

March 20, 1996  
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1300 19th St., NW  
Washington, DC 20036-1685

Re: Reverse Mortgages -- Equity Share Feature  
(Your Letter of February 5, 1996)

Dear Mr. Axelson:

You have asked several questions about federal credit union (FCU) participation in a reverse mortgage lending program. Please be advised that FCUs may make reverse mortgage loans and, under certain conditions, may take an equity share when making such a loan. In making any reverse mortgage loan, an FCU is subject to the interest rate ceiling set forth in Section 107(5)(A)(vi) of the FCU Act, 12 U.S.C. §1757(5)(A)(vi), and Section 701.21(c)(7) of the National Credit Union Administration (NCUA) Rules and Regulations, 12 C.F.R. §701.21(c)(7).

Background

You describe the reverse mortgage program at issue as a conventional non-recourse mortgage product that permits eligible homeowners to borrow against the equity in their homes and not repay the loan until they no longer occupy the property as their principal residence. The amount of principal made available to the borrower is a function of the age and number of borrowers and the value of the property. All payments to the borrower are added to the loan balance as they are made, and interest accrues on and is added to the loan balance at the end of each month.

In addition to the standard program, borrowers are offered an equity share option, which enables them to borrow a larger amount of principal. The borrower may obtain greater loan proceeds in exchange for agreeing to pay an additional fee at the time the loan is paid off. The additional fee, called the "equity share," is calculated as a percentage of the property's value at maturity.

Analysis

An FCU is permitted to make reverse mortgage loans under the lending authority set forth in Section 107(5) of the FCU Act, 12 U.S.C. §1757(5), and Section 701.21 of the NCUA Rules and Regulations, 12 C.F.R. §701.21. In addition, an FCU may take an equity share as partial consideration for a residential mortgage loan where the income to be received constitutes no more than a part of the compensation received for the use of the FCU's funds. Thus, if the borrower has an unconditional obligation to repay the loan principal, and if an FCU receives a substantial payment of interest calculated periodically as a percentage of the outstanding principal loan balance, the FCU may receive additional interest calculated on the basis of the appreciation of the security property.

In light of the unique risks of reverse mortgage loans, such as the longevity of the borrower and the appreciation of the property, NCUA expects that FCUs generally will sell such loans into the secondary market. Any FCU that chooses to keep reverse mortgage loans on its books will be examined closely to determine that the program is handled in a prudent and sound manner. Proper documentation and adequate recordkeeping must be in place to ensure that the FCU's interests are protected.

You have also asked about interest rates that FCUs may charge. You argue that Section 205(g)(1) of the

FCU Act, 12 U.S.C. §1785(g)(1), permits FCUs to charge an unlimited rate on first mortgage loans. NCUA has not interpreted Section 205(g) in that manner. As set forth in Interpretive Ruling and Policy Statement 81-3 (enclosed), NCUA has interpreted Section 205(g)(1) to grant "most favored lender" status to state chartered federally insured credit unions. On any particular class of loans, state chartered federally insured credit unions may charge interest at a rate not to exceed the greater of one percent over the discount rate on ninety-day commercial paper or the rate allowed to the "most favored lender" on the particular class of loans under state law, provided the greater of either of these rates exceeds the rate state chartered federally insured credit unions are normally permitted to charge under state law.

FCU interest rates are governed by Section 107(5)(A)(vi) of the FCU Act, 12 U.S.C. §1757(5)(A)(vi), and Section 701.21(c)(7) of the NCUA Rules and Regulations, 12 C.F.R. §701.21(c)(7). Currently, FCUs are subject to an interest rate ceiling of 18 percent. An FCU participating in the reverse mortgage program you have described could charge no more than 18 percent interest.

Sincerely,

Richard S. Schulman  
Associate General Counsel

GC/LH:sg  
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Enclosure