NatEquity, Inc. National Equity Access for Senior Homeowners

# NatEquity Knowledge Base

## The Elephants in the Room

NatEquity has been turned down by substantial private equity firms for two stated reasons: 1) "headline risk" related to reverse mortgages and 2) management's lack of a track record. Most of the NatEquity managers have known each other and worked together or at similar companies or products for ten years or more. They are hand picked for skill, sound headedness and proven dedication to helping seniors.

From an idea I grew Transamerica HomeFirst into a multi-billion dollar jumbo private reverse mortgage company. In 1999, Transamerica sold our 15,000 shared home equity contract portfolios to a Wall Street bank for about $3 billion. That bank securitized the portfolios as SASCO-RMs with an A- investment grade rating from Moody's and Fitch. They sold the securitizations within a year for reportedly about $6 billion, a sweet $3 billion profit. NatEquity's product is a redesign of one of those highly successful Transamerica HomeFirst products.

Headline risk cannot be ignored, and abuses should never be tolerated. I think the real reasons are that high salaried East Coast bankers don't understand coastal California and possibly don't care to address seniors' predicament nationally. Five issues need clarification:

1. Income inequality between salaried working years and retirement years on a fixed pension or social security.
2. Aging in place enjoying a temperate climate.
3. How can coastal California have 6% annual compound home price appreciation when nowhere else in the country enjoys that rate of property value growth?
4. Publicized reports of abuse by originators and recipients of the government guaranteed Home Equity Conversion Reverse Mortgage Program (HECM).
5. Seniors would rather opt for a compound interest rate borrowing product with known costs rather than a shared equity product, even with a cap on the upside and where the lender shares in any loss on the downside.

NatEquity's clients are school teachers, public employees and other professionals who bought close-in suburban homes in temperate coastal California during the 1960s and 1970s for $40-$50,000 that are now worth more than $1,250,000. For 'house-rich cash-poor' seniors trying to live on an average pension or social security of $1,300 per month, aging in place is not easy. Property tax relief under California's Proposition 13 helps, but for many, a NatEquity contract is a better alternative to cashing out of their home only to face skyrocketing rents.

The overarching point here is that people who have never tried to live month-to-month on a modest pension or social security income while having to make the cash flow spending choices required, can never understand the predicament these retirees are in.

1. Retirement Income is often challenged: $1,300 per month, "it can't be that low"?[1] The people who taught our kids were at the low end of the college educated pay scale. For those whose working career was at the top of the social security eligible salary range, annual social security is $48,000, $4,000 per month - $2,000 each for a couple – not that far off.

2. Aging in Place: Those who typically would say to someone who can't afford to age in place: "sell and downsize or rent" cannot imagine anyone receiving only $1,300 monthly after a lifetime's work. These retirees decided years ago to stay in the same community. California's Proposition 13 allows them to carry over their low property tax base to a new home in the same county, if they can find a smaller home in that area. Their home value is already at the low end for their community. Anything they find will probably require renovations and upgrades, netting out at about the same number as if they stayed put. If they cash out of their home, they will only face skyrocketing rents.

   For decades, retirees from the East Coast have flocked to eastern Florida. Retirees from Chicago have retired to the west coast of Florida. Many of these retirees are escaping both bad weather and high property taxes[2]. They move to retirement communities to enjoy the 12-month outdoor life in a warmer climate – think California, but it's too expensive.

3. High year-over-year HPA: Coastal California emerged from WWII has a nonagricultural, smokeless light manufacturing economy that imported steel and other components from the East. Growth was limited by lack of infrastructure and core services. In the 1960s, California graduated more credentialed teachers than the next five states combined[i]. In 1960 California graduated more students with bachelor or advanced degrees than the next 6 states combined[ii]. At the same time, by the early 1970s, California had the largest state university, state college and integrated community college system in the nation[iii]. Key job centers are clustered around major research universities (UC Berkeley, Stanford, UCLA, UC Irvine and UC San Diego/Scripps). Then, as now, this system generates and regenerates technology and associated light industry/service related high paying jobs. When one company moves, others quickly replace those jobs and housing requirements. Every time there is an economic downturn (1982 [oil embargo], 1992 [end of Cold War], 2000 [dot com bust], 2007 [economic recession caused by sub-prime mortgages]), the housing market in key target areas goes flat for 8-18 months before surging back.

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[1] A CalPERS or similar retiree in 2005, retired on $900 per month. At an annual 2% cost of living increase that is about $1,300 per month today. Most defined benefit pensions are tied to similar social security payout amounts.

[2] Property taxes in New York state and Illinois only cap when the homeowner reaches age 65.

4. Headline Risk: Dating from the 1990s, unethical reverse mortgage originators, have been a constant stain on the Government sponsored Home Equity Conversion Reverse Mortgage (HECM) program. Back in the 1990s sales agents in Florida illegally demanded cash payments from seniors in a program that specifically outlawed such upfront origination payments. The reverse mortgage market was slow to grow until 1999, when Lehman Brothers created the SASCO-RM securitization conduit and later applied it to HECM government guaranteed reverse mortgages.

   By 2007, the government guaranteed secondary HECM market led to multiple securitizers in the Ginnie Mae marketplace. The proposition was simple: write contracts with a 5% interest coupon to the homeowner, but offering a 1.75% U.S. Government guaranteed bond coupon to pool buyers. The securitizer enjoyed the immediate 25% IRR cash spread. The problem was dollar volume. The solution was writing as many front-end lump sum HECMs to boost securitization dollar volume. This led to targeting seniors in financial trouble. Worse, it led originators to convince seniors who did not need lump sums to take large upfront payments.

   Steering seniors to lump sums led to several indictments by States' Attorneys General against large aggressive reverse mortgage originators[iv]. It also led HUD to limiting the immediate access to lump sums in the HECM program. Other HUD changes to the program raised qualifying limits and imposed financial qualification provisions. Together, these halved the number of seniors applying for and qualifying for HECM reverse mortgages.

   The most recent major headline risk stories involved widows being thrown out of their homes at their husband's death because they were not recognized in the reverse mortgage documents. In fact, they where purposely not mentioned in the loan documents because by excluding the younger wife the husbands were told he could get more money during the couple's lifetime together. This blatant abuse of the program was eventually corrected by including those unnamed spouses in the continuing income stream at taxpayer expense.

   According to the Government Accountability Office in a September 2017 report, these prior HECM program abuses are currently costing the FHA Mortgage Insurance Premium (MIP) Fund $4 billion per year. There is an additional accrued liability of $14 billion coming due in the next several years from prior abuses. Much of this was highlighted in a 2014 HUD Inspector General report[v] citing an 87% fraud rate amongst HECM loans inspected.

   Last Fall, although both Congress and outside groups have called for the termination of the HECM program, movement from Congress on this is unlikely. However, Treasury is discussing elimination of Government guarantees on products sold by Government Sponsored Entities (GSEs). This would be the de facto death of HECMs because they would no longer bring a profit at securitization.

5. Homeowners understand that "borrowing" money requires paying interest. Reverse mortgages defer that interest, albeit compounding the payment of deferred interest where interest is charged on interest. Most don't understand that concept except that it is interest. The product where they have experienced the downside of compound interest is in the buildup of unpaid credit card debt.

   Allowing seniors to receive cash advances against an option for someone else to own one half of the future value of their home when it is sold is a new concept. From the standpoint of the senior and their heirs it makes lots of sense. Protecting one half of the future value of the family homestead for heirs is at the root of how most seniors think. Assuming the homeowner has a home that is constantly appreciating in value, they are really receiving cash advances against that increase in value while they continue to enjoy living in the home. For the NatEquity home equity sharing option product to be successful this change in thinking must be conveyed and reinforced.

   NatEquity's advantage is that our chosen customer base are educated seniors who have shied away from traditional reverse mortgages because of the bad press. They may also have learned their lesson and paid off growing credit card debt. Early focus group testing through trusted reverse mortgage wholesalers tells us this new concept is quickly understood. This goes back to the key underlying proposition NatEquity is founded upon – certainty of cash flow for the senior and certainty of inheritance for heirs.

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[i] *A History of Policies and Forces Shaping California Teacher Credentialing*, 2011, https://www.ctc.ca.gov/docs/default-source/commission/files/ctc-history.pdf?sfvrsn=96050f5_0
[ii] Ibid, *History of Policies …*
[iii] *Ibid, History of Policies …*
[iv] https://reversemortgagedaily.com/2010/02/09/illinois-ag-files-lawsuits-against-two-reverse-mortgage-lenders and http://www.mortgagefraudblog.com/ag_sues_two_reverse_mortgage_brokers
[v] https://www.hudoig.gov/sites/default/files/HECM%20-Refinancing-Fraud%20_Alert.pdf