

HECM Cost Reduction Discussion

AARP has made the assertion that the reverse mortgage market is a “non-competitive market” and that, as a result, lenders have been overcharging borrowers. Accordingly, AARP has been pressing Congress to pass legislation that would statutorily limit origination fees on FHA-insured HECM reverse mortgages even further than they are currently limited under HUD regulations.

NRMLA does not believe the market to be non-competitive and feels that the facts prove AARP’s assertion to be incorrect. The reverse mortgage business has become increasingly competitive as the market has expanded from 195 lenders producing 7,781 HECM loans in FY 2001 to 781 lenders producing 76,351 loans in FY 2006. The entry of major national players including Bank of America and Countrywide within the past year, as well as growing interest by several major capital market investors, assures that the competition will intensify.

As a result of increasing competition, product offerings have expanded from 4 options at the beginning of 2006 to 18 options currently available in the market place, with fixed rate proprietary products, no fee jumbo proprietary options, reduced margin “HECM 100” loans, as well as higher margin, lower origination fee options now available.

The recently introduced “HECM 100” illustrates the impact of competition and its beneficial impact upon homeowners. The 50 basis points reduction in interest rate on this product dramatically reduces life of loan costs and increases the amount of funds available to borrowers (the “initial principal limit”) from the “HECM 150,” which had previously been the only option available. With a “HECM 100” a typical 75 year-old borrower with a \$300,000 home would receive \$12,600 in additional principal limit and save over \$13,667 on the interest charged over their 12 year life expectancy at present interest rates with a full draw at closing. (*See chart entitled, “Principal Limit Increase with HECM 100 vs. HECM 150.”*)

Outside observers, as evidenced by an article in yesterday’s Wall Street Journal (“Reverse Mortgages Gain Popularity as Securities,” May 23, 2007) recognize that greater competition has caused more product options to become available, reducing costs to senior homeowners, and will continue to do so. (*See WSJ article.*)

Concerns About The AARP Proposal

AARP is pressing for a reduction in the HECM origination fee charged by changing the basis of calculation for the fee from 2% of the “Maximum Claim Amount” to 2% of the “Initial Principal Limit.” NRMLA believes this concept is flawed in several ways.

First of all, it fails to recognize the actual amount of the loan. A 62-year old with a \$300,000 home would receive a loan equal in value to an 80 year-old with a home of the same value. The HECM has been structured by HUD so that the “principal limit” grows with age and over time. Effectively, this yields a similar benefit (the amount of principal that can ultimately be advanced) to any borrower, regardless of their age.

In a case where the full principal limit is drawn at closing, HUD has developed the principal limit calculation to assure that borrowers would owe a similar sum at any given age. This puts borrowers at a level playing field regardless of their age.

The AARP concept introduces “age discrimination” into the fee calculation, causing older homeowners to pay more for a HECM than younger homeowners receiving essentially the same loan. In fact, an 80 year-old homeowner with a \$300,000 loan would pay \$948 more in origination fee than a 62 year-old homeowner with an equal value home. (See chart entitled, “AARP proposal: Origination Fee Based on Principal Limit).

Under the AARP proposal origination fees would go down anytime interest rates go up. Because the “Initial Principal Limit” is determined by a calculation that considers anticipated interest accrual, if the interest rate is presumed to be higher, the amount available to the borrower is diminished. This unfairly and inappropriately penalizes lenders in rising interest rate environments and could cause HECM loans to be unavailable in such environments – at time when seniors might be more likely to need the funds.

Under the AARP proposal, origination fees would be woefully inadequate for covering lenders costs to produce loans, leading many lenders (particularly in areas with lower home values) to drop the program and reducing competition. Lenders’ typical fixed origination costs approach \$2,500 per loan (\$1,200 for marketing and associated sales costs, plus \$1,300 for processing, underwriting and closing), plus loan officer commissions ranging from \$1,380 on a HECM with a maximum claim amount of \$138,000 to \$3,628 on a HECM with a maximum claim amount of \$362,790. Under the AARP proposal, a lender’s costs would exceed its origination fee by \$1,500 on a loan with a maximum claim amount of \$138,000. The origination fee would only yield \$116 in net revenue on a loan with a maximum claim amount of \$362,790.

Lenders incur greater origination costs than they recoup in origination fees on lower value homes (-\$1,120), and offset this through roughly equivalent gains on higher value homes (\$1,128). The AARP proposal undermines this balance by increasing the loss on lower value homes and reducing the opportunity on higher value homes. (See chart entitled, “HECM Origination Fee vs. Cost to Originate.”)

Also, the origination fee income on a HECM under the current structure is in line with the income lenders earn on traditional FHA “forward mortgages.” In fact, some fees typically paid by borrowers on FHA forward mortgages above and beyond the origination fee, such as Discount Points, Lock Fees and Processing & Underwriting Fees, are not charged in a HECM transaction. The current origination fee is an “all in” amount that incorporates all of these fees. (See chart entitled, “Comparison of Traditional FHA “Forward” Mortgage & HECM Reverse Origination Costs.)

The Likely Industry Response

The most likely response to imposing the AARP proposal would be for lenders to increase the margin on the interest rate – resulting in higher life of loan costs and lower principal limits for seniors. For example, the industry would likely be forced to eliminate the HECM 100 and return

to the HECM 150 to offset origination fee reduction, as a means of achieving breakeven revenue with the new origination fee calculation

For a 75 year-old borrowing against a \$300,000 house and drawing \$100,000 in net proceeds, the immediate savings of \$1,674 in origination costs under the AARP proposal would be entirely offset by higher interest & MIP charges by month 36. This borrower would pay \$11,546 (7.5%) more in total costs over the life of the loan compared to the current HECM 100 product. (See chart entitled, "*Total Costs Comparison: Current vs AARP Proposal.*")

The industry could adopt a 0% origination fee option to offer to seniors. However, the offset in interest rate margin that would have to take place to warrant no upfront origination fee diminishes benefits to a borrower disproportionately. We estimate that a margin of 3.75% would be necessary. In the case of a typical 75 year-old borrower with a \$300,000 home, \$62,700 less cash would be available and life of loan costs for interest would increase by \$116,856. The \$6,000 savings in origination fee would be offset by month 17 because of the higher interest rate. (See chart entitled, "*Zero Point HECM – Total Costs Comparison.*")

As an alternative to raising the interest rate margin on HECMs, lenders could also choose to offer any of the emerging proprietary products in lieu of FHA-insured reverse mortgages. These products do not always assure the same safeguards as HECM loans. Furthermore, as FHA's market share is diminished, its ability influence the overall market would be curtailed.

Alternatives For Congress To Consider

For the aforementioned reasons, NRMLA does not feel that statutory maximum origination fee limits as proposed by AARP are warranted. Authority to set fee limitations should remain within HUD's regulatory responsibility. HUD should continue to monitor the market as it does presently to assure that competition does impact the market in a manner that benefits senior homeowners.

However, if Congress feels compelled to move ahead on this issue we would suggest establishing limits calculated based upon Maximum Claim Amount, as is currently done, but with the addition of "tiered" limits based on the size of loans.

Furthermore, we would suggest that any such limitations be imposed only as overall HECM volume increases and lenders costs go down. As volume grows, many of the fixed costs associated with marketing and advertising, implementing new technology platforms, etc., will be distributed over a larger number of loans. As this occurs, lenders costs will drop. The competitive nature of the business means that such savings will ultimately be passed along to borrowers. To make sure that this happens, Congress could set origination fee limits that kick in and take effect as higher loan volumes are achieved on an industry-wide basis.

A concept for a tiered maximum origination fees could be structured with different levels of fee caps as follows:

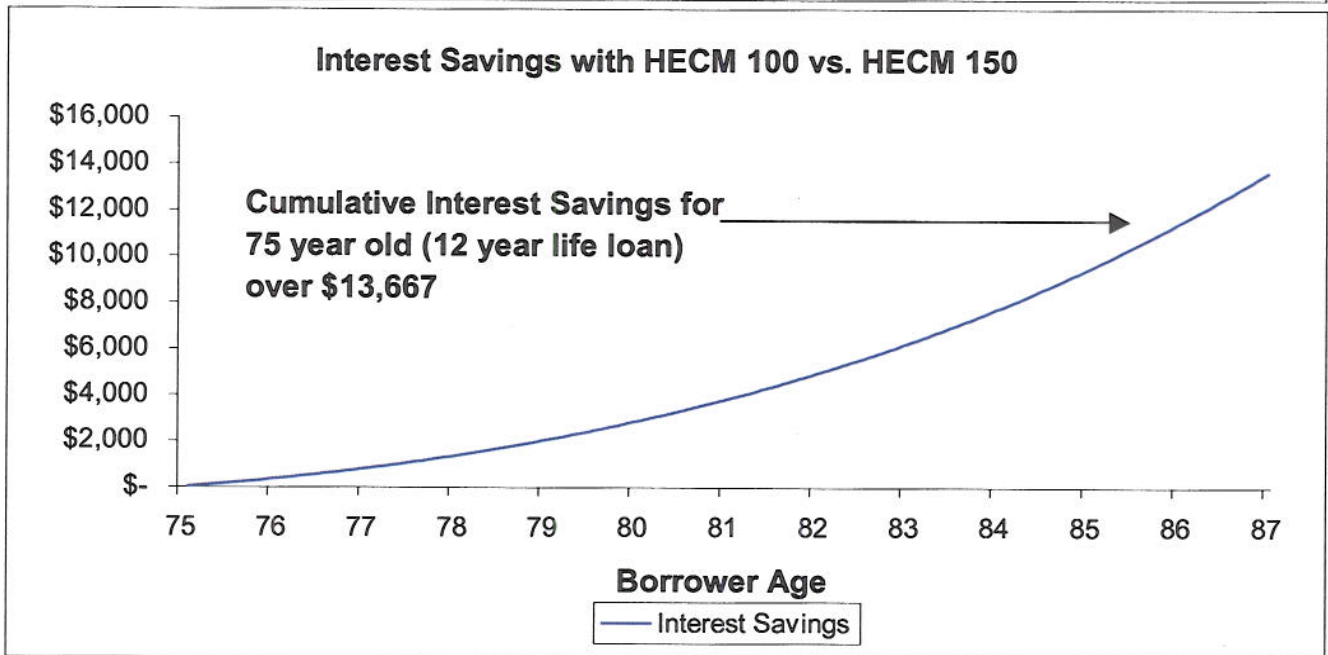
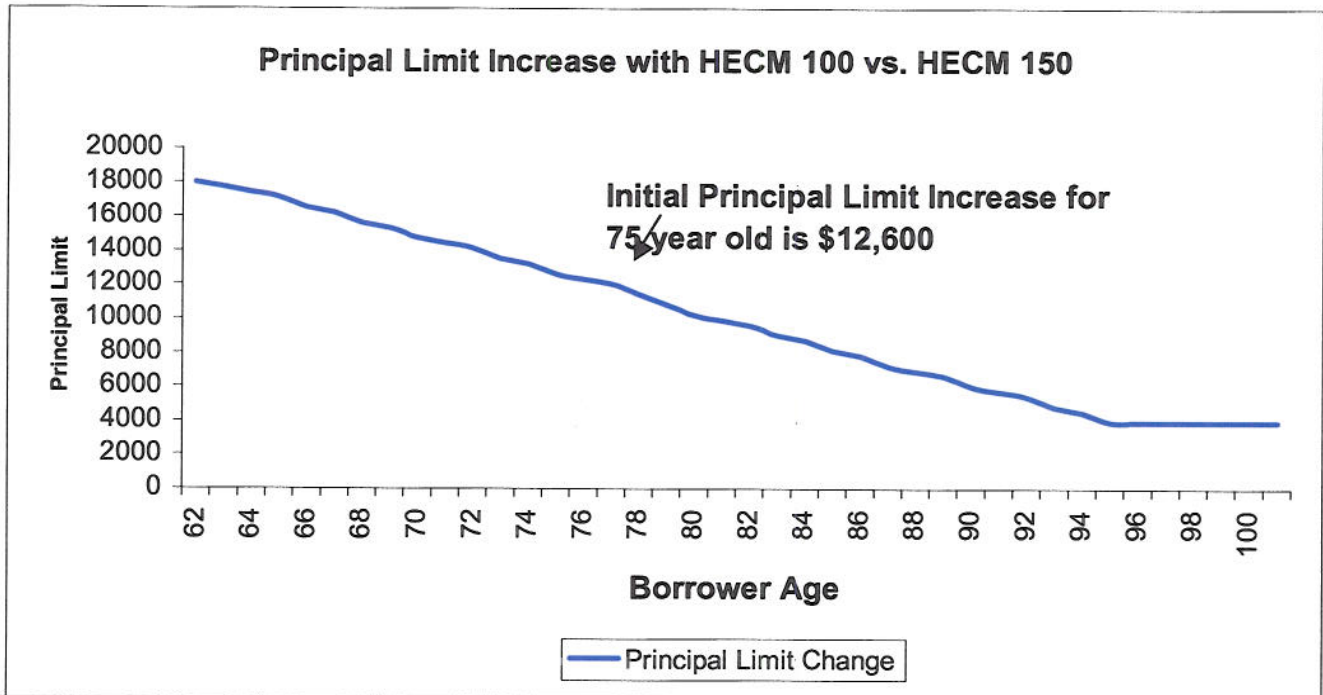
	Current	Proposed
First \$300,000	2.00%	2.00%
Next \$100,000 (\$300,001-400,000)	2.00%	1.50%
Balance over \$400,000	2.00%	1.00%
Fee Minimum	\$2,000	\$2,000

This tiered fee structure would reduce increases in origination fees as FHA lending limits rise, while allowing the industry the flexibility to innovate and compete in increasing benefits to seniors.

We would also suggest that origination fee limitations be phased in and tied to increases in overall HECM production volume, with any substantial changes deferred until production volume hits certain benchmarks, such as 350,000 or 500,000 endorsements in a fiscal year.

Finally, we would suggest that Congress consider requesting HUD to examine the feasibility of re-structuring the Mortgage Insurance Premium on HECMs. The current structure of an up-front MIP of 2% of the maximum claim amount, plus an “ongoing MIP” of ½ % per year on the outstanding loan balance creates a large upfront cost to consumers. Actuarial analysis of the HECM program performed on our behalf by Milliman USA indicates that FHA could eliminate the upfront MIP entirely, if it raises the ongoing MIP to somewhere between .90 and 1.0%, yielding the same MIP revenue to HUD as under the present structure.

This change would also have the added benefit of redistributing a higher proportion of the overall MIPs paid to HUD from older borrowers to younger borrowers. Under the current structure, older borrowers actually end up paying more MIP for less risky loans than younger borrowers pay for riskier loans.



*HECM Monthly Interest rates effective 5/15, \$300,000 home value, full draw at closing

-HECM 100 shows a history of **industry innovation benefiting seniors:**

-A 75 year old borrower would **save \$13,667** over a 12 year life expectancy, even including the effect of a larger loan balance available through principal limit increase

-Principal Limit is increased for all borrowers, with a 75 year old seeing **\$12,600 in additional principal limit** available at closing

Reverse Mortgages Gain Popularity as Securities

By LINGLING WEI

Wall Street's interest in traditional mortgages may be waning for now, but its appetite for reverse mortgages is picking up.

For years, Fannie Mae, the government-sponsored provider of funding for U.S. home mortgages, has been the dominant buyer of reverse mortgages, which are home-equity loans to senior citizens that don't have to be repaid until the home is sold or the borrower dies.

Now, lured by these products' growth potential as baby boomers retire, financial-services companies including Lehman Brothers Holdings Inc., UBS AG, Bank of America Corp. and Deutsche Bank AG increasingly are buying these high-yielding loans from lenders with the idea of repackaging them into securities for sale to investors.

"You will see a steadier stream of securitizations backed by reverse mortgages," says Patrick Fitzsimonds, a director at UBS's investment-banking division in New York. "It's always interesting for us to get into a new product area, and we're banking on reverse mortgages becoming a much bigger market."

The bet by Wall Street, in turn, has started to drive more lenders to a market long served by just a handful of companies: IndyMac Bancorp Inc.; Wells Fargo & Co.; Seattle Mortgage Co., which is being acquired by Bank of America; and closely held EverBank Financial Corp.'s BNY Mortgage Co. The more liquid the secondary market is, the thinking goes, the more money there is to be lent out.

Rising competition among lenders may lead to near-term profit pressures, industry executives say, but the resulting lowered costs may entice more consumers to take out reverse mortgages in the long run. For instance, IndyMac has said net income for Financial Freedom, its reverse-mortgage unit, may drop to roughly \$12 million this quarter from \$28 million in the first quarter. The culprit: Competitive pressures exerted by new entrants are causing the lender to make less on each loan.

Jim Maboney, chairman of Financial Freedom, believes the unit's profitability will bounce back. With more investors looking to buy reverse mortgages, he says, lenders will be able to "develop new products with more options and lower overall costs to seniors."

An expansion in offerings should bolster volumes. Reverse mortgages, which hit a record of some 76,300 last year, still represent a tiny fraction of the overall mortgage market. The volume of reverse mortgages is expected to grow more than fourfold by 2010.

This year, Moody's Investors Service expects to rate 10 bond deals backed by reverse mortgages totaling almost \$5 billion;

last year, the credit-rating agency evaluated only four such transactions representing some \$1.4 billion. By comparison, Wall Street packaged and sold about \$448 billion of subprime-mortgage securities in 2006 alone, according to UBS.

Securitizing reverse mortgages poses challenges. A reverse-mortgage borrower receives money in the form of a lump-sum payment, equal payments over time or a line of credit and doesn't send monthly mortgage payments to a bank, as with a traditional mortgage.

With a traditional mortgage bond, investors can expect a steady flow of cash passed through from borrowers every month. But because of the lack of monthly cash flow from reverse mortgages, current deals backed by those products require a significant number of loans. The rationale is that the bigger the loan pools, the more likely it is that enough of the loans would prepay in a given month to generate cash flows to pay the bondholders.

Ginnie Mae, the federal housing-finance agency, is looking into ways to structure deals backed by a mix of both traditional and reverse mortgages that would "allow slicing and dicing" of cash flows into various classes of the bonds, says Justin Burch, a senior mortgage banking analyst.

Traditional mortgages and reverse mortgages have different risk profiles. While the former carries the risk of consumer defaults, the key risk that reverse mortgages pose for lenders and investors is that the principal outstanding, plus accrued interest for the loan, could exceed the value of the borrower's home.

In the fall, Ginnie Mae expects to start guaranteeing bonds backed by reverse mortgages insured by the government, called Home Equity Conversion Mortgages, or HECM. The move, says Ginnie Mae President Robert Couch, will increase liquidity by providing capital-market funding sources to HECM lenders.

HECM loans, which limit the amount homeowners can borrow, currently represent about 80% of all reverse mortgages. To cater to people with higher-value homes, lenders such as Countrywide Financial Corp., for example, increasingly are creating their own products that don't have a loan limit.

And many lenders, led by BNY Mortgage, have been offering their lower-priced version of the traditional HECM loan. Furthermore, IndyMac's Financial Freedom expects to introduce a suite of new products over the next several months aimed at bringing down the overall costs for borrowers.

"Without Wall Street getting into the reverse-mortgage market," says Craig Corn, co-president of BNY Mortgage, "it's possible that some of the products that are being offered now wouldn't be offered."

AARP Proposal: Origination Fee Based on Principal Limit

Age	62	70	75	80
Home Value	\$ 300,000	\$ 300,000	\$ 300,000	\$ 300,000
Principal Limit	\$ 182,700	\$ 202,800	\$ 216,300	\$ 230,100
Initial Draw %	55%	55%	55%	55%
Initial Balance	\$ 100,485	\$ 111,540	\$ 118,965	\$ 126,555
Current Orig Fee @ 2% HV	\$ 6,000	\$ 6,000	\$ 6,000	\$ 6,000
New Orig Fee @ 2% PL	\$ 3,654	\$ 4,056	\$ 4,326	\$ 4,602
Fee Gap	(2,346)	(1,944)	(1,674)	(1,398)

*interest rates effective 5/15/07

HECM Origination Fee vs. Cost To Originate

<u>\$138,000 Max Claim, Age 75</u>	Current	AARP Proposed	Change
Origination Fee	\$2,760	\$2,000	(\$760)
<u>Expenses</u>			
Commissions	\$1,380	\$1,000	(\$380)
Marketing & Fixed Sales Costs	\$1,200	\$1,200	\$0
Processing, Underwriting & Closing	\$1,300	\$1,300	\$0
Profit/(Loss)	(\$1,120)	(\$1,500)	(\$380)

<u>\$250,000 Max Claim, Age 75</u>	Current	AARP Proposed	Change
Origination Fee	\$5,000	\$3,605	(\$1,395)
<u>Expenses</u>			
Commissions	\$2,500	\$1,803	(\$698)
Marketing & Fixed Sales Costs	\$1,200	\$1,200	\$0
Processing, Underwriting & Closing	\$1,300	\$1,300	\$0
Profit/(Loss)	\$0	(\$698)	(\$698)

<u>\$362,790 Max Claim, Age 75</u>	Current	AARP Proposed	Change
Origination Fee	\$7,256	\$5,231	(\$2,024)
<u>Expenses</u>			
Commissions	\$3,628	\$2,616	(\$1,012)
Marketing & Fixed Sales Costs	\$1,200	\$1,200	\$0
Processing, Underwriting & Closing	\$1,300	\$1,300	\$0
Profit/(Loss)	\$1,128	\$116	(\$1,012)

*HECM 100 rates eff. 5/15/07

Comparison of Traditional FHA "Forward" Mortgage & HECM Reverse Origination Costs

<u>Traditional FHA</u>		
<u>"Forward"</u>		<u>HECM Reverse</u>
\$3,000	Origination Fee	\$6,000
\$1,500-6,000	Discount Points (0.5% to 2.0%)	\$0
\$375	Lock Fee	\$0
\$500-1,025	Loan Processing, Underwriting and other originator fees	\$0
\$5,375-10,400	Total	\$6,000

Example uses \$300,000 home value and typical forward and reverse revenue

*Title, Escrow and other settlement services are assumed to be equal

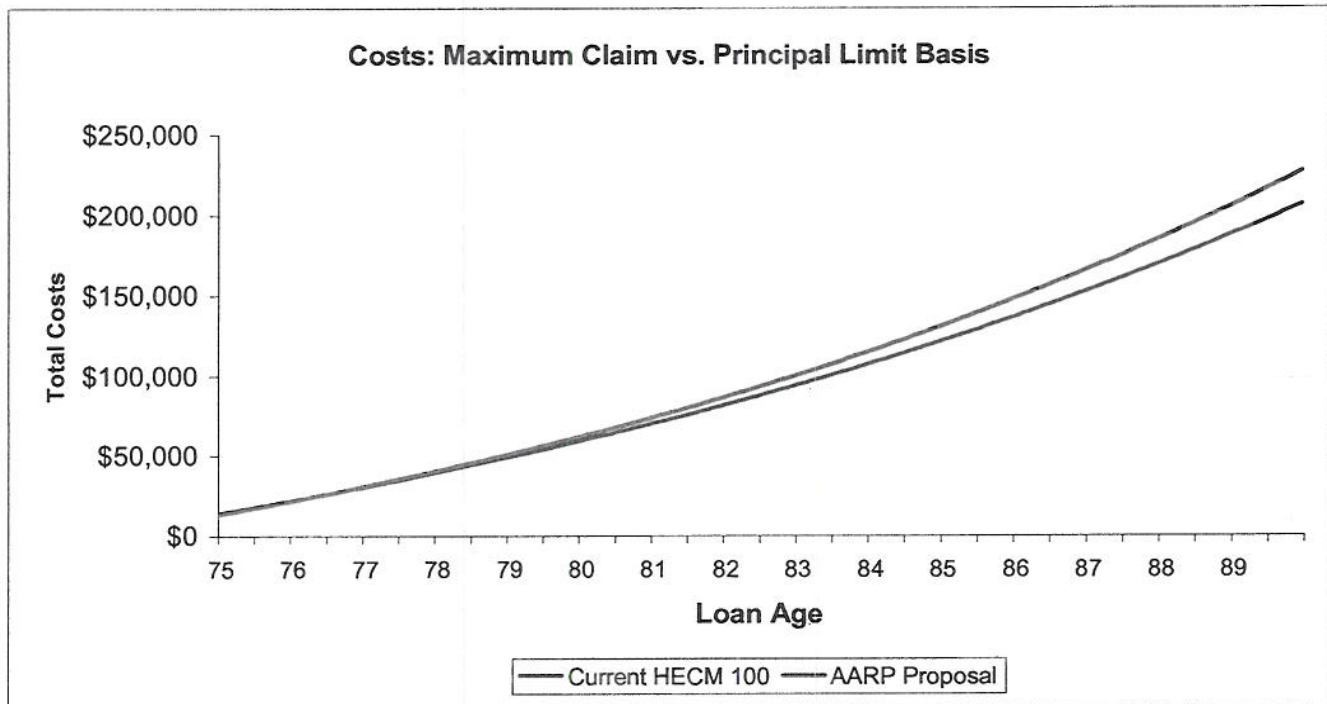
Total Costs Comparison: Current vs. AARP Proposal (Margin Increased To 150)

	Current Structure	AARP Proposal	Borrower Benefit %	Borrower Benefit \$\$	
<u>Closing Costs</u>					
Origination Fee	\$ 6,000	\$ 4,326	28%	\$1,674	cost decrease
Initial Mortgage Insurance Premium (FHA)	\$ 6,000	\$ 6,000	0%	\$0	
Other Closing Costs	\$ 2,250	\$ 2,250	0%	\$0	
Subtotal Upfront Fees	\$ 14,250	\$ 12,576	12%	\$1,674	cost decrease
<u>Ongoing Costs (12 year loan term)</u>					
Interest	\$ 123,552	\$ 136,572	-11%	(\$13,020)	cost increase
<i>Interest Margin</i>	1.00%	1.50%			margin increase
Monthly Mortgage Insurance Premium (FHA)	\$ 10,470	\$ 10,670	-2%	(\$199)	cost increase
Service Fees (\$35/mth)	\$ 5,040	\$ 5,040	0%	\$0	
Subtotal Ongoing Costs	\$ 139,062	\$ 152,282	-10%	(\$13,220)	cost increase
Total Costs	\$ 153,312	\$ 164,858	-7.5%	(\$11,546)	cost increase
Principal Limit Available	\$ 216,300	\$ 203,700	-6%	(\$12,600)	cash avail. decrease
Initial Draw (adjusted for cost savings only)	\$ 114,250	\$ 112,576	1%	\$1,674	balance decrease
Cash to Borrower (after upfront fees)	\$ 100,000	\$ 100,000	0%	\$0	

Assumptions

*interest rates eff. 5/15/07, \$300,000 home value, 75 year old borrower

**borrower benefits calculated against current HECM 100 product, 12 year life expectancy



Zero Point HECM - Total Costs Comparison

	Current Structure	Zero Point HECM	Borrower Benefit %	Borrower Benefit \$\$	
<u>Closing Costs</u>					
Origination Fee	\$ 6,000	\$ -	100%	\$6,000	cost decrease
Initial Mortgage Insurance Premium (FHA)	\$ 6,000	\$ 6,000	0%	\$0	
Other Closing Costs	\$ 2,250	\$ 2,250	0%	\$0	
Subtotal Upfront Fees	\$ 14,250	\$ 8,250	42%	\$6,000	cost decrease
<u>Ongoing Costs (12 year loan term)</u>					
Interest	\$ 171,674	\$ 292,189	-70%	(\$120,515)	cost increase
<i>Interest Margin</i>	1.00%	3.75%			margin increase
Monthly Mortgage Insurance Premium (FHA)	\$ 14,549	\$ 16,890	-16%	(\$2,341)	cost increase
Service Fees (\$35/mth)	\$ 5,040	\$ 5,040	0%	\$0	
Subtotal Ongoing Costs	\$ 191,262	\$ 314,119	-64%	(\$122,856)	cost increase
Total Costs	\$ 205,512	\$ 322,369	-56.9%	(\$116,856)	cost increase
Principal Limit Available	\$ 216,300	\$ 153,600	-41%	(\$62,700)	cash avail. decrease
Initial Draw (adjusted for cost savings only)	\$ 159,600	\$ 153,600	4%	\$6,000	balance decrease
Cash to Borrower (after upfront fees)	\$ 145,350	\$ 145,350	0%	\$0	

Assumptions

*interest rates eff. 5/15/07, \$300,000 home value, 75 year old borrower

**borrower benefits calculated against current HECM 100 product, 12 year life expectancy

