulnerable to unscrupulous landlords who do not properly maintain the property. Seniors who finance the sale-leaseback themselves would then be forced to bring an action if payments are delinquent or not forthcoming.

For those seniors with good family relations, retaining a life estate or a support mortgage may be viable options, though there are still risks.⁹⁰ For example, even assuming the best of intentions, a support mortgage can lead to litigation among family members, which adds additional costs.⁹¹ Similarly, if the transferee of a remainder interest in the senior's home fails to perform in a senior-financed transaction, the senior would be left either without the benefit of the bargain or would be forced to incur additional expenses to secure money for support.

Complicating any analysis is the fact that a relatively recent AARP survey shows that 89% of those 55 or older want to age in place and stay in their homes if that is possible.⁹² In fact, the data strongly suggests that "[t]he desire to remain in their current residence for as long as possible" is "more prevalent as age increases."⁹³ And, about 82% percent of those surveyed would prefer to have help given to them in their current home, if it eventually becomes necessary, as opposed to moving to a skilled nursing facility or moving to a friend's or relative's home.⁹⁴ Moreover, of the roughly 3 in 10 survey respondents

89. *Id.*

90. *See id.* at 82; NELSON & WHITMAN, *supra* note 9, at 20-22 (discussing support mortgages).

91. *Thompson v. Glidden*, 445 A.2d 676, 678 (Me. 1982) (holding that a support mortgage should be construed liberally in favor of the senior needing support).

92. BAYER & HARPER, *supra* note 19, at 24-25.

93. *Id.* at 25.

94. *Id.* at 28.

who said they do not expect to stay at home, 72% made no plans for when that day arrives – a statistic that seems to have held steady over more than a decade of repeated surveys.⁹⁵

For those seniors wishing to stay in their homes, reverse mortgages present an alternative. Broadly speaking, a reverse mortgage is a rising-debt/falling-equity loan that “allows a homeowner to withdraw the equity in her home in the form of a loan with a balance that increases rather than decreases over time.”⁹⁶ Typically, homeowners are able to borrow money against the equity in their home and do not have to repay the loan until a triggering event occurs, such as selling the home.⁹⁷ However, scholars, news reports, and senior advocates have drawn attention to serious concerns about predatory and abusive lending practices as well as significant costs associated with reverse mortgages.⁹⁸ Among the financial costs that have raised concerns are origination fees and insurance premiums designed to protect the lender if the home value declines and the borrower if the lender defaults as well as the impact on inter-generational wealth transfer.⁹⁹

However, as will be discussed in more detail below, with prodding from state policy makers, reverse mortgages have the potential to be useful financial products that could help some, but certainly not all, seniors age in place. The key is eliminating the tricks and traps, so that seniors and senior advocates can evaluate the financial costs associated with reverse mortgages and make an informed decision.¹⁰⁰ While the federal

95. *Id.* at 25.

96. Nelson, *supra* note 5, at 337.

97. *Id.* at 343.

98. *Id.* at 337; Bernard, *supra* note 10; TARA TWOMEY & RICK JURGENS, NAT'L CONSUMER LAW CTR., SUBPRIME REVISITED: HOW REVERSE MORTGAGE LENDERS PUT OLDER HOMEOWNERS' EQUITY AT RISK 16 (2009).

99. Bernard, *supra* note 10.

100. “Tricks and traps” is a phrase often used by Harvard Law School Professor Elizabeth Warren to refer to murky arrangements and agreements in credit card contracts. See, e.g., Elizabeth Warren on Credit Card “Tricks and Traps,” PBS.ORG (Jan. 2, 2009), <http://www.pbs.org/now/shows/501/credit-traps.html>. The term seems equally as useful here.

government plays a significant role in the bulk of the reverse mortgage market,¹⁰¹ state governments are also able to have an impact by creating opt-in programs, whereby lenders that agree to eliminate tricks and traps can benefit by being placed on a list of preferred lenders. And there may be a greater potential for success at the state level because it avoids the rancor in Congress.¹⁰²

REVERSE MORTGAGES AND THE HOME EQUITY CONVERSION MORTGAGE PROGRAM

In a nutshell, reverse mortgages function like a mirror image of traditional residential home loans. With a traditional residential home loan, lenders typically make single, lump sum payments to borrowers at the beginning of the loan term, and that money is often used as purchase money for the property in which a security interest is granted.¹⁰³ This traditional “forward mortgage” or rising equity/falling debt loan is based on a borrower’s personal creditworthiness, personal guarantee, and projected income, which is used to make payments throughout the life of the loan.¹⁰⁴ As the borrower makes payments under the terms of a traditional forward loan – excluding, for example, interest only loans, where borrowers’ payments only cover the interest accruing – the amount of principle owed will slowly decline, and the homeowner’s equity in the property will increase.

In contrast, reverse mortgages are typically nonrecourse loans secured by an elderly person’s primary residence, and a

101. Nelson, *supra* note 5, at 341; DONALD L. REDFOOT ET AL., AARP PUB. POLICY INST., 2007-22, REVERSE MORTGAGES: NICHE PRODUCT OR MAINSTREAM SOLUTION? v (2007).

102. Bayh, *supra* note 6.

103. NELSON & WHITMAN, *supra* note 9, at 1-5 (providing a basic overview of a mortgage transaction).

104. See, e.g., *Underwriting Guidelines for the Average Mortgage*, CREDIT INFOCENTER, <http://www.creditinfocenter.com/mortgage/guidelines.shtml> (last updated May 25, 2010) (discussing several underwriting criteria, such as income, debt, credit, savings, and the ratio of debt to income).

balloon payment typically is not required until a specified event occurs, often many years later, such as transfer, death, or the senior moves out of the home permanently.¹⁰⁵ Unlike traditional forward financing with regular, even monthly payments made by the borrower to the lender,¹⁰⁶ reverse mortgage lenders may make regular monthly payments to the borrower that increase the amount owed to the lender and secured by the collateralized property. However, to be eligible for insurance under the HECM program, a mortgage loan must allow for payment either:

- (A) based upon a line of credit;
- (B) on a monthly basis over a term specified by the mortgagor;
- (C) on a monthly basis over a term specified by the mortgagor and based upon a line of credit;
- (D) on a monthly basis over the tenure of the mortgagor;
- (E) on a monthly basis over the tenure of the mortgagor and based upon a line of credit; or
- (F) on any other basis that the Secretary considers appropriate.¹⁰⁷

And the borrower may convert the method of payment during the term of the mortgage, though the Department of Housing and Urban Development (HUD) has the authority to place some limitations on the convertibility of fixed-rate mortgages.¹⁰⁸

While reverse mortgages are not new – the first known reverse mortgage actually originated in Portland, Maine, in 1961 – they did not begin to become mainstream until 1988, when Congress authorized the Federal Housing Administration (FHA) to create a demonstration program insuring 2,500 reverse mortgages.¹⁰⁹ Over the next twenty years, reverse mortgages gradually became more widespread, as Congress repeatedly

105. 12 U.S.C.A. § 1715z-20(j) (West 2009); HUD Mortgage Provisions, 24 C.F.R. § 206.27(b)(5), (6), (c)(2) (2010).

106. NELSON & WHITMAN, *supra* note 9, at 2 (providing a basic overview of a mortgage transaction).

107. 12 U.S.C.A. § 1715z-20(d)(9) (West 2010).

108. § 1715z-20(d)(10).

109. Nelson, *supra* note 5, at 339. See § 1715z-20.

increased the number of loans that FHA could insure – presently 275,000 – and the private sector also expanded lending in this area.¹¹⁰

However, there are three other key ingredients that helped to make reverse mortgages more popular and accessible. First, in 1998, Congress made FHA's Home Equity Conversion Mortgage (HECM) program permanent.¹¹¹ Second, "Fannie Mae established a secondary market for home equity conversion mortgages, which by increasing liquidity, helped increase the number of lenders willing to provide home equity conversion mortgages."¹¹² Third, in 2006, the first reverse mortgage-backed securities entered the market, with two private securitizations.¹¹³ Additionally, at the beginning of October 2006, Ginnie Mae announced that it also intended to offer securities backed by FHA-approved reverse mortgages.¹¹⁴

Today, the bulk of all reverse mortgage loans -about ninety percent -are insured by FHA and must meet the administration's standards for participation in the HECM program.¹¹⁵ FHA's standards are set by statute and rule.¹¹⁶ In enacting the program, Congress said its purpose was:

[T]o authorize the Secretary to carry out a program of mortgage insurance designed-
(1) to meet the special needs of elderly homeowners by

110. § 1715z-20(g).

111. Nelson, *supra* note 5, at 339.

112. *Id.* at 340.

113. *Id.* at 340 and n.23.

114. Press Release, Ginnie Mae Media Center, New Ginnie Mae Mortgage-Backed Security Could Help Lower Costs of Reverse Mortgages for Older Americans (Oct. 17, 2006) *available at* <http://www.ginniemae.gov/news2006/10-17presshud.asp?Section=Media>.

115. Nelson, *supra* note 5, at 341; REDFOOT ET AL., *supra* note 101, at viii. Given declining home values, proprietary reverse mortgage products that are not backed by FHA are dwindling in availability. Nelson, *supra* note 5, at 341 (noting that in 2007 there were fifteen non-HECM reverse mortgage products, while by September 2008 there were only one or two products available). Nelson's conclusion that proprietary reverse mortgages are likely to decrease gains support from news reports. Kelly Greene, *Most Reverse Mortgages Dodge Credit-Crisis Woes*, WALL ST. J., Sept. 20, 2008, at B2.

116. 12 U.S.C.A. § 1715z-20 (West 2010); HUD Home Equity Conversion Mortgage Insurance, 24 C.F.R. § 206.1-206.308 (2010).

reducing the effect of the economic hardship caused by the increasing costs of meeting health, housing, and subsistence needs at a time of reduced income, through the insurance of home equity conversion mortgages to permit the conversion of a portion of accumulated home equity into liquid assets; and

(2) to encourage and increase the involvement of mortgagees and participants in the mortgage markets in the making and servicing of home equity conversion mortgages for elderly homeowners.¹¹⁷

Section 1715z-20 provides a lengthy set of requirements for borrower and lender-originator eligibility so their loans can be insured by FHA.¹¹⁸ For example, the loan originator must be approved by the HUD Secretary.¹¹⁹ And mortgagors must also meet many requirements, like the requirement that the mortgagor or his or her spouse be at least sixty-two years old.¹²⁰ In terms of programmatic substance, a loan is only eligible to be insured by FHA if the mortgagor, in addition to being a homeowner at least sixty-two years old:

(B) has received adequate counseling, as provided in subsection (f), by an independent third party that is not, either directly or indirectly, associated with or compensated by a party involved in—

(i) originating or servicing the mortgage;

(ii) funding the loan underlying the mortgage; or

(iii) the sale of annuities, investments, long-term care insurance, or any other type of financial or insurance product;

(C) has received full disclosure, as prescribed by the Secretary, of all costs charged to the mortgagor, including costs of estate planning, financial advice, and other services that are related to the mortgage but are not required to obtain the mortgage, which disclosure shall clearly state which charges are required to obtain the mortgage and which are not required to obtain the mortgage; and

(D) meets any additional requirements prescribed by

117. 12 U.S.C.A. § 1715z-20(a).

118. § 1715z-20(d).

119. § 1715z-20(d)(1).

120. § 1715z-20(b)(1), (d)(2)(A); 24 C.F.R. § 206.33 (2010).

the Secretary.¹²¹

In addition to disclosure and counseling requirements, Section 1715z-20 sets forth several provisions designed to protect elderly homeowners.¹²² For example, prepayment must be accepted without penalty; the loans are nonrecourse, which means homeowners are not personally liable for the difference between the amount of indebtedness under the mortgage and the amount the mortgagee recovers at the time the mortgage is discharged; lenders must allow homeowners to select the way they wish to receive their distributions, whether in the form of a line of credit, on a monthly basis, or on some other basis; and mortgagees must allow mortgagors to convert the method of payment.¹²³

Section 1715z-20's counseling requirement – recently amended to eliminate inappropriate cross-selling and to ensure counselors are independent – has garnered criticism from organizations like the National Consumer Law Center and the Government Accountability Office (GAO).¹²⁴ For example, despite Congressional strengthening of the counseling requirement, GAO has questioned its efficacy and the ability of HUD to adequately ensure that counselors meet basic requirements. Those requirements and protocols require a counselor to explain the following to a homeowner considering a loan through the HECM program:

- (1) options other than a home equity conversion mortgage that are available to the homeowner, including other housing, social service, health, and financial options;
- (2) other home equity conversion options that are or

121. 12 U.S.C.A. § 1715z-20(d)(2)(B)-(D).

122. 12 U.S.C.A. § 1715z-20(e), (f). In addition to disclosure requirements in Section 1715z-20, reverse mortgages must also adhere to Truth in Lending requirements. Truth in Lending, 12 C.F.R. § 226.33 (2010).

123. § 1715z-20(d).

124. See generally TWOMEY & JURGENS, *supra* note 98; *Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers: Hearing Before the S. Spec. Comm. on Aging, 111th Cong.* (2009) (statement of Mathew Scire, Director of Financial Markets and Community Investment, United States Government Accountability Office).

may become available to the homeowner, such as sale-leaseback financing, deferred payment loans, and property tax deferral;

(3) the financial implications of entering into a home equity conversion mortgage;

(4) a disclosure that a home equity conversion mortgage may have tax consequences, affect eligibility for assistance under Federal and State programs, and have an impact on the estate and heirs of the homeowner; and

(5) any other information that the Secretary may require.¹²⁵

Counseling is funded by a portion of the mortgage insurance premiums collected under the program – and the premiums are expected to fund counseling even for those homeowners who decided not to take out a loan under the program.¹²⁶

There are several other important protections that Congress included in the HECM program. First, for example, homeowners are guaranteed payment, even if their lender defaults.¹²⁷ Second, mortgagees are also protected in case home values are insufficient to cover the amount due under the terms of the note when a repayment event occurs.¹²⁸ Third, loans are only eligible for insurance by FHA if the homeowner's obligation to repay does not begin "until the homeowner's death, the sale of the home, or the occurrence of other events specified in regulations of the Secretary."¹²⁹ For example, the regulations provide that the mortgage becomes due if the mortgagor fails to keep the property in good repair, fails to pay the property taxes, or the mortgagor is absent from the premises for more than twelve consecutive months.¹³⁰ Fourth, there are caps on origination fees, so that they cannot exceed \$6,000.¹³¹

125. § 1715z-20(f).

126. § 1715z-20(l).

127. § 1715z-20(i)(1)(A).

128. § 1715z-20(g), (i)(1)(C).

129. § 1715z-20(j).

130. 24 C.F.R. § 206.27(b)(5), (6), (c)(2) (2010).

131. 12 U.S.C.A. § 1715z-20(r)(6) (West 2010).

Fifth, Congress required that mortgagees maintain firewalls so that individuals who originate reverse mortgages have no financial incentive to provide any other financial or insurance product, such as annuities, and prohibited requiring – directly or indirectly – that a homeowner purchase any other financial or insurance product, except for title and hazard insurance.¹³²

TRICKS AND TRAPS

However, in the past few years, the reverse mortgage industry has earned bad press for predatory loans that take advantage of seniors through mortgage fraud, misleading marketing, and poor adherence to pre-borrowing counseling standards set by FHA.¹³³ In fact,

[H]undreds of people who have sought reverse mortgages- in lawsuits, surveys and conversations with elder-care advocates- have complained about high-pressure or unethical sales tactics they say steered them towards loans with very high fees. Some say they were tricked into putting proceeds of their loans into unprofitable investments, while sales agents pocketed rich commissions.¹³⁴

As a result, leading senior advocacy organizations, such as AARP, have issued strong warnings against reverse mortgages.¹³⁵ Bluntly put, AARP said: “A word of caution to older Americans considering reverse mortgages: Tread

132. § 1715z-20(n)(1), (o). Internal firewalls are, of course, only as good and useful as the people adhering to them.

133. E.g., Eliot Kleinberg, *Suburban West Palm Beach Woman Charged with Defrauding 71-Year-Old*, THE PALM BEACH POST (March 23, 2010, 12:58 PM), <http://www.palmbeachpost.com/news/crime/suburban-west-palm-beach-woman-charged-with-defrauding-429990.html>; Anne Tergesen, *Mortgage Fraud: A Classic Crime's Latest Twists*, WALL ST. J. (Aug. 27, 2009, 10:41 AM), <http://online.wsj.com/article/SB10001424052970204044204574362641338197748.html>. See, e.g., SCIRE, *supra* note 125, at 10.

134. David Pratt, *Retirement in a Defined Contribution Era: Making the Money Last*, 41 J. MARSHALL L. REV. 1091, 1113 (2008) (citing Charles Duhigg, *Tapping Into Homes Can Be Pitfall for the Elderly*, N.Y. TIMES, Mar. 2, 2008, at A1).

135. Carole Fleck, *Reverse Mortgages Ripe for Abuse*, AARP BULLETIN (AARP), Oct. 7, 2009.

carefully.”¹³⁶

To address some of the concerns with reverse mortgages, Congress “provide[d] needed housing reform” in the Housing and Economic Recovery Act of 2008 (HERA).¹³⁷ The substance of the law vis a vis reverse mortgages is discussed in detail elsewhere, but it is helpful to briefly review some of the key changes.¹³⁸ Of the many changes included in HERA, three stand out as particularly important protections for consumers in the HECM program:

HERA reduced the maximum cap on origination fees for home equity conversion mortgages from \$7,256 to \$6,000.¹³⁹

To better protect seniors – who are required to receive pre-borrowing counseling discussing borrowing options other than reverse mortgages; the financial implications of a reverse mortgage; and disclosures about tax, inheritability, and eligibility for federal and state programs – Congress strengthened the independence requirement for counselors and boosted funding for counseling.¹⁴⁰

136. *Id.*

137. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654.

138. *See generally*, Nelson, *supra* note 5; Emily Brandon, *How the Housing Law Affects Reverse Mortgages*, U.S. NEWS & WORLD REP. (Aug. 18, 2008), <http://www.usnews.com/money/retirement/articles/2008/08/18/how-the-housing-law-affects-reverse-mortgages.html?PageNr=2>.

139. Nelson, *supra* note 5, at 349; 12 U.S.C.A. § 1715z-20(r) (West 2010).

140. The current statutory language in Section 1715z-20(d)(2)(B) requires that seniors:

- B)** ha[ve] received adequate counseling, as provided in subsection (f), by an independent third party that is not, either directly or indirectly, associated with or compensated by a party involved in—
- (i)** originating or servicing the mortgage;
 - (ii)** funding the loan underlying the mortgage; or
 - (iii)** the sale of annuities, investments, long-term care insurance, or any other type of financial or insurance product;

Under subsection (f),

The Secretary shall provide or cause to be provided adequate counseling for the mortgagor, as described in subsection (d)(2)(B). Such counseling shall be provided by counselors that meet qualification standards and follow uniform counseling protocols. The qualification standards and

The sale of annuities, insurance, or other similar products, in tandem with a reverse mortgage is now prohibited. HERA took a three-pronged approach to this issue. First, third-party counseling cannot be provided by anyone who is “directly or indirectly, associated with or compensated by a party involved in . . . the sale of annuities, investments, long-term care insurance, or any other type of financial or insurance product.”¹⁴¹ Second, HERA added an explicit prohibition against requiring a borrower to purchase “an insurance, annuity, or other similar product as a requirement or condition of eligibility,” except for title, hazard, or other customary insurance products.¹⁴² Third, loan originators are also prohibited from participating in, being associated with, or employing any party that participates in these transactions.¹⁴³

counseling protocols shall be established by the Secretary within 12 months of July 30, 2008. The protocols shall require a qualified counselor to discuss with each mortgagor information which shall include—

- (1) options other than a home equity conversion mortgage that are available to the homeowner, including other housing, social service, health, and financial options;
- (2) other home equity conversion options that are or may become available to the homeowner, such as sale-leaseback financing, deferred payment loans, and property tax deferral;
- (3) the financial implications of entering into a home equity conversion mortgage;

- (4) a disclosure that a home equity conversion mortgage may have tax consequences, affect eligibility for assistance under Federal and State programs, and have an impact on the estate and heirs of the homeowner; and

- (5) any other information that the Secretary may require.

The Secretary shall consult with consumer groups, industry representatives, representatives of counseling organizations, and other interested parties to identify alternative approaches to providing consumer information required by this subsection that may be feasible and desirable for home equity conversion mortgages insured under this section and other types of reverse mortgages. The Secretary may, in lieu of providing the consumer education required by this subsection, adopt alternative approaches to consumer education that may be developed as a result of such consultations, but only if the alternative approaches provide all of the information specified in this subsection.

141. § 1715z-20(d)(B)(2).

142. § 1715z-20(o).

143. § 1715z-20(n)(1)(A), (B)(i).

Yet problems remain. For example, in June 2009, GAO cautioned Congress that “HUD’s internal controls for HECM counseling do not provide reasonable assurance of compliance with HUD requirements.”¹⁴⁴ GAO’s undercover participation in fifteen counseling sessions revealed that “while the counselors generally conveyed accurate and useful information, none of the counselors covered all of the topics required by HUD, and some overstated the length of the sessions in HUD records.”¹⁴⁵ Of particular significance is the fact that seven of fifteen counselors did not discuss alternatives to reverse mortgages, even though required to do so by HUD.¹⁴⁶ As a result, GAO concluded that while HUD has internal controls to make sure counselors meet program requirements, HUD “has not tested the effectiveness of these controls and lacks procedures to ensure that records of counseling sessions are accurate.”¹⁴⁷

Similarly, predatory practices continue to be a problem in the industry, garnering headlines and cautions from the Federal Bureau of Investigation (FBI). For example, a Florida mortgage broker scammed seniors out of about \$1 million by diverting money that should have gone to repay their conventional forward loans as part of reverse mortgage refinances.¹⁴⁸ Often, this sort of fraud is committed by people in relationships of trust and confidence with a senior, such as “homeowners’ relatives, caretakers or financial advisers,” though it “has also been cropping up recently in schemes to unload distressed real estate. Regulators cite cases in which real-estate speculators bought properties on the cheap and then sold them, using inflated appraisals, to senior citizens willing to take out reverse mortgages.”¹⁴⁹

Looking more broadly, the FBI noted that seniors as a group

144. SCIRÈ, *supra* note 125, at 10.

145. *Id.* at Introduction.

146. *Id.* at 11.

147. *Id.* at Introduction.

148. Tergesen, *supra* note 134.

149. *Id.*

tend to be more likely to be victims of financial crimes¹⁵⁰ and cautioned in March 2009 that:

unscrupulous loan officers, mortgage companies, investors, loan counselors, appraisers, builders, developers, and real estate agents are exploiting Home Equity Conversion Mortgages (HECMs)—also known as reverse mortgages—to defraud senior citizens. They recruit seniors through local churches, investment seminars, and television, radio, billboard, and mailer advertisements, and commit the fraud primarily through equity theft, foreclosure rescue, and investment schemes. HECM-related fraud is occurring in every region of the United States, and reverse mortgage schemes have the potential to increase substantially as demand for these products rises in demographically dense senior citizen jurisdictions.¹⁵¹

Scholars and consumer advocates agree with the FBI that the problem may not be limited to a few bad apples.¹⁵² With the economic downturn, “[s]ome lenders view reverse mortgages as a replacement for subprime lending as a new way to generate revenue.”¹⁵³ In fact, “[m]any of the same players that fueled the subprime mortgage boom – ultimately with disastrous consequences – have turned their attention to the reverse market.”¹⁵⁴ That is because “[l]enders, including some of the nation’s largest banks, view” the reverse mortgage market as a source of profits to replace those “that have dried up

150. *Fraud Target: Senior Citizens*, FBI, <http://www.fbi.gov/majcases/fraud/seniorsfam.htm> (last visited Feb. 7, 2011). The FBI cited five reasons why seniors are more likely to be targets of financial crimes. They are: 1. seniors are more likely to have nest eggs, making them desirable targets; 2. today’s seniors – raised in the 1930s, 1940s, and 1950s – “were generally raised to be polite and trusting;” 3. seniors are less likely to report fraud “because they don’t know who to report it to, are too ashamed at having been scammed, or don’t know they have been scammed;” 4. elderly people often make poor witnesses; and 5. seniors are ripe for fraud regarding products promising to help keep them young. *Id.*

151. *Home Equity Conversion (Reverse) Mortgages Exploited to Defraud Senior Citizens*, FBI (Mar. 24, 2009), http://www.fbi.gov/scams-safety/fraud/seniors/intelbulletin_reversmortgages (footnote omitted).

152. See, e.g., Nelson, *supra* note 5; TWOMEY & JURGENS, *supra* note 98, at 1.

153. Nelson, *supra* note 5, at 360.

154. TWOMEY & JURGENS, *supra* note 98, at 1.

elsewhere.”¹⁵⁵ Similarly, “[m]ortgage brokers see it as a new source of rich fees,” and predators have begun trying to wrestle “more wealth from vulnerable seniors.”¹⁵⁶ Moreover, “securitization, which allowed subprime loan originators to disassociate themselves from the downside risks of abusive lending, is becoming commonplace in the reverse mortgage industry.”¹⁵⁷ Considering that the penetration of reverse mortgages as a product is about one percent of its potential market, lenders “forecast tremendous growth due to the 10,000 baby-boomers turning sixty-two years old every day.”¹⁵⁸

Lastly, misleading advertising also plagues the industry.¹⁵⁹ GAO found six misleading claims that commonly show up in reverse mortgage marketing materials.¹⁶⁰ The claims, including

155. *Id.*

156. *Id.*

157. *Id.*

158. Nelson, *supra* note 5, at 360-61.

159. See *Reverse Mortgages*, *supra* note 124, at 5-6.

160. *Id.* at 7-8. The six claims that GAO identified are:

- “*Never owe more than the value of your home*”: The claim is potentially misleading because a borrower or heirs of a borrower would owe the full loan balance – even if it were greater than the value of the house – if the borrower or heirs chose to keep the house when the loan became due. This was the most common of the potentially misleading statements we found in the marketing materials we reviewed. This claim was made by HUD itself in its instructions to approved HECM lenders; however, in December 2008, HUD issued guidance to HECM lenders explaining the inaccuracy of this claim.
- *Implications that the reverse mortgage is a “government benefit” or otherwise, not a loan*: While HECMs are government-insured, the product is a loan that borrowers or their heirs must repay, not a benefit. Examples of this type of claim include the following: “You may be qualified for this government-sponsored benefit program,” and “Access the equity in your home without having to sell, move, or take out a loan.”
- *“Lifetime income” or “Can’t outlive loan”*: Although borrowers can choose to receive HECM funds as monthly tenure payments, even under this option, payments will not continue once the loan comes due (e.g., when the borrower moves out of the house or violates other conditions of the mortgage).
- *“Never lose your home”*: This claim is potentially misleading because a lender could foreclose on a HECM borrower’s home if the borrower did not pay property taxes and hazard insurance or

one by HUD itself, use broad language that can mislead seniors about the security of their interest in their homes or misrepresent reverse mortgages as a government benefit, rather than a loan product.¹⁶¹

MAKING REVERSE MORTGAGES SAFE AND SECURE

Despite the concerns discussed above, the reverse mortgage market is expected to grow significantly over the next decade.¹⁶² The anticipated growth of this market presents an opportunity to transform home equity conversion products into safe and secure borrowing options for seniors, the vast majority of whom would prefer to age in their homes.¹⁶³

Broadly speaking, state legislatures have an opportunity to establish programs in which lending institutions that agree to play by newly established rules aimed at ensuring reverse mortgage loans are safe and secure could be placed on a list of preferred lenders provided to seniors seeking a loan. Those rules could require, for example, strong consumer protection standards, a ban on yield spread premiums, a suitability analysis, a "lite" product geared toward property taxes, prohibitions on inappropriate cross-selling of annuities and other financial or insurance products, and a private right of action for damages plus attorney's fees for violations of the

did not maintain the house.

- *Misrepresenting government affiliation*: An example of this type of claim would include use of government symbols or logos and claims that imply that the lender is a government agency.
- *Claims of time and geographic limits*: These claims falsely imply that HECM loans are limited to a certain geographic area, or that the consumer must respond within a certain time to qualify for the loan. Examples include "must call within 72 hours," and "deadline extended," as well as the claim that a consumer's residence is "located in a Federal Housing Authority qualifying area."

Id.

161. *Id.*

162. Nelson, *supra* note 5, at 360.

163. BAYER & HARPER, *supra* note 19, at 28.

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program rules. For the vast majority of reverse mortgage loans, these state standards could wrap around the basic requirements of FHA's HECM program.

Seniors would benefit from reverse mortgages provided by known lenders that agree to make sure their products meet these standards. Lenders would benefit from the imprimatur of the state government or agency administering the program and easy access to the expanding market of seniors. States would benefit by directing private resources to a problem that has beguiled legislators.

The following recommendations would provide a good starting point for any discussion of an opt-in state-level program to better protect seniors:

(1) *Require participating lenders to meet tough consumer protection standards.* Ideally, HECM program standards could serve as a starting point to this discussion, especially because about ninety percent of the reverse mortgage market already adheres to FHA's standards in order to benefit from insured loans. There would be several advantages to using HECM's standards as a starting point. First, consumers would be guaranteed that FHA will step in to provide performance if the lender defaults, and the lender would have a guarantee of a minimum return on its investment, in case real estate prices drop. Second, while GAO certainly raised valid concerns about HUD's counseling requirement, the existence of the requirement benefits consumers and adherence can be improved through separate state standards or inducements. For example, the Legislature could demonstrate how seriously it takes strict adherence to this requirement by suspending from the program any lender making loans despite knowledge that counseling was insufficient for a particular loan. This could be ensured by requiring loan originators to ask targeted questions for data collection about the substance of the counseling actually received and submit that paperwork to the state oversight agency for auditing purposes. Third, the program has reasonable caps on origination fees, and the Legislature could

always tighten these standards. Fourth, lenders are subject to substantial disclosure requirements, such as Truth in Lending.

However, HECM standards may not be appropriate in all instances. For example, current program standards limit the maximum amount a senior can borrow to \$625,000.¹⁶⁴ Requiring strict adherence to the program's standards would leave some very asset-rich seniors out in the cold. But this may be a largely illusory problem in states like Maine, where the median sale price for a home in 2008 was \$178,000.¹⁶⁵

(2) *Require lenders or broker-originators to engage in a suitability analysis for reverse mortgages.* Arguably, seniors are in need of protection in a reverse mortgage transaction. Seniors are generally considered to be more likely to be victims of financial fraud or abuse, and the complexities of the transactions can be difficult to navigate.¹⁶⁶ Many brokers and lenders are trained to emphasize "the importance of building trust with potential customers."¹⁶⁷ Because reverse mortgages are business deals "where each party ostensibly protects his or her own economic interests, in many states brokers and lenders owe no fiduciary duty to borrowers, and when problems arise brokers and lenders disavow any relationship of trust and confidence with borrowers."¹⁶⁸

Requiring a suitability analysis would address some of these issues. A suitability analysis would establish "[a] standard of conduct that would require brokers and lenders to have

164. *FHA Reverse Mortgages for Consumers*, HUD.GOV, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmabou (last visited Apr. 29, 2011).

165. *Maine Economics & Demographics*, *supra* note 81.

166. *Fraud Target: Senior Citizens*, *supra* note 150. The FBI cited five reasons why seniors are more likely to be targets of financial crimes. They are: 1. seniors are more likely to have nest eggs, making them desirable targets; 2. today's seniors – raised in the 1930s, 1940s, and 1950s – "were generally raised to be polite and trusting; 3. seniors are less likely to report fraud "because they don't know who to report it to, are too ashamed at having been scammed, or don't know they have been scammed;" 4. elderly people often make poor witnesses; and 5. seniors are ripe for fraud regarding products promising to help keep them young. *Id.*

167. TWOMEY & JURGENS, *supra* note 98, at 19.

168. *Id.*

reasonable grounds for believing that a reverse mortgage is suitable for the borrower.”¹⁶⁹ Consumer advocates have argued that it “is necessary to counteract market forces that favor profitability over responsible lending.”¹⁷⁰ Imposing a suitability analysis requirement emerged as a significant recommendation of the National Consumer Law Center and AARP for making the reverse mortgage market safe.¹⁷¹

The suitability analysis is a well-established concept in securities law, where it “imposes a duty on a securities broker to sell only securities to a buyer that are ‘suitable’ for the buyer based on the buyer’s financial wherewithal, tax status, investment objectives, and other factors.”¹⁷² It is not a generally recognized concept in mortgage law, but it has begun to gain currency after the subprime mortgage meltdown.¹⁷³ While mortgage loans are generally considered to be arm’s length business transactions that do not impose the duties of trust and confidence, there are some legal justifications for imposing these additional duties, especially if a “borrower lacks access to information, is unsophisticated, has specific known infirmities, or some other unusual status.”¹⁷⁴ Given that seniors are more likely to be victims of financial fraud, perhaps they would fall into this category.¹⁷⁵

(3) *Require appraisals conducted for reverse mortgages to be truly independent.* To avoid inflated values and abuse of the borrowing-lending process, it would be wise to require truly independent value appraisals for loans originated through this program. Doing so would remove another recently emerging area of fraud in the reverse mortgage market: instances where

169. *Id.*

170. *Id.*

171. *Id.* at 18-19; REDFOOT ET AL., *supra* note 101, at xx.

172. Frank A. Hirsch, Jr., *The Evolution of a Suitability Standard in the Mortgage Lending Industry: The Subprime Meltdown Fuels the Fires of Change*, 12 N.C. BANKING INST. 21, 21 (2008).

173. *Id.*

174. *Id.* at 24.

175. *Fraud Target: Senior Citizens*, *supra* note 150.

speculators buy properties at low prices and, using inflated appraisals, sell them to seniors willing to take out a reverse mortgage as part of the transaction.¹⁷⁶

A cost-effective way to tackle this issue would be to have the agency administering this program maintain a list of appraisers. During the application process, the lender or borrower could call the agency, which could then dispatch an appraiser directly to the property. The gist of the idea is to remove control in selecting appraisers from lenders. While appraisers are typically paid by and work for borrowers, as a de facto matter, lenders and broker-originators often set up the appraisal, which leads to an informal business incentive to keep the lender happy.

(4) *Ban yield spread premiums for reverse mortgages originated as part of this program.* Yield spread premiums are payments from lenders to brokers “in exchange for the broker selling the borrower a loan with a higher interest rate than the borrower could have received.”¹⁷⁷ Final Rules of the Federal Reserve Bank that went into effect on April 1, 2011, seek to address this issue by prohibiting “a loan originator from steering a consumer to consummate a loan that provides the loan originator with greater compensation, as compared to other transactions the loan originator offered or could have offered to the consumer, unless the loan is in the consumer’s interests.”¹⁷⁸ It is too soon to tell what the full effect of this rule change will be, and states that enact a comprehensive opt-in program, as suggested here, may benefit from adopting a similar prohibition.

(5) *Create a “lite” reverse mortgage product specifically geared toward property taxes.* This suggestion would target one of the chronic complaints of many homeowners – that property taxes

176. Tergesen, *supra* note 133.

177. TWOMEY & JURGENS, *supra* note 98, at 19.

178. *Regulation Z: Loan Originator Compensation and Steering* 12 CFR 226, BD. OF GOVERNORS OF THE FED. RESERVE SYS., <http://www.federalreserve.gov/bankinforeg/regzcg.htm> (last visited May 15, 2011). See 12 C.F.R. § 226.36(d), (e); 75 Fed. Reg. 58512 (Sept. 24, 2010).

are too high for seniors to remain in their homes. A limited or “lite” product could be created with a streamlined application process, reduced origination fees, and, ideally, an explicit requirement for quick and easy pay-offs. Doing so would help seniors get targeted relief for property taxes, which could be made even more effective if lenders offer to escrow property taxes for borrowers. This suggestion would build on one of the key recommendations of AARP.¹⁷⁹

(6) *Prohibit the sale of annuities, insurance, or other similar financial products; prohibit directing borrowers to other services where the broker, lender, or an affiliate would gain, directly or indirectly, in conjunction with a reverse mortgage transaction.* Mostly, this is a belt-and-suspenders approach to piggy-back on HERA’s prohibitions in the HECM program. However, a state legislature could expand the prohibition so that lenders, brokers, or their affiliates would be banned from directing borrowers to contractors or purveyors of other services, if the lender, broker, or an affiliate would gain financially. At its core, the motivating principle is that brokers and lenders should not gain from a transaction in which they help seniors tap into the equity of their homes only to redirect it back to themselves or an affiliate.

(7) *Require adherence to advertising regulations aimed at eliminating misleading advertising.* As discussed above, GAO identified six commonly appearing misleading claims in reverse mortgage advertising materials. Lenders participating in this program should forgo all misleading advertising and claims, or lose their status as a preferred lender. To help with enforcement of this requirement, the agency administering the program could be authorized to deal with complaints of misleading advertising administratively, subject of course to judicial review.

(8) *Lenders that are the subject of repeated substantiated complaints resulting in findings of program violations or other evidence impugning trustworthiness lose their preferred status.* This suggestion is aimed at providing recourse against a lender that

179. REDFOOT ET AL., *supra* note 101, at 112.

flouts program regulations either as a matter of policy or as a result of a few bad apples. The carrot extended to lenders is participation as a preferred lender. If lenders fail to adhere to the program's guidelines, they should lose the benefit of that status.

(9) *Provide the appropriate agencies with enforcement power as well as authorize a private right of action with the lender/broker paying attorney fees for the borrower if they are found to have preyed upon a senior.* This suggestion is a counter-point to (8) and serves as the stick. For consumer protection laws to be effective, there must be a punishment for action that harms consumers. With that backdrop in mind, legislatures should consider providing the appropriate agencies with enforcement powers to seek civil or even criminal penalties, if conduct by lenders' warrants it. Consumers should also be empowered to bring actions, with the lender bearing the cost if it turns out the lender has violated program rules and brought harm to the consumer. For example, in Maine, the state's Unfair Trade Practices Act provides a ready legal rubric within which these goals could be achieved, and it would be worth considering whether the most effective approach would be to deem violations of the reverse mortgage program violations of the Maine Unfair Trade Practices Act, or a similar statute in another state.¹⁸⁰

Even if reverse mortgages can be successfully reformed to eliminate tricks and abusive practices, there are significant limitations to the product in the context of a broader analysis for seniors. Seniors, advocates, and those helping seniors through these decisions should give serious consideration to all available alternatives, especially when there are family members who could help to facilitate a sale-leaseback, transfer of all but a life estate, or a support mortgage. While lenders have recently dropped or waived origination and other fees, these fees and the mortgage insurance premium required by HUD are typically up-front costs that may make a reverse mortgage less attractive

180. ME. REV. STAT. ANN. tit. 5, §§ 205-A – 214 (2010).

for seniors who anticipate moving a few years after taking out the loan.¹⁸¹ Moreover, an income stream or lump sum of money may have an impact on a senior's ability to benefit from need-based social welfare programs that look to a person's level of liquid assets during the eligibility analysis.¹⁸² Lastly, there could also be significant estate planning impacts.¹⁸³ Reverse mortgages eat up available equity that could otherwise be transferred to the next generation.¹⁸⁴ Ultimately, whether it makes sense to move ahead with a reverse mortgage is a question to be answered in the context of the needs faced by a particular senior and his or her family.

CONCLUSION

Many states are at a crossroad when it comes to policy aimed at tackling the problem of an increasing number of seniors who face rising costs and diminishing or stagnant incomes. Maine tried a public sector solution through the Elderly Tax Deferral Program, but it lacked staying power, in part because it tied up significant resources. And recent efforts aimed at reviving the program – even with a higher minimum age for eligibility – demonstrate that policy makers are less than excited about the prospect of committing substantial public resources to this problem.

That leaves the private sector, and state legislatures have a unique opportunity to help shape market forces so that seniors are offered a safe and secure financial product. Given the overwhelming desire of most seniors to remain in their homes, one way to guide the market would be for state legislatures to offer to place reverse mortgage lenders on a preferred list if the

181. Bernard, *supra* note 10. For a good discussion of a hypothetical reverse mortgage borrower and the costs involved, see *id.*

182. *Id.* However, it could also be argued that allowing an asset-rich person to benefit from Medicaid programs while preserving the value of their home for their children is bad social policy.

183. *Id.* For a good discussion of a hypothetical reverse mortgage borrower and the costs involved, see *id.*

184. *Id.*

lenders agree to play by rules designed to ensure fair transactions for seniors. Those rules could include, for example, tough consumer protection standards, a ban on yield spread premiums, a suitability analysis, a "lite" product geared toward property taxes, prohibitions on inappropriate cross-selling of annuities or other financial products, a private right of action for damages plus attorney's fees for violations of the program rules, as well as the other suggestions discussed above.

Whether now or later, state policy makers will be faced with the daunting task of planning for the support of an aging population. By taking active steps now to get in front of the problem before it grows further, policy makers will be laying the groundwork for a larger group of seniors to age with dignity.