

How Loan Servicing and Servicing Oversight Help Maximize Reverse Mortgage Value

Book 3: Life Expectancy Set Aside (LESA)

An eBook Series from Reverse Market Insight



While servicing oversight can help minimize potential losses of inefficient loan servicing, it's first essential to properly educate borrowers at the time of origination. One of the most important areas to focus on is the Life Expectancy Set Aside (LESA).

How Originators Can Clearly Share the Truth About LESAs

Reverse mortgage originators play a critical role in helping borrowers understand the LESA and how it can impact their financial future. A few of the main points to explain are:

1. How to define the LESA upfront
2. How LESAs are calculated
3. What it covers and what it doesn't
4. How to track and protect LESA balances

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1. Explaining the LESA on Day One

It's important to help borrowers fully understand how the LESA helps them meet their financial obligations at the very beginning. And it's easy. Some of the key points to hit are:

- **The LESA's Purpose:** Provides a convenient alternative that uses funds reserved from the borrower's loan proceeds to pay for future property taxes and homeowners insurance and help avoid the risk of default.
- **How It Works:** A loan may be originated with a Mandatory LESA or a Voluntary LESA. A Mandatory LESA may be either Partially-Funded or Fully Funded. A Mandatory LESA is determined through an evaluation of the credit file and the borrower's financial assessment prior to closing. Partially-Funded LESAs are only intended to cover a portion of the borrower's anticipated property charge obligations based on life expectancy and residual income while a Fully-Funded LESA is intended to cover all of the borrower's anticipated property charge obligations for the life of the loan. With a Partially-Funded LESA, the lender will issue a disbursement to the borrower, but the borrower is responsible for making that payment directly to their taxing authority or insurance carrier where as with a Fully-Funded LESA, the servicer will make the payment directly to the required party. Voluntary LESAs are always Fully-Funded and unlike a Mandatory LESA, a Voluntary LESA is not required to close the loan.

The Impact on Borrowers: Since the LESA is funded from the reverse mortgage proceeds, it reduces the amount of money available to borrowers in either their lump sum or monthly payments, but it does provide peace of mind that the necessary expenses will be better covered for years to come.

2. Sharing How the LESA is Calculated and Why That's So Important

The "Life Expectancy" Set Aside is really a misnomer. These days, it can run out long before the borrower's calculated life expectancy because of the steadily increasing costs for property charges.

Once you explain that life expectancy tables used to calculate the LESA are based on 1979 Female life expectancy and how taxes and insurance costs rarely go down, borrowers get a better appreciation of their potential future responsibilities. And, remember some of these rising costs are even greater in certain regions, such as the California wildfires' effect on hazard policies and New Jersey's steadily increasing tax assessments.

But Don't LESA Funds Grow?

LESAs do grow at the same rate as the line of credit or loan balance's interest rate plus a half a percent, but it's unlikely that will outpace rising costs of what it needs to cover. We need to make sure our clients understand this and that they are fully responsible for funding their own taxes and insurance once the LESA is depleted.

3. Explaining What the LESA Covers ... and What it Doesn't

Foreclosures for nonpayment of property charges are significantly down since the establishment of the LESA because of the set aside itself and lenders' upfront assessment of each borrower's ability to cover their property charges. Still, it's important to explain to them:

What LESA Funds Can Be Used For:

- Property Taxes
- Homeowners Insurance

What LESA Funds Can't Be Used For:

- HOA fees
- Ground Rents
- Maintenance & Repairs

What About Unused Funds?

It's also important to explain to borrowers that any excess funds in the LESA account after the death of the last borrower are treated like they were never borrowed. The borrower doesn't have to repay those funds, but they also can't use them for any other purpose.

4. Revealing How Tracking and Protecting LESA Balances is Easy and Essential

Borrowers should understand they'll receive regular statements and notices about their LESA just like any loan they have:

- **Monthly Statements** include the funded balance and transaction history
- **Regular Letters** share important status updates
- **Annual Analysis**, similar to forward mortgage escrow analysis, outlines anticipated property charges relative to available funds.
- **Final Notice** when funds are depleted stating that the borrower is now responsible for property payments

Knowing How to Use All This Knowledge

With all this information, borrowers can make sure that they:

- Avail themselves of any tax exemptions that they may have with their county or their local taxing authorities,
- Get new quotes to potentially lower their insurance costs each year
- Identify the timing and source of needed funds once LESA is depleted

Want to learn more?
Contact RMI today!

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Learn How To Minimize Losses In Any Reverse Servicing Portfolio

Upfront education about the Life Expectancy Set Aside is just one step to effective loan servicing. Portfolio Managers and HECM Issuers holding financial interest are often unaware of how operational inefficiencies can inflate loss severities within their servicing portfolios. RMI's seasoned servicing experts specialized in reverse can provide insights to transform performance, and our cutting-edge software is equipped with business rules designed to appropriately manage these assets. Contact us to learn about Servicing Oversight with Reverse Market Insight.



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How Accurate are LESA's?

LESAs are estimates of both life expectancy and housing related costs. This first item is based on 1979 Female life expectancy rates and the second may not fully recognize that taxes and insurance costs rarely go down.

While LESAs do grow at the same rate as the line of credit or loan balance's interest rate plus a half a percent, it's unlikely that will outpace rising costs of what it needs to cover.

How do I track the status of my LESA?

Borrowers receive regular statements and notices about their LESA just like any other loan they have:

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