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Reverse Mortgages: A Financial Planning Device for the Elderly, 1 Elder L.J. 75 (1993)

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REVERSE MORTGAGES: A FINANCIAL PLANNING DEVICE FOR THE ELDERLY

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An analysis of the merits of reverse mortgages from individual and public policy perspectives is the subject of Professor Hammond's article. She argues that the elderly's typical "house rich, but cash poor" problem warrants approval of a method which allows the elderly to tap their home equity for income purposes while allowing them to remain in their homes. Professor Hammond analyzes other means for tapping equity and finds each lacking in its ability to accomplish the stated goal. She also describes the three types of reverse mortgages currently available. Finally, Professor Hammond sets forth a list of legal issues that remain as obstacles to the broad use of reverse mortgages and suggests ways in which these obstacles can be overcome, including federal preemption through the use of banking laws, the adoption of the AARP's Model Act, and Fannie Mae's drafting uniform forms for mortgage properties geared to each state's laws.

Concern for the needs of elderly Americans[1] is increasing as both the absolute number of and the proportion of aged to nonaged citizens grow.[2] For example, in 1978 the American Bar Association established the Commission on Legal Problems of the Elderly to examine law-related concerns of older

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1. For purposes of this article, "elderly," "aged," or "senior" citizens are those age 62 or over. The 62-year cut-off is arbitrary and was chosen primarily because many of the reverse mortgage programs, the focus of this article, set 62 as the age of borrower eligibility. *See* 24 C.F.R. §§ 206.33-206.39 (1991). On the other hand, 65 years is the cut-off for purposes of the Bureau of the Census in its Current Population Survey. *See* U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, STATISTICAL ABSTRACT U.S. tbl. 41 (111th ed. 1991) [hereinafter ABSTRACT]. Many recent articles dealing with problems of the elderly use the 65-year mark. *See, e.g.*, M.H. Hoeflich, *Housing the Elderly in a Changing America: Innovation Through Private Sector Initiative*, 1985 U. ILL. L. REV. 1; John J. O'Brien III, Note, *Reverse Annuity Mortgages and the Lien Priority Problem*, 8 ANN. REV. BANKING L. 687 (1989).

2. Although approximately 17 million people were over 65 in the United States in 1960 and approximately 26 million people were over 65 in 1980, the number of people over 65 in the United States had jumped to approximately 31 million in 1989. ABSTRACT, *supra* note 1, tbl. 41. Estimates are that by the year 2000, the number will reach almost 35 million. *Id.* A 1991 study prepared for the U.S. Special Committee on Aging foresees that, by the year 2000, this group will represent 13% of the total population, and, by 2030, 66 million persons age 65 and older will equal 21% of the population. *Attorney's Guide to Home Equity Conversion*, 1992 A.B.A. COMMISSION ON LEGAL PROBS. ELDERLY & SEC. REAL PROP. PROB. & TR. L. 1 (Stephanie Edelstein, compiler) [hereinafter *Attorney's Guide*]. The first edition of the first casebook on "the emerging field of

persons, including home equity conversion. In 1988, there were only thirty-five members of the newly formed National Academy of Elder Law Attorneys; by 1992, the number had grown to 1800 members.[3]

Moreover, many of these elderly face the dilemma of being "house rich, but cash poor."[4] The reverse mortgage is one of several home equity conversion devices that allow the aged homeowners to use the equity in their home as an income supplement[5] while they continue to live there.[6] The reverse mortgage is a desirable tool from both an individual and a public perspective. It allows the individual to use this substantial asset to increase individual choice and financial independence. And, by allowing the elderly to convert this asset into an income flow, the reverse mortgage reduces the dependency of the elderly upon public funds.[7] In part I of this article, I review the desirability of equity conversion and evaluate alternatives to the reverse mortgage.

Information[8] about reverse mortgages has increased dramatically since the first national conference on home equity was held in Madison, Wisconsin, in May 1979.[9] The potential for greater availability of reverse mortgage loans was enhanced by Congress authorizing the Department of Housing and Urban Development (HUD) to insure through its Federal Housing Administration (FHA) up to 25,000 loans through 1995.[10] The Federal National Mortgage Association's (Fannie Mae) willingness to purchase these FHA-insured reverse mortgages encourages lender participation in the FHA program.[11] Moreover, non-FHA reverse mortgages that are privately insured[12] increasingly are available.

Nevertheless, the reverse mortgage market is still small. As of mid-1992, the FHA-insured program had generated only 2000 loans in its two and one-half

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aging law and policy" was published in fall 1992. LAWRENCE A. FROLIK & ALISON PATRUCO BARNES, ELDER LAW (1992).

3. Andrew Fegelman & Sharman Stein, *As One Ages, Legal Problems Only Grow*, CHI. TRIB., Oct. 7, 1992, § 1, at 1, 21.

4. Hoeflich, *supra* note 1; *Home Mortgages in Reverse—An Option for Elderly Homeowners*, CONSUMER REP., Oct. 1992, at 637 [hereinafter CONSUMER REP.]. *See infra* text accompanying notes 18-31.

5. In this article, I use the definition of the Current Population Survey of the Bureau of the Census to include earned income. *See infra* note 27.

6. See *infra* text accompanying note 32 for a discussion of home equity conversion generally.

7. Jane Sjogren & Judith Feins, *Home Equity Conversion Through Reverse Annuity Mortgages: An Income Supplement for the Elderly*, FED. HOME LOAN BANK BOARD J., Jan. 1983, at 15.

8. Ken Scholen is founder and the director of the National Center for Home Equity Conversion, 1210 East College Drive, Marshall, MN 56258; Bronwyn Belling, currently Senior Program Specialist for the Home Equity Information Center, American Association of Retired Persons, provides information and technical assistance to consumers, attorneys, and housing counselors.

9. NATIONAL CTR. FOR HOME EQUITY CONVERSION, HOME-MADE PENSION PLANS 12 (1982) [hereinafter HOME-MADE PENSION PLANS].

10. *Attorney's Guide*, *supra* note 2, at 5.

11. CONSUMER REP., *supra* note 4, at 637.

12. *See infra* text accompanying notes 110-34. Andrew Bary, *Heaven Can Wait—Providential Seeks to Cash in on the Graying of America*, BARRON'S, Mar. 16, 1992, at 16.

years of operation.[13] Nine thousand new private loans originated from 1990 to 1992.[14] Although the relative newness of the reverse mortgage partly explains the relatively small market for it, and although the market is growing as word gets out,[15] some remaining hurdles impede the widest availability of these loans and use by the elderly.

My goal in this article is to increase availability of reverse mortgages and to encourage their wider use. In part II, I identify a variety of state laws preventing lenders from making reverse mortgage loans[16] in those jurisdictions and suggest reforms that would make reverse mortgages available to all elderly homeowners. In part III, I discuss how this tool fits into a comprehensive elder plan[17] in the hope that this will encourage greater use.

I. An Evaluation of Alternatives to the Reverse Mortgage

The slogan that the elderly are "house rich and cash poor" accurately reflects the economic circumstances of that demographic group. Studies show that household income peaks at ages forty-five to fifty-four years and then begins to decrease; thus, householders sixty-five years and over in 1989 had a median income of $15,771, compared to $41,523 for the younger group.[18] Yet, the pattern of wealth for different age groups, measured by ownership of assets, is just the opposite. The members of the high income group aged forty-five to fifty-four have a median net worth of $57,500, whereas the relatively low-earning senior citizen has assets of $83,500.[19] And comparing the 1988 survey with identical data from 1984 reveals that the share of wealth controlled by working age Americans is eroding, while the share controlled by elderly Americans is increasing.[20]

Despite the relative wealth of the elderly, much of that wealth is tied up in

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13. Kenneth R. Harney, *Dispute Building over Reverse Mortgages*, CHI. SUN-TIMES, Sept. 18, 1992, at 30A.

14. *Id.* The volume of private reverse mortgage loans increased 350% during the same period. *Id.*

15. *Id.*

16. See discussion *infra* of lien priority of advances in text accompanying notes 190-217; see discussion *infra* of negative amortization in text accompanying notes 260-63; see discussion *infra* on mortgage recordation taxes in text accompanying notes 218-23; see discussion *infra* of limits on use of mortgage proceeds in text accompanying footnotes 234-40; see discussion *infra* of maximum term of year in text accompanying notes 224-25; see discussion *infra* of restriction of variable rate mortgages in text accompanying notes 226-33; see discussion *infra* of usury laws in text accompanying note 263; see discussion *infra* of mandatory counseling requirement in text accompanying notes 241-59.

17. See discussion *infra* of reverse mortgages' effect on a borrower's eligibility for public entitlements in text accompanying notes 301-09; see discussion *infra* regarding federal income tax consequences in text accompanying notes 310-16; see discussion *infra* regarding estate planning in text accompanying notes 317-26.

18. ABSTRACT, *supra* note 1, tbl. no. 723.

19. Charles F. Longino, Jr. & William H. Crown, *Older Americans: Rich or Poor?*, AM. DEMOGRAPHICS, INC., Aug. 1991, at 48, 49.

20. *Id.* at 50.

the equity of their homes, a nonliquid, non-income-producing asset.[21] In 1987, the median value of homes owned by the elderly was $58,900, and eighty-six percent were owned free of liens.[22] An overwhelming majority of the elderly are homeowners rather than tenants.[23] Not surprisingly, eighty-six percent of respondents to a recent American Association of Retired Persons (AARP) survey indicated that they wished to live in their homes for the rest of their lives,[24] thus continuing their dilemma of having a valuable asset that provides no improvement in their current income. In fact, because of increasing home maintenance/repair costs and energy costs, elderly homeowners spend a disproportionately higher percentage of their income on housing than either seniors who are renters or all homeowners (in all age groups).[25] Yet, for psychological reasons, including a reluctance to move from a familiar environment[26] and a fear that their housing costs as renters would be unstable and increasing, the elderly continue to remain in their homes.

To supplement their earned income,[27] the aged increasingly depend on Social Security payments and private pensions.[28] About twenty-five percent of the group are poor or near poor[29] and may be eligible for public entitlement programs such as Supplementary Security Income (SSI) and Medicaid. Moreover, the rate of growth of real median income of the aged was substantially lower in the 1984-89 period than in the 1967-84 period[30] and the ratio of aged to nonaged median incomes fell slightly from 1984 to 1988.[31]

From both public policy and individual points of view, a device that allows the elderly to change some of their home equity into an income flow while allowing the homeowner to continue living in the house is desirable. With the use of such a device, the individual aged homeowner would be able to meet the desire

21. Estimates of the amount of equity in homes owned by seniors range from $750 billion to $1 trillion. Bary, *supra* note 12, at 16.

22. *Older Americans Profiled*, PUB. REL. J., May 1991, at 20.

23. A study published in 1978 showed that, in that year, 70% of the aged lived in their own homes and, in 1980, 72% owned their own homes (84% of these owned their homes free and clear). Hoeflich, *supra* note 1, at 3. By 1987, the Bureau of the Census found 80% owned their homes and 20% were tenants. ABSTRACT, *supra* note 1, tbl. 1285.

24. J. Linn Allen, *Illinois Elderly Get New Way To Tap Home Equity*, CHI. TRIB., Dec. 29, 1991, § 16, at 1.

25. Hoeflich, *supra* note 1, at 4.

26. Kent M. Shimeall, *Boon or Bust: Home Equity Conversion*, 4 DEL. LAW. 48 (1985).

27. The Current Population Survey of the U.S. Census Bureau defined income as cash income before taxes. Total income is separated into five major income types: earnings (wages and salaries; self-employment income); Social Security benefits; property income (interest, dividends, rent, royalties, and estate and trust income); pensions (government and private pensions, annuities); and other income (for example, Supplemental Security Income [SSI] and public assistance). Daniel B. Radner, *Changes in the Income of Age Groups, 1984-89*, SOC. SECURITY BULL., Dec. 1991, at 4.

28. *Id.* at 10-14.

29. Radner, *supra* note 27, at 10; Sjogren & Feins, *supra* note 7, at 22.

30. Radner, *supra* note 27, at 3. Detailed comparable estimates by the Bureau of the Census have been kept since 1967.

31. *Id.*

to stay in the home and would maintain financial independence. The burden on government support of the elderly would be reduced, if not eliminated, at least relative to what it would have been without such a home equity conversion device.[32]

A fair criticism of any plan to keep the elderly in their own homes is that it contributes to inefficient allocation of existing housing.[33] Housing for the elderly is generally underused; homes that the elderly own were built to house more than the one or two persons who currently occupy them. Also, if people live in their houses longer than they otherwise would without a home equity conversion device, less turnover of housing will occur at a time when there is a great need for additional housing for nonseniors.[34] Still, the likelihood that home equity conversion is not a perfect solution to all housing and financial needs of society does not mean that its burdens outweigh its tremendous benefits.

The following review and evaluation of traditional methods for tapping home equity will be the basis for arguing that the reverse mortgage is generally a more suitable device for increasing the income of the senior homeowner while allowing him to remain in the house until death or serious illness forces him out.

A. Sale of the House

Perhaps the most obvious way for the elderly homeowner to convert home equity to an income-producing use is the sale of the house. The homeowner could invest the proceeds of sale and use the income derived to provide rental housing or use part of the proceeds to buy a less expensive housing unit (e.g., a smaller house or a condominium). Although this approach may be suitable for some senior homeowners,[35] it conflicts with the stated wish of many to remain in the family home.[36] There are other drawbacks as well.

Senior citizens worry about the security of their investments and whether the income from them will be stable and adequate to meet their needs,[37] including likely rent increases. With the sudden drop in income from treasury bonds and savings deposits between 1991 and 1992, the elderly homeowner's worry is well founded.

Also, current tax rules may have a bearing on the decision of whether to sell. If the elderly homeowner sells his home during his lifetime, he is liable for a capital gains tax on the difference between the sales price (minus certain amounts

32. Sjogren & Feins, *supra* note 7, at 23.
33. *See, e.g.*, O'Brien, *supra* note 1, at 697.
34. Sjogren & Feins, *supra* note 7, at 23.
35. The lawyer as counselor to an elderly client should keep in mind that no single approach will work for every client, not even the reverse mortgage. Indeed, many of the state and federal laws that facilitate reverse mortgages *mandate* counseling on alternatives by one other than the lender. *See infra* text accompanying notes 241-59.
36. *See supra* text accompanying notes 24, 26.
37. Phillip B. Springer, *Home Equity Conversion Plans as a Source of Retirement Income*, SOC. SECURITY BULL., Sept. 1985, at 10, 12.

for cost of selling) and his basis in the asset.[38] Section 121 of the Internal Revenue Code (I.R.C.) provides a once-in-a-lifetime exclusion from capital gains of $125,000 to those who sell a home in which they have been residing if they are at least aged fifty-five.[39] Many seniors, however, have homes that have appreciated significantly more than the $125,000 exclusion. The possibility of putting off paying a tax on the amount that exceeds the exclusion may be a strong incentive not to sell. The desire to delay the tax consequences is especially attractive in light of § 1014 of the I.R.C.,[40] which provides that if appreciated property is acquired from a decedent (for example, by the heirs), the basis of the property in the hands of the transferee shall be the fair market value of the property at the date of the decedent's death[41] (that is, the decedent's basis plus the appreciation). Therefore, when such a person sells the house, no capital gains tax will be owed on the pre-inheritance appreciation.[42]

Use of a conventional mortgage for refinancing or a second mortgage home equity line of credit generally will not be suitable. Both approaches are based on the borrower's ability to make monthly payments as soon as the loan is made;[43] lenders will not make loans to those elderly unable to show such capability. Also, the supplementary income such a loan provides may be small; the monthly payment will include both interest and a repayment of principal.[44] Therefore, if a person needs to increase income, neither a conventional mortgage nor a home equity line of credit will work. Fear of missing a payment and risking foreclosure and eviction also may plague the elderly borrower, who typically is averse to risk taking.

B. Sale-Leaseback

Another technique for converting home equity while allowing the senior to continue living at home is the sale-leaseback. Although its popularity has been primarily as a financing device for commercial real estate,[45] it has been suggested and used as a method to unlock home equity. 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 on the loan from the seller to the buyer. The owner/seller, now a ten-

38. I.R.C. § 1001 (1992).
39. *Id.* § 121.
40. *Id.* § 1014.
41. *Id.*
42. *Id.*
43. O'Brien, *supra* note 1, at 691.
44. *Id.*
45. Robert Kratovil & Raymond J. Werner, Modern Mortgage Law & Practice § 23.01, at 319 (2d ed. 1981); Michael T. Madison & Jeffry R. Dwyer, The Law of Real Estate Financing § 6.04, at 6-17 (1981); Thomas Homburger & Gregory Andre, *Real Estate Sale and Leaseback Transactions and the Risk of Recharacterization in Bankruptcy Proceedings*, 24 Real Prop. Prob. & Tr. J. 95 (1989).

ant/lender, also pays monthly rent to the buyer/landlord/borrower.[46] One drawback of this alternative is the transaction's complexity; the terms of the sale-leaseback agreement, the deed, a long-term lease, and loan documents must be negotiated and drafted.[47] Although the National Center for Home Equity Conversion will assist individuals and their attorneys, there is no national program comparable to the FHA-insured reverse mortgage,[48] and other problems with the sale-leaseback are daunting.

A fundamental obstacle to a sale-leaseback transaction is finding the buyer/investor. Tax incentives for ownership of rental properties were reduced by the Tax Reform Act of 1986.[49] Besides third-party investors, other potential investors include family members or friends of the elderly homeowners who are trying to be helpful. However, as a tenant, the former homeowner would lose some control to a landlord, and whether the landlord is one of the children or an investor, most people would prefer not to make this transition.[50]

The federal tax consequences of a sale-leaseback may be even more of a barrier. Partly, the tax issues stem from the fact that the applicable Internal Revenue Service (IRS) rules were developed for commercial sale-leasebacks; thus, a critical question is whether there is a real sale that allows the buyer to depreciate the property.[51] In the context of a residential sale-leaseback, factors that determine whether the buyer has assumed control of the property and the benefits and burdens of real ownership include whether the buyer paid fair market value and whether the tenant pays fair market rent and not simply an amortization of the purchase price plus interest. (This factor presents a problem if the rent increases are severely restricted in the lifelong lease, a provision that is often important to the owner/seller.) If a later determination is made that the attempted sale-leaseback is not a valid sale,[52] then the "buyer" may have acquired only a remainder interest.[53]

A question could also be raised as to whether the elderly "seller" in a sale-leaseback is entitled to the I.R.C. § 121[54] one-time capital gains exclu-

46. KEN SCHOLEN, HOME MADE MONEY 33-34 (3d ed. 1991); *Attorney's Guide*, *supra* note 2, at 23.

47. *Attorney's Guide*, *supra* note 2, at 23.

48. *See infra* text accompanying notes 138-60.

49. I.R.C. §§ 1 to 9602 (1986).

50. *Providential Takes a Giant Step*, HOME EQUITY NEWS, Aug. 1984, at 2 (National Center for Home Equity Conversion interview with John F. Settel, President, Prudential-Bache Mortgage Services, as to why it rejected sale leaseback program as an investment vehicle).

51. ROBERT KRATOVIL & RAYMOND J. WERNER, REAL ESTATE LAW § 20.10(a), at 281, 282 (9th ed. 1988).

52. For an excellent discussion of the case law on this issue, including Frank Lyon Co. v. United States, 435 U.S. 561 (1978), see Hoeflich, *supra* note 1, at 21-24.

53. Such a determination could mean the homeowner may not take his § 121 exclusion and the buyer could not take deduction for expenses and depreciation. SCHOLEN, *supra* note 46, at 37; Thomas H. Steele, *Sham in Substance: The Tax Court's Emerging Standard for Testing Sale-Leasebacks*, 14 J. REAL EST. TAX'N 3, 8 (1986).

54. I.R.C. § 121(a), (b) (1992).

sion.[55] The uncertainty surrounding characterization of the transaction for federal tax purposes[56] may not be tolerable for the elderly who wish to use the sale-leaseback as an important feature of their financial plan. Additionally, if the elderly homeowner has financed the sale, he must pay income tax on interest received from the buyer on that loan.[57] Furthermore, if the homeowner does not provide the financing but a third-party lender does, the senior should have concerns about defaults by the buyer and the possibility of foreclosure[58] and its implication for a tenant.

Concerns that the sale-leaseback transaction would cause ineligibility for federal Supplementary Security Income and other public entitlements[59] have been alleviated to a great extent by a recent program circular issued by the Social Security Administration that details its policy regarding sale-leasebacks.[60] Still, great care must be used in drafting the note and mortgage the senior may hold,[61] and the senior must understand that any amount received from the buyer must be spent in that month to avoid ineligibility.[62]

C. Retaining a Life Estate

The transfer of the remainder interest in the home while the homeowner retains a life estate has long been available as a scheme for the elderly person to convert some equity to cash while remaining in possession. This approach is based on the fundamental devisability of ownership of land into present estates (here, the life estate) and future interests (here, the remainder). Such a transfer may have nostalgic appeal for the attorney who recalls the first-year property course's focus on the freehold estates and future interests.[63] Simply, the homeowner sells the remainder for a lump sum, monthly payments, or a combination of both. Upon the death of the seller, and the termination of the life estate, the remainderman has full title and the right to possession. However, as with the sale-leaseback, an initial difficulty with this approach is that of finding an investor outside the family.[64]

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55. Lew Sichelman, *Equity Conversion Could Aid Seniors*, CHI. TRIB., Feb. 22 and 23, 1985, § 3, at 1, 2; see Hoeflich, *supra* note 1, at 18-19, for discussion of this issue.

56. Hoeflich, *supra* note 1, at 17, 18.

57. I.R.C. § 61(a)(4) (1992).

58. A memorandum of the lease should be recorded and should be superior to any third-party mortgagee in order to protect the senior's right to possession. *Attorney's Guide*, *supra* note 2, at 27.

59. *See, e.g.*, Susan M. Blumenstein & Gale Harmann, *The Effect of Reverse Annuity Mortgages on SSI*, 16 U.C. DAVIS L. REV. 435, 436 (1983).

60. SOCIAL SECURITY ADMIN., PROGRAM CIRCULAR No. 04-91-0SSI (1991). Neither the Social Security statute nor its regulations explicitly address the impact of sale-leasebacks. *Attorney's Guide*, *supra* note 2, at 25.

61. *Attorney's Guide*, *supra* note 2, at 25, 26.

62. *Id.*; *see infra* text accompanying notes 301-09.

63. *See, e.g.*, JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY 167-68 (2d ed. 1988).

64. One attempt to provide a nonfamily investor, the Home Equity Living Plan (HELP), was begun by the City of Buffalo, N.Y., in 1986 with the help of Jack Guttentag of the Wharton

The transfer of a remainder interest often is used to provide the transferor/donor certain charitable gift tax benefits while retaining a right to live in the house during the donor's lifetime. Obviously, this charitable remainder trust,[65] in which the remainder is donated to a charity and the donor receives an immediate charitable deduction, will not meet the needs of an elderly person who needs monthly income.

The income tax and public entitlements implications of selling the remainder are uncertain. On the question of whether such a taxpayer would be able to use the § 121 exclusion, the I.R.C. is not clear on what property interest in the home must be sold. Two private letter rulings were issued by the IRS on this point. The first, issued in 1980, characterized a sale of his residence by a fifty-five-year-old taxpayer where he retained a life estate as a sale of a remainder interest and ruled that such a sale was ineligible for the § 121 exclusion.[66] In the second private letter ruling[67] issued in 1982, the service ruled that a sale by a taxpayer over the age of fifty-five who owned the life estate and a sale by two other taxpayers over fifty-five who owned the remainder interest in the same house failed to qualify for the § 121 exclusion even though the entire fee was thereby transferred.[68] In 1984, the IRS published a ruling[69] in a case involving a taxpayer over fifty-five who sold a life estate, all the interest he owned, to a nonrelative. The IRS ruled that a sale of less than the full fee, so long as it was the seller's entire interest, qualifies for the § 121 exclusion.[70] Although the 1984 ruling moderated the severity of the IRS's prior rulings, it does not seem to support the claim of the senior who retains a life estate for the § 121 exclusion.[71]

Even the recent Social Security Administration Program Circular[72] dealing with sale-leasebacks and reverse mortgages does not answer the difficult question about how the sale of a remainder interest in a senior's home would affect eligibility for Supplemental Security Income[73] and Medicaid.[74] The Social Security Ad-

School and $1.3 million in HUD block grants. HELP buys out the remainder interest in the elderly person's house in either a one-time lump sum cash settlement or in monthly payments for life. The life tenant gets to live in the house until death while the city picks up the costs of major property repairs and maintenance plus property taxes and insurance. The program was targeted to owners in older neighborhoods to stem their decline. HELP is no longer accepting applications, and a later attempt to begin a similar plan failed. SCHOLEN, *supra* note 46, at 38.

65. *See* I.R.C. § 2522(c) (1992).
66. Priv. Ltr. Rul. 80-29-088 (Apr. 25, 1980).
67. Priv. Ltr. Rul. 82-46-123 (Aug. 23, 1982).
68. *Id.*
69. Rev. Rul. 84-43, 1984-1 C.B. 27.
70. *Id.* at 28.
71. Hoeflich, *supra* note 1, at 19.
72. *See supra* note 60.
73. 42 U.S.C. §§ 1382a-h (1992).
74. *Id.* §§ 1395, 1396a-t. While the majority of states have the same standards for Medicaid as have been established for Social Security Income benefits, 13 states have stricter standards for Medicaid than Social Security Income: Connecticut, Hawaii, Illinois, Indiana, Montana, Missouri, Nebraska, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, and Virginia. *Attorney's Guide*, *supra* note 2, at 18.

ministration could classify the payments (lump sum or monthly installments) from the sale of the remainder interest as conversion of a resource from real property to cash.[75] Although the cash would not be considered income, any amount retained would be considered as part of the senior's resources. If the resource limit is exceeded, the recipient would be ineligible for either Supplemental Security Income or Medicaid benefits until the resource amount is reduced to the maximum allowable limit.[76] Of course, that part of the proceeds considered interest will be characterized as unearned income and, as such, will reduce the Social Security Income benefit dollar for dollar.[77] The ABA's *Attorney's Guide to Home Equity Conversion*[78] expresses concern that, because of the way the transaction is structured,[79] the Social Security Administration could categorize any payments due the seller as unearned income, thereby affecting the individual's eligibility and/or reducing monthly benefits.[80]

D. Special-Purpose Home Equity Conversion Programs[81]

Public sector deferred loans account for approximately ninety percent of Home Equity Conversion Mortgages (or HECMs) that have been written to date.[82] These public sector HECMs are special-purpose loans provided by the federal government that do not have to be paid until the borrower dies or leaves the home. The proceeds of the loan must be used for a specified purpose.[83] So-called deferred program loans (DPLs)[84] have been offered by local housing agencies to upgrade and maintain housing for the elderly. The two basic types of these loans are those in a lump sum and those disbursed in a series of periodic installments.[85]

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75. 20 C.F.R. § 416.1207(e) (1992).

76. *Id.* § 416.1205.

77. *Id.* §§ 416.1121(c), 416.1123.

78. *Attorney's Guide*, *supra* note 2.

79. The reasoning is that the sale of a remainder interest usually prohibits a life tenant from later selling the life estate; that if, additionally, the seller receives monthly payments from a buyer to whom title of the remainder has passed, the Social Security Administration could decide that the house is no longer a resource. Because the seller's life estate cannot be converted, the Social Security Administration could consider seller's interest as extinguished. *Id.* at 31.

80. *Id.*

81. Financial planners have paid much attention to reverse and reverse annuity mortgages since the mid-1970s. In theory, the simple forms described above appear to be an easy solution to the home equity conversion needs of many elderly homeowners. However, because of legal and regulatory barriers, as well as the economics . . . , planners have been slow to exploit this technique.

Hoeflich, *supra* note 1, at 13.

82. Lew Sichelman, *Equity Conversion Beginning To Move*, NAT'L MORTGAGE NEWS, Sept. 16, 1991, at 10.

83. HOME-MADE PENSION PLANS, *supra* note 9, at 21.

84. *Deferred Payment Loans* is a term used in the report of the SENATE SPECIAL COMM. ON AGING, TURNING HOME EQUITY INTO INCOME FOR OLDER HOMEOWNERS, S. Doc. No. 216, 98th Cong., 2d Sess. 1, 6 (1984), and is a term used in much of the literature on HECMs. *See, e.g.*, Dorothy E. Cumby, *Effects of Legislation on the Reverse Annuity Mortgage as a Means of Home Equity Conversion*, 13 FORDHAM URB. L.J. 869, 883, 884 (1985).

85. Cumby, *supra* note 84, at 883-90.

The various property tax-deferred programs offered by local and state governments are another public sector HECM. These programs allow the elderly, and often only low-income[86] elderly, homeowners to borrow money from the government to pay real estate taxes.[87] The government has a lien, and the loan is repaid with accrued interest at the end of the loan term.[88] Usually, the government requires a first-lien position,[89] which means that a life-term reverse mortgage, at least of the FHA-insured type,[90] will not be available to an elderly borrower who takes advantage of a property tax deferral HECM because FHA requires that it be in the first-lien position. Some states will subordinate their liens.[91]

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86. *See, e.g.*, ILL. REV. STAT. ch. 67 1/2, para. 452(a) (1991); SCHOLEN, *supra* note 46, at 13.

87. Alaska—ALASKA STAT. § 29.45.030(e) (1992). Age requirement: 65 years or older or 60 years old and the surviving spouse of a person who qualified for an exemption. Amount of exemption: may not exceed the assessed value of $10,000 for any one residence. *Id.* § 29.45.050. The exemption will be granted on the first $150,000 of the assessed value—in case of hardship an exemption can be provided beyond the first $150,000. *Id.*

Colorado—COLO. REV. STAT. § 39-3.5-102 (1992). Age requirement: 65 or older. *Id.* Interest rate: 8%. *Id.* § 39-3.5-105(5). Deferral amount: accumulated value plus interest cannot exceed the market value of the property, less all mortgages constituting liens. *Id.* § 39-3.5-103(f). The lien shall attach on the date of recordation of the certificate for deferral, shall be junior to any mortgage or deed of trust recorded prior to the date of recording of such certificate, shall have priority over all liens attaching subsequent to the date of recording. *Id.* § 39-3.5-10(4).

Georgia—GA. CODE ANN. § 91A-2401 (Michie 1989). Age requirement: 62 or older. *Id.* § 91A-2403.1. Income eligibility: gross household income of $15,000 or less. *Id.* § 91A-2404. Interest rate: 3/4 rate. *Id.* § 91A-239.2. Deferral amount: where assessed value for ad valorem taxes is greater than $50,000, the deferral may apply only to that portion of the assessed value which is $50,000 or less. *Id.* § 91A-2403. Individuals in a county with a population of 550,000 or more who are entitled to claim a homestead exemption may elect to defer payment of all or any part of that ad valorem taxes levied on the individual's homestead which exceeds 4% of the individual's gross household income of the preceding year. *Id.* § 91A-2403.1.

Utah—UTAH CODE ANN. § 59-2-1107 (1992). Age requirement: 65 or older. *Id.* § 59-2-1109. Income eligibility: deferral or abatement is provided for the poor (one whose income is less than $15,000). *Id.* § 59-2-1208(1). Interest rate: 6% per annum. *Id.* § 59-2-1108(2). Deferral amount: county board can defer any tax levied on residential property subject to the conditions of § 59-2-1109.

Virginia—VA. CODE ANN. § 58.1-3210 (Michie 1989). Age requirement: 65 years or older. *Id.* Income eligibility: total combined income received from all sources during the preceding calendar year by owners who use it as a principal residence and owners' relatives who live in the dwelling shall not exceed the greater of $30,000 or the income limits based upon family size for the respective metropolitan area. Net combined financial worth of owner(s) and spouse, less value of land and dwelling (less than 1 acre) cannot exceed $75,000. *Id.* § 58.1-3216. Interest rate: shall not exceed 8%. *Id.* Deferral, taxes, and interest if applicable shall constitute a lien upon said real estate as if it had been assessed without regard to the deferral permitted. Any such lien shall to the extent it exceeds in the aggregate 10% of the price for which such real estate may be sold, be inferior to all other liens of record.

Wisconsin—WIS. STAT. § 77.63 (1989). Age requirement: 65 years or older. *Id.* § 77.64(4). Income eligibility: $20,000 or less. *Id.* § 77.65(5). Interest rate: determined by the Secretary to be sufficient to meet expenses of the program. *Id.* § 77.66(1). Deferral amount: $1,800 or the amount of property taxes levied for the year for which the loan is sought, including interest and penalties, whichever is less. The statutory lien created shall have priority over any lien that originates subsequent to the recording of the notice. *Id.* § 77.66(9).

88. *Attorney's Guide*, *supra* note 2, at 3.

89. *See, e.g.*, ILL. REV. STAT. ch. 67 1/2, paras. 453(2) and (5) (1991).

90. 24 C.F.R. § 206.27(b)(3) (1992).

91. *Attorney's Guide*, *supra* note 2, at 3.

E. Reverse Mortgages

Private sector reverse mortgages are available to elderly homeowners of all incomes and can be used for any purpose.[92] Three different types of reverse mortgages are available: the uninsured loan,[93] the lender-insured loan,[94] and the FHA-insured reverse mortgage.[95] Certain characteristics are common to all basic types. In its simplest form, the reverse mortgage[96] involves an agreement between the lender and borrower to create a rising-debt loan, that is, one in which the balance increases over time[97] because the lender periodically "advances"[98] additional payments to the borrower. Often, the interest due on the loan also is added to the principal loan amount. Both the accumulated principal indebtedness and all the accrued interest become a lien against the house.[99] The borrower will not be obligated to repay the loan[100] until the occurrence of an event, including: (1) sale of the property,[101] (2) the maturity of the loan,[102] or (3) the death or extended absence of the borrower from the premises. Thus, the reverse mortgage is structurally similar to an open-ended mortgage, a negative amortization mortgage, and a balloon mortgage.[103]

The reverse mortgage is very different from the common, "forward" mortgage that the purchaser of a home gives to the lender in exchange for a loan of a portion of the sale price. Although the principal amount of the conventional mortgage is the highest at the beginning and decreases (or is self-amortized) as the borrower makes payments,[104] the reverse mortgage principal amount is highest at the end, and the interest charges will be "back loaded"[105] because the elderly borrower is not making any payments. On the contrary, the lender typically makes

92. *Id.* at 4.
93. *See infra* text accompanying notes 110-16.
94. *See infra* text accompanying notes 117-37.
95. *See infra* text accompanying notes 138-60.
96. The first major government-sponsored study of this device was Jack M. Guttentag, *Reverse Annuity Mortgages: How S & L's Can Write Them*, FED. HOME LOAN BANK BOARD J., July 1977, at 18.
97. SCHOLEN, *supra* note 46, at 15.
98. *See infra* text accompanying notes 193-95.
99. Cumby, *supra* note 84, at 877.
100. Federal regulation of lenders making "alternative mortgages" applies to most reverse mortgages and requires lenders to allow prepayment of the loan before it is due without penalty. 24 C.F.R. § 206.209(a) (1992).
101. The exceptions to the federal regulations that restrict enforcement of due-on-sale clauses have been amended to reflect the typical repayment trigger for reverse mortgages. *See id.* § 591.5(b)(1).
102. Uninsured reverse mortgages are typically for fixed terms. *See infra* text accompanying notes 110-13.
103. Hoeflich, *supra* note 1, at 12. In an open-ended mortgage, the proceeds are paid to the borrower gradually over time rather than in a sum at execution of the mortgage. Negative amortization refers to the fact that a portion of the interest is not paid; it is capitalized, or added to the principal; and that interest is thus subject to the interest rate of the mortgage. A balloon mortgage is one where the whole amount is due in a single payment rather than being amortized over time. *Id.*
104. KRATOVIL & WERNER, *supra* note 45, § 10.12, at 155.
105. Highest interest charges will be at the end. Hoeflich, *supra* note 1, at 12.

monthly disbursements throughout the borrower's life.[106] Also, the parties to the conventional mortgage limit the amount of the loan depending on the appraised value of the real estate at the start; an eighty percent loan-to-value ratio is common.[107] The reverse mortgage, in contrast, sets the total loan amount[108] based on current appraised value, anticipated appreciation, and the life expectancy of the borrower.[109]

The uninsured reverse mortgage was the earliest available and is the most basic[110] type of device offered by the private sector. Without an insurance feature to protect the lender, this reverse mortgage is written for a fixed term of from five to ten years. The loan-to-value ratio is generally eighty percent of the appraised value at the time the mortgage is made.[111] The loan must be paid off at the end of the term or sooner if the borrower dies or sells the property. The lender cannot take the risk involved with a life-term alternative[112] because the borrower might outlive the lender's expectations. Clearly, this type of reverse mortgage is not suitable for the elderly homeowner who wants a guaranteed right to live in the house until death.[113]

The first, long-term reverse mortgage plan to pool the risks of the unpredictability of the life expectancy of the borrower, property appreciation (as a feature of lender income), mobility of the borrower, and casualty was developed in 1982 by a New Jersey corporation called American Homestead.[114] The plan provides monthly loan advances until the borrower dies, sells the home, or reaches age 100. The amount of the loan depends on the borrower's life expectancy and the home's value. No repayment is due until the end of the term. As consideration for these favorable terms, the borrower gives up some or all of any future appreciation on the house in addition to repaying all principal and interest.[115] Still, these reverse

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106. *Id.*

107. *Id.*

108. Some state laws require a maximum. *See, e.g.*, R.I. GEN. LAWS § 34-25.1-2 (Supp. 1992); *see infra* text accompanying notes 224-25.

109. *See infra* text accompanying notes 114-16.

110. See, e.g., HOME-MADE PENSION PLANS, *supra* note 9, at 12-16, for a discussion in 1982 of "reverse mortgages" that clearly corresponds to the uninsured type. Moreover, by that year, only 200 such loans had been made in California, Maine, Ohio, Pennsylvania, New Jersey, Wisconsin, Minnesota, and Arizona. *Id.* For a concise listing of the uninsured, or term, reverse mortgage, see HOME EQUITY CONVERSION PROJECT, NEW HOME EQUITY CONVERSION CTR., FINAL REPORT OF THE HOME EQUITY CONVERSION PROJECT TO THE ADMINISTRATION ON AGING OFFICE OF HUMAN DEVELOPMENT SERVICES, U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES 16-18 (1982) [hereinafter FINAL REPORT].

111. *Attorney's Guide*, *supra* note 2, at 4.

112. *See infra* text accompanying notes 138-42.

113. SCHOLEN, *supra* note 46, at 30. These uninsured reverse mortgages are available in Arizona, Connecticut, Massachusetts, and parts of New Jersey, California, Minnesota, and New York. *Id.* at 32.

114. HOME-MADE PENSION PLANS, *supra* note 9, at 17. For most of the 1980s, lifetime reverse mortgages were only offered by American Homestead and were only offered in a handful of east coast states and California. Allen, *supra* note 24; *see also* FINAL REPORT, *supra* note 110, at 19-21.

115. HOME-MADE PENSION PLANS, *supra* note 9, at 17.

mortgages are nonrecourse loans, and neither the borrower nor the borrower's estate is liable for any amount owed beyond the value of the home.[116]

The primary advantage of the lender-insured loan, as compared with the FHA-insured loan, is that the lender-insured loan is not limited to the $124,000 regulatory ceiling placed on the FHA loan.[117] The FHA ceiling results in a limit on the monthly disbursement to about $400 for the oldest borrower. In contrast, the privately insured lenders can make mortgages that come closer to the fair market value of higher valued properties.[118] On the downside, the lender-insured reverse mortgage is more expensive to the borrower. FHA-insured mortgages carry an up-front fee of 2% and a variable interest rate that currently is about 6.25%. Lender-insured loans are at 10-12% interest rates, usually give a share of any appreciation in the property to the lender, and have an initial 7-10% fee.[119]

In 1992, only two companies offered these lender-insured reverse mortgages and only in a few places. Capitol Holding Company (CHC) is a Kentucky-based insurance company.[120] CHC is the largest provider of such mortgages, has been in operation since 1989, and has approximately $250 million in loans outstanding in California, Florida, Kentucky, Maryland, and Virginia. CHC's product is called "homeamings."[121] The Providential Corporation was founded in late 1987 and, with seed money from venture capital firms, began to offer its "Life-time Reverse Mortgage" to California senior citizens with significant equity in their homes.[122] By October 1990, Providential had made 700 loans which had grown in principal value to about $25 million, but Providential was unable to make any new loans because of an inability to raise financing.[123] In February 1992, an Initial Public Offering (IPO) on the NASDAQ exchange raised capital of about $150 million to enable Providential to expand its product offering to borrowers.[124] The company

116. Compare the nonrecourse feature here and in the FHA-insured program, see *infra* text accompanying note 141, with the typical uninsured, forward mortgages where borrower is liable for any deficiency resulting from a difference between foreclosure sale price and total debt owed. GRANT S. NELSON & DALE H. WHITMAN, REAL ESTATE FINANCE LAW § 8.1, at 594-98 (2d ed. 1985).

117. *See infra* text accompanying note 152. The applicable FHA maximum varies by location. For example, a senior homeowner in Vermont may want a reverse mortgage for $150,000, but the FHA limit there is $67,500. Phil Roosevelt, *Are 'Reverse Mortgages' Finally Getting off the Ground?*, AM. BANKER, May 24, 1991, at 10. The maximum FHA-insured loan will be $151,725 beginning in 1993 due to a recent amendment of the statute. *FHA Loan Guarantees Increase to $151,725*, CHI. SUN-TIMES, Oct. 23, 1992, at 6A.

118. For example, Providential can make advances of $1000 a month or more on a house which, in California, can easily exceed $250,000. Bary, *supra* note 12, at 17.

119. *Id.*

120. Capitol Holding Company's bond rating of AA or AAA by Standard & Poor's Corp. is reassuring to investors. Capitol is located at 680 Fourth Avenue, P.O. Box 32830, Louisville, KY 40232. *Id.* at 28.

121. *Id.*

122. *Id.* at 16. The address of Providential Corporation is Three Embarcadero Center, Suite 2250, San Francisco, CA 94111.

123. *Id.* at 17.

124. *See id.*

expected to originate 10,000 new loans over the next five years.[125]

However, in September 1992, what housing advocates called "[a] surprise attack by the federal government against a key source of income for thousands of senior-citizens"[126] had a catastrophic impact on Providential Corporation, which saw its publicly traded stock drop sixty percent.[127] The Securities and Exchange Commission's (SEC) accounting staff was alerted in a preliminary IPO filing from American Homestead Corporation to what the SEC determined to be unacceptable accounting methods used by Providential;[128] American Homestead was responding to Providential's success by creating a competitive product. The SEC accounting office required two changes. First, Providential had to stop reporting the interest accruing on its reverse loans as income[129] even though another federal agency, the IRS, considers it income and insists on tax payments on such interest as it accrues, not just when it is received by the lender.[130] Second, Providential would have to assume, in the financial projections it provides to investors, that there would be zero appreciation in the value of the real estate securing its loans, even though conventional mortgages, and the FHA-insured reverse mortgages, assume appreciation.[131]

An equally surprising flip-flop by the SEC followed a lobbying effort by the 33-million-member AARP.[132] In an election year, AARP was able to set off alarm bells within the Republican administration. An administration official commented: "You simply can't have a debate over accounting standards in a campaign atmosphere when the bottom line of your position seems to be that you're against helping old people. That's a no-win."[133] Still, Providential and other potential providers may be cautious, and investors may hesitate to buy shares in reverse mortgage products.[134]

Furthermore, lender-insured reverse mortgages face the same hurdles that have prevented even the FHA-insured HECMs from being available to elderly citizens in every state.[135] The absence of a secondary mortgage market also discourages private lenders from offering reverse mortgages. The willingness of the Fannie Mae[136] to buy all FHA-insured loans has increased the availability of those

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125. *Id.*

126. Harney, *supra* note 13, at 30A.

127. *Id.*

128. Kenneth R. Harney, *Gray Matter Brings SEC Reversal on Reverse Mortgages*, BARRON'S, Oct. 5, 1992, at 60.

129. Harney, *supra* note 13, at 30A.

130. *Id.*

131. *Id.* FHA-insured reverse mortgages are based on presumed appreciation of 4%. *Id.*

132. Harney, *supra* note 128, at 60.

133. *Id.*

134. *See* William J. Texido, Chief Executive Officer, Providential Corporation, Release in reference to agreement between Providential and Securities and Exchange Commission on reverse mortgage accounting methods (Aug. 21, 1992) (on file with the author).

135. *See infra* text accompanying notes 161-263.

136. 12 U.S.C. §§ 1716-1719 (1978 & Supp. 1992).

loans by guaranteeing a fresh supply of cash. Fannie Mae has confirmed that it is working on a program, to begin in 1993, to purchase private, non-FHA-insured reverse mortgages.[137]

A real boost to the widespread availability of reverse mortgages for senior homeowners came in 1989 when HUD[138] started a pilot program to provide the FHA insurance for 2500 reverse mortgages.[139] This insurance would pay the insured-lender if a borrower exceeded life expectancy (so that the total monthly installments plus accrued interest exceeded the value of the home) or if the home value decreased.[140] This is the mortgagee's only recourse against the borrower because the loan is nonrecourse and no deficiency is allowed.[141] Also, the insurance covers the borrower by insuring that the lender makes all of the payments it promises to provide for the life of the loan.[142]

Because of certain restrictions in the pilot program, including the fact that lender eligibility was determined by a lottery and then limited to fifty loans each, the FHA-insured program started very slowly. In 1990, Congress expanded[143] the program[144] by extending it through September 30, 1995, and making insurance available for up to 25,000 loans[145] through all 10,000 FHA-approved lenders.[146]

In May 1991, Fannie Mae announced that it would purchase more than $12 billion of FHA-insured mortgages.[147] Originating lenders who do not want to maintain the HECM loans in their portfolio can sell these to Fannie Mae.[148] As of the end of 1991, Fannie Mae had purchased only 900 HECM loans, but this statistic does not reflect the significant increase in the pace of such loans throughout 1991.[149] Also, the Federal Home Loan Mortgage Corporation (Freddie Mac)[150] has

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137. Harney, *supra* note 128, at 60.

138. Congress authorized the Home Equity Conversion Mortgage Insurance Demonstration HECM at 12 U.S.C. § 1715z-20 (1987 & Supp. V 1987).

139. For guidelines, processing procedures, and HUD forms, see DEP'T HOUS. & URBAN GOV'T HANDBOOK 4235.1, HOME EQUITY CONVERSION MORTGAGES (1989) [hereinafter HUD HANDBOOK No. 4235.1].

140. 24 C.F.R. § 206.123 (1992).

141. *Id.* § 206.27(b)(8).

142. A second mortgage is made by the borrower to HUD to secure payment of amounts disbursed to the borrower if the original lender defaults and HUD pays instead. *See id.* § 206.17.

143. *Attorney's Guide*, *supra* note 2, at 5.

144. 12 U.S.C. § 1735z-20(g) (1992).

145. Still, as of mid-1992 only 3000 applications had been processed in about 40 states. CONSUMER REP., *supra* note 4, at 637; see also *infra* text accompanying notes 161-263 for discussion of other hurdles that limit widespread availability of reverse mortgages.

146. The AARP lists only 151 lenders as certified under the FHA-insured HECM program. AMERICAN ASS'N RETIRED PERSONS, HOME EQUITY INFORMATION CTR., SUMMARY OF REVERSE MORTGAGE PLANS (1992).

147. Phil Roosevelt, *Mortgage Banking: Prospects for Reverse Loan Doubtful, Despite New Help*, AM. BANKER, May 24, 1991, at 1.

148. Most such loans are transferred to Fannie Mae through Wendover Funding, Inc., Greensboro, N.C., which charges $25 per month for the life of the loan for its "correspondent services." *Attorney's Guide*, *supra* note 2, at 7.

149. Arthur Axelson & Cheryl Moliken, *A Roadmap for HECM's*, MORTGAGE BANKING, Feb. 1992, at 53, 54.

150. 12 U.S.C. §§ 1451-1459 (1978 & Supp. 1992).

announced its participation in buying these loans, but it has not purchased any yet.

Borrower eligibility requirements include that the younger owner be at least sixty-two years of age and live in a single family home or FHA-approved condominium that meets certain minimum property standards.[151] There are no minimum or maximum asset or income limits. However, the maximum loan amount ranges from $67,000 to $124,875.[152] Borrowers may select from five payment options: tenure, term, line of credit, modified tenure, and modified term. The borrower may select or change an option at any time.[153] Interest in the loaned amounts is available at a fixed rate,[154] adjustable rate,[155] or with shared appreciation to the lender.[156]

By the terms of the loan document, a lender shall require full and immediate payment when: (1) the last borrower dies, (2) the borrower conveys all of the title and no other borrower retains title or a long leasehold, (3) the property is not the borrower's principal residence, (4) a borrower fails to occupy the premises for more than twelve consecutive months because of physical or mental illness, or (5) the borrower otherwise defaults.[157]

As a condition to obtaining a reverse mortgage, HUD requires homeowners prior to loan application to receive independent, third-party counseling on both the financial aspects of the loan and other options, including home equity conversion alternatives and housing alternatives.[158] This requirement has been criticized because there are only 1700 trained counselors nationwide, and in many areas there are no counselors.[159] The mandatory counseling requirement under FHA guidelines, and under some state laws for non-FHA loans, may be a significant and unwarranted obstacle to widespread availability and use of reverse mortgages.[160]

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151. 24 C.F.R. §§ 206.33-206.39 (1992); *Attorney's Guide*, *supra* note 2, at 6.

152. HUD HANDBOOK No. 4235.1, *supra* note 139, provides guidelines and processing procedures for the Home Equity Conversion Insurance Program. Maximum mortgage amounts will increase to $151,725 in 1993.

153. *Id.* For a clear, easy to understand description of the options, see FEDERAL NAT'L MORTGAGE ASS'N, MONEY FROM HOME, A CONSUMER'S GUIDE TO HOME EQUITY CONVERSION MORTGAGES 10-13 (1992) [hereinafter FANNIE MAE].

154. In some states, only a fixed rate reverse mortgage is valid. *See infra* text accompanying notes 226-33.

155. Title VIII of the Garn-St. Germain Depository Institutions Act, 12 U.S.C. §§ 3801-3805 (1982), gave state-chartered lenders parity with federally chartered lenders to make adjustable rate mortgages despite conflicting state law. However, five states overrode the federal preemption in whole or in part: Maine, Massachusetts, New York, South Carolina, and Wisconsin. *See infra* note 188 and accompanying text.

156. None of the shared appreciation loans that HUD is authorized to insure has been offered by a HECM lender. *Attorney's Guide*, *supra* note 2, at 6; *see also* 24 C.F.R. § 206.23(a) (1992).

157. 24 C.F.R. § 206.27(c) (1992).

158. 12 U.S.C. § 1715z-20(f) (1992); 24 C.F.R. § 206.41 (1992).

159. Harriet J. Brackey, *Homeowners Take Payday—Reverse Mortgages Let Borrowers Tap Equity*, USA TODAY, May 11, 1992, at 1B, 2B.

160. *Id.*

II. State Laws and Regulations

The laws governing the creation, perfection, and enforcement of security interests in real estate are the mortgage laws of the state in which the real estate is situated.[161] For purposes of this discussion, I include state laws that regulate or restrict the availability of reverse mortgages indirectly by making a lender unlikely to offer such a product to the elderly[162] and those that virtually invalidate a reverse mortgage loan.[163] On the other hand, the rules governing the type of loans a lending institution is authorized to offer (including loans secured by real estate) are set by state and federal regulatory agencies. Federally chartered banks are regulated by the Office of the Comptroller of the Currency.[164] Federally chartered savings and loans are regulated by the Office of Thrift Supervision of the U.S. Treasury.[165] State-chartered lending institutions are governed by a separate set of rules.[166]

When state mortgage law and the rules regulating a federal lending institution conflict or are inconsistent, generally the local, state law will be applicable unless the federal law preempts the state law.[167] For example, there was such a conflict regarding the enforceability of the standard due-on-sale clause[168] before 1982 when some states, notably California, had state laws that limited the enforceability of such clauses[169] and the regulations of federally chartered savings and loan associations passed in 1976 provided that the clauses were always enforceable.[170] The U.S. Supreme Court decided in *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta*[171] that the federal regulations preempted the state law and that the due-on-sale clause in a mortgage to a federally chartered savings and loan was

161. *See* NELSON & WHITMAN, *supra* note 116, § 11.6, at 811-25.

162. Lien priority problems, mortgage recordation taxes, maximum term mortgages, restrictions on variable rate mortgages, and usury are some examples.

163. Examples include limits on use of the proceeds, mandatory counseling requirements, restrictions on negative amortization, and restrictions on the type of institutions that may make reverse mortgage loans.

164. 12 C.F.R. pt. 34 (1992).

165. 12 C.F.R. § 500.10 (1992); *see id.* § 545.32 for authority to make real estate loans and limitations.

166. E.g., in Illinois, rules for state chartered savings and loans are in the Illinois Savings and Loan Act of 1985. ILL. REV. STAT. ch. 17, paras. 3301-1 to 3312-5 (1991). Rules for state-chartered banks are in the Illinois Banking Act, *id.* paras. 301-394, and the rules for state credit unions are found in the Illinois Credit Union Act, *id.* paras. 4401-4473.

167. NELSON & WHITMAN, *supra* note 116, §§ 11.4-11.6. The Supremacy Clause, U.S. CONST. art. VI, § 2, has been interpreted to make federal law that is validly enacted supersede state law if it is within the power of the federal government. McCullough v. Maryland, 17 U.S. (Wheat.) 316, 404 (1819).

168. *See, e.g.*, Fannie Mae/Freddie Mac Uniform Instrument—Illinois—Single Family—Form 3014, Sept. 1990, amended May 1991, Uniform Covenant No. 17:

> If all or any part of the Property or any interest in it is sold or transferred (or if a beneficial interest in Borrower is sold or transferred and Borrower is not a natural person) without Lender's prior written consent, Lender may, at its option, require immediate payment in full of all sums secured by this Security Instrument.

169. *See* Wellenkamp v. Bank of America, 582 P.2d 970 (Cal. 1978).

170. 12 C.F.R. § 591.3 (1992).

171. 458 U.S. 141 (1982).

enforceable in the face of conflicting state mortgage law.[172] In 1982, Congress passed Section 341 of the Garn-St. Germain Depository Institutions Act of 1982.[173] It preempted state law as to virtually all lenders regarding the enforceability of due-on-sale clauses, including noninstitutional individuals.[174]

Federal preemption of an issue is one way to resolve the impact of nonuniform and conflicting rules in the reverse mortgage arena,[175] thereby clearing the hurdles to widespread availability of reverse mortgages. Federal preemption depends on the federal government having the power to preempt state law.[176] Additionally, a clear expression of Congress's or an administrative agency's intention to preempt state law is very significant.[177] Politically, achieving preemption over the broad range of issues identified and described in the following text may be easier said than done.

Nevertheless, unless federal law is preemptive where a state's mortgage law in some way, directly or indirectly, does not recognize the validity of a reverse mortgage, the fact that a lending institution doing business in that state is authorized to make reverse mortgage loans does not mean that the elderly citizens of such a state will be able to take advantage of this device. Indeed, HUD requires that the lender determine that the state law has been reviewed, the documents comply with state law requirements, and the lender complies with any state law disclosure requirement.[178] Fannie Mae, which has agreed to acquire all the FHA-insured reverse mortgages for its secondary market and which is considering the purchase of lender-insured reverse mortgages in 1993, instructs the lenders from whom it purchases these mortgages that they must warrant that they have complied with any local, state, or federal laws[179] and "that the mortgage documents are enforceable under all applicable laws and regulations and that nothing it has done, or failed to do, will jeopardize Fannie Mae's right to acquire title to the property . . . ."[180] The remedies for breach of the warranties include requiring the lender to repurchase the mortgage.[181] Significantly, neither the Cranston-Gonza-

172. *Id.* at 152-70.

173. 12 U.S.C. § 1701j-3 (1982).

174. *Id.* Certain exceptions were recognized for certain states. *See* NELSON & WHITMAN, *supra* note 116, § 5.24, at 332.

175. *See infra* text accompanying notes 264-82.

176. Clearfield Trust Co. v. United States, 318 U.S. 363 (1943). The U.S. Supreme Court in a lien priority case involving the Farmers Home Administration and the Small Business Administration, United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), articulated a three-pronged test: (1) Is the nature of the federal program such that a nationally uniform rule is necessary? (2) Would application of conflicting state law frustrate objectives of a federal program? (3) Would application of federal law disrupt regular commercial dealings that were established assuming the applicability of state law? NELSON & WHITMAN, *supra* note 116, § 11.6, at 819.

177. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 153 (1981).

178. 24 C.F.R. § 206.9(a) (1992).

179. FEDERAL NAT'L MORTGAGE ASS'N, HOME EQUITY CONVERSION MORTGAGE INSTRUCTION PACKAGE 8 (1992).

180. *Id.*

181. *Id.* at 9.

lez National Affordable Housing Act of 1990 that amended Title II of the National Housing Act[182] that authorized the FHA-insured reverse mortgage program,[183] nor the regulations issued by HUD regarding that program,[184] express the intention to preempt state law.[185] The federal law simply authorizes HUD to insure reverse mortgage loans made in any of the fifty states.

Moreover, because of the special treatment of FHA and government loans in many statutes, the lender-insured reverse mortgage programs cannot even argue that federal preemption protects them from the vagaries of state law except on their ability to make variable rate, including shared appreciation, mortgages that the Garn-St. Germain's Title VIII-Alternative Mortgage Transactions Parity Act of 1982[186] addresses.[187] Several states[188] even opted out of the impact of the Parity Act on variable rate mortgages, as was permitted by the statute.[189]

A number of legal issues remain as a hurdle to reverse mortgages. These issues include priority of liens, mortgage recordation taxes, restrictions on terms and rates of mortgages, limitations on use of proceeds, and mandatory counseling requirements.

A. Lien Priority of Future Advances

One of the most important problems that reverse mortgages present involves the lien priority of future advances that the lender makes to the borrower during the disbursement period.[190] With a forward mortgage the lender usually has a lien, as of the date the mortgage is recorded, that is prior to all other liens that are subsequently perfected (with the exception of real property tax and assessments owed to local government). If the borrower is in default and the lender elects to get satisfaction of its debt through a foreclosure sale, the order of lien priority determines the order in which each lien is satisfied from the proceeds of the sale. Obviously, the lender prefers first lien status and some lending institutions are limited by their regulatory agencies to only offer first mortgage loans.[191] With forward mortgages[192] the lender disburses the stated amount at execution and the amount owed decreases as the borrower makes payments of interest and

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182. 12 U.S.C. § 1715z-20 (1992).
183. *See supra* text accompanying notes 143-46.
184. 24 C.F.R. §§ 206.1-206.211 (1991).
185. Axelson & Moliken, *supra* note 149, at 58.
186. 12 U.S.C. § 3801 (1992).
187. *Id.* § 3803(c). "An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State Constitution, law or regulations."
188. *See, e.g.*, ME. REV. STAT. ANN. tit. 9-A, § 1-110 (West Supp. 1992); N.Y. BANKING LAW § 6-g (McKinney 1990).
189. 12 U.S.C. § 3804(a) (1992).
190. Advances often are monthly throughout the remaining lifetime of the borrower. See *supra* text accompanying note 153 for discussion of tenure option of FHA-insured product.
191. *See* NELSON & WHITMAN, *supra* note 116, § 12.1, at 826-33.
192. This is a conventional mortgage where borrower receives a lump sum at the beginning of the loan period and has the loan period to repay the loan with interest.

principal. The mortgage as recorded achieves priority over subsequent liens for the entire stated amount if the loan is disbursed.

In contrast, with a reverse mortgage, none (or a relatively small amount[193]) of the maximum loan amount is disbursed at closing, and the balance of the loan is disbursed through monthly payments made to the borrower for the loan term.[194] If a second lien is created after the reverse mortgage is recorded, but before all of the loan amount is disbursed to the senior borrower, a question of lien priority arises. For example, suppose that a judgment for a tort in the amount of $150,000 attaches after the reverse mortgage is recorded and after only $25,000 of the total disbursement of $75,000 of a reverse mortgage with a stated maximum amount of $125,000 has been paid to the borrower. Will the reverse mortgage lender be protected in its first lien status, and thereby be encouraged to satisfy its obligations under the note and mortgage to continue making monthly payments to the borrower? If the house is sold for $175,000 at the borrower's death, or at any other terminating event provided for in the mortgage,[195] will the lender be certain to get up to its total lien value of $125,000? Or will the lender get the first $25,000 and the tort judgment creditor the next, and final, $150,000?

The answers to the questions and the resolution of the lien priority issue vary by state. The majority of jurisdictions follow the common-law rule that is based on a distinction between so-called obligatory advances and optional advances.[196] The subsequent and/or intervening liens are subordinated to any and all obligatory advances[197] whether the first lien lender has knowledge of the subsequent lien or not. In contrast, the first lien lender loses its priority as against subsequent, intervening liens where the advances are optional and the lender has notice.[198] In the hypothetical, the reverse mortgage lender will be paid first, up to the maximum stated amount if the future advances, made to the elderly borrower every month, are characterized as obligatory. If these advances are characterized as optional (and if the lender has notice of the judgment creditor), the lender will only get the first $25,000 of the proceeds.

This seemingly simple common-law rule is more complicated and uncertain when applied. First, there is a split among jurisdictions as to what kind of notice to the lender is required for an optional advance to lose its senior status. A majority of states require that the mortgagee has actual notice at the time the advance is made.[199] A minority of states charge the mortgagee with constructive notice by

193. *See supra* text accompanying note 153.

194. *See supra* text accompanying note 153.

195. See *supra* text accompanying note 157 for typical terminating events for reverse mortgages.

196. O'Brien, *supra* note 1, at 699.

197. Brant K. Maller, *The Priority Problem in Mortgages for Future Advances*, 14 REAL EST. L.J. 360, 364 (1986).

198. *Id.*

199. NELSON & WHITMAN, *supra* note 116, § 12.7, at 893.

the public records, so that appropriate recordation of the subsequent lien would remove the priority of all future advances whether the lender had actual notice or not.[200]

Second, the determination of whether the future advances provided for by a mortgage are obligatory or optional is fraught with uncertainty[201] and often will be definitively made long after the lender has made, or not, those payments. Even if the three requirements[202] of obligatory advances are met,[203] a court can make a determination of "optional" based on the equities of the case.[204]

A cynical explanation of the obligatory/optional distinction was offered by Grant Gilmore.[205] Because the line between the two is so blurred, any advance that appears to be optional can be classified as obligatory, and vice versa, depending on the equities of the situation.[206]

Because lenders want loans to be as secure as possible, the uncertainty of treatment of a future advance could be very troubling. A primary and distinguishing feature of reverse mortgage loans is that advances, representing the bulk of the total debt, are made monthly, often over many years. If the reverse mortgage lender is not certain about the priority of its lien as to all the money disbursed to the elderly borrower, then the lender may refuse to make such a reverse loan.[207]

Many jurisdictions have enacted statutes to deal with the uncertainty of the common-law rule. Some states have revised completely the common-law rule and give all future advances the same priority as the original mortgage regardless of their optional character.[208] This rule is most protective of lenders. The certainty that, if the document is properly drafted and executed, all advances will have priority over intervening liens, will encourage lenders to make reverse mort-

200. *Id.*

201. Ryan P. Dyches, Comment, *Priority Disputes in Future Advance Mortgages: Picking the Winner in Arizona*, 1985 ARIZ. ST. L.J. 537, 547.

202. NELSON & WHITMAN, *supra* note 116, § 12.7, at 890. Three generally accepted requirements must be met before an advance will be characterized as obligatory: (1) Lender must have a genuine contractual obligation to lend without much discretion; (2) lender must assert the condition it has reserved in the loan agreement; (3) the lender must make no further advances after the default by the borrower. *Id.*

203. *Id.*

204. Dyches, *supra* note 201, at 545.

205. 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 35.4, at 925-31 (1965).

206. *Id.* at 929-30.

207. O'Brien, *supra* note 1, at 706.

208. CAL. CIV. CODE § 3136 (West 1974); CONN. GEN. STAT. ANN. § 49-3 (West Supp. 1992); DEL. CODE ANN. tit. 25, § 2118(a) (1989); FLA. STAT. ANN. § 697.04 (West Supp. 1993); GA. CODE ANN. § 44-14-2 (Michie 1992); HAW. REV. STAT. § 506-1 (1993); ILL. REV. STAT. ch. 30, para. 37a (1991); KAN. STAT. ANN. § 58-2336 (1983); ME. REV. STAT. ANN. tit. 9-B, § 436 (West Supp. 1992); MD. REAL PROP. CODE ANN. § 7-102 (1988); MONT. CODE ANN. § 71-1-206 (1991); NEB. REV. STAT. § 76-238.01 (1986); NEV. REV. STAT. § 106.370 (1991); N.H. REV. STAT. ANN. § 479:3 (1992); N.M. STAT. ANN. § 48-7-9 (Michie 1987); OHIO REV. CODE ANN. § 5301.232 (Page 1989) (preserving common-law optional-obligatory distinction); S.C. CODE ANN. § 29-3-50 (Law. Co-op. 1991); S.D. CODIFIED LAWS ANN. § 44-1-13 (Supp. 1992); TENN. CODE ANN. § 47-28-102 (1988).

gages.[209] Other states preserve the obligatory/optional distinction,[210] and Rhode Island essentially codifies the common-law rule.[211]

Many of the state statutes require that a statement of the maximum amount of debt be contained in the document[212] for priority to be guaranteed. Moreover, statutes in Florida, Maine, Massachusetts, Missouri, Nebraska, and Rhode Island[213] permit the mortgagor to file a note limiting the priority of advances to that amount which has been actually disbursed. Any advance made by the lender subsequently takes priority only as of the date received.[214] Thus, interest accruing on the disbursements that had been made before the borrower gave notice to preclude subsequent advances would not be treated as having the same lien status as the original mortgage. This could be a serious, and unacceptable, risk to a reverse mortgage lender.

Some of the statutes are part of comprehensive open-end mortgage[215] legislation or reverse mortgage legislation.[216] For example, the revolving credit laws, or open-end mortgage laws, in four states, although eliminating the distinction between obligatory and optional, impose temporal limits of twenty years on the period during which future advances will be given priority.[217] The twenty-year limit may be appropriate for the typical home equity line of credit mortgage, but for reverse mortgages the consequences may be very negative to a lender. Any

209. O'Brien, *supra* note 1, at 707.

210. *See, e.g.*, OHIO REV. CODE ANN. § 5301.232 (Page 1989).

211. R.I. GEN. LAWS §§ 34-25.1 to 34-25.3 (Supp. 1992).

212. FLA. STAT. ANN. § 697.04 (West 1991); ILL. REV. STAT. ch. 17, para. 3301-6(b) (1991); ME. REV. STAT. ANN. tit. 9-B, § 436(1)(A) (West Supp. 1992); MASS. GEN. L. ch. 183, § 28A (1992); MO. REV. STAT. § 443.055 (1975); NEB. REV. STAT. § 76-238.01(1) (1986); R.I. GEN. LAWS § 34-25.1-1.1 (1991).

213. FLA. STAT. ANN. § 697.04 (West 1991); ME. REV. STAT. ANN. tit. 9-B, § 436(1)(A) (West Supp. 1992); MASS. GEN. L. ch. 183, § 28A (1992); MO. REV. STAT. § 443.055 (1975); NEB. REV. STAT. § 76-238.01(1) (1986); R.I. GEN. LAWS § 34-25.1-1.1 (1991).

214. O'Brien, *supra* note 1, at 704.

215. An "open-end" mortgage is one where the lender reserves the option to make advances, even after the borrower has paid down his mortgage. Comment, *The Open-End Mortgage—Future Advances: A Survey*, 5 DEPAUL L. REV. 76 (1955). Both credit card revolving loans and home equity lines of credit secured by a mortgage are examples of open-end loans. The reverse mortgage also fits this description. Hence, rules that affect reverse mortgages may be found in open-end credit statutes.

216. *See, e.g.*, CAL. CIV. CODE § 3136 (West 1974); CONN. GEN. STAT. ANN. §§ 49-2 to 49-4a (West Supp. 1992); DEL. CODE ANN. tit. 25, § 2118 (1989); FLA. STAT. ANN. § 697.04 (West Supp. 1993); HAW. REV. STAT. § 506-1 (1993); ILL. REV. STAT. ch. 17, para. 312 (1991); KAN. STAT. ANN. § 58-2336 (1983); LA. CIV. CODE ANN. arts. 3292-3293 (West Supp. 1993); ME. REV. STAT. ANN. tit 9-B, § 436 (West Supp. 1992); MASS. ANN. LAWS ch. 183, § 28B (Law. Co-op. 1987); MO. ANN. STAT. § 443.055 (Vernon Supp. 1992); N.H. REV. STAT. ANN. §§ 479:3-479:5 (1992); N.M. STAT. ANN. § 48-7-9 (Michie 1987); N.C. GEN. STAT. §§ 45-67 to 45-74 (1991); OHIO REV. CODE ANN. § 5301.232 (Page 1989); OKLA. STAT. ANN. tit. 42, §§ 5, 9 (1990); R.I. GEN. LAWS §§ 34.25.1-1 to 34.25.1-8 (Supp. 1992); S.C. CODE ANN. § 29-3-50 (Law. Co-op. 1991); S.D. CODIFIED LAWS ANN. § 44-8-26 (1983); VT. STAT. ANN. tit. 8, § 1207 (1970); WASH. REV. CODE ANN. § 60.04.220 (West 1990).

217. Florida—FLA. STAT. ANN. § 697.04 (West Supp. 1993); Illinois—ILL. REV. STAT. ch. 17, para. 3301-6b (1991); New York—N.Y. REAL PROP. LAW § 281 (McKinney 1989); Tennessee—TENN. CODE. ANN. §§ 47-28-103 to -104 (1988).

advances are limited in protection to only twenty years after the mortgage originates. If the elderly borrower under the typical reverse mortgage is still living in the mortgaged premises, the lender's lien priority protection for all the disbursements made during the period is lost. Consequently, the lender needs to limit the duration of the loan to twenty years, not the lifetime of the borrower, to be protected.

B. Mortgage Recordation Taxes

Several states impose a mortgage tax, or a mortgage registration tax, on the recordation of the mortgage document. The statutory basis for calculating these taxes usually is on the total loan amount at closing. Although this makes some sense when applied to "forward" mortgages, when applied to reverse mortgages, the statutes[218] require that all possible future advances and accrued interest charges be part of the base amount—whether it is likely that all of the advances and interest will ever be owed. The rate of these taxes varies from 0.1% for Oklahoma[219] to 0.75% for New York.[220] The Minnesota statute recognizes the special case of reverse mortgages[221] and has a base calculation of the expected total disbursement but not of the likely, accrued interest.[222] The New York legislature considered, but did not enact, a bill to eliminate the need to pay mortgage recording tax on readvances.[223]

C. Maximum Term Mortgages

In those states in which the law limits the validity of a mortgage to a maximum term,[224] reverse mortgage lenders may avoid making their loans available to seniors in those places. Lenders will not take the risk that the borrower's life will be longer than the maximum term allowed.[225]

D. Restriction of Variable Rate or Adjustable Rate Mortgages

Although Title VIII of the Garn-St. Germain Act, the Alternative Mortgage

218. Alabama—ALA. CODE § 40-22-2 (Supp. 1992); Kansas—KAN. STAT. ANN. § 79-3102 (Supp. 1992); Minnesota—MINN. STAT. ANN. § 287.05 (West Supp. 1993); New York—N.Y. TAX LAW § 253 (McKinney Supp. 1993); Oklahoma—OKLA. STAT. ANN. tit. 68, § 1904 (West Supp. 1993); Tennessee—TENN. CODE ANN. § 67-4-409 (Supp. 1992).

219. OKLA. STAT. ANN. tit. 68, § 1904 (West Supp. 1993).

220. N.Y. TAX LAW § 253 (McKinney Supp. 1993).

221. MINN. STAT. ANN. § 287.05(6) (West Supp. 1993).

222. *Id.*

223. Maller, *supra* note 197, at 360 n.2.

224. Florida, 20 years—FLA. STAT. ANN. § 697.04 (West Supp. 1993); Indiana, 40 years—IND. CODE ANN. § 28-1-21.5-1 (West Supp. 1992); Kentucky, 10 years—KY. REV. STAT. ANN. § 287.215 (Michie/Bobbs-Merrill 1988); Massachusetts, 10 years—MASS. ANN. LAWS ch. 167E, § 2(14-A) (Law. Co-op. Supp. 1992); New Jersey, 10 years—N.J. STAT. ANN. § 46:10B-17 (West 1989); Wisconsin, 40 years for variable rate mortgage—WIS. STAT. ANN. § 138.056(2)(a) (West 1989).

225. A lender safely could make a mortgage with a fixed term to comply with the statutory rule. *See supra* text accompanying note 113.

Act,[226] preempted state law on the issue of whether lenders could offer "alternative rate mortgages,"[227] New York[228] and Maine[229] elected to override the preemption section of the Act.[230] In New York, all mortgages (including reverse mortgages) must be fixed rate mortgages.[231] This prohibition of variable rate mortgages also makes shared appreciation loans illegal.[232] In addition, several states that permit variable rates for forward mortgages have rules that prohibit variable rates in reverse mortgages.[233]

E. Limits on Use of Mortgage Proceeds

Perhaps the most clear obstacle to availability of reverse mortgages exists in Texas, where a highly protective homestead policy, expressed in the state's constitution,[234] voids a mortgage or other lien on a homestead other than a purchase money mortgage[235] or one which reflects improvements made on the homestead.[236] Because reverse mortgages do not fit within the constitutional restrictions, these are not valid in Texas. The opinion of the Attorney General of Texas[237] denies that the homestead provision of the Texas Constitution has been preempted by federal legislation[238] regulating savings and loan associations and other lending institutions.[239] Still, the opinion suggests that the issue ultimately is "for judicial resolution in an adversary proceeding."[240] To date no case has arisen directly on point.

F. Mandatory Counseling Requirements

Alongside the difficulties of meeting the mandated counseling required for

226. 12 U.S.C. §§ 3801-3805 (1982).

227. *See* discussion *supra* at text accompanying notes 186, 189.

228. N.Y. BANKING LAW § 6-g (McKinney 1990).

229. ME. REV. STAT. ANN. tit. 9-B, § 241(3) (West Supp. 1992).

230. 12 U.S.C. § 3804(a) (1982). To accomplish this a state had to reassert its own regulations prior to Oct. 15, 1985. *Id.*

231. Cumby, *supra* note 84, at 895.

232. *Id.*

233. *E.g.*, IND. CODE ANN. § 28-1-21.5-4(1)(D) (West 1986). In Wisconsin, variable rate mortgage terms are limited to 40 years. WIS. STAT. ANN. § 138.056(2)(a) (West 1989).

234. TEX. CONST. art. XVI, § 50.

235. A purchase money mortgage is one where the mortgagee provides the loan covenant as all or part of the purchase price. NELSON & WHITMAN, *supra* note 116, § 1.1, at 2, 3.

236. Until a change in the Illinois statute, effective Jan. 1, 1992, (ILL. REV. STAT. ch. 17, para. 312 (1983), amended by ILL. REV. STAT. ch. 17, para. 312 (1991)), Illinois lenders have been unable to participate in reverse mortgage programs, including the FHA-insured plan, because the 1983 law required that payments to homeowners be used for taxes, insurance, or home repairs. *See* Allen, *supra* note 24.

237. JM-1269 Op. Att'y Gen. 6779 (Texas 1990) [hereinafter Opinion].

238. The federal legislation specifically considered by Attorney General Mattox is the Home Owner's Loan Act of 1933, 12 U.S.C. § 1464 (1992), that now authorizes savings and loan associations to issue line-of-credit home equity conversion mortgages, or reverse mortgages. Opinion, *supra* note 237, at 6786.

239. *Id.* at 6784-86.

240. *Id.* at 6786.

FHA-insured reverse mortgages,[241] various states have considered statutes requiring counseling as a precondition to the making of any reverse mortgage by any lender.[242] California considered legislation that not only required third-party independent counseling without any provision for funding, certifying, or supervising the counseling,[243] but also prohibited mortgage companies and insurance companies from making reverse mortgages—thereby invalidating even FHA-insured HECMs in most instances.[244] Luckily, with the strong opposition of even the supporters of reverse mortgages, the governor vetoed the bill.[245]

In 1986, Arizona enacted a statute requiring counseling by an independent, third party approved by a state agency, but no funding was ever provided to support the requirement.[246] In 1990, the entire reverse mortgage law was repealed in part in response to an argument by an Arizona Aging and Adult Administration attorney that the mandatory counseling requirement is unconstitutional age discrimination.[247] The repealer also eliminated the exclusion of mortgage companies and insurance companies that, as in the California bill, seriously jeopardized the availability of even the FHA-insured reverse mortgage.

Currently, three states require counseling. In 1989, Massachusetts passed legislation mandating that the prospective borrower complete a program approved by the Executive Office of Elder Affairs.[248] One statewide organization earned the approval, but no state funds were provided in the statute.[249] Thus the ability of a person living in Massachusetts to get a reverse mortgage depends upon the availability of counseling in that part of the state. In 1991, North Carolina enacted a law prohibiting consumers from obtaining a reverse mortgage without state-approved counseling,[250] but provided no funding to assure access. Only Minnesota seems to have met the state responsibility for providing reverse mortgage counseling when it has mandated it.[251] Perhaps the efforts of the National Center for Home Equity Conversion, located in Marshall, Minnesota, explain the responsiveness of the legislature in setting up a statewide, state-funded counseling program.

No doubt the most recent legislative proposals reflect the influence of

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241. *See supra* text accompanying notes 158-60.

242. This requirement is in sharp contrast to no requirement of counseling where the state itself provides the funding or administers the program. Of 26 state reverse mortgage programs, only one required any counseling; and of 16 state property tax deferral programs, none required counseling. NATIONAL CTR. FOR HOME EQUITY CONVERSION, REVERSE MORTGAGE COUNSELING—PREPARING FOR THE NEXT STAGE OF MARKET DEVELOPMENT 19 (1992) [hereinafter REVERSE MORTGAGE COUNSELING].

243. *Id.* at 23-26.

244. *Id.*

245. *Id.* at 26.

246. *Id.* at 27, 28.

247. *Id.* at 28.

248. MASS. ANN. LAWS ch. 167E, § 2, para. (14)(A) (Law. Co-op. Supp. 1992).

249. *Id.*

250. N.C. GEN. STAT. § 53-270(6) (Supp. 1992).

251. MINN. STAT. ANN. § 462A.28 (West 1991).

AARP.[252] In 1991, Illinois enacted a statute that closely resembles the AARP Model Act:

> No reverse mortgage commitment may be made by a lender unless the loan applicant attests, in writing, that the applicant has received from the lender, at the time of initial inquiry, a statement prepared by the Department on Aging regarding the advisability and availability of independent information and counseling services on reverse mortgages.[253]

Here, the word *advisability* refers to "independent information and counseling services," not to "reverse mortgage loan."

Similarly, proposed legislation in New York uses the "mandatory referral" to counseling language of the Model Act.[254] Colorado's new and comprehensive reverse mortgage statute[255] adopts the referral approach as well.

The availability of counseling problem likely can be resolved most easily in the context of a nationwide program like HUD. For example, one potential solution is to approve entities other than official HUD counseling agencies to provide the reverse mortgage counseling. In fact, area agencies on aging, legal service organizations, and other nonprofit organizations have become qualified under recent program changes.[256] And HUD evaluators are considering elimination of the "face-to-face" counseling requirement to allow telephone counseling where that is more convenient. When each state imposes its own, idiosyncratic counseling mandate, especially without needed financial support, redlining can occur so that only citizens in some parts of the state will be eligible for reverse mortgages and, sometimes, no senior citizens will be eligible. Moreover, the paternalism of the mandated approach receives legitimate criticism.[257] There is no counseling requirement generally for a borrower mortgaging his home (even on an equity line of credit), a person formulating a financial plan, or a person buying life insurance, even though each of these transactions is important financially and complicated to understand.

No lender fraud or abuse has been reported in reverse mortgages to date to justify this stigmatization of reverse mortgages.[258] Moreover, singling out reverse mortgages "as the only financial transaction the state finds so hazardous that consumers must be pre-counseled as a matter of state law"[259] discourages those most likely to benefit from using this tool.

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252. *See* American Association of Retired Persons Model State Law on Reverse Mortgages, *infra* appendix A.
253. ILL. REV. STAT. ch. 17, para. 313.1(e) (1991) (effective Jan. 1, 1992).
254. REVERSE MORTGAGE COUNSELING, *supra* note 242, at 34, 35.
255. COLO. REV. STAT. § 11-38-111 (Supp. 1992).
256. REVERSE MORTGAGE COUNSELING, *supra* note 242, at 42.
257. *Id.* at 65-67.
258. *See* REVERSE MORTGAGE COUNSELING, *supra* note 242, at 3. Political concerns in passing the HUD program and lack of confidence in HUD's competency during the 1980s may explain the inclusion of the mandatory counseling provision in the final 1987 draft of the federal legislation. *Id.* at 36-39.
259. *Id.* at 67.

G. Negative Amortization and Usury

State restrictions on negative amortization and usury limits on the interest rate that may be charged on so-called interest on interest are legitimate concerns for reverse mortgage lenders. Because reverse mortgages defer interest payments until the end of the loan and the interest is added to the principal of the loan,[260] such a loan is characterized as having negative amortization in that the principal is increased rather than decreased over time.

In Wisconsin, for example, the variable rate loan statute[261] regulates negative amortization so that within ten years after the loan is made, and at least every five years thereafter, the loan payment amount must be readjusted to ensure that the loan principal will be amortized, or repaid, over the remaining term of the loan. Because no repayment is due on a reverse mortgage loan, such a loan cannot comply with this rule. Hence, adjustable rate reverse mortgages are not valid there.[262]

A related concern exists over whether the interest charged, and accrued, on interest that has been deferred on a reverse mortgage may invalidate the loan or have other civil or criminal consequences. For federally insured HECMs, preemption principles[263] probably resolve this issue. However, the fate of non-FHA reverse mortgages remains uncertain.

H. These Obstacles to the Availability of Reverse Mortgages Can Be Overcome

1. FEDERAL PREEMPTION

Even in those states that did not override the federal preemption of state limits on alternative mortgage transactions,[264] the federal support of reverse mortgages in the form of HUD's insurance does not guarantee that all elderly homeowners who want them can get them. The Garn-St. Germain legislation expressly preempts state law only on the enforceability of the due-on-sale clause and the ability of lending institutions to make loans with adjustable rates.[265] It does not deal at all with the other problematic rules that limit, or invalidate, reverse mortgages like state usury laws,[266] state laws that threaten the lien priority of advances made by reverse mortgage lenders,[267] state prohibitions on negative amortization of reverse mortgages,[268] or state requirements that loan proceeds be used in ways that do not reflect the needs and choices of elderly homeowners.[269] The federal

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260. NELSON & WHITMAN, *supra* note 116, § 11.4, at 783.
261. WIS. STAT. ANN. § 138.056(5) (West 1989).
262. *Attorney's Guide*, *supra* note 2, at 20.
263. 12 U.S.C. § 1735f-7 (1992).
264. Garn-St. Germain Depository Institutions Act of 1982, 12 U.S.C. § 1701(j)-3; Title VIII Alternative Mortgage Transactions Parity Act of 1982, 12 U.S.C. § 3801.
265. *See supra* text accompanying notes 186-89.
266. *See supra* text accompanying note 263.
267. *See supra* text accompanying notes 190-217.
268. *See supra* text accompanying notes 260-62.
269. *See supra* text accompanying notes 234-40.

law authorizing FHA insurance for these loans[270] does not remedy these problems because, admittedly, HUD only has authority to insure mortgages that are otherwise valid.[271]

Nevertheless, by the further exercise of its preemptive power, the federal government could eliminate several of the serious issues. For example, a provision could be added to the federal banking laws patterned on Section 204(3) of Article IX of the Uniform Commercial Code.[272] Article IX sets forth the rules governing the creation, perfection, and satisfaction of security interests in personal property[273] and is the analogue to mortgage law. Under Section 9-204(3), no distinction between the lien priority of future advances is recognized on the basis of the advance being obligatory or optional; all advances have the same lien priority as the original extension of value. If the Comptroller of the Currency,[274] the National Credit Union Administration,[275] and the Office of Thrift Supervision[276] adopted regulations characterizing any advances made as part of reverse mortgage loans as having the same lien priority as the originating mortgage, then under express, regulatory language in each set of regulations, that principle would be operative in loans made by the respective institutions without regard to state law limitations.[277] Of course, Congress could confirm the preemption by amending the lending institutions statutes as it did by the Garn-St. Germain law in the Alternative Mortgages Transactions Act[278] and the Alternative Mortgage Transactions Parity Act of 1982 to expressly include "reverse mortgage" as a category of alternative mortgage transactions[279] and to cover "all housing creditors," not just the federally regulated ones.[280] Similarly, Congress could amend the banks and banking statute[281] that exempts from state usury laws certain FHA-insured mortgages by including all reverse mortgages under its protection. Whether the political climate would permit such an exercise of federal power is a difficult question. Yet, the AARP lobby indicated its strength recently in getting the SEC to change its position in short order on an issue that had impact on the availability of reverse mortgages.[282]

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270. 12 U.S.C. § 1715z-2 (1992).
271. *Id.*
272. U.C.C. § 9-204(3) (1990).
273. *Id.* § 9-102 and official comment.
274. 12 C.F.R. § 34.1 (1992). The comptroller regulates national banks.
275. National Credit Union Administration, 12 C.F.R. § 790.1-.3 (1992). This group regulates national credit unions.
276. 12 C.F.R. § 545.1-142 (1992). This group regulates federally chartered savings and loan associations.
277. *See, e.g.*, 12 C.F.R. § 34.2; 12 C.F.R. § 545.2 (1992).
278. 12 U.S.C. § 1701(j)-3 (1992).
279. See Opinion, *supra* note 237, at 6784-87, stating that current version of these federal statutes do not expressly preempt Texas's homestead limitations because these statutes deal only with interest rates and repayment terms of the loans.
280. 12 U.S.C. § 3802(2)(B) (1992).
281. *Id.* § 1735f-6.
282. *See supra* text accompanying notes 126-34.

2. MODEL STATE LAW

AARP's Model State Law On Reverse Mortgages[283] offers a second approach and one that deals comprehensively with the obstacles to the availability of these loans. In Section 2, the Model State Law provides special rules for reverse mortgage lenders.[284] Section 2-B gives lien priority to all accrued interest and advances. Section 2-C allows fixed, adjustable, and shared appreciation interest. Section 2-F limits a state recordation tax to the cost of recording the reverse mortgage. Section 2-G restates the repayment trigger events to parallel the FHA-insured model.

Section 3 provides a coherent, comprehensive structure to clarify and emphasize the difference between the "forward" mortgage and the "reverse" mortgage. It specifically exempts the reverse mortgage from following regulations originally meant for the "forward" mortgage: 3-A) limits on purpose or use of proceeds, 3-B) temporal limits on future advances, 3-C) temporal limits on lien priorities or advances, 3-D) requirements of statement of maximum mortgage amounts, 3-E) limitations on loan-to-value ratio, 3-F) to 3-H) limits on balloon payments, compound interest, and interest rates.

Section 4 deals with the treatment of loan proceeds by public entitlement programs. It substantially conforms with the current federal and most state regulations.[285]

Finally, Section 5-A does not include the FHA-insured *mandatory* counseling before an elderly person can apply for a loan.[286] Instead, the Model Act requires that the applicant receive a statement regarding the advisability and availability of independent counseling.

Another approach, neither as comprehensive as AARP's Model Act nor as politically sensitive as an exercise of preemptive power, could facilitate the use of the reverse mortgage. Fannie Mae should draft appropriate documents (e.g., note, mortgage) for each state that would have uniform provisions on key terms of reverse loans, with adjustments to conform to the peculiarities of the law in each of the states. Fannie Mae already has drafted uniform forms for various types of mortgage properties (for example, single family, condominium, or two- to four-unit residential) geared to the laws of each state. Use of such forms would enable lenders to feel certain that Fannie Mae would be willing to acquire their mortgages.[287] As with the forms it has made available for forward loans, Fannie Mae would consult with the land title insurance industry to conform the draft lan-

283. *See infra* appendix A.

284. See generally Illinois's recent statute that closely resembles the Model Act, ILL. REV. STAT. ch. 17, para. 312 (1991).

285. *See infra* text accompanying notes 301-09.

286. *See supra* text accompanying notes 158-60.

287. This is especially important if Fannie Mae acquires lender-insured mortgages for the secondary market. *See supra* text accompanying note 147.

guage to title requirements for the special endorsements applicable to reverse mortgages.[288]

III. Significant Advantages for the Elderly Who Use Reverse Mortgages

The elderly will make greater use of the reverse mortgage as part of their financial plan if the attorneys who advise them understand that the advantages of releasing home equity[289] can be achieved without significant risks or detriments to their clients.[290] Indeed, the titles of various publications directed at the consumer and/or their legal advisers seek to dispel some of the anxiety that may accompany consideration of the reverse mortgage. For example, Ken Scholen has prepared one of the early studies called *Home-Made Pension Plans*[291] and a book, *Retirement Income on the House*.[292] Fannie Mae's guide is *Money From Home, A Consumer's Guide to Home Equity Conversion Mortgages*;[293] and AARP has published a guide written by Ken Scholen,[294] *Homemade Money: Consumer's Guide to Home Equity Conversion*.

More importantly, many of the early problems associated with reverse mortgages have been reduced or eliminated over the last several years as their availability has increased,[295] and the remaining obstacles to their availability are being identified, examined,[296] and resolved.[297] For example, the current models of reverse mortgage, lender-insured, and FHA-insured loans have eliminated the risk that the borrower would outlive the loan.[298]

Life-term reverse mortgages guarantee that a predetermined amount will be disbursed to borrowers each month no matter how long they live.[299] If a borrower lives longer than expected, the insurance covers the risk, even if disbursement plus accrued interest exceed the value of the real estate; and the loans are nonrecourse.[300]

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288. Lending institutions typically request the following special endorsements for their reverse mortgages: lien priority of future advances, usury, negative amortization, and adjustable rates. The title insurance backs up any representations or warranties the lender makes to FHA or Fannie Mae. Of course, the title company will issue such endorsements only when it determines that legally these aspects of the mortgage are valid under all applicable law. *See generally* KRATOVIL & WERNER, *supra* note 51, § 15.06(c), at 220, 221.

289. See *supra* text accompanying notes 18-32 for discussion of the advantages of reverse mortgages.

290. *See Attorney's Guide*, *supra* note 2, at 1.

291. HOME-MADE PENSION PLANS, *supra* note 9.

292. KEN SCHOLEN, RETIREMENT INCOME ON THE HOUSE (1992).

293. FANNIE MAE, *supra* note 153.

294. KEN SCHOLEN, HOMEMADE MONEY: CONSUMER'S GUIDE TO HOME EQUITY CONVERSION (1992) (guide published by AARP).

295. *See supra* text accompanying notes 138-46.

296. *See supra* text accompanying notes 161-263.

297. *See supra* text accompanying notes 264-88.

298. *See generally* Sjogren & Feins, *supra* note 7, at 20, 21.

299. Of course, events other than the death of a borrower may trigger an obligation to repay. *See supra* text accompanying note 157. However, uninsured reverse mortgages for a fixed term are usually due at the end of the term. *See supra* text accompanying notes 110-13.

300. 24 C.F.R. § 206.129(b) (1992).

Also, concerns[301] about the impact of reverse mortgage payments on eligibility for Supplemental Security Income (SSI)[302] and Medicaid are alleviated by a recent Social Security Administration Program Circular[303] which provides that proceeds from a reverse mortgage should not be defined as income.[304] Still, care must be taken to spend the disbursement in the month it is received; accumulation of any funds, including loan proceeds, may make the borrower ineligible under the resources limit rule of SSI.[305] Also, because Medicaid eligibility criteria are more restrictive than SSI eligibility criteria in thirteen states,[306] the regulations in these states must be carefully reviewed. Minnesota, Massachusetts, and Ohio exempt reverse mortgage proceeds from being considered income or resources.[307] Additionally, Connecticut, Illinois, Nebraska, New Hampshire, North Carolina, and Virginia generally treat reverse mortgages proceeds in the same manner that the SSI program does;[308] however, the effect of the Social Security Administration's Program Circular,[309] if any, is not clear.

Moreover, although the IRS has not made a revenue ruling directly addressing reverse mortgage issues, the federal income tax consequences of reverse mortgages seem fairly clear.[310] For a home that has appreciated significantly, a borrower should be concerned that the one-time $125,000 exclusion of capital gains upon sale[311] may not exclude all of the appreciation of the asset from the tax on capital gains if the sale of the asset occurs *before* the borrower dies.[312] This possibility suggests that the reverse mortgage borrower should reserve sufficient assets to pay these taxes. On the other hand, if the borrower dies before the house is sold, the heirs or devisees take the asset at the appreciated value.[313] When the house is later sold, the donee will only owe capital gains on any appreciation accruing *after* the donee acquires the house.[314]

Revenue Ruling 80-248[315] allows the borrower to deduct interest on a re-

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301. *See generally* Blumenstein & Harmann, *supra* note 59, at 456-59; Cumby, *supra* note 84, at 885-90; Bruce Hagel, *Home Equity Conversion Programs: Are They Compatible With Public Entitlement Programs?*, 15 CLEARINGHOUSE REV. 254, 255 (1981); Sjogren & Feins, *supra* note 7, at 21.

302. *See generally* Joan Loeff et al., *Social Security Programs in the United States*, SOC. SECURITY BULL., July 1989, at 62-65.

303. SOCIAL SECURITY ADMIN., *supra* note 60.

304. *Id.*

305. *Id.*

306. *Attorney's Guide*, *supra* note 2, at 18.

307. *See* Massachusetts—MASS. ANN. LAWS ch. 19A, § 36 (Law. Co-op. Supp. 1992); Minnesota—MINN. STAT. ANN. § 256.99 (West 1982)); Ohio—OHIO ADMIN. CODE § 5101:1-39-273 (1992).

308. *Attorney's Guide*, *supra*, note 2, at 19.

309. SOCIAL SECURITY ADMIN., *supra* note 60.

310. *See generally Attorney's Guide*, *supra* note 2.

311. I.R.C. § 121 (1992).

312. E.g., if borrower permanently vacates the house to live in a nursing home, payment of the loan will be due. *See supra* text accompanying note 157.

313. I.R.C. § 1014 (1992).

314. *Id.*

315. Rev. Ruling 80-248, 1980-2 C.B. 164.

verse mortgage when the interest is actually paid. Thus, the interest deduction accrues until the expiration of the loan term as a deduction from the sale price if sold during the borrower's lifetime, or from the estate if sold after the borrower's death.[316]

Finally, the implications of the reverse mortgage on estate planning is probably consistent with a trend first recognized by Professor John Langbein.[317] Briefly, Langbein's thesis is that there have been fundamental changes in the very nature of wealth. For the broad middle class, wealth is now in "the investment in skills" acquired from extended education instead of the traditional wealth forms in the family farm or business.[318] As a consequence, "intergenerational wealth transmission no longer primarily occurs upon the death of parents,"[319] but rather during the parents' lives in the form of paying for education.[320] Secondly, because these parents, who make their main transfer of wealth to their children *inter vivos*, are living longer, a new claim to family wealth, in the lengthened period of support to the parents, necessarily reduces the estate that would otherwise have passed to survivors.[321] Indeed, Langbein argues that the increasingly important pension system as a source of wealth "has been deliberately designed to promote lifetime exhaustion of the accumulated capital."[322]

The structure of the reverse mortgage device that allows the older person to use up the equity in the home while living there and receiving a monthly payment is consistent with Langbein's prediction. Although the elderly borrower may choose an option that preserves some of the equity,[323] the comment of a New Jersey couple who decided to take advantage of the reverse mortgage may be indicative of a changing attitude among the elderly, as both the notion of family and the basis for family wealth change.[324] In explaining the reaction of their grown children to the loss of their potential inheritance, Mr. Pitcher said: "It's no sweat, no jealousies, no nothing . . . . I told them we'll probably spend every nickel."

Also, Professor Langbein limits his theory to the broad middle class and recognizes that for the very rich and the very poor[325] the trends he discusses have had less influence than for the upper one-third to upper one-half of the population. As everyone connected with the reverse mortgage device, including its

316. See *Attorney's Guide*, *supra* note 2, at 16, 17, for alternative theory that would allow borrower to deduct the interest as it accrues.
317. John H. Langbein, *The Twentieth-Century Revolution in Family Wealth Transmission*, 86 MICH. L. REV. 722 (1988).
318. *Id.* at 723.
319. *Id.*
320. *Id.* at 730.
321. *Id.* at 723.
322. *Id.* at 744.
323. *See supra* text accompanying note 153.
324. Brackey, *supra* note 159, at 1B.
325. Langbein, *supra* note 317, at 724.

strong proponents, has stressed, the loans are not for everyone.[326]

326. *See generally supra* text accompanying notes 241-59. See also D. Murphy, *Converting Home Equity Into Cash: A Comparative Analysis of Reverse Mortgages and Sale-Leasebacks*, TAXES, Sept. 1992, at 622, for a comparison of the two devices from an income tax and estate tax perspective. The author admits a planner should suggest the comparison only in circumstances where the senior client has a family member who is capable of buying the house. *Id.*

APPENDIX A

AARP Model State Law on Reverse Mortgages

1) Authorization

A) Statement of Purpose

It is the intent of this legislation that elderly homeowners be permitted to meet their financial needs by accessing the equity in their homes through a reverse mortgage.

The legislature recognizes that many restrictions and requirements that exist to govern traditional mortgage transactions are inapplicable in the context of reverse mortgages.

In order to foster reverse mortgage transactions and better serve the elderly citizens of this state, this legislature authorizes the making of reverse mortgages, and expressly relieves reverse mortgage lenders and borrowers from compliance with inappropriate requirements.

B) Definition

"Reverse mortgage" means a non-recourse loan secured by real property which:

1) provides cash advances to a borrower based on the equity in a borrower's owner-occupied principal residence,
2) requires no payment of principal or interest until the entire loan becomes due and payable, and
3) is made by any lender authorized to engage in business as a bank, savings institution, or credit union under the laws of the United States or of (*name of state*), or any other lender authorized to make reverse mortgage loans by the (*name of state agency*).

2) General Rules For Reverse Mortgages

Reverse mortgage loans shall be governed by the following rules, without regard to the requirements set out elsewhere for other types of mortgage transactions:

A) **Prepayment**—Payment, in whole or in part, shall be permitted without penalty at any time during the period of the loan.

B) **Intervening Liens**—All advances made under a reverse mortgage and all interest on such advances shall have priority over any lien filed after the closing of a reverse mortgage.

C) **Interest**—A reverse mortgage may provide for an interest rate which is fixed or adjustable, and may also provide for interest that is contingent on appreciation in the value of the property.

D) **Periodic Advances**—If a reverse mortgage provides for periodic advances to a borrower, such advances shall not be reduced in amount or number based on any adjustment in the interest rate.

E) **Lender Default**—Lenders failing to make loan advances as required in the loan documents, and failing to cure such default as required in the loan documents, shall forfeit any right to collect all interest. Lenders may also be subject to administrative penalty as determined by the department.

F) **Mortgage Recordation Tax**—The recordation tax (Title 00, Sec 00) on reverse mortgages shall not exceed the actual cost of recording the mortgage.

G) **Repayment—1)** The mortgage shall become due and payable upon the occurrence of any one of the following events:
a) the home securing the loan is sold,
b) all borrowers cease occupying the home as a principal residence,
c) any fixed maturity date agreed to by the lender and the borrower is reached, or
d) an event occurs which is specified in the loan documents and which jeopardizes the lender's security.
Repayment—2) The repayment requirement is also expressly subject to the following additional conditions:
a) temporary absences from the home not exceeding 60 consecutive days shall not cause the mortgage to become due and payable;
b) temporary absences from the home exceeding 60 consecutive days but less than one year shall not cause the mortgage to become due and payable so long as the borrower has taken prior action which secures the home in a manner satisfactory to the lender;
c) the lender's right to collect reverse mortgage proceeds shall be subject to the applicable statute of limitations for loan contracts in Title 00, Sec. 00. Notwithstanding section 00, the statute of limitations shall commence on the date that the mortgage becomes due and payable;
d) the lender must prominently disclose any interest or other fees to be charged during the period that commences on the date that the mortgage becomes due and payable, and ends when repayment in full is made.

3) Inapplicability of Related Statutes

Reverse mortgage loans may be made or acquired without regard to the following provisions for other types of mortgage transactions set out in the statute specified below:

A) limitations on the purpose and use of future advances or any other mortgage proceeds (Title 00, Sec. 00);

B) limitations on future advances to a term of years, (Title 00, Sec. 00), or limitations on the term of credit line advances (Title 00, Sec. 00);

C) limitations on the term during which future advances take priority over intervening advances (Title 00, Sec. 00);

D) requirements that a maximum mortgage amount be stated in the mortgage (Title 00, Sec. 00);

E) limitations on loan-to-value ratios (Title 00, Sec. 00);

F) prohibitions on balloon payments (Title 00, Sec. 00);

G) prohibitions on compounded interest and interest on interest (Title 00, Sec. 00);

H) interest rate limits under the usury statutes (Title 00, Sec. 00); and

I) requirements that a percentage of the loan proceeds must be advanced prior to loan assignment (Title 00, Sec. 00).

4) Treatment of Reverse Mortgage Loan Proceeds by Public Benefit Programs

A) Reverse mortgage loan payments made to a borrower shall be treated as proceeds from a loan and not as income for the purpose of determining eligibility and benefits under means-tested programs of aid to individuals.

B) Undisbursed funds shall be treated as equity in a borrower's home and not as proceeds from a loan for the purpose of determining eligibility and benefits under means-tested programs of aid to individuals.

C) This section applies to any law relating to payments, allowances, benefits, or services provided on a means-tested basis by this State, including but not limited to supplemental security income, low-income energy assistance, property tax relief, medical assistance, and general assistance (Titles 00, Sections 00).

5) Consumer Information and Counseling

A) No reverse mortgage commitment shall be made by a lender unless the loan applicant attests, in writing, that the applicant received from the lender at time of initial inquiry a statement prepared by the (*name of state agency*) regarding the advisability and availability of independent information and counseling services on reverse mortgages.

B) The (*name of state agency*) shall be responsible for

1) developing the content and format of the statement described in section 5-A;

2) providing independent consumer information on reverse mortgages and their alternatives; and

3) referring consumers to independent counseling services with expertise in reverse mortgages.