

# TITLE ISSUES

## *TITLE INSURANCE FOR REVERSE MORTGAGES*

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Reverse mortgages, recognized statutorily in Illinois since 1978, have been slow to emerge as a significant new loan product. Only small numbers have been written in Illinois, more in states such as California and Florida. Changes in the law here in 1991, encouragement provided by a federally insured HUD pilot project, and steady increase in general awareness of the basic concept have resulted in steadily increased availability and usage of these vehicles for home equity conversion.

As borrowers and lenders broadened their understanding of these transactions, they worked with Chicago Title Insurance Company underwriters to craft title insurance coverage to fit loans very different from the traditional kind.

Basically, a reverse mortgage involves conversion of equity built up in their home by an elderly couple. The lender agrees to make monthly cash payments, or provide a revolving credit facility, or even a lump sum, in an amount determined by the age of the borrowers and the value of the property securing the loan. "Reversing" the usual format, the borrowers are not required to repay until the survivor dies, sells, or is absent for a prolonged period from the home. "Tenure" loans, the most commonly made, provide a fixed monthly payment for the remainder of the borrowers' lives. The loans are non-recourse and are repaid by the estate, or otherwise entirely from the proceeds of sale of the home.

These loans were early characterized as "RAMS", or reverse annuity mortgages, because at a certain point in the future, the borrowers will have "outlived" the debt and any practical repayment from the property. Lenders underwrite not the credit-worthiness or the ability to repay of the borrowers, but, rather, their life expectancy, together with the value of the secured property.

Borrowers are faced with the fact that their estate will be steadily depleted, perhaps surprisingly quickly, and their ability to relocate severely impacted by entering into

such a transaction. Lenders were extremely cautious about reverse mortgages because of indefinite periods without cash flow and unfamiliarity with yields driven by life expectancy tables as opposed to interest rates. Not unexpectedly, the earliest, and still the most enthusiastic source of funds for these loans was not conventional, thrifts and banks, but life insurance companies.

U.S. Census figures show that approximately 17 million people were over sixty-five in 1960, about 26 million in 1980, and 31 million in 1989. Estimates for the year 2000 are for 35 million Americans, or 13 percent of the total population.<sup>1</sup> Estimates of the amount of equity in homes owned by seniors range from \$750 billion to \$1 trillion.<sup>2</sup> A study published in 1978 showed that, in that year, 70 percent of the aged lived in their own homes and, in 1980, 72 percent owned their own homes (84 percent of these owned their own homes free and clear).<sup>3</sup>

Motivation on the borrowing side is the desire of "house-rich but cash poor" seniors to supplement their incomes. On the lending side is great interest (pun intended) in tapping into billions of dollars of home equity value.

### **Federal Demonstration of 1987: The HUD Program**

These motivations proved insufficient to spur more than a trickle of such transactions before Congress in 1987 enacted a federally insured demonstration program. It reflected the mandate of the Housing and Community Development Act of 1987 to encourage borrower group specific loan formats.

Under the Home Equity Conversion Mortgage Demonstration,<sup>4</sup> the U.S. Department of Housing and Urban Development (HUD) was to insure up to 2,500<sup>5</sup> reverse mortgages for borrowers at least 62 years old, who occupy their residences. HUD commits to make

payments to the mortgagor reflecting late or discontinued disbursements by a mortgagee who becomes unwilling or unable to make all payments, including late charges. HUD requires a second mortgage to secure its potential payments. The Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) will purchase loans which comply with the regulations. Mortgage insurance premiums to partially offset the risks (of deflated value or unusual longevity) are included in the monthly increasing indebtedness. The originating lender has a short window of opportunity, usually shortly before the life expectancy projection, to sell the loan to FNMA or FHLMC.

The regulations allow deferral of all interest, either fixed or at adjustable rates, until the loan becomes due and payable. The loans are due and payable only upon (1) death, (2) sale or (3) whenever the mortgaged property is not occupied as the principal residence of at least one surviving mortgagor for a period of longer than 12 consecutive months.

The HUD program requires information services for potential mortgagors: counseling on the financial implications, the impact on estate planning, and the availability of other ways to supplement income.<sup>6</sup> An early growing pain was the scarcity of qualified HUD-approved counselors.

Eligibility as a HUD demonstration mortgagee requires<sup>7</sup> authorization to make reverse mortgages under state law or “under a Federal Law other than Section 255 of the National Housing Act, including Section 804 of the Garn-St. Germain Depository Institutions Act of 1982.”

This implies that reverse mortgages might be considered Alternative Mortgage Transactions under Garn-St. Germain.<sup>8</sup> A lender qualifying for treatment of its loan as such under Garn-St. Germain might overcome, by the Act’s preemptive provisions, state law problems critical to the viability of the loan. In other states, these have included state prohibitions against compounding of interest, shared appreciation interest, and restrictions on due-on-sale clauses. Illinois, however, statutorily addressed reverse mortgages early on, albeit with major conditions which chilled demands.

### **Illinois Statutory Treatment**

In 1978, banks, savings and loan associations, and credit unions were authorized to make reverse mortgage loans to senior citizen property owners for purposes of paying real estate taxes on their homestead property.<sup>9</sup> Amending legislation in 1982 removed the age restriction adding as permitted purposes the making of home improvements or repairs and paying insurance premiums.<sup>10</sup> Almost no loans were made under these approaches. Borrowers were reluctant enough to explore this new loan, without having major limitations on the use of the proceeds. Illinois, in 1992, joined the growing number of states in

enacting legislation reflective of the prompting intended by the federal demonstration program.<sup>11</sup>

Section 6.1 of the Illinois Banking Act<sup>12</sup> reinstated the age requirement (borrower or spouse must be 62), but required no specific usage of the proceeds. Immediately borrowers and lenders began to look seriously at this kind of loan.

*The Act closely paralleled and accommodated the HUD program:*

Non-recourse<sup>13</sup> reverse mortgage loans are subject to the following provisions:

- (1) Payment, in whole or in part, shall be permitted without penalty at any time during the term of the mortgage.
- (2) A reverse mortgage may provide for an interest rate that is fixed or adjustable and may provide for interest that is contingent on appreciation in the value of the property.
- (3) If a reverse mortgage provides for periodic advances to a borrower, the advances may not be reduced in amount or number based on any adjustment in the interest rate.
- (4) A reverse mortgage may be subject to any additional terms and conditions imposed by a lender that are required under the provisions of the federal Housing and Community Development Act of 1987 to enable the lender to obtain federal government insurance under that Act.<sup>14</sup>

. . . 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 the initial inquiry, a statement prepared by the Department on Aging of the State of Illinois regarding the advisability and availability of independent information and counseling services on reverse mortgages.<sup>15</sup>

### **Title Insurance Needs for the Lender-Priority**

Lenders want insurance for the validity, enforceability and priority of advances made pursuant to the terms of the mortgage, agreement or note, but made to a large extent subsequent to the date of policy. The mortgage lien priorities part of the Mortgage Foreclosure Law has, since 1987, provided that “all monies advanced or applied, whenever advanced or applied, in accordance with the terms of a reverse mortgage shall be a lien from the time the mortgage is recorded.<sup>16</sup> The Chicago Title Family of Title Insurers relies on that provision to provide the priority coverage desired by lenders.

Loan policy insureds will also want insurance that variable rates of interest do not affect validity, enforceability, or priority. Deferred or compounded interest, whether at a variable or fixed rate is not covered by the policy without affirmative coverage, which lenders will want. After consideration of the forms of documentation, CT Family underwriters will commonly provide this coverage.

### Amount of Insurance

Reverse mortgages under the HUD program, and the Illinois statutory scheme, have no fixed mortgage debt. Nevertheless, such mortgages may, on their face, secure the repayment of a debt up to a stated maximum principal amount. Illinois case law requires a maximum principal amount (a cap) for notice purposes.<sup>17</sup> Title insurance will be provided in the amount shown as the "cap" on the mortgage.

An endorsement to the policy is available which addresses all of these needs. The underwriter will need to review the forms of loan documentation to determine whether they comply with the statute, and if applicable, the HUD program requirements. The underwriter will require information, in the form of an affidavit, establishing the age of the borrowers,<sup>18</sup> the character of the property and the owned estate.

Further, the underwriter will require information that the lender has furnished the borrower with the statement concerning counseling prepared by the Department on Aging of the State of Illinois; and if the HUD program is involved, the similar evidence of counseling by a HUD-approved agency.

If the title company is providing closing services, the lender must comply with the new disclosures required by amendments to the Truth-in-Lending ACT (TILA), effective June 7, 1995.<sup>19</sup> These are to assist consumers in comparing costs of reverse mortgages.

Regulations implementing Public Law 103-325<sup>20</sup> require lenders to furnish additional disclosures to consumers for a reverse mortgage at least 3 business days prior to consummation of a transaction.<sup>21</sup>

The additional disclosures include a "good faith projection" of the total cost of credit to the consumer by means of a table of annual interest rates. The projection is required to use the term "total annual loan cost rate" rather than "annual interest rate."<sup>22</sup> This is to reflect common costs other than interest, e.g. annuity premiums, appraisal fees, and percentage of appreciation in consumers equity,<sup>23</sup> regardless of whether these costs are considered finance charges as defined elsewhere in TILA regulations. At least three distinct sample sets of rates and periods of time must compose the table, based on three assumed loan terms and value appreciation rates.

These new regulations do not appear to have slowed emerging lender interest in providing reverse mortgages.<sup>24</sup> It seems that the level of understanding of this product has resulted in a feeling of comfort and confidence that this long discussed product can "work" for all parties. The Chicago Title Family of Title Insurers remains active in building upon that understanding.

1. U.S. Department of Commerce, Bureau of the Census, Statistical Abstract (111th Ed. 1991).
2. Celeste M. Hammond, "Reverse Mortgages: A Financial Planning Devise for the Elderly", *Elder Law Journal*, Vol. 1, No. 1, published by the University of Illinois Law School.
3. M.H. Hoeflich, "Housing the Elderly in a Changing America: Innovation Through Private Sector Initiative", 1985 *U. Ill. L. Rev.* 1, 3.
4. 12 U.S.C. Sec. 1715 z-20; 24 C.F.R. Secs. 206 et. seq.
5. Public Law 101-508 amended this Section November 5, 1990 to increase the total number of loans to 25,000 and extended the sunset to loans committed to before September 30, 1995.
6. 24 C.F.R. §206.41. HUD approved counselors provide certificates stating the mortgagor has received counseling which must be presented to the mortgagee.
7. 24 C.F.R. §206.9.
8. 12 U.S.C. 3801 et. seq.
9. P.A. 80-1290, approved 8-1-78, as amended in 1982, is 205 ILCS 5/5a
10. P.A. 82-294
11. The following states have legislation recognizing reverse mortgages: CA, CO, FL, GA, IA, IL, IN, KY, MA, MD, ME, MN, LA, MT, NC, NJ, NY, RI, SC, SD, TN, TX, UT, VA, WA, WI.
12. 205 ILCS 5/6.1, added by P.A. 87-488, Section 1, eff. 1-1-92.
13. A non-recourse loan is not defined in the statute. It is defined in Black's Law Dictionary as a loan by which a lender agrees to accept the collateral security as full satisfaction of the loan in lieu of repayment from the borrower if he is unable to pay or if the value of the security falls below the amount of the loan.
14. 205 ILCS 5/6.1(b)
15. *Ibid.* (paragraph 6.1(e)).
16. 735 ILCS 5/15-1302(b)(2)
17. *Northridge Bank v. Lakeshore Commercial Finance Corporation*, 48 Ill. App. 3d 82(1977). The Appellate Court (1st district) found that where a mortgage, although it initially stated that it secured a debt of \$30,000, allowed the mortgagee to make unlimited future advances under the same instrument and contained no language setting a ceiling on the amount of such advances, the mortgage did not show the amount of indebtedness on its face and therefore was insufficient to give constructive notice.
18. The HUD program requires both borrowers to be 62. The Illinois statute only required one spouse to be 62.
19. TILA is at 15 U.S.C. 1601-1666j
20. 12 C.F.R. 226. The final regulation implemented the Home Ownership and Equity Protection Act of 1994, contained in the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103-325).
21. 12 C.F.R. 226.31 (c)(2) amending section 138 of TILA
22. 12 C.F.R. 226.33
23. Shared appreciation (as additional interest) is permitted under the Illinois Statute and HUD programs, but has rarely been made part of reverse mortgage loans. Title insurance underwriting on this kind of situation remains to develop.
24. As of mid-1995, about 10,000 federally insured reverse mortgages had been originated nationally. From "Turning Your Home Into Pension Income With a Reverse Mortgage" Steven Baer, Senior Income Reverse Mortgage Corporation, Chicago, Illinois, part of American Bar Association. Young Lawyers Division program, August 7, 1995: "Reverse Mortgages and Other Senior Income and Housing Options", ABA Annual Meeting, Chicago, Illinois.