

[Servicing Matters: Repair Set-asides – A Default Dilemma](#)

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In this first in a series of regular columns examining servicing issues in the reverse mortgage sector, practitioners are provided with an understanding of repair set-aside rules – including one-year deadlines – and the importance of adequately notifying seniors about them. We welcome questions on this and other servicing issues, some of which will be addressed in future columns.

Commencing with the repair set-aside subject is worthwhile because reverse mortgage providers can, often unwittingly, create default and foreclosure problems for seniors, servicers and, eventually, themselves by failing to properly understand and advise their clients on this matter.

A repair set-aside is 150 percent of the amount that is in the repair appraisal, or in the repair estimate, made by the underwriter. So, if it's going to be a \$1,000 repair then \$1,500 is set-aside from the amount of funds available to the senior. Servicers set up a \$1,500 repair set-aside for the repair and an additional amount for inspections.

The Loan Agreement is supplemented with a Repair Rider that defines the timelines in which the borrower must complete the repairs. Most of the riders we see allow six months, however some lenders go nine. In no case can the timeframe in a rider exceed 12 months. HUD guidelines require completion of repairs within a year of closing. If the rider is less than 12 months and repairs are in progress, servicers must request extensions from HUD up to the one year.

A lot of times, borrowers – not realizing the importance of that one-year deadline – procrastinate and don't get the work done by the end of that year. It's not unusual for them to be caught in a winter dilemma; they'll get a loan in the fall and then don't get the repair work done quickly; the next thing they know it's the middle of winter.

That happened this winter with one of our customers. The senior had six months to get the repair work done but was 11 months into her reverse mortgage and still hadn't contracted anybody to paint her house – in Minnesota, in winter. Regardless, when the repairs are not completed within that year, the loan is actually in default.

Driving the industry a bit crazy

Currently, when servicers know (or suspect) that a repair is not in progress they have to refer the case to HUD for due and payable consideration. If HUD approves that, the servicer must advise the borrower the loan is due and if the default is not cured and foreclosure action will be initiated. What's driving the industry a bit crazy is that even a small uncompleted repair can cause a default.

One of my colleagues said HUD had approved a default over a \$400 repair issue. It sort of defies common sense – and maybe human decency – but the borrower had a \$150,000 reverse mortgage and hadn't done the \$400 repair job on their house and somebody is going to put this 82-year-old single woman on the street. So, HUD has to look long and hard at these situations and decide what kind of policy changes they're going to make, long-term.

Many originators, when they close a loan, may not realize that they need to educate borrowers, saying: "This is not a game; this is something that has to be done. You have to get this repair work done as quickly as possible and not dawdle."

However, a borrower may not have been properly advised of their obligation to complete the repairs. Then, that borrower, 13 or 14 months later, is being referred to foreclosure because a loan officer told them they didn't (really) have to. Sometimes litigation against the lender can result.

If a lender is giving borrowers bad information it will eventually come back to haunt the lender. Lenders must be aware that how they educated borrowers who have repair set-asides has a ripple effect on everybody that touches that loan after it's originated. Servicers and investors, like borrowers, can be hurt by the resulting defaults and foreclosures.

Another thing that's very important is, if you have a borrower who has a credit line and hasn't done the repair work, Section 3.5 of the Handbook 4905.1 states: "If the required repairs are not completed within time periods specified for repairs in the loan agreement the lender must discontinue payments from the loan, freezing the loan . . ." This is not just a freeze on the credit line, it's a freeze on any payments. Those are the folks I really feel for because they're most likely to be the people using that money to supplement their income. And, after getting hit by losses in the stock market, this money from reverse mortgages means more to them than it did before. By the way, on occasion we've had to freeze payments and sometimes it works in getting repair work completed – sometimes it doesn't.

How inspection fees are paid

Lenders also need to make borrowers aware that inspection fees are paid out of the repair set-aside funds. When you give the borrower the final accounting on their money and point out the repair costs and the cost of doing inspections, they ask, "Why am I paying for this?" That's something borrowers are not made aware of upfront.

And inspections have to be done on a property before we can release money to cover the cost of the repairs. I think we're going to see more and more defaults and foreclosures come out that are repair based.

One company that does a really good job on this is Urban Financial Group. The President, Bryan Hendershot ensures that his staff pays particular attention to detail and borrowers' full understanding of tax, insurance and repair set-aside requirements.

They really emphasize with their loan officers the importance of informing borrowers about all requirements of the reverse mortgage. We've been in discussions with them about formulating a Repair Rider and tax and insurance checklist that their loan officers will go over with borrowers during the application process and have borrowers sign off on, saying, "I understand I have these responsibilities."

Getting the repair work done within that one-year time frame is the borrower's responsibility, but it is the originator's responsibility to make sure the borrower understands this and follows through.

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