NatEquity Knowledge Base

Summary of NatEquity's Recent Product Design Forum

Recently NatEquity's staff of veteran reverse mortgage pioneers held a one-day seminar and product design forum. The purpose of the exercise was to reexamine mistakes from our past to envision and design private reverse mortgage products for markets other than the stable home price appreciation coastal California market. These would be variants of the successful Transamerica HomeFirst private jumbo reverse mortgages combining shared appreciation with a compound accrued interest component to insulate against downside market price instability. When Transamerica sold its portfolio of contracts to Lehman Brothers in 2000, these shared appreciation products were rated Aaa by Moody's and bundled into successful bonds still traded today. Litigation against Transamerica's product design stopped this design combination until 2006. In 2006 a California appeals court ruled that shared appreciation was an acceptable component of reverse mortgage design. Since then variants of share equity design have reappeared in products tailored to markets for younger home buyers where investors share in future home price appreciation.

For 20-years the reverse mortgage industry in America has relied upon and exploited the artificially simplistic framework government let evolve in the Home Equity Conversion Reverse Mortgage (HECM) program. One size fit's all does not work from sea-to-shining-sea. HECM allows the measurable (interest rates) to be held low and the aspirational (home price appreciation [HPA]) to be pegged at an unrealistic 4% national average. When the myth does not work out the loan losses are returned to the U.S. taxpayers via the cover of the underlying government guarantee. This has led to a current program loss of $4 billion annually, with about $14 billion of accrued future program losses and still counting.

The emerging private reverse mortgage market recognizes the need to tailor and offer products to suite different markets. NatEquity understands that select markets 50-miles from either coast and a 50-mile radius of major job centers have materially different socio-economic and job opportunity characteristics than margin areas. The 6% compounded annual home price appreciation enjoyed in coastal California does not exist in inland California or anywhere else nationally. Just like traditional mortgage lending, private reverse mortgages must have variants that can be tuned to the characteristics of both borrowers and their local communities.

Private reverse mortgage design tradeoffs are simple, but solid historic local knowledge and data are required. Coastal California can support a year over year assumption of 5% cumulative compound HPA. That historically proven cyclical fact does not work for communities in the radius 30-50 miles from major job centers. Those margin areas require a base accrued interest rate component, plus some supportable level of cyclical HPA upside. More than 50 miles inland from the Pacific Ocean further changes the complexion of products. These observations come from 30-years as veteran pioneers in the reverse mortgage business.

NatEquity draws upon products we designed at Transamerica HomeFirst in the 1990s, several of which we had on the shelf but never brought to market. The housing market nationally suffered its worst decline in 40 years in 2008. Analysis of data after the 2008 housing crisis supports our design thesis. Home prices in key coastal California zip codes went flat or down 3% in 2008 but rebounded dramatically after 18-24 months. Home values in these areas have nearly doubles in the 10 years since 2008. Home in the radius of 20-50 miles from a major job center or from the coast have fared less well. Much of the mid-west is only beginning to again enjoy 2008 home price levels.

Product Design for the Margins in California and Elsewhere

NatEquity has modeled and is comfortable with a supplemental product that profits from future home appreciation capped at 3% to 4%, combined with a today initial accrued interest rate of 4%. The anticipated future home appreciation rate used will draw upon NatEquity's historic HPA studies done for secondary and margin markets in California and out of state. Stress testing has shown this alternative product to perform better than NatEquity's core shared future home appreciation product for our primary coastal California markets, but with more potential volatility.

NatEquity's home equity sharing "option" type contract is currently unregulated under regulations from the Federal Reserve, the Consumer Financial Protection Bureau and the State of California. NatEquity does not believe this will always be the case. NatEquity's disclosures and contract documentation mimic and are compliant with FED and CFPB standards, but do not contain the regulated interest coupon component.

The introduction by NatEquity of a regulated interest component product will require operating as either a state licensed mortgage broker or State of California regulated community bank. Transamerica HomeFirst operated as state regulated community bank.

2.1 million senior homeowners over age 75 live in the coastal eleven counties of California. Part of this population live in the 20-50-mile radius from major employment centers which NatEquity considers secondary markets. These secondary markets require an additional product to support both NatEquity's contract and captive sales forces. Approximately 2.5 million additional senior households are in margin inland California markets and markets identified out of state.

NatEquity recognizes we will not attempt to offer product in locations where we do not expect to be able to operate profitably. As stated above and reinforced by historical data, not all reverse mortgage markets can be expected to be profitable for private market products. Operating in markets without profitable economies of scale inhibit the ability to proactively service contracts on a cost-effective basis.

Product Design is Trial and Error – What Were the Errors?

1. Line of credit features that became instant lump sum draws:

   In reaction to HECM introducing a line of credit/limp sum feature in 1994, HomeFirst introduced the “Cash Account”. Mathematically it was not difficult to scale the available lump sum to the prevailing interest rate and anticipated life expectancy of the borrower. Like HECM, the longer the homeowner did not draw on the line of credit, thus accruing interest, the larger the available balance became over time.

   The oversight for both HomeFirst and HECM was the appeal of this product to senior homeowners with deep financial problems requiring immediate full drawdown of any available cash. HomeFirst hoped to counter this by using a simple financial planning workbook, but not checking credit history. Of the many thousands of contracts HomeFirst wrote, the cash account proved to be the most troubling. Like HECM would later discover, once the cash is drawn down there is insufficient money left to create a livable money payment to sustain the homeowner. HomeFirst engaged in workouts not requiring foreclosure. One high profile HECM servicer initiated 32,000 HECM foreclosures in a single calendar year.

   NatEquity’s Solution:

   First, do not offer more than modest lump sums (catch-ups) for homeowners to clear up modest credit card debt or other manageable debt relief. NatEquity’s month cash advances can be adjusted downward to account of these payments.

   Secondly, home inspections at time of contract origination alert NatEquity to necessary and homeowner specific desired home improvements. History tells us these range from roofing material and gutter replacement to replacing heating systems, water heaters and kitchen appliances.

   NatEquity’s program of kitchen and bathroom modernization was talked about back in the HomeFirst days, but only seldom introduced and never as a contract option. Modernizing a kitchen allows the senior to enjoy the improvements while living in the home and enhances the salability of the home and reduced time on market when the home is later sold. NatEquity’s modernization program draws upon state-of-the-art augmented reality (AR) computer design to quickly insert quality brand name appliances, new cabinet front, countertops, flooring and retrofits for electronics into 3-D photos in working sessions with homeowners. Typical 50/50 home appreciation ratios are adjusted to compensate for the upfront expenses.

2. Hands-on Contract Servicing and Annual Inspections:

   HomeFirst maintained telephone and personal written contact with our borrowers but was not proactive about inspecting properties. This meant when a problem came to our attention it involved more effort and expense than had we solicited homeowners to alert us to problems. HUD now requires inspections by HECM servicers. This requirement has not been implemented because HECM product design does not account for this cost and servicers are financial institutions distant from borrowers, and merely computer disbursement centers and foreclosure contractors.

NatEquity has developed our own home inspection standards and will employ our own trained staff to inspect homes during the contract origination process. NatEquity staff will focus on issues in and around the home that need replacement and/or items like modernization that maintain and add value. Traditional home inspection contractor firms like Waypoint inspect for building code violations and cosmetic issues at time of home resale or for new construction. Some but not all of their criteria apply to a senior homeowner who intends to live in their home safely for another 6-12 years.

NatEquity will utilize quarterly phone contact with homeowners introduced successfully by HomeFirst. HomeFirst staff bonded with their rooster of homeowners who looked forward to quarterly contact. Much of the discussion centered around the homeowner's health and grandchildren. To encourage contact NatEquity will send gift cards after each successful call. From the lessons learned handbook, NatEquity will go further to solicit concerns about home repair issues and the today problem of homeowners bringing in tenants in violation of their contract with NatEquity.

NatEquity will be proactive about offering and installing home safety improvements. These include a package of shower/tub and stairway grabrails, lever handles on doors and ramp to the home's entrance. Regulations are currently being developed at the Center for Medicare & Medicaid Services to include these safety upgrades as a no cost item in Part C Medicare Supplement Plans.

The takeaways: One-Size-Does-Not-Fit-All; and local knowledge is better than the Expert from Out of Town.

Peter M. Mazonas
Chief Executive Officer
NatEquity, Inc.
peter.mazonas@NatEquity.com
(415) 924-6269

Eric Ranson
Chief Actuary and Director of Capital Markets
eric.ranson@NatEquity.com

Annalise Mazonas
Director of Home Improvement
NatEquity, Inc.
annalise.mazonas@NatEquity.com

March 9, 2019

Peter Mazonas was the founder and CEO of Transamerica HomeFirst from 1989 to 2000. In addition to designing HomeFirst's products, HomeFirst helped HUD design the first commercial HECM product. From 2000 through 2006, Mazonas was a key witness defending Transamerica, Aegon and MetLife in a series of lawsuits brought by unsuccessful plaintiffs over reverse mortgage product design.