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INVESTMENT
ADVISOR

July 2016 Presentation

Hosted by Berkeley, Inc.

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Agenda

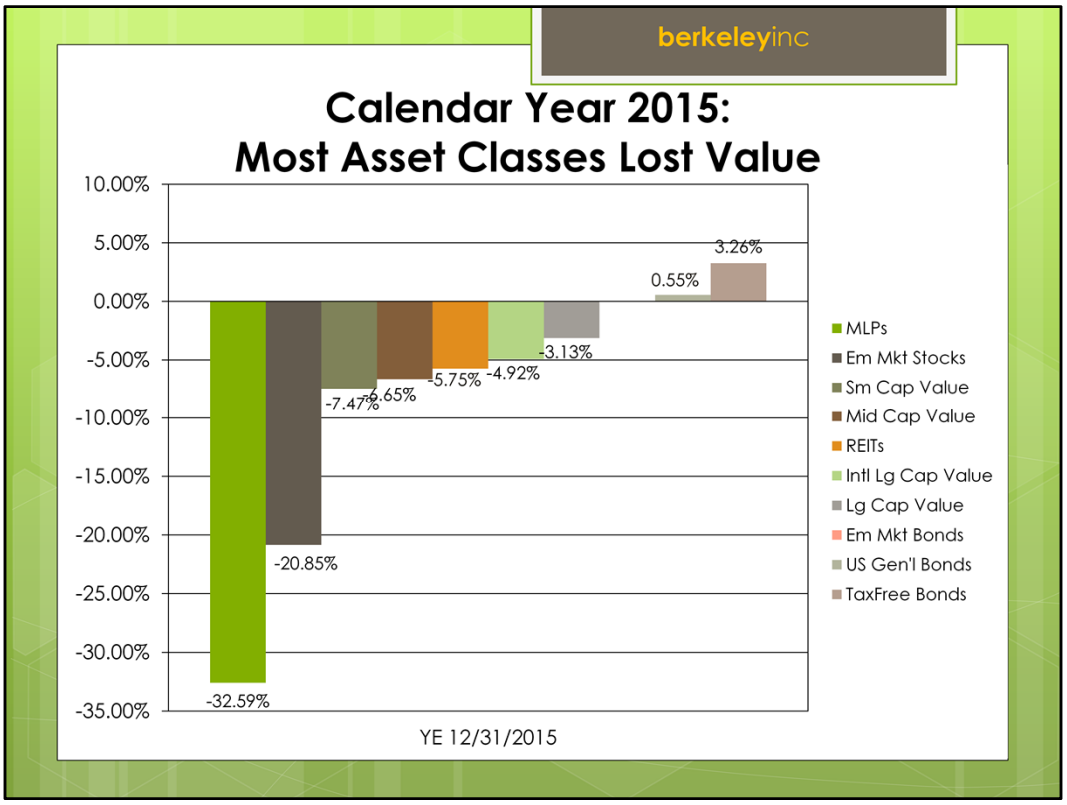
Investment Review

Consumers, Votes, & Brexit

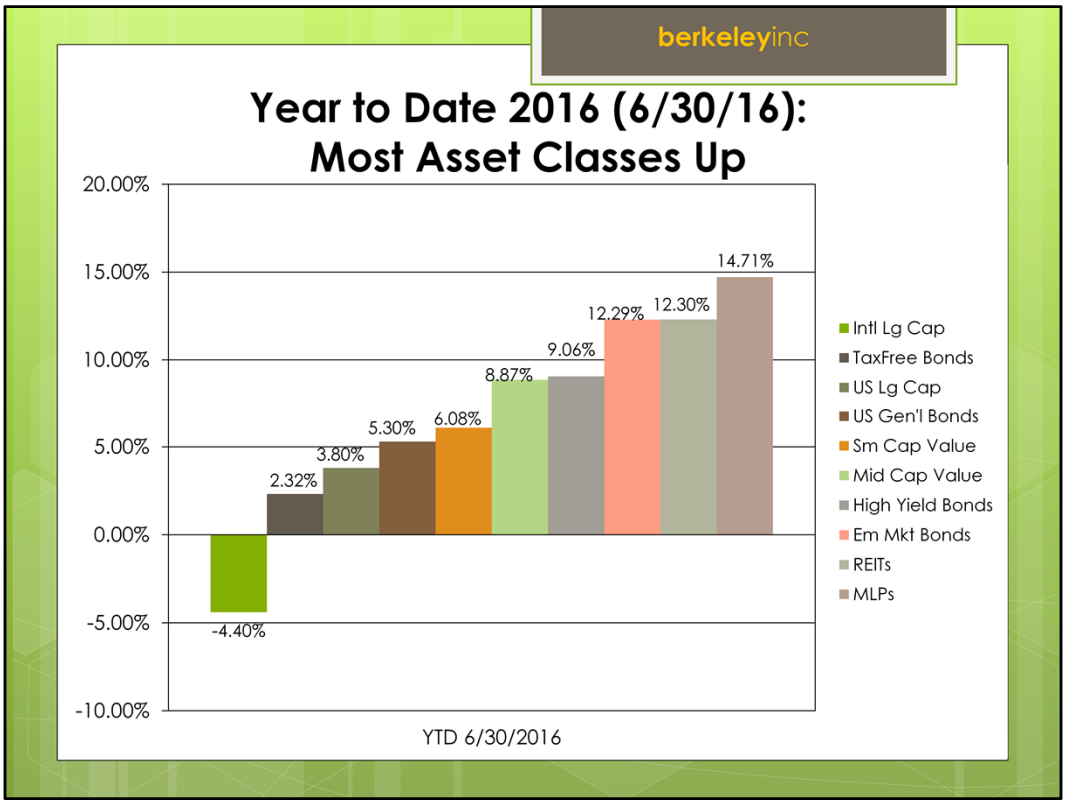
Reverse Mortgages

Technology Update

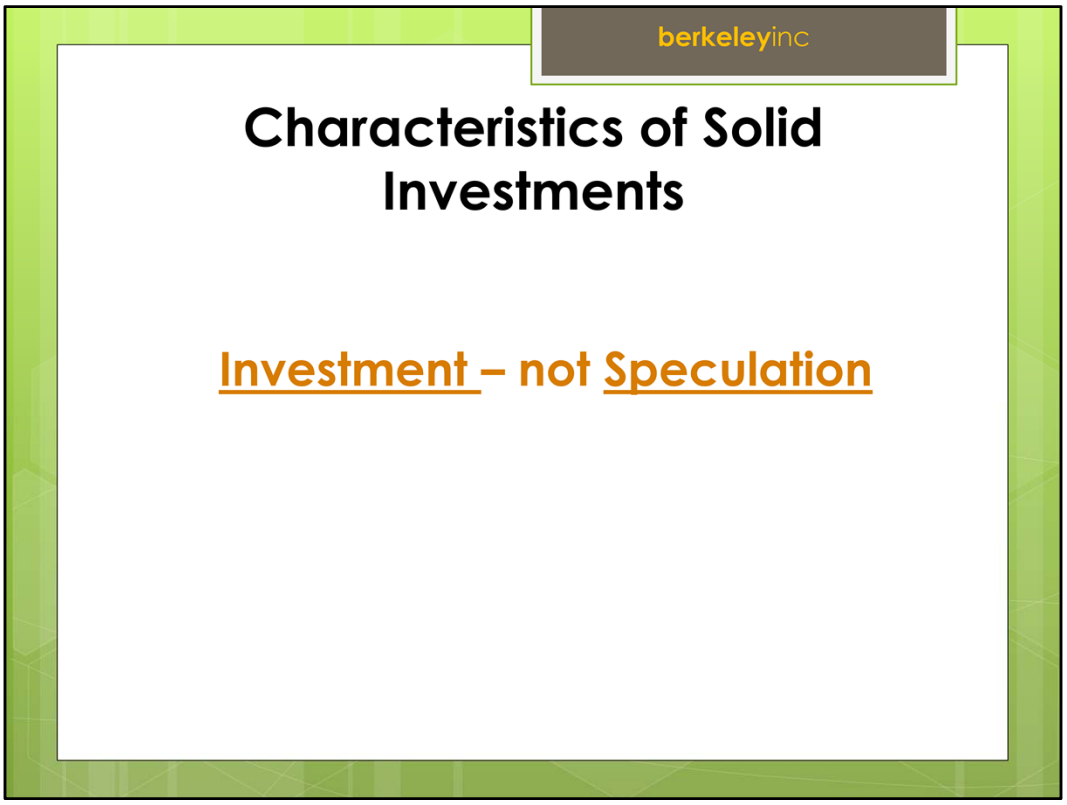
While mid-year was balanced between winners and losers the gap narrowed by year's end.



- In 2015, just about all asset classes were down—with exception of domestic bonds, which eked out a barely positive gain, and tax-free bonds up 3%+
- Notably, MLPs (oil/gas pipelines) and emerging market stocks were down sharply. MLPs followed oil prices down, whereas nervous investors sold emerging market stocks when it appeared that the US was about to enter an interest rate raising cycle.



- Thus far in 2016, the returns are all positive—except international markets, where a combination of reactions to the Brexit vote and nervousness about weak economies in the Euro Zone teetering close to recession.



Paraphrasing Benjamin Graham: investments produce income; all others may be judged as speculations. Given low interest rates, Berkeley's focus is in part ensuring that every investment in your portfolio produces some level of income.

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Characteristics of Solid Investments

Income Statement

- Reasonable revenue growth; prefer mostly organic growth
- Stable to improving margins
- Few or no extraordinary items
- Growing dividend payments
- Stable to declining share count

- Extraordinary items are supposed to be unusual, one-time events; unfortunately with many companies, they happen way too frequently to be considered "one time." Recurring "non-recurring" events—ironic indeed!
- We look for dividends that are not only growing, but where the companies have the capacity to continue that growth. Some of the things we look at in this area include dividend payout ratios and whether the dividends are amply covered by free cashflow.
- Share counts don't have to decline especially with rapidly-growing businesses, but in well-run, shareholder-oriented businesses that we favor, they do tend to decline over time. Ample free cashflow affords both solid dividends that are growing, and net share count reductions.

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Characteristics of Solid Investments: Income Statement

	2011	2012	2013	2014	2015
Reve[illegible]	[illegible]714.0	7,391.0	8,346.0	9,473.0	9,667.0
YOY [illegible]g	[illegible]1.2	[illegible]	[illegible]	[illegible]	2.0%
Op Income	2,713.0	3,937.0	4,5[illegible].0	5,106.0	5,078.0
Op Margin	40.4%	53.3%	54.0%	53.9%	52.5%
Net Engs	[illegible],9[illegible]	[illegible]	[illegible]	[illegible],617.0	3,808.0
A/T Margin	28.4%	[illegible]	37.9%	38.2%	39.4%
YOY Chg	3.3%	44.8%	12.9%	16.1%	5.3%
EPS	1.48	2.19	2.56	3.09	3.39
YOY Chg	[illegible]	[illegible]	[illegible]	[illegible]6%	9.5%
FD Shs Outs	1,264.0	1,258.0	1,215.0	1,169.0	1,124.0

What company is this???

Mastercard

- Solid year-over-year growth in revenues
- Very high operating margins (rarely see them this high)
- Meaningful reduction in shares outstanding

Characteristics of Solid Investments

Balance Sheet

- Ample cash & marketable investments
- Low to modest debt

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Characteristics of Solid Investments: Balance Sheet

What company is this??? Juniper Networks

	2011	2012	2013	2014	2015
Curre[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]064.4
Assets	[illegible]	[illegible]	[illegible]	[illegible]	[illegible],619.2
Pension Assets	-	-		-	-
Total Adj Assets	9,984.0	9,832.0	10,326.0	8,403.1	8,619.2
Total Adj Tangible Ass[illegible]	[illegible]	[illegible]	[illegible]	[illegible],359.2	5,604.0
Cash/sh	[illegible]	[illegible]	[illegible]	6.79	7.99
Funding:					
Current Liab (net)	754.0	728.5	735.6	746.9	979.0
Deferred Revenue	713.0	[illegible]93.5	705.8	780.8	822.9
Short-Term Debt					
Long-Term Debt	[illegible]	[illegible]	[illegible]	1,349.0	1,648.8
Op Lse	352.7	266.1	225.2	137.1	113.7
Pension PBO	-	-		-	-
Total Adj Debt	[illegible]	[illegible]	[illegible]	[illegible]486.1	1,762.5
Equity	7,[illegible]9.0	6,99[illegible]	7,[illegible]	[illegible],919.1	4,574.4

- Ample cash on balance sheet.
- Deferred revenue is essentially revenue that has already been collected, but which accounting conventions allow recognition over time as the service/product is delivered.
- Adjusted debt bouncing around a bit; appears that company periodically borrows to buy back shares, then pays down the debt—then begins a new cycle.

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Characteristics of Solid Investments

Cashflow Statement

- Stable to growing cashflow
- Modest capital expenditures required
- Reasonable cash returned to shareholders via dividends & share buybacks

- The cashflow statement captures the changes in the balance sheet and adjusts the income statement results so one can see what's really going on with a company.
- Some companies may appear to be healthy when reviewing the income statement—but look fairly weak when examining the cashflow statement. As an example, consider mining companies, railroads or utility stocks—they may produce decent income, but they have to invest so much money into capital projects that little, if any, cash is left to pay dividends, buy back stock or pay down debt.

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Characteristics of Solid Investments: Cashflow Statement

	2011	2012	2013	2014	2015
Cash [illegible]					
Op Ca[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	368.6
CAPX	[illegible]	[illegible]	[illegible]	[illegible]	140.3
Free Cashflow	189.6	178.2	159.2	198.7	228.3
FCF/Share	[illegible]	2.21	[illegible]	2.92	3.55
FCF Margin	[illegible]	[illegible]	[illegible]	6.8%	7.6%
FCF Growth YOY	[illegible]	[illegible]	[illegible]	35.8%	21.6%
FCF/EPS	1.34	1.18	0.97	1.29	1.16
Dividend/FCF	0.27	0.29	0.41	0.36	0.32
Net Payout Yield					
Dividends	[illegible]	[illegible]	[illegible]	63.4	70.8
Plus Stock Buybacks	422.1	287.3	333.4	239.6	306.3
Less Stock Issuances	33.1	43.4	41.2	29.3	16.3
Plus Debt [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	366.2
Less Debt [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	480.8
Total as % of Market Value	21.2%	8.3%	5.3%	6.2%	7.1%

What company is this???

Brinker International

- Attractive trends in free cashflow generation
- Very solid returns of capital to shareholders. Ideally, we like to see 5%+ over time—but practically speaking, we don't see numbers approaching those levels that often. This company, however, is doing a fine job on this front.

Speculation vs. Investment:

What company is this???

	Year Ended December 31,		
	2015	2014	2013
Net product sales	$ 79,268	$ 70,080	$ 60,903
Net service sales	27,738	18,908	13,549
Total net sales	107,006	88,988	74,452
Operating expenses (1):			
Cost of sales	71,651	62,752	54,181
Fulfillment	13,410	10,766	8,585
Marketing	5,254	4,332	3,133
Technology and content	12,540	9,275	6,565
General and administrative	1,747	1,552	1,129
Other operating expense (income), net	171	133	114
Total operating expenses	104,773	88,810	73,707
Income from operations	2,233	178	745
Interest income	50	39	38
Interest expense	(459)	(210)	(141)
Other income (expense), net	(256)	(118)	(136)
Total non-operating income (expense)	(665)	(289)	(239)
Income (loss) before income taxes	1,568	(111)	506
Provision for income taxes	(950)	(167)	(161)
Equity-method investment activity, net of tax	(22)	37	(71)
Net income (loss)	$ 596	$ (241)	$ 274
Basic earnings per share	$ 1.28	$ (0.52)	$ 0.60
Diluted earnings per share	$ 1.25	$ (0.52)	$ 0.59
Weighted-average shares used in computation of earnings per share:			
Basic	467	462	457
Diluted	477	462	465

- Solid, big numbers on the revenue line
- Volatile profits, and fairly miniscule as a percentage of revenue (less than 1% in 2015). Maybe a grocery store chain?

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Speculation vs. Investment:

What company is this???

FINANCING ACTIVITIES:			
Excess tax benefits from stock-based compensation	119	6	78
Proceeds from long-term debt and other	353	6,359	394
Repayments of long-term debt and other	(1,652)	(513)	(231)
Principal repayments of capital lease obligations	[illegible]62)	(1,285)	(775)
Principal repayments of finance lease obligations	[illegible]1)	(135)	(5)
Net cash provided by (used in) financ[illegible]tiv[illegible]	[illegible])	4,432	(539)
Foreign-currency effect on cash and cash equivalents	(374)	(310)	(86)
Net increase (decrease) in cash and cash equivalents	1,333	5,899	574
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 15,890	$ 14,557	$ 8,658

Amazon

…No cash returned to shareholders via dividends & share buyback

Questions?

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Consumers & Voters: A Mixed Message

The vastly differing opinion between the economic “numbers” and how consumers “feel” is perplexing. Maybe a bit of “the grass is always greener.”

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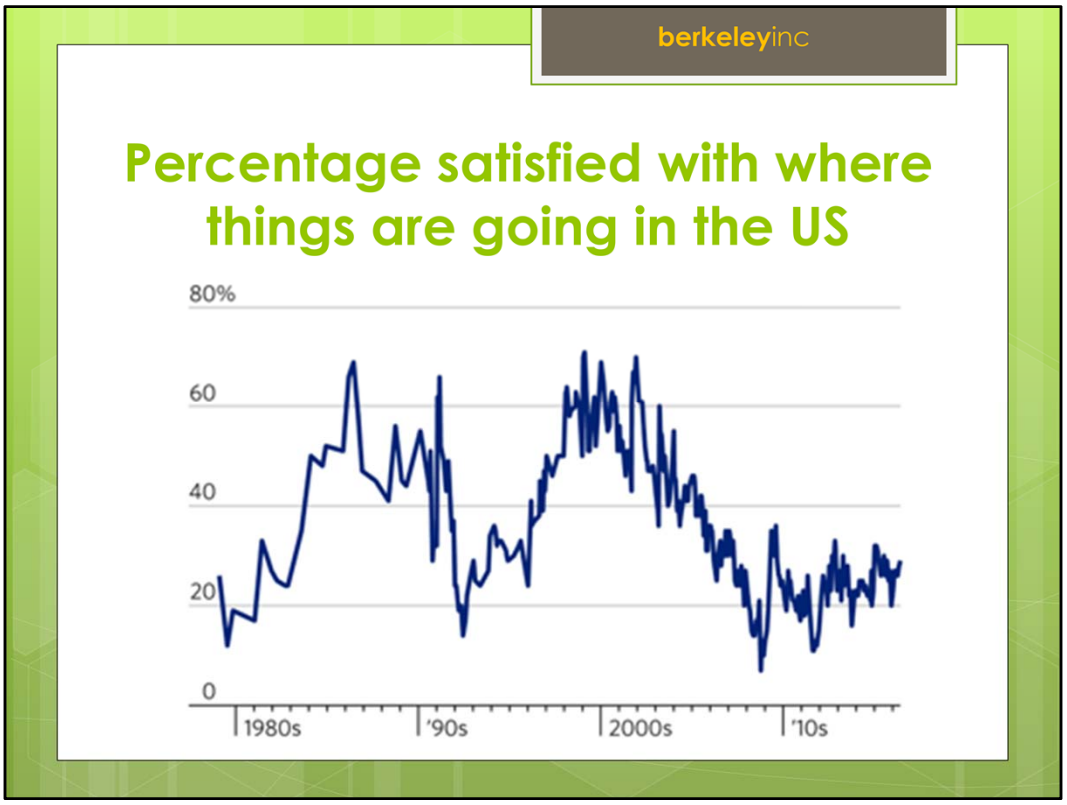
Are US Consumers Being Realistic?

Morning Consultants

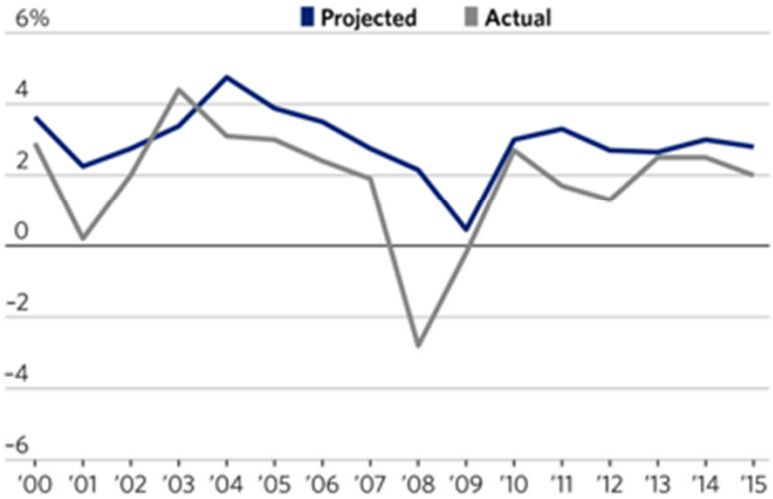
- Voters poll "Better Than Today"
  - 1960s – 31%
  - 1980s – 37%
- Economists "Better Off Today"
  - 1960s – 88%
  - 1980s – 87%
- Between 1960 & 2015
  - Life expectancy increased 10 years
  - Median personal income 55% higher inflation adjusted

The vastly differing opinion between the economic "numbers" and how consumers "feel" is perplexing.

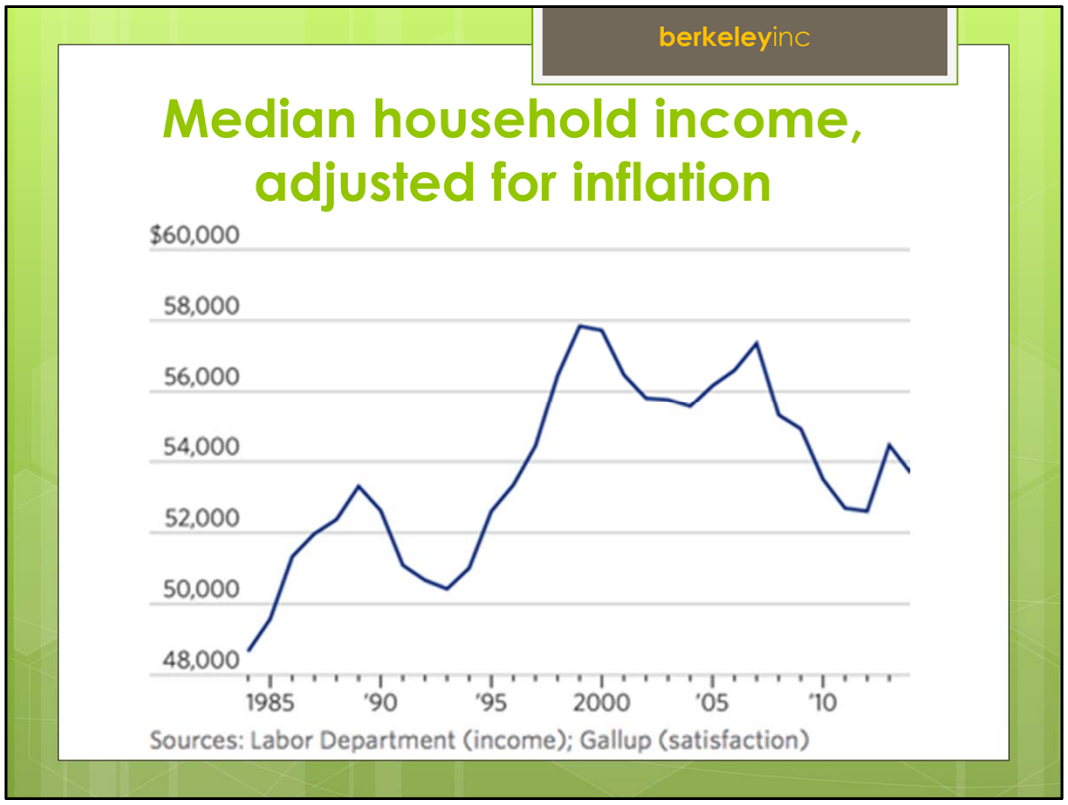


American median household incomes, adjusted for inflation, have fallen 7% since 2000. In the process, a persistent majority of individuals have come to believe the country is on the wrong track.

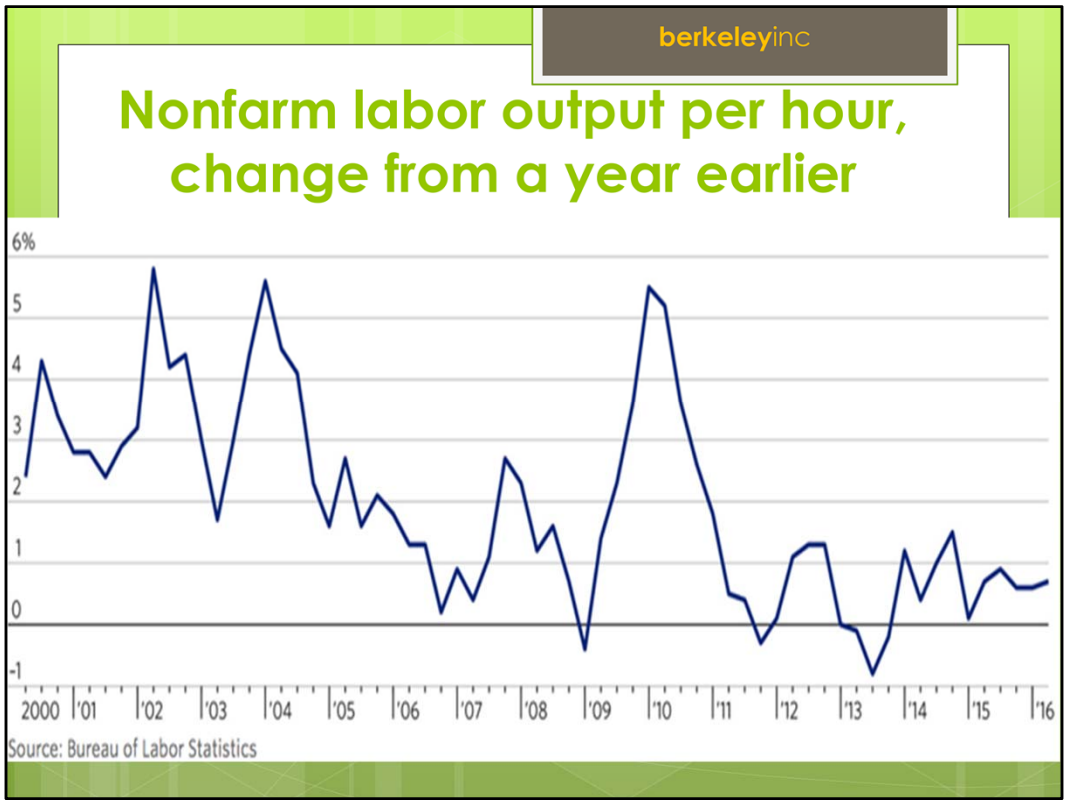
GDP Growth



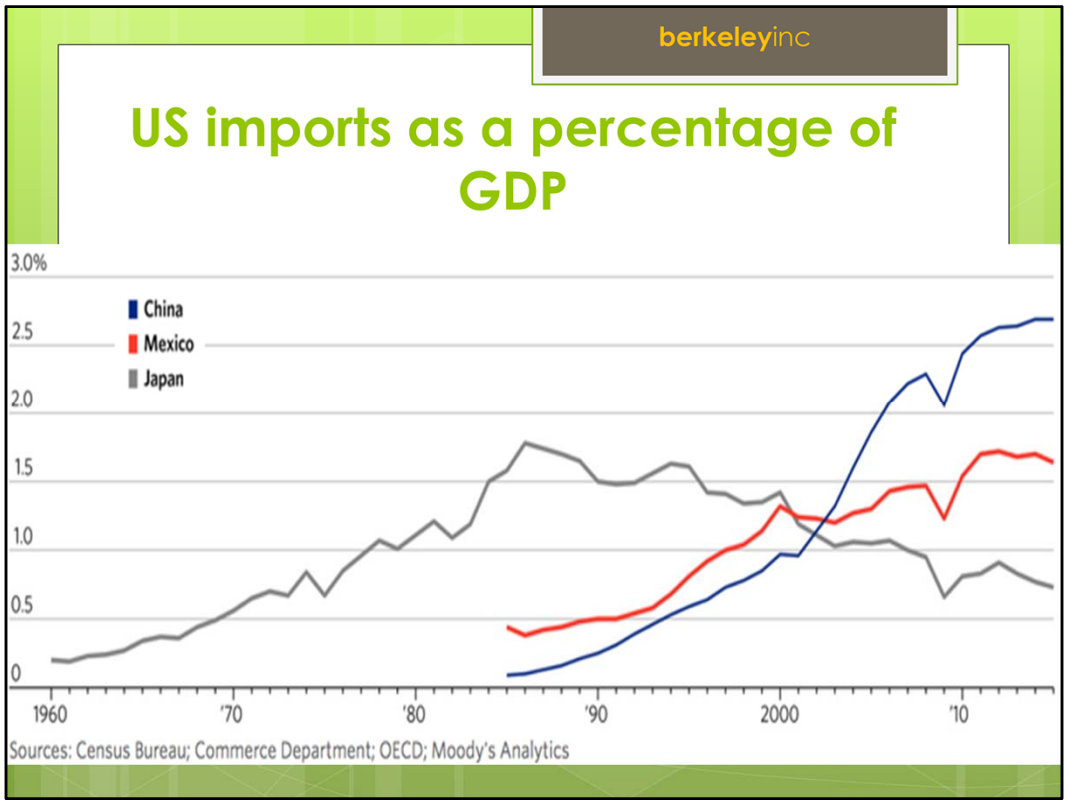
Source: Federal Reserve, Commerce Department



Household income peaked in 2000 and then nearly returned to that level in 2006. Compared to 15 years ago consumers feel “less well off” and yet their standard of living is still high.



Productivity and output growth have slowed while technology has polarized the workforce. Thus the general feeling that foreign labor is taking jobs.



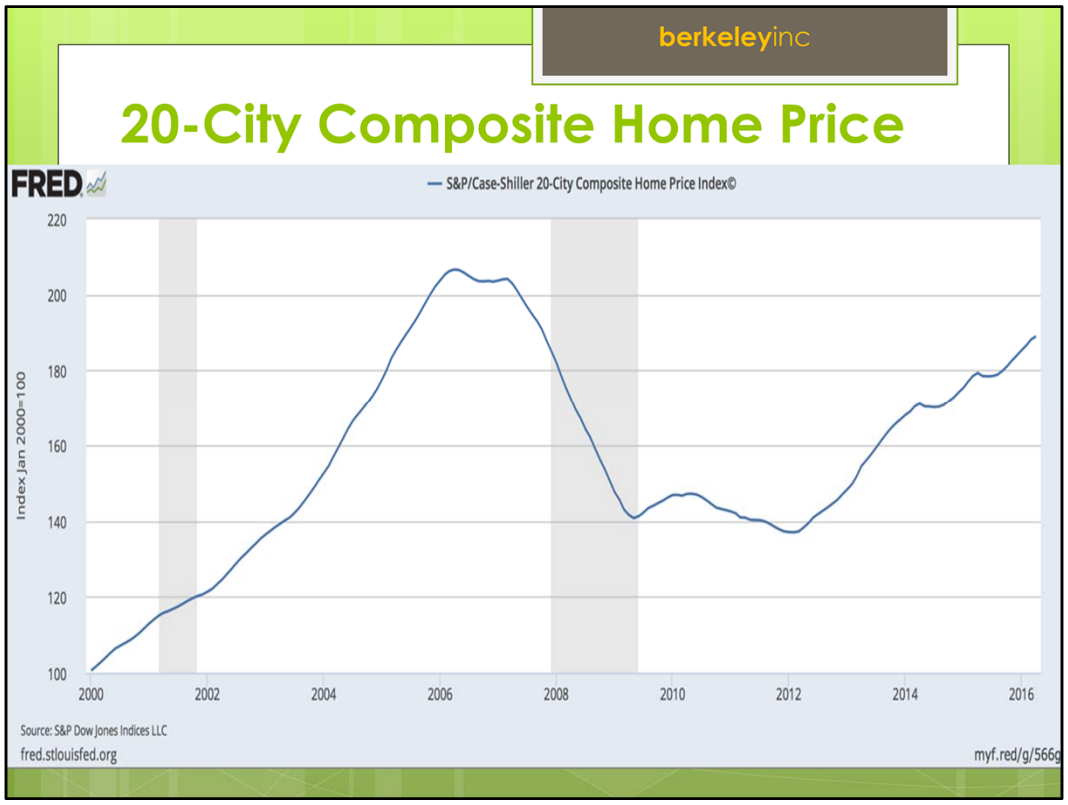
But the sizable increase in goods and services from China show a basis for the feeling that blue collar workers are loosing jobs to foreigners.

Are US Consumers Being Realistic?

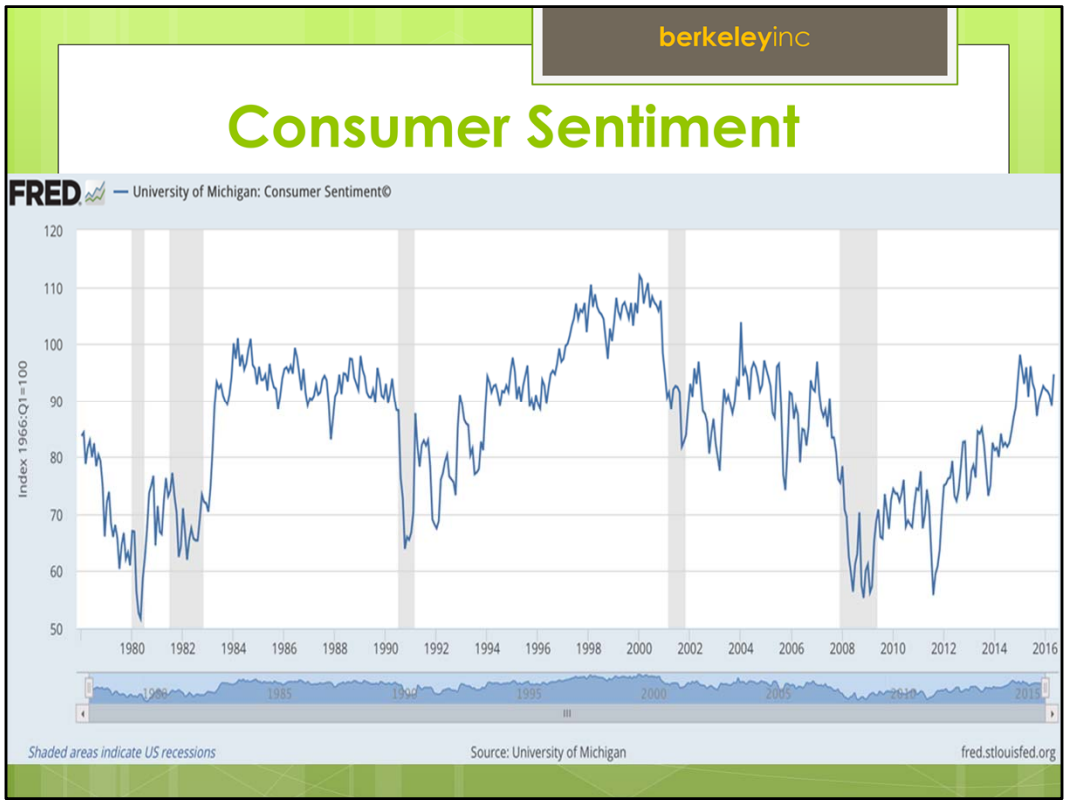
Possible Reasons for Pessimism?

1. White, middle-aged men have lost jobs
2. Last decade middle American lost ground
3. Uncertainty as tech & social changes accelerate
4. 24/7 media
5. Global conflicts
6. Caustic election process

The vastly differing opinion between the economic “numbers” and how consumers “feel” is perplexing. Maybe a bit of “the grass is always greener.”

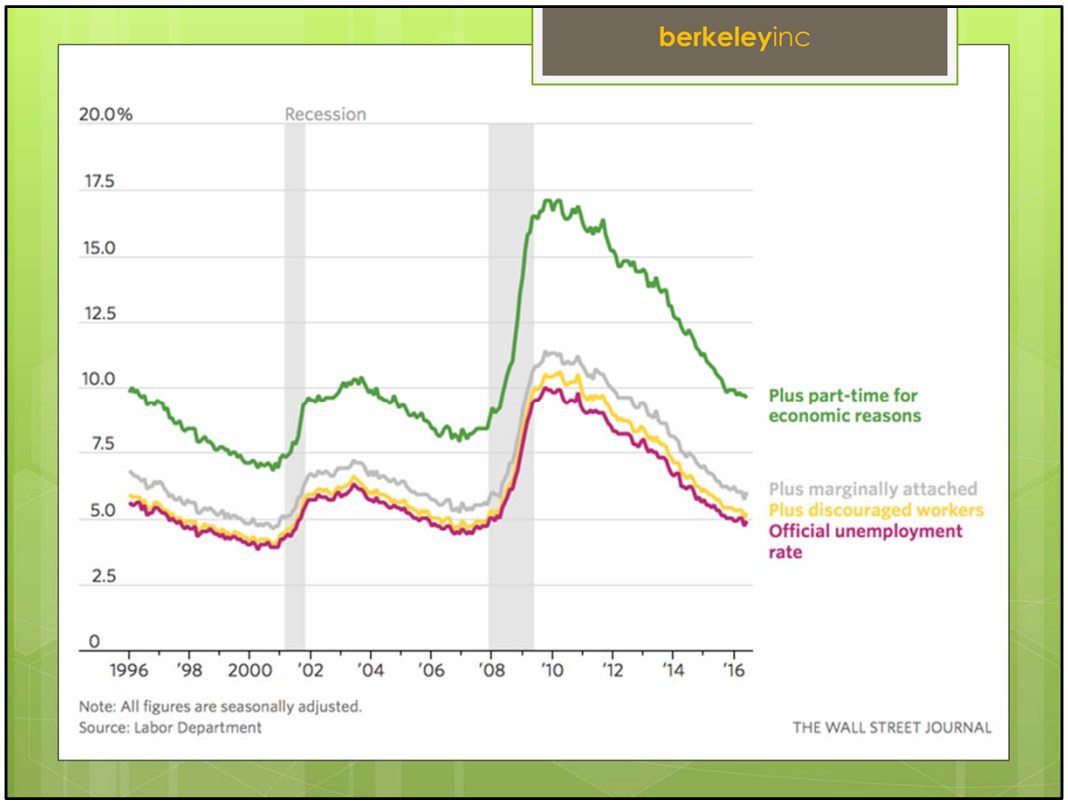


Housing prices have not reached new all-time highs but this sectors is still solid.



As polled by the University of Michigan, since the 2008-09 recession consumers are feeling good. This contradicts polling that shows voters think the US is on the wrong track.

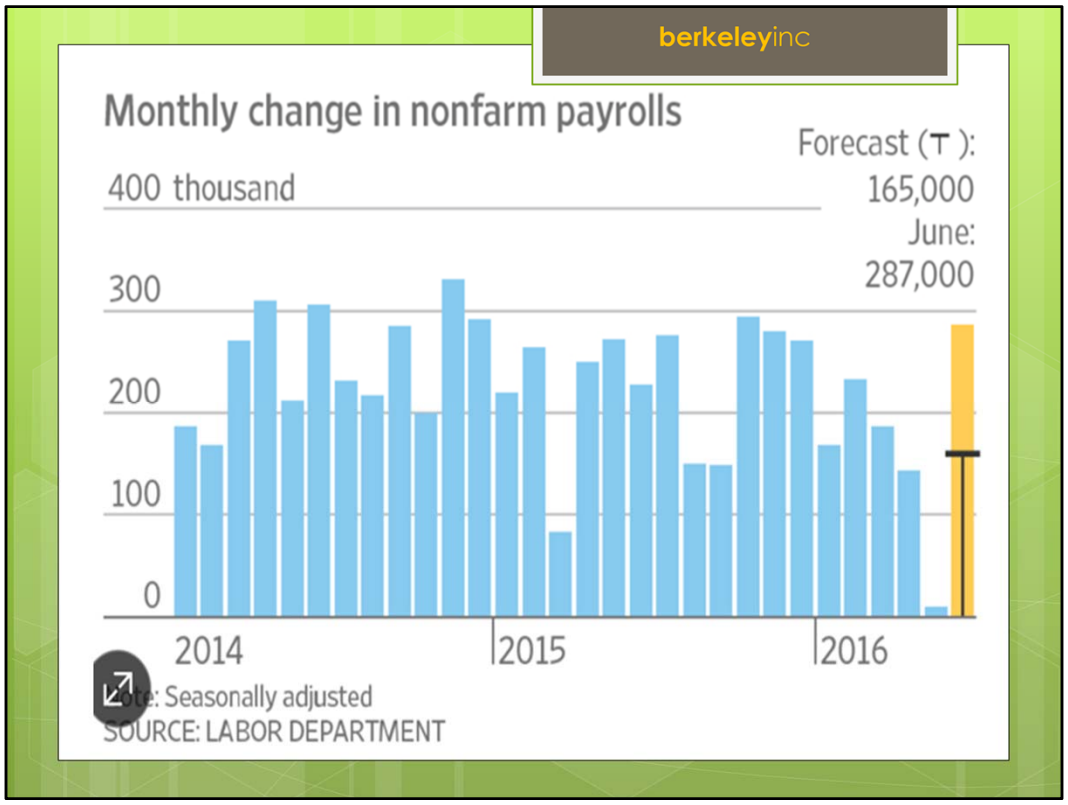
Unemployment has reached a level that should begin increasing inflation. In other words jobs are available for most Americans.



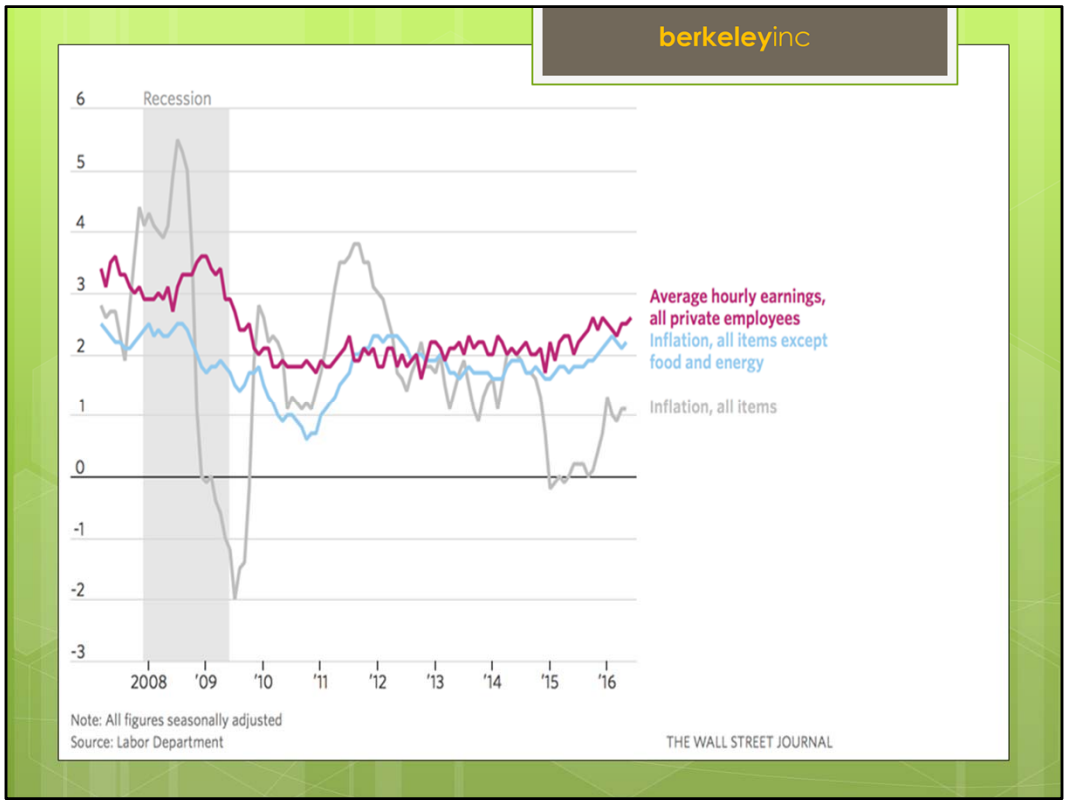
The official unemployment rate rose to 4.9 percent, from 4.7 percent. And average hourly earnings ticked up again, continuing a pattern set by three months of rising wages.

The welcome report on Friday showed the largest single monthly job gains since October 2015.

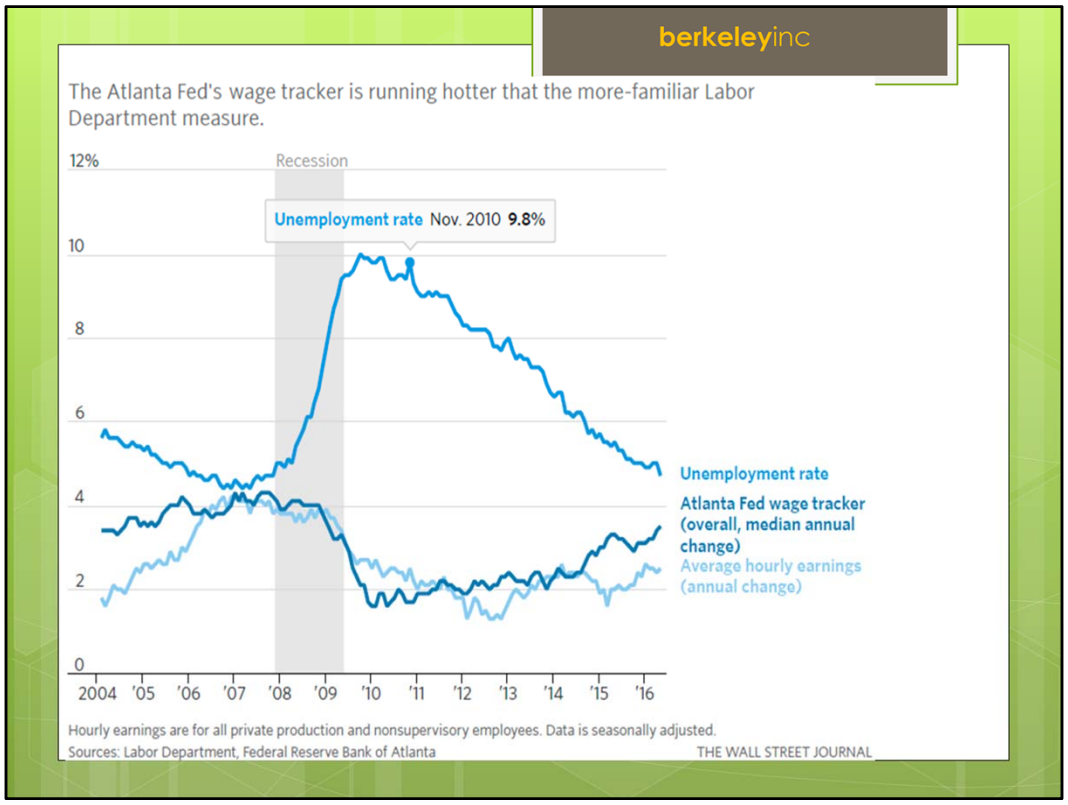
The standard unemployment rate can be an imperfect measure of overall slack in the labor market. A broader measure of unemployment and underemployment, including Americans who are working part time because they can't find full-time jobs, ticked down to 9.6% in June from 9.7% in May. It's still high, historically.



May's payrolls figure was revised down to a gain of 11,000, the weakest month of hiring since the U.S. stopped shedding jobs in 2010. But the June number was nearly double the forecasted rate.



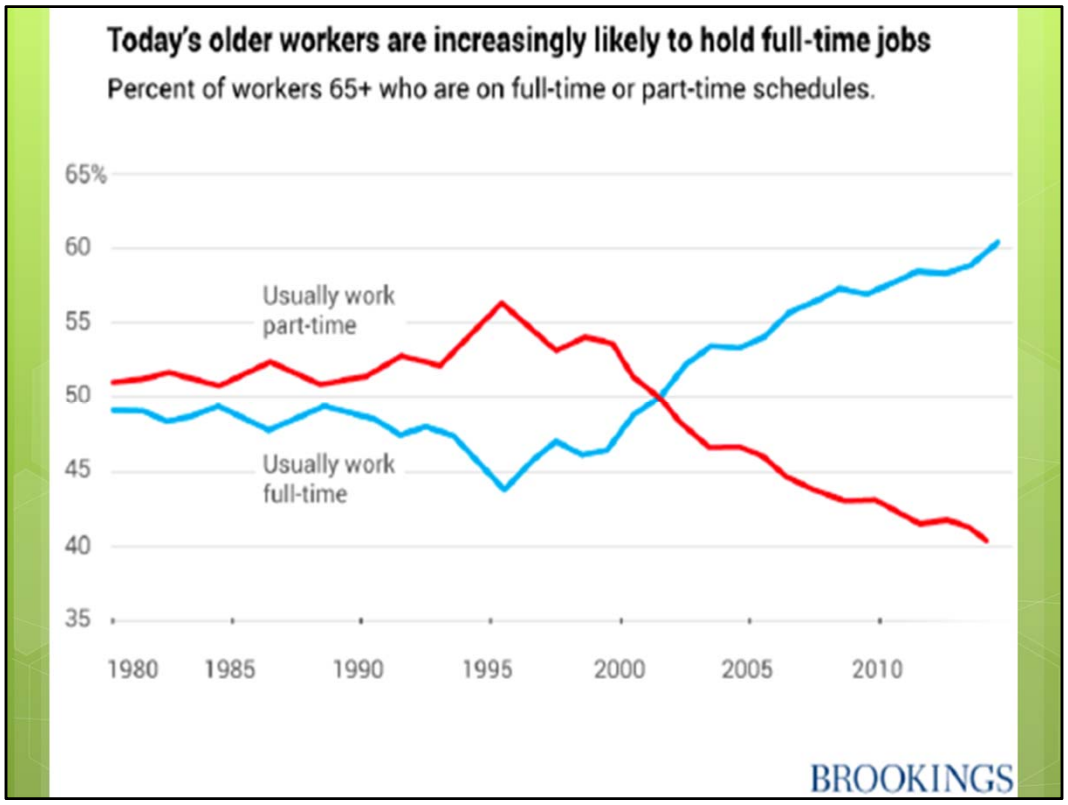
Wages were up 2.6% compared with a year earlier, matching the fastest annual growth rate since July 2009



One measure gaining popularity is the Federal Reserve Bank of Atlanta's wage tracker. Some economists say the indicator, which hit a seven-year high last month, is a better gauge of wage inflation because it adjusts for composition bias. The more familiar average hourly earnings series put out by the Labor Department's Bureau of Labor Statistics is influenced by demographics — namely, the large number of retiring baby boomers who are leaving the workforce with wages that are higher than those of new entrants. "It's masking an underlying gradual increase," said Nariman Behravesh, chief economist at IHS, of the BLS wage data that showed wages rose 2.5% from a year earlier. He favors the Atlanta Fed's measure because it looks at wages of people who have remained in their job for at least a year.

"Under normal labor market conditions, we'd expect the Atlanta numbers to run ahead of the regular hourly earnings series because people who remain in the same job tend to see their wages rise more quickly over time," says Pantheon Macroeconomics chief economist Ian Shepherdson. But the spread is widening, he warns, with the current gap between the Atlanta Fed's tracker (last up 3.4% from a year earlier) and the BLS average hourly earnings measure "much wider than early 2006, when the unemployment rate last slipped below 5%." Back then, the spread between the measures disappeared and hourly earnings briefly ran hotter than the Atlanta measure. While the Atlanta Fed's gauge doesn't always lead the BLS numbers, Mr. Shepherdson says it would be dangerous to ignore it.

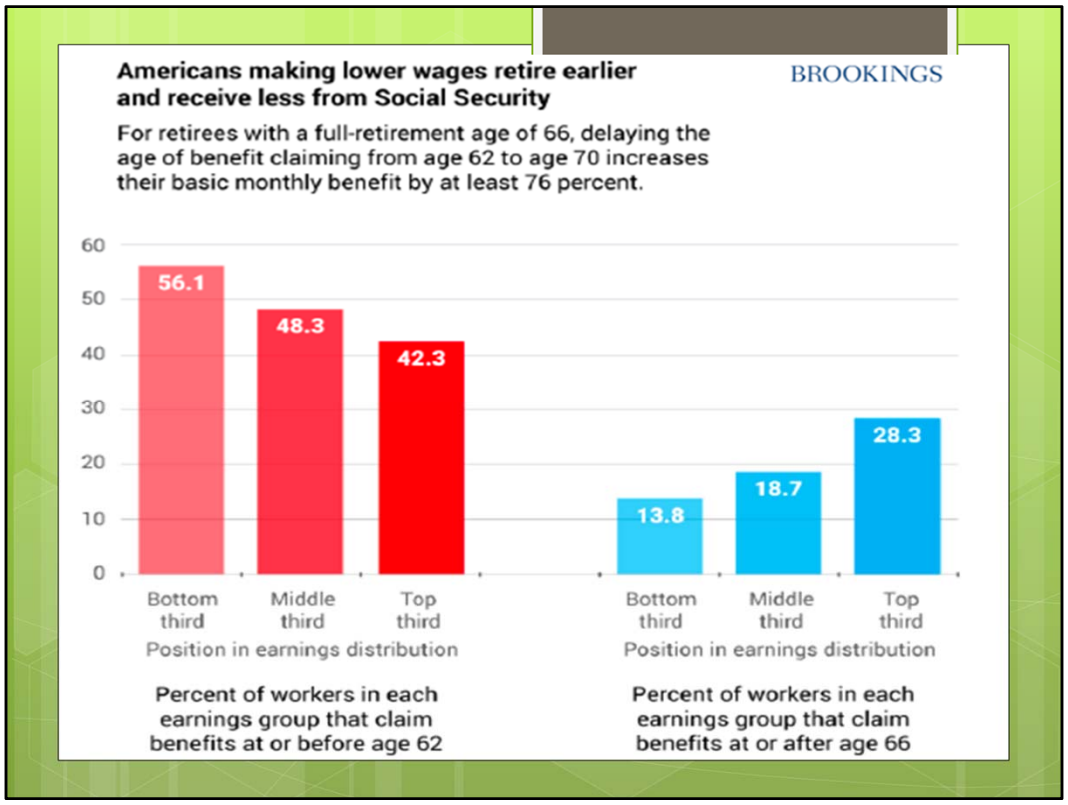
…& Senior Citizens?

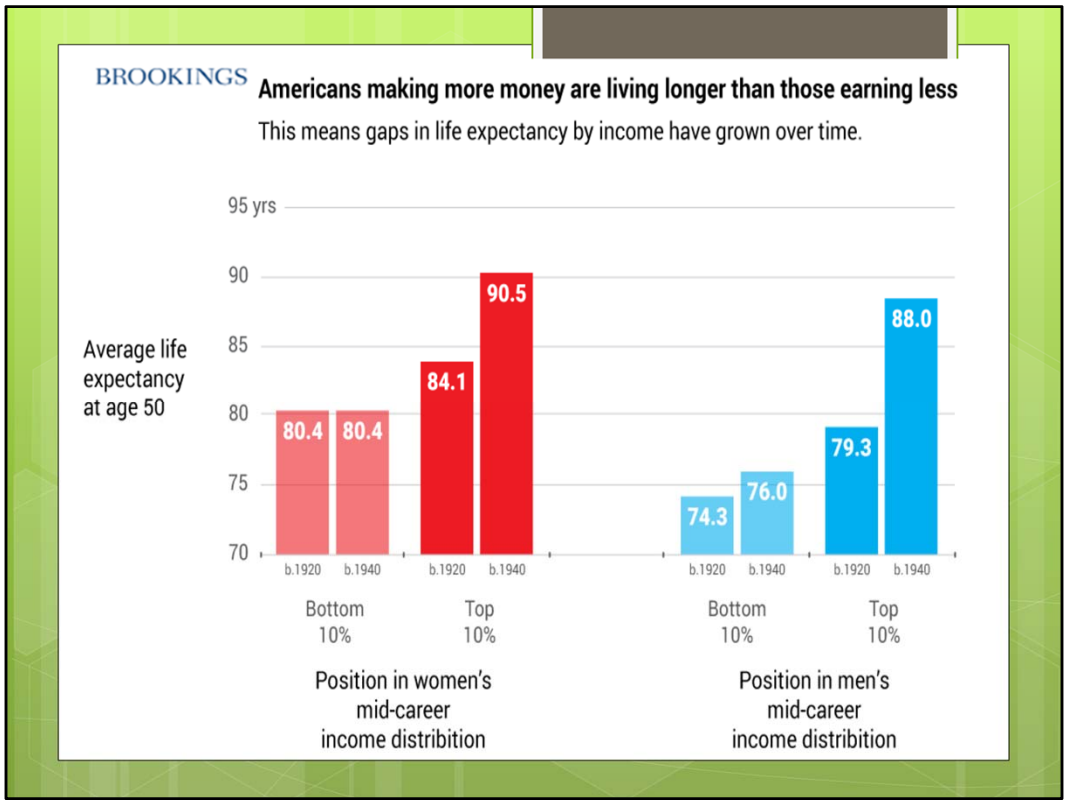


Americans who earn lower wages retire earlier than those earning high wages

But a closer look at who's retiring when shows big differences based on income. Fifty-six percent of men and women in the bottom third of the mid-career income distribution—and with a full-retirement age of 66—begin claiming Social Security at or before age 62. Only 13.8 percent delay claiming a pension until they're 66 years old.

We know that the longer a person works, the more money they receive from Social Security each month once they start claiming retirement benefits. What this means, then, is that early benefit claiming by low-wage workers—when combined with delayed claiming by high-wage workers—magnifies the difference in monthly benefit payments received by low- and high-wage workers. For retirees with a full retirement age of 66, delaying the age of benefit claiming from age 62 to age 70 increases their basic monthly benefit by at least 76 percent.


Americans making lower wages retire earlier and receive less from Social Security
BROOKINGS
For retirees with a full-retirement age of 66, delaying the age of benefit claiming from age 62 to age 70 increases their basic monthly benefit by at least 76 percent.
60
50
40
30
20
10
0
56.1
48.3
42.3
13.8
18.7
28.3
Bottom third
Middle third
Top third
Position in earnings distribution
Bottom third
Middle third
Top third
Position in earnings distribution
Percent of workers in each earnings group that claim benefits at or before age 62
Percent of workers in each earnings group that claim benefits at or after age 66



A growing number of studies suggest recent gains in life expectancy have been greater at the top of the income and education distributions than at the bottom. Bosworth, Burtless and Zhang find, for example, that the average life expectancy of man born in 1920 in the *top 10 percent* of the mid-career income distribution is 79.3 years. The same man in the *bottom 10 percent* of the distribution has an average life expectancy 5 years lower. Worse still is that the gap has grown over time. For men born 20 years later in 1940, the difference in average life expectancy is 12 years.

Even social security is further dividing the "well-off" and "not-so-well-off"

Brexit

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Brexit

- What – Britain's exit from the European Union
- When – June 23, 2016
- Why – 52% of UK voted to exit
  - Nonbinding but seen as a voter mandate
  - Article 50 of Lisbon Treaty is formal 2-year process
  - Terms approved by majority of 27 EU members

Britain is gateway into EU's markets with English-speaking country

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European Union History

- 1945-1959
  - A peaceful Europe – the beginnings of cooperation
- 1960-1969
  - A period of economic growth
- 1970-1979
  - A growing community – the first enlargement
- 1980-1989
  - The changing face of Europe – the fall of the Berlin Wall
- 1990-1999
  - A Europe without frontiers
- 2000-2009
  - Further expansion
- 2010-2016
  - A challenging decade

With statements such as Winston Churchill's 1946 call for a "United States of Europe" becoming louder, the Council of Europe was established in 1949 as the first pan-European organization. As of 1950, the European Coal and Steel Community begins to unite European countries economically and politically in order to secure lasting peace. The six founding countries are Belgium, France, Germany, Italy, Luxembourg and the Netherlands.

EU countries stop charging custom duties when they trade with each other. They also agree joint control over food production.

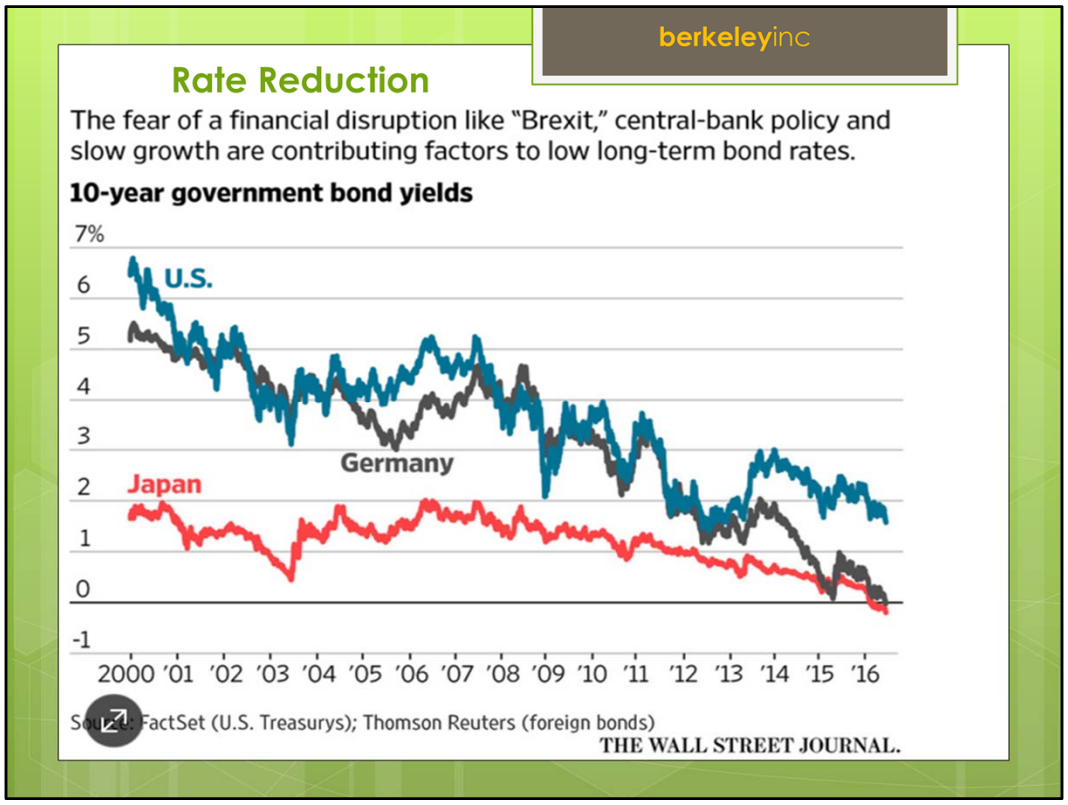
Denmark, Ireland and the United Kingdom join the European Union on 1 January 1973, raising the number of Member States to nine.

In 1981, Greece becomes the 10th member of the EU, and Spain and Portugal follow five years later. In 1986 the Single European Act is signed.

In 1993 the Single Market is completed with the 'four freedoms' of: movement of goods, services, people and money.

The political divisions between east and west Europe are finally declared healed when no fewer than 10 new countries join the EU in 2004, followed by Bulgaria and Romania in 2007.

Croatia becomes the 28th member of the EU in 2013. Climate change is still high on the agenda and leaders agree to reduce harmful emissions. European elections are held in 2014 and more Eurosceptics are elected into the European Parliament.

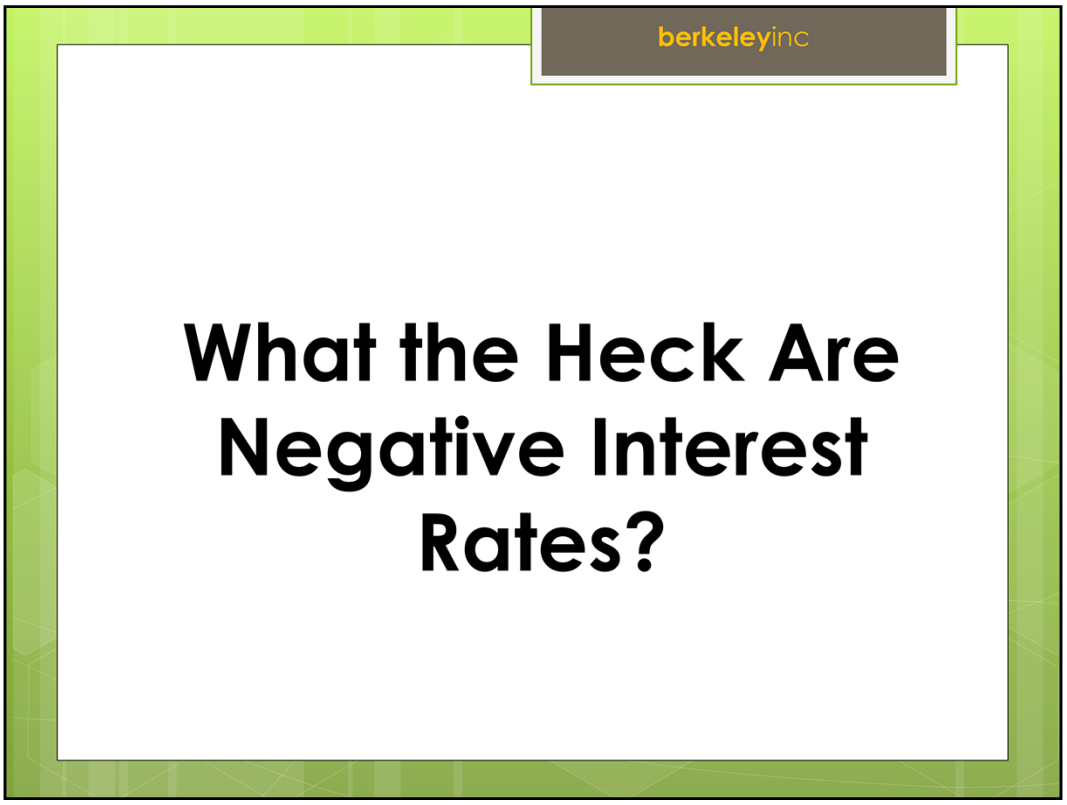


The Federal Reserve and the Bank of Japan left monetary policy unchanged, yet government bond yields plumbed fresh lows—they went negative in Germany, further negative in Japan and hit three-year lows in the U.S.

Of the many reasons for this drop, three stand out: central banks' efforts to stimulate economic growth with zero or negative short-term rates and bond buying; investors' desire for safety, driven in great part by next week's U.K. vote on whether to leave the European Union; and slowing economic growth around the world.

The first two are largely short-term phenomena. But the third is more intractable and therefore more worrisome. And it suggests the U.S. and many other countries are coming to resemble Japan, whose floundering economy has resisted two decades of resuscitation efforts.

Bond yields are determined by what investors expect short-term rates to be over the next decade plus some extra compensation, called the "term premium," for locking their money up for so long. The term premium has historically averaged 0.5 to 2 percentage points. But Cornerstone Macro, an investment advisory, estimates it is now negative 0.6 percentage point in the U.S., negative 1.6 points in Germany and negative 1.7 points in Japan.



Some corporations, many insurance companies and most banks are required to invest cash reserves in Treasury Bonds, so they Must pay for the privilege.

Basic Conclusions

- The US Economy remains solid
- Interest rates remain low
- China struggles
- The UK & Europe struggle
- 'Life is good, but not unbelievable.'

Questions?

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Reverse Mortgages: A Retirement Planning Tool

Whether or not the United States faces a retirement crisis, there is little doubt that many older Americans are not well prepared financially. Many retirees face the prospect of running out of money as they age. The reverse mortgage is a financial instrument that can brighten the financial prospects of older Americans and reduce the chances of an old age spent in financial straits… but the finer details are tricky and this type of loan does have downsides. The following slides were put together to provide a brief overview of what a Reverse Mortgage is, some basic facts, how they work, the payout options, as well as the downside to this type of loan.

Reverse Mortgages used to have a bad rap due to the lax regulations, but the government (FHA & HUD) stepped in and regulated and backed them. Remember Henry Winkler peddling them on obscure cable channels?

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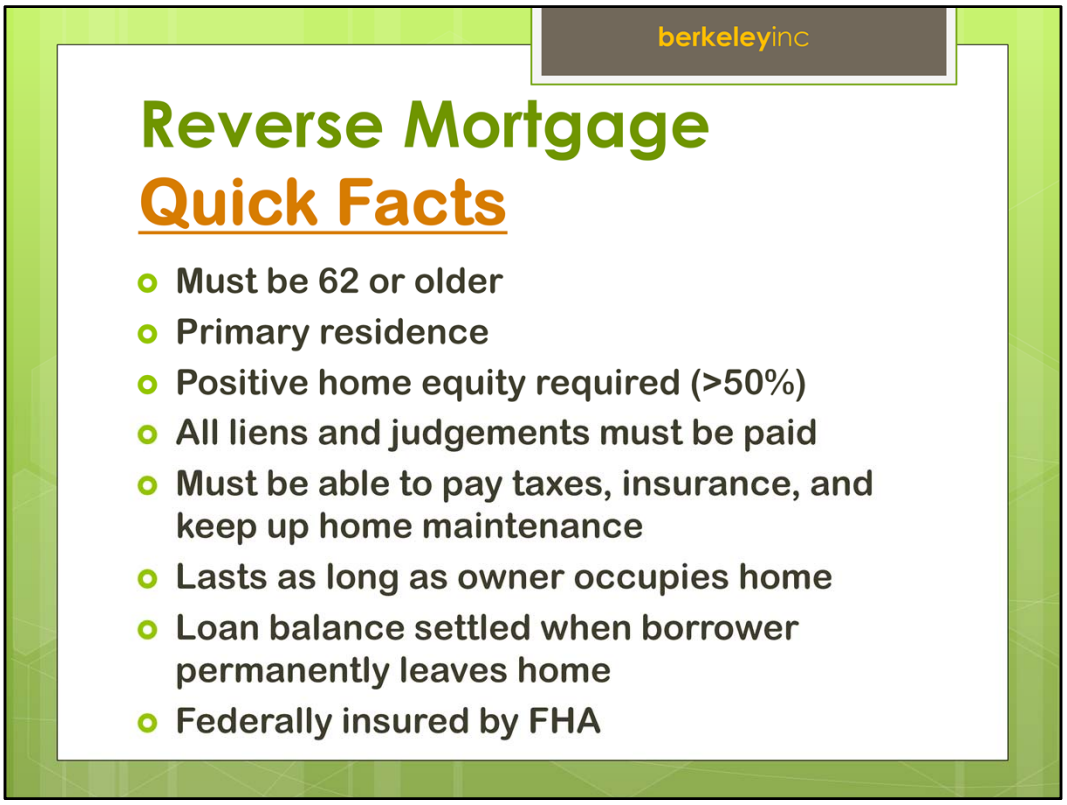
What is it?

Home Equity Conversion Mortgage (HECM)

- More commonly known as a 'Reverse Mortgage'
- A special loan allowing seniors with home equity to tap the equity to:
  - Pay off existing mortgage
  - Provide additional retirement income
  - Cover bills or health care expenses
  - Any other desired use
- FHA Program
- Minimal income & credit qualification

- A "reverse mortgage" is still a mortgage: a loan with the borrower's home as collateral. But unlike a conventional mortgage, it is designed as a way for homeowners age 62 and over, with substantial home equity, to tap that equity as a source of funds to pay off their existing mortgage, cover bills or health care expenses, or to provide additional retirement income. Unlike conventional mortgages, borrowers are not required to make monthly payments. The loan must be repaid only when the borrower moves or dies. This feature is the key advantage for retirees who need more income: so long as they live in the house, a reverse mortgage does not add a claim on the income they already have.
- "Regulators and academics have given mixed commentary on the reverse mortgage market. Some economists argue that reverse mortgages allow the elderly to smooth out their income and consumption patterns over time, and thus may provide welfare benefits. However, regulatory authorities, such as the Consumer Financial Protection Bureau, argue that reverse mortgages are "complex products and difficult for consumers to understand," especially in light of "misleading advertising," low-quality counseling, and "risk of fraud and other scams." Moreover, the Bureau claims that many consumers do not use reverse mortgages for the positive, consumption-smoothing purposes advanced by economists."



- If married, only one borrower needs to be over age 62. Spouse under 62 is called a "non-borrowing spouse" and is not listed on the loan document.
- Condos and townhomes qualify; second homes and investment properties do not. Modular homes have to meet FHA guidelines.
- The FHA-insured Home Equity Conversion Mortgage, or HECM, was signed into law on February 5, 1988 by President Ronald Reagan as part of the Housing and Community Development Act of 1987.
- In 2001, Congress passed legislation making Reverse Mortgages a permanent government program.
- FHA insures the loan and protects the lender and lender's heirs from an "upside down" situation. Loan has PMI/MIP.
- Age 73 is the average age of borrowers. This age has been continuously declining since the 1990s.

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Reverse Mortgage Benefits

- Borrower keeps title to home
- ALL income is tax-free
- Flexibility to use funds for any need
- No loan payments while living in home
- Non-recourse loan – home is only asset to claim
- Can keep home in a living trust

- As it is unlikely that seniors can rely solely on social security to fund their retirement years comfortably, they need to find alternative sources of income. Though often overlooked, home equity can provide a new source of income in retirement.
- A reverse mortgage allows you to pay off any other existing mortgages, subsidize health care, make home improvements, help family members, or make lifestyle enhancements.

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Reverse Mortgage Myths

- Bank owns home
- Can outlive the loan
- Proceeds are taxable
- Impacts ones Social Security or Medicare
- Borrowers can be forced to leave home
- Debt passes to heirs
- Loan interest is tax deductible

- Owner maintains title to property
- Note is due on the 150th birthday of the borrowers
- Loan proceeds are not taxable
- Borrowers are required to pay property taxes, insurance, and general upkeep
- A **non-recourse loan.** FHA protects borrower, heirs and estate. Lender's only recourse is to sell the property.
- Interest charged is not deductible until it is actually paid, that is, at the end of the loan.

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Required Mortgage Counseling

- Counseling required BEFORE loan originated
- Provides important safeguarding & program credibility
- Lenders can't send to particular counselor
- Lenders prohibited from contacting counselors or attending
- Counselors prohibited from talking to lenders on clients

- On March 2, 2015, FHA implemented new guidelines that require reverse mortgage applicants to undergo a financial assessment. Though HECM borrowers are not required to make monthly mortgage payments, FHA wants to make sure they have the financial ability and willingness to keep up with property taxes and homeowner's insurance (and any other applicable property charges).
- Counseling session can be done over the phone or in person and usually take 60 to 90 minutes
- The counselor is a non-biased, HUD-approved third party who should be able to answer all questions that have not been previously answered by your loan officer.
- The counseling is meant to protect borrowers, although the quality of counseling has been criticized by groups such as the Consumer Financial Protection Bureau.

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How they work

- Principal Limit –
  - % of home value that can be lent
    - Usually 50-60%
  - Based on age of borrower, current interest rate, & home value
  - Increases with age
  - Decreases as interest rates rise
- Max home value capped at $625,500

- The total pool of money that a borrower can receive from a HECM reverse mortgage is called the principal limit (PL)
- The amount of money that can be borrowed depends on the age of the youngest borrower or eligible non-borrowing spouse, the current interest rate, and the value of the home.
- The principal limit tends to increase with age and decrease as the Expected Interest Rate rises. In other words, older borrowers tend to qualify for more money than younger borrowers, but the total amount of money available under the HECM program tends to decrease for all ages as interest rates rise.
- Closing costs, existing mortgage balances, other liens, and any property taxes or homeowners insurance due are typically paid out of the initial principal limit. Any additional proceeds available can be distributed to the borrower in several ways.

Loan Repayment

Loan repayment begins when:

- Residence is sold
- Stop residing in home for 12 months
- Last owner on title is deceased
- Payment of taxes or insurance stops
- Property maintenance ceases

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Loan Disbursement Options

1. Lump Sum
2. Tenure payments
   - Lifetime income
3. Line of Credit
4. Term
   - Payments for set period of time
5. Modified Term
   - Combo of LOC & payment stream
6. Modified Tenure
   - LOC & lifetime payments

- If the total mandatory obligations (which includes existing mortgage balances, all closing costs, delinquent federal debts, and purchase transaction costs) to be paid by the reverse mortgage are less than 60% of the principal limit, then the borrower can draw additional proceeds up to 60% of the principal limit in the first 12 months. Any remaining available proceeds can be accessed after 12 months.
- **Lump sum-** usually chosen when then goal is to pay off the existing mortgage, but funds can be used for any need including debt payoff, medical bills, investments, gifts to family, etc.
- **Tenure payment**s- structured payout that provides tax-free monthly income as long as property remains principal residence… often rest of life.
- **Term payments-** structured payout that provides payments for a set number of months. It provides a larger monthly income for shorter period of time than tenure.
- **Line of Credit-** draws on credit line providing flexibility on frequency and amounts. Use as funds are needed. See next slide…

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Line of Credit

Disbursement

- Can apply for loan now & tap credit line later
- Ideal for inconsistent income or expenses
- Supplement income while portfolio returns are down
- LoC continues to grow even if home value doesn't

- The Line of Credit (LOC) option is a compelling financial planning tool. Due to the growth rate an unused credit limit, available funds (Principal Limit) continue to grow even if home value doesn't.

- A study by Barry Sacks & Stephen Sacks ("Reversing the Conventional Wisdom: Using Home Equity to Supplement Retirement Income") found using a reverse mortgage line of credit to systematically tap during market downturns and replace thereafter after recovery could enhance lifetime retirement income.

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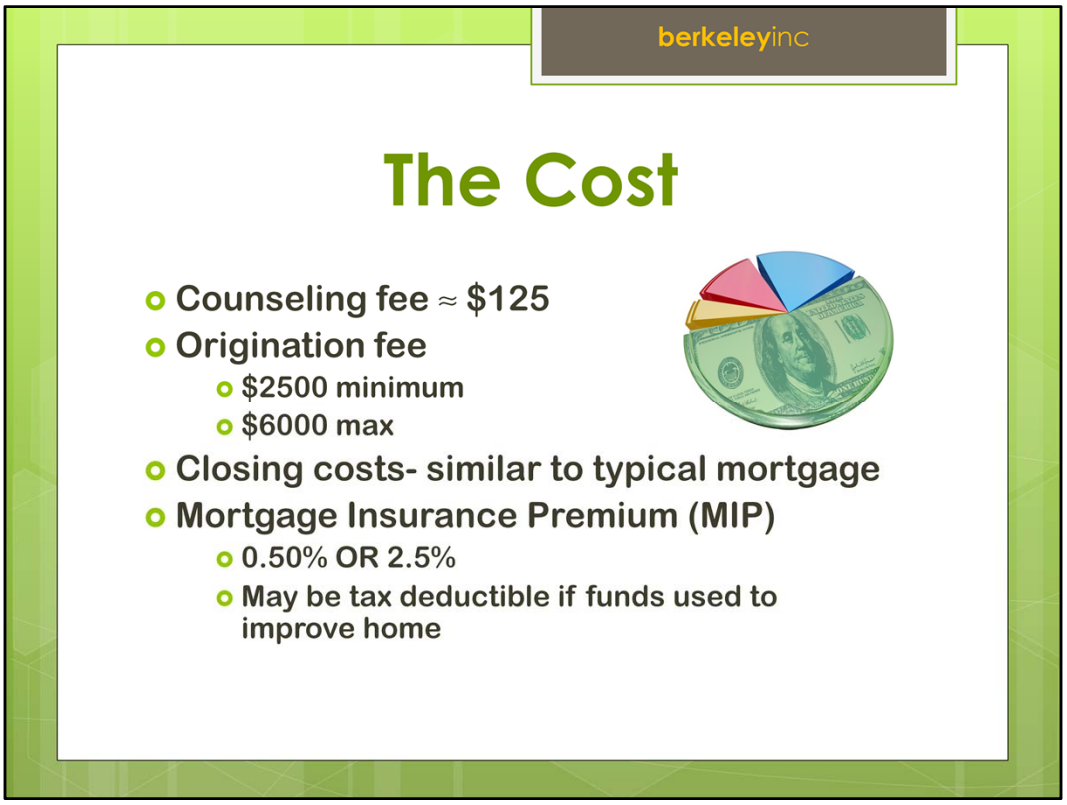
Line of Credit

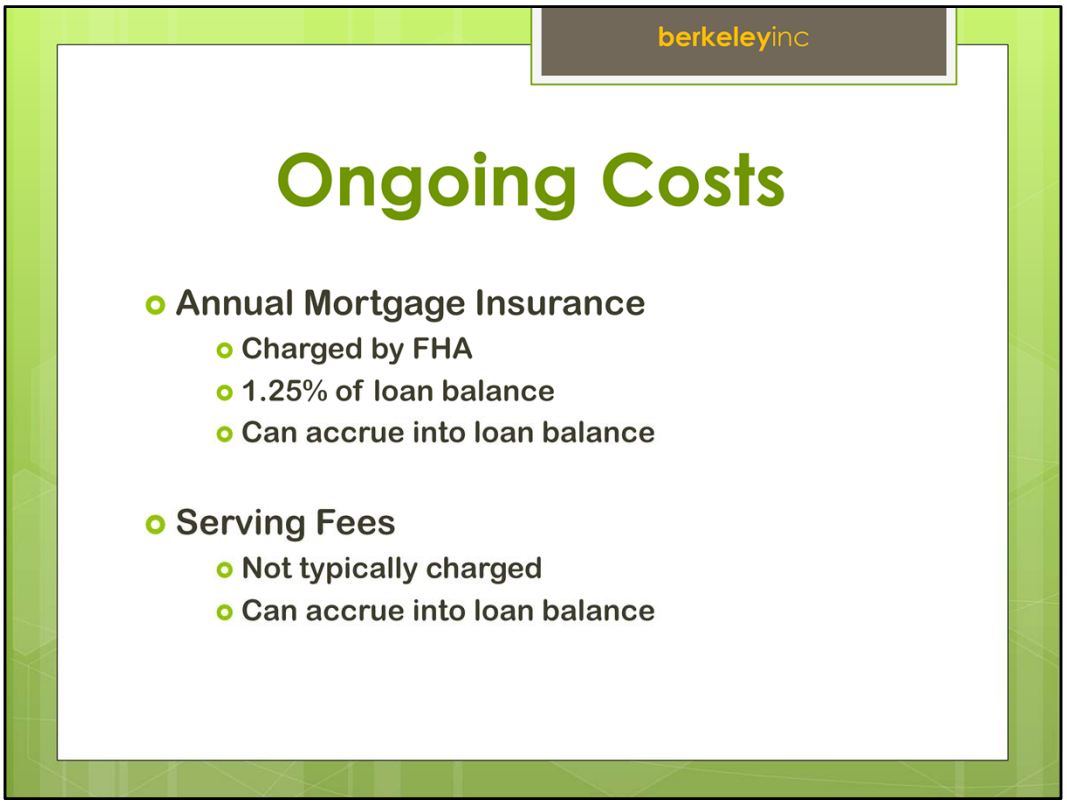
Growth Factor

- Unused LOC value grows annually
- Growth rate=interest rate+mortgage insurance
  - i.e. $100K LOC, 4% interest rate, mort insurance 1.25%
  - $100K x 5.25% = $5250 annual growth
- Accrue interest on origination fee & closing costs even if you don't use line of credit

- Borrowers accrue interest on total of origination fees and closing costs
- Borrowers accrue interest only on loan funds they actually receive.
- Even if the value of the home declines, the line of credit will continue to grow without regard for the home's subsequent value. This is what makes this option a potentially powerful retirement planning tool. Combining this with the fact that a HECM is a non-recourse loan means that the HECM provides a very valuable hedging property for home prices.



- Similar to a regular home loan, there are costs associated with a reverse mortgage.
- Most of the cost can be financed from the loan proceeds.
- **Counseling fee:** The average cost of the counseling session is usually around $125, but some counselors often don't charge at all.
- **Origination fee:** charged by lender to process the HECM loan. FHA formula= max of 2% on 1st $200k, 1% after with minimum of $2,500 and $6,000 maximum. Generally about double the traditional mortgage amount.
- **Closing Costs:** These fees are for third-party services hired to complete the reverse mortgage, such as appraisal, title insurance, escrow, government recording, credit reports, etc.
- **Mortgage Insurance Premium (MIP):** This fee is paid both as one-time at closing and annually to FHA to insure the reverse mortgage and protect both lenders and borrowers. The MIP protects lenders by making them whole if the home sells at the time of loan repayment for less than what is owed on the reverse mortgage. This protects borrowers as well because it means they will never have to pay out of other assets to settle up the reverse mortgage if they owe more than the home is worth. How the MIP is calculated was changed in 2013. The MIP is now charged as either 0.50% or 2.50% of the max claim amount (which usually equals the appraised value of the home up to a maximum of $625,500), depending on how much of the principal limit is utilized within the first 12 months of the loan. If the utilization is under 60% of the principal limit, the lower rate applies. If it's above that amount, then the higher rate applies.
- The mortgage insurance premium may be deductible on the 1040 long form if funds are used to substantially improve the home.



- **Mortgage Insurance Premium (MIP):** This fee is paid both as one-time at closing and annually to FHA
- **High interest rate**. The interest rate on a reverse mortgage is often higher than the rate for a more traditional home equity loan. Between the up-front fees on the reverse mortgage and the high interest charges, you might be surprised at how little money you actually end up getting. It's your equity, but the bank gets an awful lot of it.

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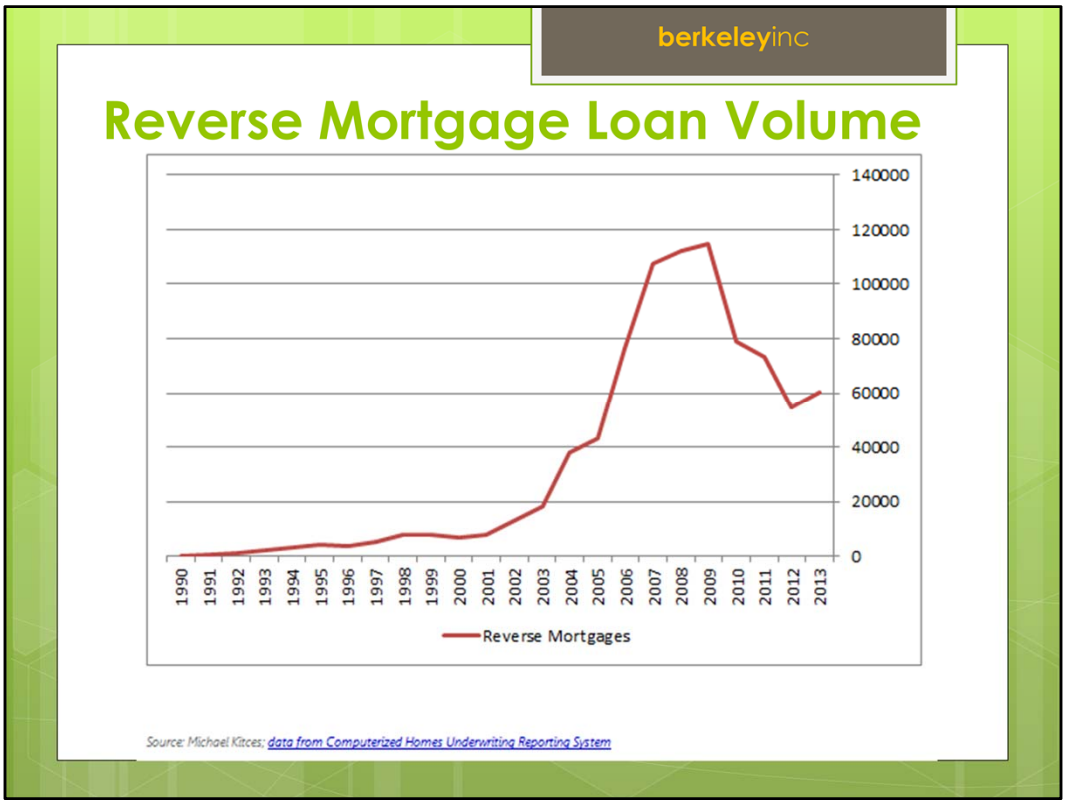
Loan Interest Rates

- Fixed & adjustable rate options
- 2 different rates:
  - Initial Interest Rate (IIR)
    - Rate interest accrues on outstanding loan balance
    - Today's current rate approx. 4.5%
  - Expected Interest Rate (EIR)
    - Determines how much RM borrower qualifies for
    - The expected average rate over life of loan

- The HECM reverse mortgage offers fixed and adjustable interest rates. The fixed-rate program (HECM Saver lump sum program only) comes with the security of an interest rate that does not change for the life of the reverse mortgage, but the interest rate is usually higher at the start of the loan than a comparable adjustable-rate HECM. Adjustable-rate reverse mortgages typically have interest rates that can change on a monthly or yearly basis within certain limits.
- IIR- The initial interest rate is the actual note rate at which interest accrues on the outstanding loan balance on an annual basis. For fixed-rate reverse mortgages, the IIR can never change. For adjustable-rate reverse mortgages, the IIR can change with program limits up to a lifetime interest rate cap.
- EIR- The expected interest rate is used mainly for calculation purposes to determine how much a reverse mortgage borrower qualifies for based on the value of the home and age of the youngest borrower. The EIR is often different from the actual note rate, or IIR. The EIR does *not* determine the amount of interest that accrues on the loan balance (the IIR does that).



Of course, not surprisingly, as the real estate boom turned to a bust – along with the economy overall in the midst of the financial crisis – reverse mortgage loan volume fell dramatically, and is still running at only 50% of its peak, as shown in the chart. 54,926 RM loans were issued in 2015, with CA having the most at 8,777 (16%).

In response to the falling loan volume, in 2010 the FHA and HUD announced the "HECM Saver" loan, with 10%-18% lower borrowing limits but also a significantly lower upfront cost (reducing the initial Mortgage Insurance Premium {MIP} from 2% to 0.01%). The goal was to reinvigorate the declining reverse mortgage marketplace with a lower cost version of the loan.

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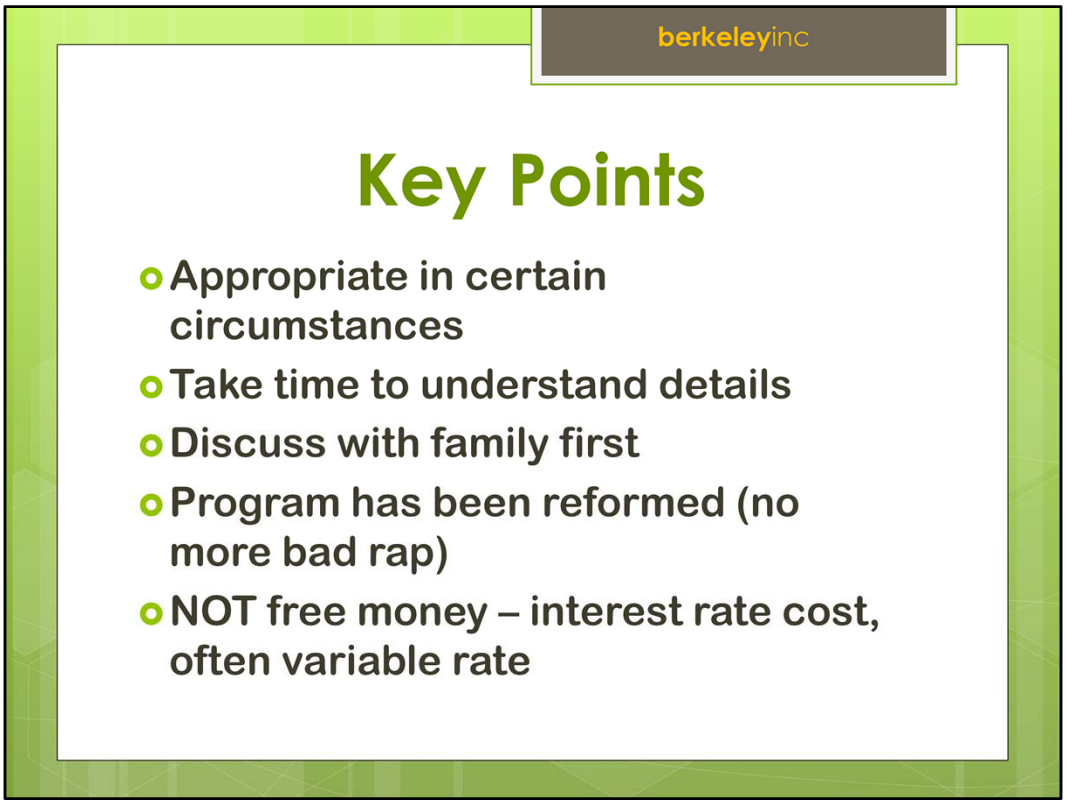
2015 2014 2013

Reverse Mortgage Data by State

State	Reverse Mortgages	Refinances	Total	Avg. Interest Rate	Avg. Principal Limit	Avg. Home Value
Alaska	55	5	61	3.16%	$175,695	$294,994
Alabama	741	7	758	3.3%	$86,696	$149,077
Arkansas	331	7	343	3.28%	$86,758	$150,203
Arizona	1,550	145	1,826	3.46%	$145,486	$247,864
California	8,320	2,796	11,573	3.42%	$265,590	$439,909
Colorado	1,264	139	1,493	3.44%	$182,468	$312,906
Connecticut	575	13	597	3.2%	$180,797	$293,020
Delaware	174	14	202	3.39%	$152,815	$263,581
Florida	3,940	540	4,860	3.46%	$144,247	$244,661
Georgia	1,108	48	1,210	3.42%	$112,966	$193,887
Hawaii	167	12	186	3.13%	$316,762	$529,649
Iowa	247	6	260	3.31%	$87,222	$149,346
Idaho	308	16	360	3.47%	$126,496	$217,468
Illinois	1,176	189	1,389	3.23%	$128,855	$212,998

The chart shows 2015 statistics for a few states including Idaho & California. You'll notice the average interest rate for last year was around 3.4%. The large amount that can be received (principal limit) can be compared to the home values (50-80%). The principal limit is determined by multiplying the home value (up to $625,500) by the principal limit factor, which is determined by the age of the youngest borrower and the average interest rate. The national average Principal Limit for 2015 was $168,700



Best For:
- Those who own their own home
- Have significant equity built-up
- Expect to stay in their house for the foreseeable future
- Need immediate cash

Not so good for:
- Those who plan to sell their home or move in the next few years
- Those who have their hearts set on leaving their home to their children

One question that comes up often with reverse mortgage deliberations (or ought to at least) is this: If you are so hard up for money, shouldn't you just sell and downsize? The answer isn't always so clear. Is there a serious illness? Longtime neighbors who can look in on borrower? Is family nearby who can help borrower stay at home a bit longer? Or people who could help pack up and move? And what if there are no family or friends close to the most appropriate place to downsize?

Sources

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- Wikipedia – "Reverse Mortgage,"
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Questions?

FAQs-

Can you do a RM if one of the owners on title is under 62?

Has to be spouse age 18 or older
Changes made last year clarifies who a "Non-borrowing spouse" is. Only the older spouses name goes on loan & the younger is declared as the non borrowing spouse. The EIR will be determined off the younger borrowers age.

What loan fees are paid if a LOC is selected but not drawn on?

LOCs typical done on refi. Lump sums & purchases are fixed rate loans usually. Fees include the origination fee & customary closing fees. The interest beginning accurring on these fees immed & continue to build even if not drawing on LOC.

Is the loan growth factor based off IIR or EIR?

Based on IIR plus the 1.25% MIP, is variable. About 5.75% today.

What's current interest rate (IIR) in ID & CA? 4.5%, adjustable