

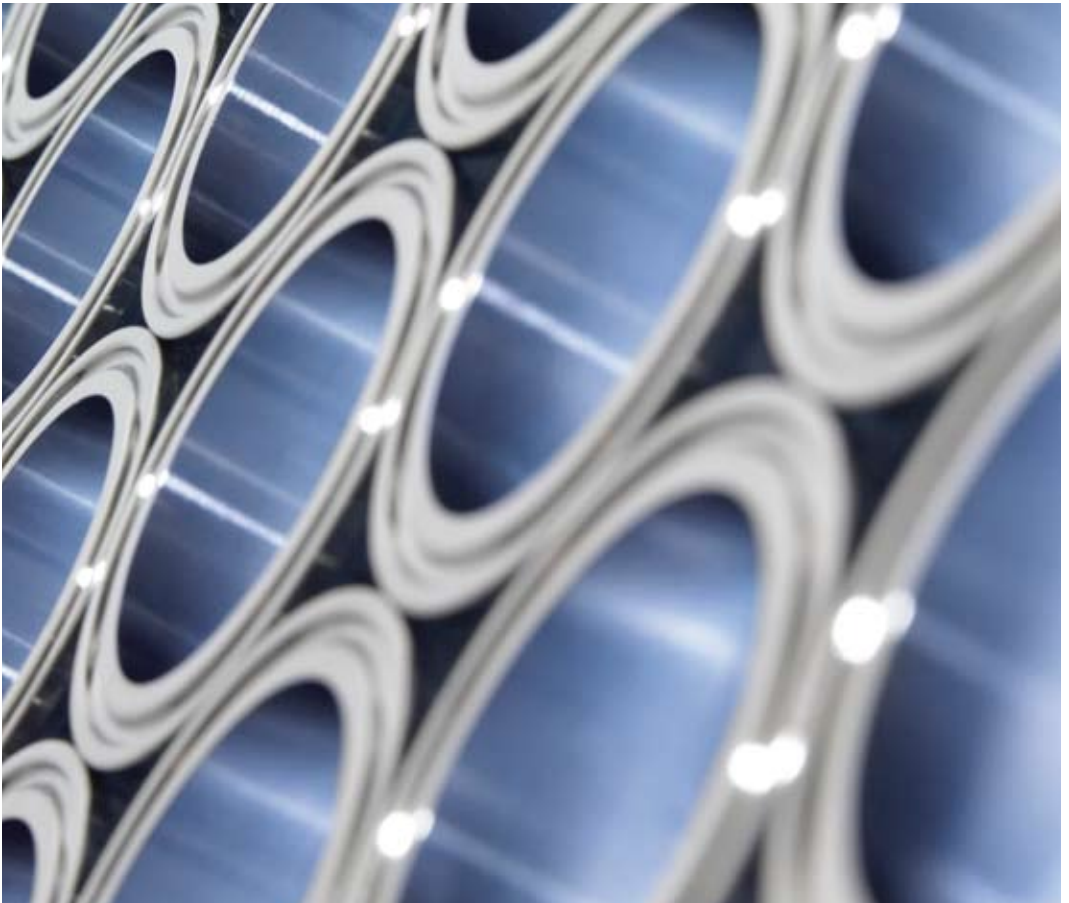
Innovation Series
GLOBAL CORPORATE TRUST

Reverse Mortgages: Back to the Future

Demographic trends point to substantial reverse mortgage growth in the years ahead, based on the pending global retirement of the post-World War II baby boomer generation.



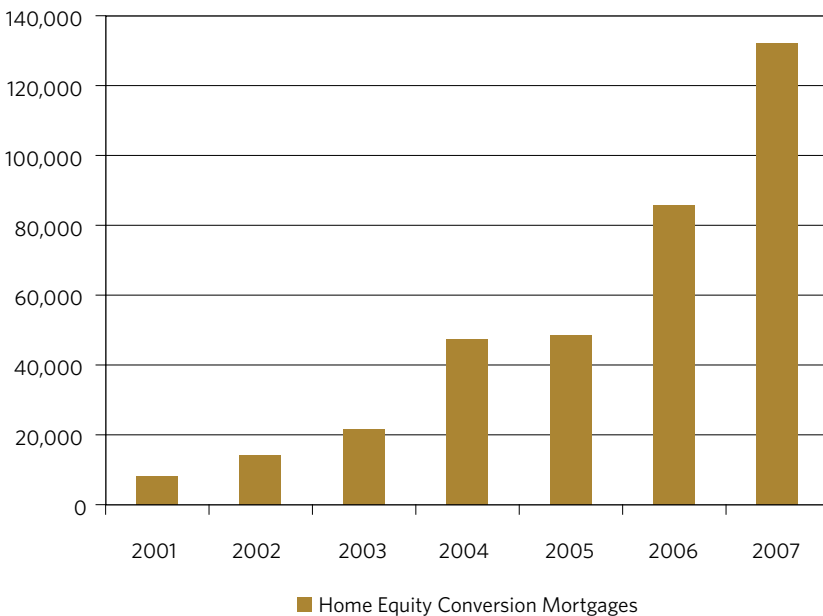
THE BANK OF NEW YORK MELLON.



Reverse mortgages (RMs) were once considered the sole province of poor retirees, a last resort for individuals without adequate retirement savings. Now the market is shifting in a way that may portend bigger things to come.

RMs are fast becoming the financial tool of choice for house-rich but cash-poor seniors. Prior to RMs, retirees could only access home equity by selling or by taking a home equity loan. With the recent real estate downturn, selling has become a less palatable option.

The influx of new RM borrowers has led to market growth, with more than 300,000 originated (HUD chart) during the past five years. Yet this figure represents less than 1% market penetration, according to the National Reverse Mortgage Lenders Association (NRMLA). They estimate 80% of seniors (62+) own their own homes (about 27 million senior homeowners) and hold about \$4.3 trillion in untapped home equity.



Source: US Housing and Urban Development/NRMLA

Demographic trends point to substantial RM growth in the years ahead, based on the pending global retirement of the post-World War II baby boomer generation. In response, The Bank of New York Mellon has been building a sophisticated, end-to-end RM platform to support origination and securitization by government-sponsored entities (GSEs) and the private market. This platform, currently being developed in the United States, may eventually be rolled out worldwide as RM-type products take hold in other graying nations.



What is a Reverse Mortgage?

In a traditional “forward” mortgage, a borrower uses a home as collateral to obtain a loan from a lender, making regular principal and interest payments until the debt is repaid. In an RM, the home is used as collateral to obtain an income stream from a lender, similar to a home equity loan or home equity line of credit (HELOC). RM funds can likewise be used for any reason and taken as a lump sum, as a series of periodic or monthly payments, or as a credit line. RM payouts do not affect Social Security or Medicare eligibility (*Just the FAQs: Answers to Common Questions About Reverse Mortgages, NRMLA*).

RM borrowers remain in their homes, retaining full title and ownership. Principal and accrued interest are due when the borrower or last remaining spouse dies, the property is no longer the borrower’s primary residence, or if the borrower fails to pay property taxes, maintain insurance, or keep the home in good repair. The borrower and/or heirs have the option to keep the home and pay the loan balance or proceed with a sale to pay the balance.

RM underwriting is based on the age (62) and gender of the borrower, the interest rate on the mortgage, and value of the home. Generally the older the borrower the higher the available credit line due to the anticipated earlier loan repayment. RM withdrawals are non-recourse to the borrower. In the event a borrower remains in the home longer than anticipated, the lender assumes the risk of loss. RMs therefore are originated at low loan-to-value ratios.



The U.S. Census Bureau projects a doubling of the older population by 2030, from 36 million to 72 million.

RM Securitization

RM securitization is ramping up. In 2006, *Leasing News* reported that investment banks had been acquiring RM loans and structuring deals (“Reverse Mortgages on the Rise,” September 2006). Lehman Brothers’ \$598 million RM Loan Trust was nominated for 2006 MBS Deal of the Year by *Total Securitization* (March 19, 2007 issue). In November 2007, Ginnie Mae issued a \$116 million HECM security.

RM Lending

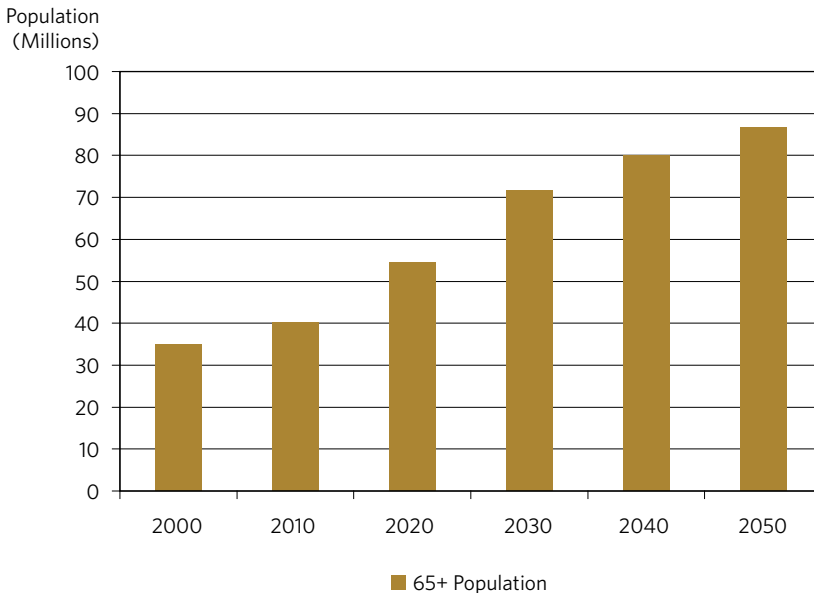
The Home Equity Conversion Mortgage (HECM) represents about 95% of the RM market, according to NRMLA. HECMs are federally insured by the Federal Housing Administration (FHA), a branch of the U.S. Department of Housing and Urban Development (HUD). HECMs generally carry traditional mortgage fees, which may be added to the loan balance.

Fannie Mae’s Home Keeper loan offers higher loan limits and waives certain fees. Home Keeper also targets downsizing retirees by combining elements of a forward and reverse mortgage, enabling borrowers to buy a new home based on existing home equity.

Lenders have added valuable RM innovations, customizing HECMs to match borrower needs and creating a jumbo RM market. Nearly 800 new lenders entered the RM market in 2007, more than doubling the 2006 level, according to 2007 year-end FHA data.

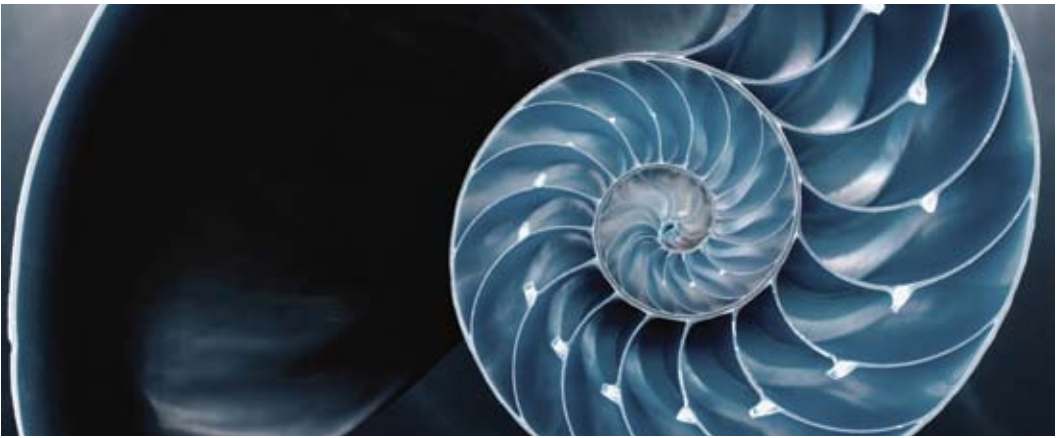
Demographic Trends

Long-term trends point to substantial aging of the population among the world's industrial societies. In the U.S., the Census Bureau projects a doubling of the older population by 2030, from 36 million to 72 million, an increase from 12% to 20%. By 2050, this group is projected to grow to 86.7 million (*65+ in the United States: 2005*, National Institute on Aging, U.S. Census Bureau).



Source: U.S. Census Bureau

Conforming RM loans will end up in GSE loan pools. But huge potential also exists for private-market securitization in the jumbo RM (>\$417,000) and super-jumbo RM (>\$1.5 million) space, similar to forward mortgage securitization.



Elsewhere, the over-60 group is expected to comprise 39% of Italy's population and 44% of Japan's ("Five Population Trends to Watch," *Foreign Policy*, September 2007. The BBC reports that by 2025 more than a third of the U.K.'s population will be over age 55 ("Welcome to the ageing future," *BBC News*, November 29, 2004).

Experts believe such population shifts will severely strain social insurance programs at the very time seniors will be most dependent on them. McKinsey & Company predicts these trends will create significant downward pressure on household savings and financial wealth accumulation (*The Coming Demographic Deficit: How Aging Populations Will Reduce Global Savings*, January 2005.)

RM legislation is under consideration in France, Japan, and India. Spain, Australia, and New Zealand have established RM markets. In the U.K., home reversion programs allow a homeowner to sell an equity interest in the home in exchange for an equivalent percentage of cash. Legal ownership passes to the reversion company and any remaining portion is held in trust. If the full equity is sold, the homeowner can remain in the home rent free until relocation or death.

An April 2007 report by Defaqto, an independent product research company, noted that a combination of underfunded pensions, low annuity rates, demographics, and pensioner debt, along with high levels of equity in housing stock, will make equity release in the U.K. an important retirement planning alternative (*Equity Release in the UK 2007 - Lifetime Mortgages and Home Reversions: A Retirement Solution*).

A Key Financial Planning Tool

Demographic trends suggest the RM has important financial and estate planning attributes that coincide with the services provided by many diversified financial institutions. For example:

- Long-term care (LTC). About 60% of people over age 65 will require LTC care during their lifetimes, according to the National Clearinghouse for Long-Term Care Information. RMs could fund a long-term care policy or be used to meet out-of-pocket LTC expenses.
- Medigap. A Medigap policy is health insurance sold by private insurance companies to fill gaps in the original Medicare Plan coverage. Some Medigap policies cover costs not included under Medicare.
- Life insurance. Heirs expecting to inherit childhood homes may be disappointed to learn an outstanding RM will require the home to be sold. One solution: use RM cash flow to maintain payments on an existing life policy or to purchase additional coverage. At death, beneficiaries can use the proceeds to pay the RM loan balance or receive a tax-free equivalent that will pass free of probate.

The reverse mortgage has important financial and estate planning attributes that coincide with the services provided by many diversified financial institutions.



Growing Grayer

The world's industrialized societies will be growing grayer in the years ahead, challenging the ability of public and private retirement safety nets to meet future demand. These trends will drive the RM concept worldwide, as the asset-rich, baby boom generation moves closer to retirement. Home equity, which can easily be accessed through an RM or other equity-conversion, may offer retiring homeowners an alternative nest egg.

The Bank of New York Mellon is laying the groundwork to provide clients with a comprehensive approach to RM services. Although RM securitization is in its infancy, it should grow rapidly as demand for RM takes hold. Conforming loans will end up in GSE loan pools. But huge potential also exists for private-market securitization in the jumbo RM (>\$417,000) and super-jumbo RM (>\$1.5 million) space, similar to forward mortgage securitization.

For much of the postwar era, the baby boom generation greatly expanded the need for housing, particularly in the suburbs. The RM represents the first step back to the future, with financial institutions helping clients to unwind housing positions built over a generation.

Building a Reverse Mortgage Life Cycle Solution

A long list of third-party services are often required to support an RM custodial file as it moves from origination to securitization and beyond. The Bank of New York Mellon is building a complete RM life-cycle solution, one that will provide government-sponsored entities, lenders, and underwriters with efficiency of scale, dependability of service, and cost savings. These services generally fall into the following areas.

- Document Custodian. When an RM loan is originated, a document custodian is typically charged with holding a physical collateral file that contains the RM note, the title policy, the deed of trust (depending on the state of origination), the assignment form, as well as insurance and other documents. The document custodian is charged with safekeeping, document review, borrowing base calculations, and reporting.

RM custodial duties appear similar to forward mortgages, but they are not. Each type of RM loan may require a different set of criteria and documentation. Some of these loans require holding 26 separate documents, including the credit file and HUD requirements, in addition to mortgage-related documents. The Bank of New York Mellon has developed specialized RM loan-custody processes, reviewing, certifying, and warehousing the documents from locations in New York, Texas, and California.

- **Collateral Agent.** As custodian, The Bank of New York Mellon safekeeps collateral in segregated accounts and marks-to-market daily to ensure prescribed collateral margins are maintained. The Bank's proprietary collateral management system can process a wide array of transaction types, including tri-party repurchase agreements (both equity and fixed income), portfolio swaps, collateralized loans, and swap collateralization deals.
- **Trustee.** A trust indenture mandates the appointment of a trustee to provide a central point of contact and serve as the noteholder's representative. Divergent legal environments influence the role of the trustee and the extent of any administrative duties undertaken; however, the core administrative services remain largely the same. The Bank of New York Mellon's service platform and product suite offer a single source for all trustee needs. Choosing the right trustee could influence an issue's rating as well as its potential performance in the secondary market.
- **Master Servicer.** The Bank of New York Mellon currently monitors primary servicing functions for public and private forward mortgages. These duties include monitoring primary and special servicers, acting as back-up servicer, managing payment flows, collecting monthly reports, aggregating and validating loan level data, and customizing investor reporting. As of May 31, 2007, The Bank of New York Mellon was master servicing more than 131,855 loans totaling \$25.1 billion (Fitch Ratings, December 4, 2007). RM master services will be added in the near future.



As head of Global Structured Finance Product Management, Tony oversees a team of product managers around the globe. He is responsible for product strategy and development for services supporting capital market participants. He joined The Bank of New York Mellon in 2006 as business head of Mortgage Backed Securities. Tony has 20 years of financial services organization experience holding management positions within business unit management, technology, and business strategy.

The author wishes to thank his colleagues at The Bank of New York Mellon, Global Corporate Trust, for their contributions to this article: Douglas MacInnes, Managing Director; Alex Tsarnas, Managing Director; Dario Parente, Vice President; Nicola X. Dale, Vice President, and Rossana Abueva, Vice President.

The Bank of New York Mellon's corporate trust business services \$11 trillion in outstanding debt from 54 locations around the world. It services all major debt categories, including corporate and sovereign debt, mortgage-backed and asset-backed securities, collateralized debt obligations, derivative securities and international debt offerings.

The views expressed herein are those of the authors and may not reflect the views of The Bank of New York Mellon Corporation or any of its subsidiaries ("BNY Mellon"). The material contained herein is for informational purposes only. The author has taken reasonable measures to ensure that the information and data presented in this report is accurate. However, BNY Mellon makes no express or implied warranty regarding such information or data, and hereby expressly disclaims all legal liability and responsibility to persons or entities who use this report, based on their reliance on any information or data that is available in this report. The content of this report is not designed or intended to provide authoritative financial, accounting, investment, legal, regulatory or other professional advice which may be reasonably relied on by its readers. In addition, the terms of this disclaimer extend to BNY Mellon, its directors, officers and employees. The presentation of this material neither constitutes an offer to sell nor a solicitation of an offer to buy any securities described herein and no recommendation is made concerning securities described and it may be unlawful to offer to sell or to solicit an offer to buy the described securities in certain jurisdictions.

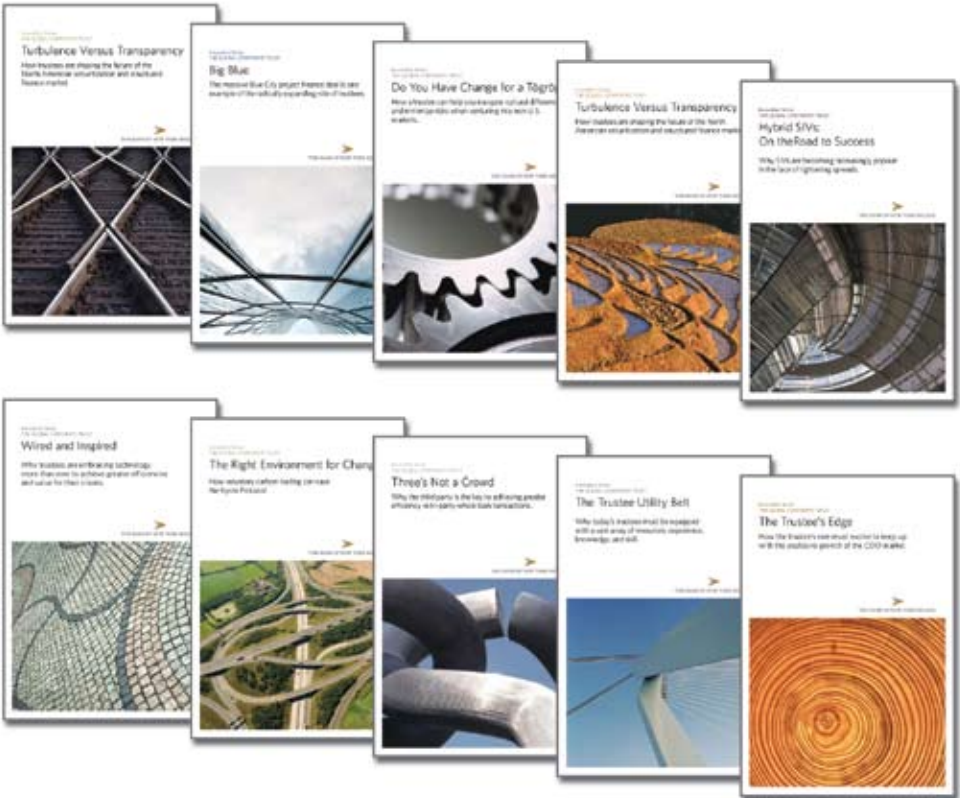
For more information, please contact:

Tony A. Nunes, Managing Director
Global Product Management
San Francisco: 415 263 2424
tony.nunes@bnymellon.com

Come see the future
of Global Corporate Trust.

Innovation Series
GLOBAL CORPORATE TRUST

Who's Helping You?



THE BANK OF NEW YORK MELLONSM

Reverse mortgage growth may grow exponentially, in keeping with the pending global retirement of the post-World War II baby boomer generation. In this edition of the Global Corporate Trust Innovation Series, you'll learn about reverse mortgage trends and how The Bank of New York Mellon is laying the groundwork to provide comprehensive reverse mortgage services.

Who's Helping You?



By Tony A. Nunes



THE BANK OF NEW YORK MELLON.

The Bank of New York Mellon
Corporate Trust Publishing
bnymellon.com/gctinnovation