NatEquity, Inc. National Equity Access for Senior Homeowners

Product Design Considerations Mitigate Risk

1 Accrued Interest with Shared Appreciation Product Description

NatEquity's path to designing a balanced and socially responsible senior home equity access product required a number of steps to get where the product is today. From inception we knew it was a balancing act to assure senior homeowners' their home equity would provide them with continuous monthly cash flow while assuring a substantial home value legacy for their heirs. Important for us, the product needs to reflect our social conscience. After a number of false starts, NatEquity's founder decided to improve upon a highly successful product line he developed at Transamerica HomeFirst almost thirty years ago. Time demonstrated this product needed improvements. To be successful the product had to appeal to multiple constituencies with varied interests:

1. Senior homeowners sharing home equity needed the assurance of continuous monthly cash flow to continue to enjoy their home while also taking care of immediate financial problems which were the triggers that got them to the point of pursuing this avenue of debt relief and income security; while leaving a substantial legacy for heirs.
2. Institution investors demand a product, when bundled and sold, provide an acceptable rate of investment return with sufficient downside protects they can stress test with some level of confidence.
3. Loan originators need a product they can quickly understand and explain that provides them sufficient fee income at a prospective volume that gets their attention.
4. NatEquity's investors need to be comfortable that the product provides sufficient cash flow to make the company successful in an environment where company's participants are proud of what they are doing and will benefit from the success.
5. Senior homeowner's children need to believe that the equity given up provides for the wellbeing of their parents while relieving them from the stress of future financial commitment to their parents which they cannot usually afford. Not to be overlooked is that the children want to know they have a residual home equity stake when the home is sold.
6. The media is always skeptical of any financial product targeting senior homeowners. The media assumes and jumps on the opportunity to expose wrongdoing, actual or case specific. Unfortunately, senior financial products, including the government's Home Equity Conversion Reverse Mortgage (HECM), have had design flaws capitalized on by market participants.

2 PRODUCT DESCRIPTION

In the simplest form, NatEquity agrees to buy one half of each home based upon the current appraised value. At time of future sale NatEquity receives one half of the home's sales price, plus recoups loan principal advanced and accrued interest. In exchange NatEquity pays the homeowner a stream of monthly payments as long as they live in the home, may advance an agreed upon "fresh start" payment to clean up small debts, replace a roof, modernize a kitchen, pay off a reset HELOC and pays the balance of the home's appraised origination value to the homeowner in a lump sum at time of sale. Homes are inspected annually. Provided a home is maintain the homeowner receives a 2% annual cost of living increase in their monthly payments, without any change to their equity and appreciation sharing ratios.

NatEquity believes 1 in 4 contracts will include additional upfront advances to payoff reset HELOCs ($75,000) and monies to replace a roof, modernize kitchens and bathrooms ($100,000). These additional advances will adjust the initial 50/50 future sharing ratio to 55/45.

3 MITIGATION OF THINGS THAT CAN GO WRONG

Addressing the things that can go wrong is the balancing act that draws upon experience. If it can go wrong, it will. Transamerica HomeFirst was the first, and to date, the only successful private senior home equity conversion appreciation sharing product. The lessons learned are many from early product design and, after the sale of the company, watching how market participants incorrectly modified or discarded key product features. NatEquity's goals are two:

A. Limit the impact of foreseeable problems for both homeowners and investors.
B. Through product design, offer features senior homeowners need and want in a format acceptable to all stakeholders.

Below are product design and contractual considerations:

1. **Does the product appeal to senior homeowners?**
    a. The NatEquity share appreciation equity sharing contract is a substantially improved version of what Transamerica HomeFirst successfully sold in volume in the 1990s. Discussions with senior lenders and senior focus groups helped mold the product. No product exists today which meets the upscale home value market need for continuous monthly income while assuring the heirs of an inheritance.
    b. NatEquity conservatively only estimates 2% market penetration for this initial coastal California product. This is in line with the market penetration

for the down-market government Home Equity Conversion Reverse Mortgage (HECM) product.

   c. In January 2020, existing GAAP mark-to-fair-value rules became effective for residential mortgage products. For longevity dependent products targeting seniors, portfolios of contracts are worth the net present value of predictable future portfolio cash flows. This requires the offering company to have a longevity predictive tool equivalent to the Longevity Cost Calculator (LCC), for which NatEquity has an exclusive license. Without such a tool to predict future portfolio cash flows, those portfolios are valued at substantially less than cost.

2. **Does it have sufficient appeal to sell in acceptable volume?**
   a. Both conventional and reverse mortgage originators have reviewed and been part of the NatEquity product design process. They understand it and believe homeowners will quickly embrace the product. Sales commissions have been initially set at 2% of loan origination value (one half of appraised value).
   b. For both conventional and reverse mortgage originators this is an addon product they need to not miss a sales opportunity. The process and documentation are very similar to what they sell today. The regulatory and compliance requirements are government complaint and consistent with what they apply today.
3. **Does NatEquity or the product have or expect any regulatory issues?**
   a. This is a big point of departure for NatEquity from the number of small companies offering unregulated “option” type products. NatEquity was originally conceived as an option type company that would shadow most regulatory requirements but not be an accrued interest regulated product type. The decision was made to become a California regulated financial lender to comfort originators operating in a regulated world; and to use a low rate of accrued interest to stabilize product and portfolio downside risk.
   b. As a California regulated financial lender NatEquity must comply with federal and California truth in lending and other regulatory requirements. Considering NatEquity always assumed the “option” product market would eventually become regulated and already intended to comply, the leap is not great to start as a regulated lender.
   c. NatEquity’s principals have operated as officers in regulated mortgage banks and are comfortable in this environment.
4. **What if the economy and markets do not produce target HPA?** To protect lenders/investors and their collateral, each contract contains protections to smooth out any unexpected downturns or catastrophes. Contractual downside protections establish a floor on profits:
   a. Any actual adjustment to the settlement payment is determined based upon the home’s sales price. Home price appreciation in excess of 4% on

NatEquity's portion of home value is earmarked as a shortfall reserve. At time of sale, this reserve is drawn down to provide NatEquity 4% cumulative compound HPA profits. After this reserve is fully utilized, if actual value at sale is less than the target 4% HPA, one half of the HPA shortfall is deducted from the settlement payment, but this payment never falls below zero. For homes in target markets, historic HPA cycles show a surplus due the homeowner. Only homes sold during a continuous downturn experience an HPA shortfall which reduced their settlement payment at sale.

b. The homeowner subordinates their interest in the home to the lender so that in the event of a catastrophe the lender receives first monies at sale, foreclosure or receipt of insurance proceeds. Homes are statistically revalued quarterly to reaffirm contract values for contract valuation and insurance purposes in the event of a catastrophe relying upon insurance proceeds for payment.

5. **What about when homes are modified to accommodate renters to extended family?**
    a. Contract foreclosure provisions require a homeowner to have in writing from NatEquity permission to modify, improve or in any way alter their home to accommodate renters or extended stay by family members.
    b. Photographic annual home inspections determine if there are any unreported home modifications.
6. **Must homes meet a certain standard at time of loan origination?**
    a. NatEquity only enters into contracts where the home meets our inspection standards or can be brought up to those standards at time of loan origination. Costs to bring homes up to standard are part of the initial loan advance.
    b. NatEquity's inspection standards recognize the homeowner intends to reside in the home for years to come. Our standards focus on maintaining home value increases and on homeowner safety.
7. **What about when homes are allowed to deteriorate from lack of upkeep?**
    a. Non-upkeep or home deterioration is a foreclosure condition which allows NatEquity to step in or, if nor cured by the homeowner, initiate foreclosure as a course of last resort but can usually by prevented.
    b. Each homeowner has agreed to be a resident manager of their largest asset. For this reason compliance is in their best interest. Deteriorating health may be the mitigating factor. This is usually uncovered in the quarterly call and or annual inspection.
    c. At time of initial home inspection each home is evaluated to determine what needs to be improved or replaced. The need for a new roof is often the trigger that prompted the homeowner to call in the first place. Items needing immediate repair or replacement are taken care of out of the initial loan draw. Items which may need replacement in the future are scheduled for future evaluation in NatEquity's customer relationship

management system and appear as question for each quarterly call or annual inspection. These items are taken care of when the need arises.

d. Quarterly NatEquity conducts a phone interview with each resident homeowner to ascertain their needs and condition. At Transamerica HomeFirst we would that these calls were welcomed by homeowners who develop a relationship with their call center contact person.
e. This writer was the creator and CEO of Transamerica HomeFirst. I would send personalized birthday cards to each borrower with my private phone number. I got a lot of call in which I could ask questions and get feedback. One come questions was about how they spent the money we provided them each month. The usual answer was that they spent 1/3 on themselves, 1/3 on their kids and grandkids and 1/3 on home maintenance.
f. Annually, or more often if warranted, NatEquity home inspection staff conduct an in-person home inspection along with resident homeowners. Knowing this inspection is coming and knowing that if the home is well maintained they will receive a 2% cost of living monthly payment increase, most homeowners are eager to show off how they are an active resident manager of their property.

8. **What about fire damage from isolated fires or wildfires?**
   a. At the time each new NatEquity contract is originated each home undergoes a homeowner's replacement value insurance analysis. Each home must have and maintain a replacement value policy. Typically, these policies contain clauses that allow policy replacement limits as high as 150% of stated replacement cost value. These replacement cost policies also provide one year of alternative living expenses while the home is being rebuilt.
   b. NatEquity encourages homeowners to conduct or NatEquity will conduct a photo inventory of the home and its possessions.
   c. NatEquity also encourages homeowners to scan and place in safekeeping copies of any plan, building permits and engineering for their home. In the event of fire, many California communities allow homes with plans, permits and engineering to be rebuilt as built without lengthy permitting or review processes.
   d. At time of loan origination, if a home is located in a wildfire danger zone, NatEquity conducts a home hardening analysis to Firewise USA standards and performs home hardening as part of the homeowner's initial loan advance.
9. **Nonpayment of homeowner's insurance or property taxes?**
   a. NatEquity subscribes to a property tax reporting service and is named on the homeowner's insurance policy.

   b. This is a contract foreclosure triggering condition. NatEquity will step in and reduce homeowner payments to make up any deficiencies and keep payments current.

10. **What precautions do you take for Earthquakes?**
    a. Earthquake is an ever-present problem in parts of California. At time of initial home inspection homes in known earthquake zones are identified using state-level mapping and probable earthquake damage estimator tools.
    b. Part of NatEquity's home inspection evaluation is determining if the home is properly anchored to the inground cement foundation. When deficiencies are noted, and as part of the initial loan draw, NatEquity will supervise or conduct sufficient work to assure the home is properly anchored it its foundation and that the exterior walls are properly nailed.
11. **Homes do not sell for full value at time of resale?** In coastal California target markets homes typically are slow to sell or sell below market price because to home has not been modernized sufficiently to satisfy the new buyers who are stretching available cash to meet lender down payment requirements. "Mom" would rather keep looking and hoping rather than wait 5-years before they can afford a modernized the kitchen and bathrooms.
    a. At the time of initial home inspection at loan origination, NatEquity staff discuss with homeowners the option of modernizing their kitchen and bathrooms to meet their expectations. If the homeowner decides to have such modernizations, NatEquity design staff work with the homeowner to replace and modernize items to meet homeowner expectations. For kitchens these include new appliances, countertops, flooring, cabinet doors and lighting. The option made available are from highly respected vendors in each price range. NatEquity designers use augmented reality photos to insert chosen appliances and other amenities for homeowner approval. NatEquity supervises licensed renovation contractors who specialize in kitchen and bath renovations.
    b. In the absence of family interest, NatEquity is prepared to step in and cleanout, paint and stage each home for resale. In the event NatEquity does this, we may have a working agreement with the listing real estate agent or may elect to be the listing agent.

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