

NatEquity Knowledge Base

Proprietary Reverse Mortgage Life Cycle Design Considerations

The life cycle of a properly executed proprietary reverse mortgage type product ideally brings together the interconnected needs of stakeholders. The funder wants the assurance of an acceptable return of investment. The homeowner wants to age in place comfortably. Heirs do not want to be disinherited as with conventional reverse mortgages. The realtor who lists the property after the contract matures wants a well-maintained home that is easy to sell. The new buyer wants a home ready to move in and resume their new life. NatEquity has challenged our years of experience by interviewing stakeholders to design a program to benefit each element of this life cycle.

Reverse mortgage market practices today are reliant upon a HUD/FHA program property level loss guaranty which has led to sloppy underwriting because originators immediately sell the contracts into securitized reverse mortgage backed securities (RMBS) backed by the full faith and credit of the U.S. Treasury. Immediate profits are made by the originator/secritizer based upon the spread between the effective interest rate on the contract (5.5%±) and lower yield on the securitized pool (1.85%±). Long-term risk resides with the third-party servicer. The upfront securitization profit approximates a 25% yield with no effective claw-back.

NatEquity is a senior focused residential real estate company whose business is to option the right to own one half of the future value of well-located coastal California single family homes. NatEquity's goal is to own a large geographically distributed portfolio of owner managed properties that have not been on the market since purchase, usually 30-40 years ago. NatEquity profits from the consistent home price appreciation (HPA) in these homes rather than charging compound interest as do reverse mortgage lenders.

NatEquity is an originator who will retain ownership and the servicing responsibilities. This demands a different and more expensive class of underwriting and servicing to protect our long-term interests in each contract we co-manage with the resident senior homeowner.

NatEquity's ideal client is someone who has made the conscious decision to age in place in the home they enjoy and are accustomed to maintaining. These clients understand that by maintaining their home they can live in comfort and are assuring their heirs the highest possible residual value when the home is sold.

Selecting target property markets has come from an understanding of the history and trajectory of regional geography and job markets. Paramount are markets with predictable job growth where people want to live. This means homes in those locations will always attract new home buyers. Affordability means different things to different people. The current senior homeowners wanting to age in place need to know they can continue to afford to live there on a predictable limited monthly cash flow. The new buyer needs to have job

prospects allowing them to financially stretch when buying a home in the best location to satisfy their family's needs.

NatEquity has purposely chosen coastal California to introduce the first home equity sharing option product for senior homeowners. Management understands the geographic and economic drivers of these distinct coastal markets. Coastal California was relatively undeveloped with little industry until after World War II. The war in the Pacific brought an array of industrious workers who decided to settle. During the 1960s California graduated more credentialed teachers with advanced degrees than the next five states combined. This was possible because in the 1960s California unified a large growing system of state universities, colleges and local community colleges. The graduates from this system have created a continuous growth of technological, agricultural and bioscience innovation. Today this has led California to become the 5th largest economy in the world.

California did not start this boom with a large legacy of last century industrial economy. Educated entrepreneurs grasped and developed an array of new economy businesses. These ranged from wine and hospitality in Sonoma and Marin Counties, to finance and technology in San Francisco, Contra Costa, San Mateo and Santa Clara Counties. Further south Ventura, Los Angeles, Orange and San Diego counties became leaders in aerospace and the movie industry. All of these clean industries enjoy a large educated work force who are attracted by moderate climate and the life style it affords. These industries and the universities supporting them continue to spawn new associated industries in a seemingly never-ending cycle.

A key factor making these markets ideal for proprietary reverse mortgage type products came in 1978 when California enacted Proposition 13, which froze homeowner property taxes until homes were sold at a later date. The State and communities have learned to live with this constraint from property tax revenues. State income taxes are high for those who choose to live here. Every time there has been an attempt to repeal Prop. 13 it fails worse than in previous attempts – property owners vote. For California seniors aging in place this means the home they bought in the 1970s for \$25,000 which is now worth \$1,250,000, enjoys a \$3,000 instead of \$25,000 annual property tax bill.

The case for offering proprietary reverse mortgage type products to seniors living in \$1,250,000 coastal California selected housing markets is only partially answered by California's economic engine, temperate climate and low property taxes. Consistent year-over year cumulative 5% home price appreciation (HPA), coupled with housing demand that outstrips housing supply near job centers assures NatEquity's funders continuous HPA growth. Data tells management there are 2.1 million households over age 75 living in the selected coastal California counties.

Realtors and prospective home buyers add a new prospective to this equation at the time of sale. NatEquity's typical homeowner has lived in their home for more than 35 years. Realtors and prospective buyers lament that when these homes come to market, they often have outdated kitchens and bathrooms that detract from the homes value and mean an extended time on the market before sale. Prospective reverse mortgage customers tell NatEquity that, if cash was available, they would remodel both their kitchen and bathrooms to enjoy them while they continue to live in the home.

This convergence of front-end improvements leading to backend enhanced value and reduced time to sale led NatEquity to examine and design a program to offer homeowners the option of remodel both kitchens and bathrooms at the time they enter into a contract

with NatEquity. Region specific remodeling statistics reinforce claims that moderate kitchen and bathroom remodeling adds value at time of future sale. Kitchen remodels costing \$25-35 thousand offer homeowners new appliances, fixtures, countertops, cabinet doors and flooring. Bathroom remodels costing \$15-20 thousand mean new fixtures, tile and showers or walk-in tubs. All of this is accomplished by expanding NatEquity's future home price appreciation sharing ratio beyond the Company's typical 50/50 ratio.

Managing and accomplishing this has led NatEquity to form an internal unit to accomplish these remodels. At contract origination NatEquity staff specialists perform the home inspection of each home for necessary improvements like new roofs at the time of contract origination. These or other necessary improvements are handled now or in the future by contract modifications. Homeowners who are prospects for kitchen or bath remodels work with NatEquity designers using "augmented reality" (AR) 3D photos of their kitchens and or baths to select from top brand appliances, fixtures, cabinet fronts, countertops and flooring options to select from. If the decision is to proceed the contract is modified and the work is performed by contractors supervised by NatEquity staff.

These necessary and voluntary home improvements add to the homeowner's piece of mind and home enjoyment while preserving and enhancing the homes value. NatEquity's continuous customer service outreach monitors these and future home improvements. These and other proactive considerations yield a different type of senior living experience designed to benefit all parties now and for the life cycle of each home.

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