NatEquity, Inc. National Equity Access For Senior Homeowners

NatEquity Knowledge Base

Origins, Practices and Reflections on Transamerica HomeFirst

I started Reliance HomeFirst in the fall of 1989 and sold it to Transamerica in the fall of 1992, renamed Transamerica HomeFirst (THF). The idea came to me after reviewing and reverse engineering products introduced by Providential Home Income Plan. Providential was the first proprietary senior home equity access product and the most successful IPO of 1991. To my mind their product had design flaws and made market assumptions that could not be supported. They were products I could not recommend to my mother or anyone else's. Thus, began the journey of a product designer meeting the needs of senior homeowners. Ultimately, Providential went bankrupt before they came out of their Section 144 lockup period in 1992.

1990-1991 were spent officing with friend at the Pacific Union companies, designing and testing various product designs and methods of securitizing these products. Product concepts were presented to any group of seniors or financial planner/CPAs who would listen. The clear takeaway was that consumers and their advisors wanted the guarantee of consistent future income, while leaving an inheritance for heirs. A modest upfront lump sum was added to clear up any reasonable expenses or debt ("fresh start"). Initially these were pure accrued interest rate debt products. The inherent problem with this form of equity access product is that by about contract year 8 the compounding accrued interest starts to consume the senior's entire home equity because no credit is given for future home price appreciation. The flip side of this problem are product designs that give too much credit for home appreciation in national markets where year-over-year HPA is 1% to 2% annually. This typically occurs in unstable regional economic markets. This would later become the problem for the government guaranteed Home Equity Conversion Reverse Mortgage (HECM) which assumes 4% annual compound HPA nationally.

In early 1992, I was introduced to Anthony M. (Tony) Frank. Tony had just come off being U.S. Postmaster General for four years. Early in his banking career Tony, working with the San Francisco's Buck Foundation, had launched the first proprietary reverse mortgage in America, right here in Marin County. Tony had been approached to join Transamerica's Board. He asked if he could present to them the idea of funding my reverse mortgage company. We agreed, and that is how it seemed to get going. I say seemed, because of took from January to October of 1992 for Transamerica to decide upon the details.

Transamerica's commitment gave me the time to assemble a team and perfect product design. Tony brought a unique perspective. He had created a reverse mortgage in the early 1980s to advance property taxes and other home expenses to allow California seniors to remain in their homes, only repaying the debt when they moved. Tony had created First Nationwide Savings, one of the largest savings and loans in the U.S. His mantra was trying to figure out new ways to “get someone to walk by the other guys branch and bank with you”. By 1992, Tony had spent years exploring the needs of seniors. At the Post Office, he formed one of the first partnerships with AARP to provide low cost mailings to their members. This was pre-internet and the early days of the ATM. Principles from that era still apply today, especially for older seniors.

In October 1992, we convened a two-day THF conference. In addition to Tony, we invited a friend of my wife, Joan Goldhamer and Joan’s friend Barbara, the wife of a political science professor at UC Berkeley. After college, in the 1940s at Columbia, Joan helped pioneer the new concept of focus group interviews at McCann Erickson, a large New York ad agencies and later as an early employee of RAND Corporation. A lot of our time over two days was spent exploring two concepts: 1) Age Identity and 2) Wealth Factor. The interplay of these concepts is important to understanding the senior markets and why so often senior equity access product designers miss the mark.

Age Identity is learning how to understand seniors, their experience-based thinking and what they really want and don’t want for their future. Seniors identify best with people within 10 years of their age. The Wealth Factor, or lack thereof, is critical to this understanding. Both are best learned and practiced by employees who are seniors teaching younger colleagues. Learning to successfully think like a senior homeowner takes understanding what they have gone through to get to where they are today. In California, many of these seniors were the young teachers and other professionals who put down roots in the 1970s and 1980s when they bought their first home. They had modest incomes and made do with what they could afford, while enjoying the environment around them. Today these seniors live in million-dollar houses but continue to live on modest fixed retirement incomes. Aging in place is a challenge. No splurges, just extra income is what they want.

We did drills at the outset of the two day conference that AARP uses to focus on senior needs. Linda Hubbard, who had been the maid-of-honor in our wedding and my wife’s close friend had, until becoming part of the THF team, been the Managing Editor of Modern Maturity, the AARP magazine. Modern Maturity had a monthly circulation of 32 million, the largest of any magazine in the world. As today, AARP partnered with large corporations who will co-brand products at a substantial lose to gain access to AARP’s membership. IBM provided two examples of conditions often encountered by seniors. First, rub Vaseline on the inside of a pair of glasses to experience diminished eyesight. Second, IBM computer folks had determined that often seniors see the top half of computer font because of the distraction from serif (squiggly bottoms) of many type fonts. This later point led many states and the federal government to require the use of 12-point, non-serif fonts, in marketing materials and contracts presented to anyone over age 65.

Joan Goldhamer, her friend Barbara and Tony led group discussions. From a product design and program implementation standpoint, it became clear that both the reality and public perception of a product had to address the needs of the largest population of seniors. Age Identity and the Wealth Factor came front and center. Tony had made $300 million on his sale of Nationwide Savings and another $300 million as the first and lead outside Director at Charles Schwab. He had spent years observing that people of wealth, especially young people of wealth, had misconceptions of what seniors want. Joan, Barbara and Tony were all over age 60 and we were in our 40s. The key takeaways for the THF teams allowed us to focus on a set of product design and operating principles allowing us to create a successful company funded by a large insurance conglomerate.

Transamerica HomeFirst was not without mistakes. Fitting into the structure of a large corporation took compromise. As founder my long-term financial fate was tied to a profits interest above a hurdle rate in the ultimate sale of the portfolio of contracts. My colleagues received stock option in the parent company. At times this split loyalties. One unifying upside was the generous benefits package Transamerica offered.

With hindsight, other problems of being a highly visible part of a major national corporations was our parent company's desire for HomeFirst to have a national footprint. Later analysis show that we never really made money in states outside of California. Even in California, equity access contracts in inland California were only marginally profitable. A little understood component of the California real estate market is Proposition 13 that froze property taxes at 1978 levels until a home is resold. By contrast, Illinois increase the property tax base until a person reaches age 65 before freezing the tax. That high property tax, combined with low retirement income explains why many seniors in Illinois, New Jersey, Connecticut and New York relocate when they retire. There are more than 2 million senior households, age 75+, living in homes valued at more than $600,00 (year 2010 census) in the 11-counties, 18 thousand square miles of coastal California. The average home value in the rest of the country is about $300,000. Research tells us that there are only 3 million high value household in the rest of the 1.9 billion square miles in the U.S.

NatEquity's decision to initially offer product in coastal California is based upon historical trends, the strong economic proposition and the diversification the eleven coastal counties. Coastal California is mostly a smokeless manufacturing and service economy that changed materially after the shakeout at the end of the Cold War. Technology, biomedical and entertainment are supported by a large university system that keeps turning out top talent for more higher paying jobs. Companies from around the world create companies to utilize this talent, which in turn creates new spinoffs. No other part of the United States matches this profile. These highly paid workers need homes. They are attracted to the older homes in close-in suburbs when these homes come to market. That is why many of these homes are all cash sales or have prearranged financing.

Except for the later addition of the "House Money" line of credit product, THF's main product was an accrued interest contract where we shared in future home appreciation. The introduction of this product in 1993 was problematic because of high interest rates and the economic downturn in the California economy caused by the end of the Cold War. THF wrote contracts designed around a forward assumption of 2.5% future HPA at a time when housing prices were in a deep decline: declining as much as 50% each year in Southern California. By 1996 the economy had diversified beyond the “military industrial complex” and house prices rebounded at 50% or more each year.

Homeowners, egged on by plaintiff’s lawyers, took advantage of this to sue Transamerica. At deposition and trial, we were constantly confronted with incorrect examples of low ‘market bottom pricing pitted against high home values after the turnaround when prices were high. Other items confronted at trial were phrases taken out of context in marketing materials and a forced arbitration clause. Transamerica and other defendants never lost at trial but Aegon, who acquired Transamerica, exacerbated the situation by continuously settling cases for disproportionately high amounts. This became a viciously cycle until the last Flores trial in 2006, when most of our contract provisions and the element of shared appreciation were found to be valid. Ironically, this led to a flood of new shared appreciation option type equity access products in 2007.

Below is an outline and description of these design principles and observations:

1. To be accepted and sell, a product needs to be perceived as fair to the senior homeowner, their children, as well as advisors and the press.
2. The largest cohort of senior homeowners want to accomplish three things when accessing their hard-earned home equity:
    a. Clear up some nagging expenses or commitments,
    b. Have continuous future income while they live in their homes and
    c. Leave some inherence to their heirs.
3. A balance had to be found between cash advances and monthly income while meeting the inheritances expectations of homeowners.
4. Strong product stress testing with all available data needs to be done to assure the senior that the design of the product they were buying will not consume their home equity over their stay in the home. The homeowners need to understand and know that, yes, we are making money but they are also gaining in value while they continue to live in and manage their home.
5. Like the highly successful Trader Joes philosophy, do not offer consumers too many choices, it only slows down their decision process. They can always go to another vendor to get a specialized product that meets their unique needs.
6. Offer a flexible product that offers them the ability to feel like they are part of the decision process and are tailoring a product to meet their needs.
7. Don’t present products that offer too much cash and the opportunity to rapidly deplete remaining home equity. These borrowers lose interest in maintaining their homes.
8. The largest earning asset of a coastal California senior homeowner is their home. They are proud of it and want the means to maintain the home, so it continues to “earn” and appreciate for them.
9. Responsible seniors told THF they spent about one third of our cash advances on home maintenance but would have liked to have more to be proactive about home maintenance. THF’s contracts did not have repair advance provisions.
10. Recognize from the outset that your profitability comes when the home is sold at the highest value. Remember and be compensated for work and costs you will incur to clean, stage and list the home for sale.

11. The relationship between the lender and the homeowner has to be one of respect and small “p” partnership.
    a. That said there need to be real teeth in the contract to force remedies and even foreclosure when the homeowner breaches a contract provision.
12. Senior homeowners come from an era when “banking” was personal. They would like to know they have a personal relationship with someone at their lender.
13. Quarterly phone contact and annual home visits are actually welcomed by seniors.
    a. At THF I would send personal birthday cards to our borrowers with a private phone number if they wanted to call and talk. After several years I was taking 30 or so calls a month. These calls gave me an understand of how our seniors spent their money and how the additional monthly cash flow help give them and their children peace of mind.
    b. Our outbound call center would send a two-part post card to borrowers for them to send back half with a convenient time for their relationship manager to call and chat.
    c. Where we had any questions or concerns, THF scheduled annual walk throughs of properties.
14. THF’s marketing materials and financial planning workbooks were specific to senior needs.
15. A downside was that our contracts did not give us much flexibility to provide for homeowner financial and household needs after origination. Ultimately, we stretched to accomplish some of these needs.
    a. A common problem was at the end of the contract when the senior moved out. Often the family had scavenged what they wanted from the home and left it for THF to get the dumpster and do the end of term cleanup. Without this the home could not be sold and our return on investment collected.
    b. Our homeowner’s kids often did not have the financial capability to assist their parents with in-home healthcare or even funeral expenses. Our contracts had no provisions for THF to advance sales proceeds to assist with these expenses.
16. As witnessed by abuses in the HECM program, seniors are smart and will exploit program loopholes to the disadvantage of their lenders.
17. Advancing large cash lump sums often led to unintended consequences that neither we nor the homeowner intended. Cash advances tied to enhancing collateral seemed to pay dividends while excess unrestricted cash presented cash management and opportunities for abuse.

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March 15, 2017