National Reverse Mortgage Lenders Association

2022 Annual Meeting & Expo

November 1-3, Atlanta, GA

HECM / HMBS and Proprietary Product

Current State of the Secondary Capital Markets

HMBS and Proprietary Product Comparison

<u>Proprietary Product Summary</u>

- ❖ Self-insured – remaining equity in the home is the insurance
- ❖ All else equal, for a given age cohort, LTV < PLF
- ❖ Issuers have accumulation risk, HMBS issuers less so
    - ✓ Rising rates: fixed rate loans originated early are worth less
    - ✓ Capital markets: may not function, eliminating securitization entirely
    - ✓ Losses: defaults can occur early
    - ✓ Liquidity: volume slowdown leaves insufficient pool size to securitize

HMBS and Proprietary Product Comparison

<u>Proprietary Product Investor Risk Overview</u>

- ❖ Crossover loss – unlike HMBS, investors can be hurt by loan level losses
- ❖ Interest rate risk
  - ✓ Rising rates make older fixed rate loans worth less
  - ✓ For ARMs, reset “lag” and caps lower values
- ❖ Prepayment risk – loans paying faster than expected can reduce returns
- ❖ Liquidity – small securitization size limits ability to trade securities

HMBS and Proprietary Product Comparison

<u>HECM and HMBS Summary</u>

- FHA insurance allows more proceeds to borrowers
- Ginnie Mae's P&I guaranty gives HMBS securities implied AAA rating
- HMBS issuer accumulation risk less material because HECMs originations are mostly adjustable rate and issue size is much smaller
- HMBS investors have no crossover loss exposure but do have interest rate risk in a rising rate environment where caps and adjustment frequency cause "lag" in weighted average coupons
- Mostly, HMBS investors have exposure to prepayment risk

HMBS and Proprietary Product Comparison

HMBS Investor Risk Overview

- ❖ Prepayment exposure is significant because securities sell at prices greater than Par
- ❖ When investor returns are calculated, both interest rate and “premium” return of principal paid over Par are used
- ❖ For premium securities, faster than expected prepayments lowers yield
- ❖ The sudden drop in interest rates and corresponding increase in refinance activity since 2020 has dramatically increased prepayment speeds, lowering returns to investors

Proprietary Product Timeline

Originators have "accumulation risk" due to the following:

- ❖ Loans are inventoried until critical mass is reached for securitization
- ❖ In a rising rate environment, loans originated early worth less than newer loans with higher interest rates
- ❖ Remaining home equity falls faster with rising rates, unless LTVs are adjusted down
- ❖ Loans originated in falling HPA have less equity available as "insurance"
- ❖ Changes in capital markets sentiment prior to securitization
- ❖ Warehouse lenders impose annual, other limits on accumulation

Proprietary Product Timeline

Minimum Securitization Size

- $300 million is recommended minimum to create sufficient liquidity for investors, and to spread out fixed costs
- Over the last two+ years, proprietary product securitizations have been ~$200 million
- Of late, size has fallen to $150 million, as issuers work to minimize accumulation risk, and tailor securities to specific investor needs

Proprietary Product Timeline

Investors face many of the same risks:

- For fixed rate securities, rising rates lower values
- For adjustable-rate loans, as rates rise, risk of crossover loss increases from faster interest accretion
- Adjustable-rate loans and securities also have exposure to interest rate ”lag” from caps and reset frequency
- In a falling HPA environment, lower remaining equity increases risk of crossover loss

Proprietary Product Securitization

Proprietary Product Securitization

- Because RMs don’t typically pay interest, investors rely on payoffs to receive return of principal and interest
- When securitizations are structured, certain prepayment speeds are assumed to calculate investor returns
- Speeds outside of these assumptions affect overall investor returns
- If prepayments are greater than expected, less time to build overcollateralization puts lower rated securities at risk to receive full return of principal and interest

Proprietary Product Current State

- Price (re)discovery underway
- Investors have lost confidence in current securitization structures and "predictive" performance of reverse mortgages
- Retreating yields, nervous investors, and falling volume all hurting proprietary product securitization

HMBS and HREMIC Securitization Timeline

<u>HMBS and HREMIC Securitization</u>

- ❖ HMBS does not have material minimum size requirements
- ❖ Ginnie Mae guaranty creates sufficient liquidity for trading
- ❖ HMBS pools are created and sold through Broker/Dealers
- ❖ Broker/Dealers re-securitize HMBS into 2-class HREMIC securities, to better align cashflow performance with investor needs
- ❖ Typically structured into ”Par Floaters” and “Interest Only (IO)” Securities

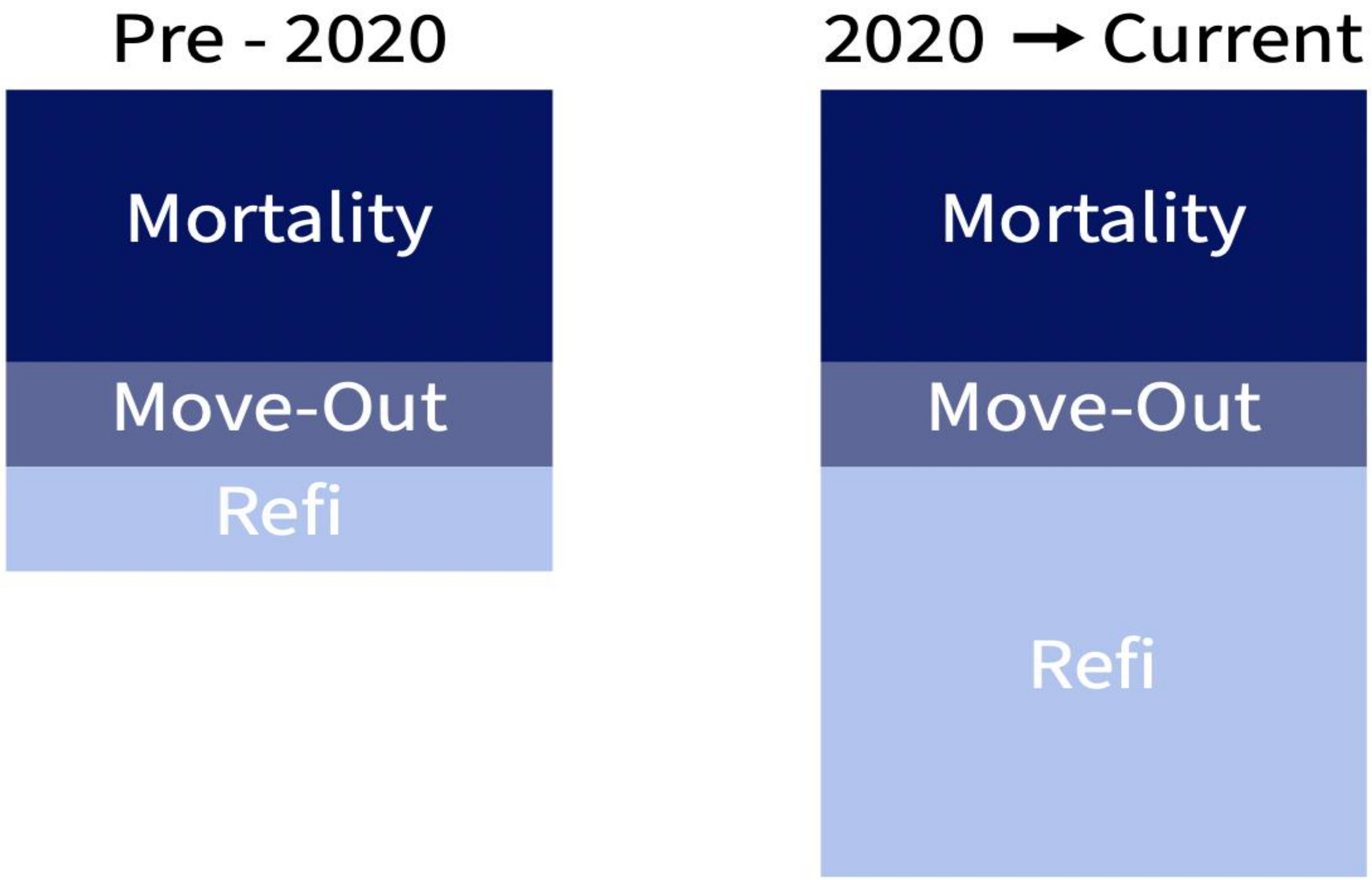
HMBS and HREMIC Securitization Structure

All AAA Rated

Impact of Interest Rates on HECM and HMBS

- ❖ Stable interest rates always create most favorable lending conditions
- ❖ Rising interest rates leave investors with lower-than-market returns
  - ✓ Rising rates also lower PLFs to borrowers
  - ✓ Prepayments slow down, somewhat offsetting the impact of rates
- ❖ Falling interest rates increase prepayment speeds as borrowers have opportunity to refinance, hurting investor returns
  - ✓ Falling interest rates increase PLFs to borrowers

HMBS and HREMIC Prepayment Change



HMBS and HREMIC Current State

<u>Prepayments Have Been the Story</u>

- ❖ At all-time highs, and outside historical bands for 2+ years
- ❖ Investors have lost confidence in the “predictive” prepayment story reverse mortgages used to enjoy
- ❖ Rising rates are slowing prepayments, but yields are falling
- ❖ Investors fear any drop in interest rates could spark new round of refinance activity
- ❖ Investors reluctant to pay premiums our industry became accustomed to