

HMBS Issuer Risk & Responsibilities

NRMLA 2011

Industry Growth

- Originators and Issuers need to work together to produce good quality loans
- For the industry to gain momentum and for us to have more institutions enter the space; having a financial assessment of the borrower is imperative.
 - Issuers need the ability to lower their own exposure
 - Reduce the risk on HUD so they continue to grow and support the program
 - Reduce any headline risk for seniors being foreclosed upon (*why give a loan to someone we know will end up in foreclosure*)

THEN - FNMA

- Most loans were sold to FNMA
 - Paid servicers
 - Handled cash outlay for advances
 - Took on REO
 - Responsible for losses

NOW - ISSUERS

- Issuers take over risks & responsibilities
- Loans still have HUD insurance

Categorize Risks into two main components:

- SIGNIFICANT CASH NEEDS
- LOSSES ON LOANS

Risks, Losses & Requirements

Risks

- Cash requirements -
 - Can put non-banks out of business
 - Future draws and MIP payments
 - Taxes & Insurance advances for loans in default
 - 98% of Max Claim Mandatory assignment - good
 - 98% of Max Claim Mandatory assignment - bad
 - Appraisal based claims

Appraisal Based Claim

- After marketing period HUD pays difference between loan balance and Appraised Value

• Loan balance	\$210,000
• Appraised Value	\$150,000
• Claim	\$60,000
• Immediate cash need	\$150,000+

Losses

- Appraisal Based Claim
 - Tax & Insurance advances
 - Maintain Property
 - Realtor
 - Borrowing costs
 - *Debenture Interest*
- Possible losses on tails (future sales)
 - Original loan Libor 150
 - Current loans Libor 250
 - Fixed 5.5% vs. 5%

Debenture Interest Loss

- Once the loan is officially in default HUD pays the issuer debenture interest but the bond holder gets note rate.
- Typically 1%-1.5% below note rate determined at application
- If home sells below loan balance you will lose money unless you buy loan from pool and cost of funds are less than debenture rate.

Reserves

- Issuers establish a loan loss reserve on their balance sheet for future potential losses
- Reserve has been 0 - 100 BPS
- Reserves are based on:
 - Future home values
 - Loss on debenture interest
 - Low cost of funds could avoid loss if purchased from pool upon default
 - How long a borrower will remain in their home
 - How quickly a loan will pay off
 - Other

Requirements (Risk)

- Capital
 - \$5 million in equity
 - 1% equity for outstanding portfolio and commitment authority
 - 20% of requirement must be liquid
- \$1 Billion in outstanding unpaid balance
 - \$5 mm
 - \$10 mm
 - Need \$15mm in equity/ \$3mm liquid
- For each \$100,000 in upb you need to net 1% after all costs

Servicing

- Must own servicing rights
- Can use sub-servicer
- Must be able to track multiple pools
- Managing the portfolio properly can help lower losses
 - Alert borrowers immediately when taxes or insurance are late
 - Remind borrowers ahead of time of payments
 - Manage the REO process properly

Thank you