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Client
Irwin Home Equity

Project
White paper

Objective

Educate mortgage brokers on specialized financing options for select, qualified homeowners.

Background

Irwin Home Equity specializes in high loan-to-value (HLTV) mortgage programs that allow qualified homeowners to finance 100% (or more) of their home equity.

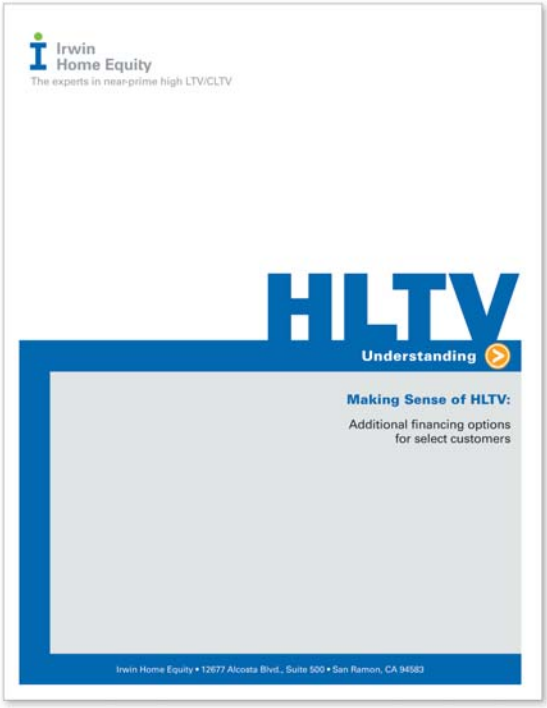
As the crisis in subprime funding emerged, mortgage brokers were hesitant to consider such solutions for their clients. But that reluctance was based on the assumption that HLTV financing is a subprime product, which is not the case for Irwin's programs.

This white paper was written to dispel that myth and position HLTV financing as an excellent option for select clients.

Project Overview

To put HLTV programs into perspective for mortgage brokers, this white paper explains that Irwin only offers 100%+ financing to borrowers with high credit scores and high disposable incomes. When applicants have excellent payment histories and a demonstrated capacity to repay, lenders needn't rely so heavily on the value of the collateral to approve an HLTV loan.

In addition to helping brokers understand HLTV programs from the lender's point of view, this white paper presents various scenarios to describe the benefits of these products, general lending criteria, and pricing information.


Irwin
Home Equity
The experts in near-prime high LTV/CLTV

HLTV
Understanding

Making Sense of HLTV:
Additional financing options for select customers

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See below to read this white paper,
Making Sense of HLTV.

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Executive Summary:
HLTV financing caught in the spotlight

Over the last few years, mortgage lenders have introduced a wide range of new programs to give borrowers more flexibility and choices for buying real estate or accessing cash from their home equity.

One group of programs — high loan-to-value (HLTV) products — were developed to help homeowners consolidate debt or fund home improvements by financing 100%, or even up to 125% of a home's value. Irwin Home Equity and Irwin Union Bank & Trust Company began offering such loans in 1995.

But recent news reports on the status of subprime lenders and the loans they've made have brought intense media scrutiny on 100%+ financing options. Unfortunately, many HLTV products have been mistakenly caught in that spotlight, creating an unfair characterization that all such products were designed for subprime borrowers.

Yet nothing could be further from the truth. In this white paper, you'll learn:

- **Why HLTV products are *not* subprime loans** – in fact, quite the opposite, because of strict requirements for above-average FICO scores
- **How HLTV programs help a specific segment** of near-prime borrowers meet their financial goals
- **Why HLTV financing costs more** than traditional mortgage programs, yet substantially less than other options such as personal loans and credit cards
- **How lenders such as Irwin** evaluate HLTV applications, and why criteria such as disposable income are used instead of more traditional standards such as the debt-to-income ratio.

With more media attention on the subprime market, it's understandable why you'd be concerned about discussing HLTV lending with your clients.

Yet as this white paper explains, HLTV loans *can* be appropriate to offer your near-prime customers who have excellent credit scores and high incomes.

HLTV Defined:
More focus on the borrower, less on the collateral

When Irwin Home Equity began offering high loan-to-value financing, we saw it as an opportunity to give homeowners another alternative for managing credit card debt. Lately, however, we've been hearing more questions like these:

- "My borrower is not a subprime applicant, so why are your rates so high?
- "Why would you require such high credit scores for subprime loans?"
- "Why is disposable income more important than the debt-to-income ratio?"

From questions like these, it seems that there is a misperception any HLTV program is "subprime," but as you will see, many such products require that borrowers have at least a near-prime level of credit.

The confusion stems from what's been going on in the real subprime sector, where many lenders have loosened credit requirements to allow less qualified applicants access to 100% financing.

Yet while HLTV lenders such as Irwin are willing to finance up to 125% of value, these programs were *never* designed to serve the subprime marketplace. Because Irwin requires higher than average credit, borrowers are less likely to resort to bankruptcy and more likely to work with lenders to repay their loans if faced with financial difficulties.

By understanding how HLTV underwriters evaluate a borrower's application, you can see why subprime and HLTV programs actually represent completely different segments of the mortgage marketplace.

Financing criteria:
Lending money to Paul and Sam

Every mortgage lender evaluates two basic underwriting criteria: the financial character of the borrower and the value of the collateral used to secure the loan.

Consider an example: Your friend Paul Prudent asks you for a loan of $10,000. Would you lend him the money?

Obviously, you're going to think carefully about Paul's character, existing debt, assets, and income. If Paul has demonstrated a sense of responsibility in managing debt and makes a high enough income, you might lend him the money, relatively confident that you'll be repaid.

Now another friend of yours, Sam Subprime, asks you for a loan.

If Sam has a high debt load and a relatively low income, you might not have as much confidence in Sam's ability to repay the loan and may decline to lend him the money.

But if Sam *really* wants the $10,000 loan, he may be willing to let you hold the title to his car as collateral. Would you now make the loan? Obviously that would depend on the car. If it's a brand new Lexus, your loan is secure.

So with sufficient collateral, you'd be willing to make the same loan to Sam Subprime as you'd make to Paul Prudent without such collateral — and sleep soundly at night making either loan.

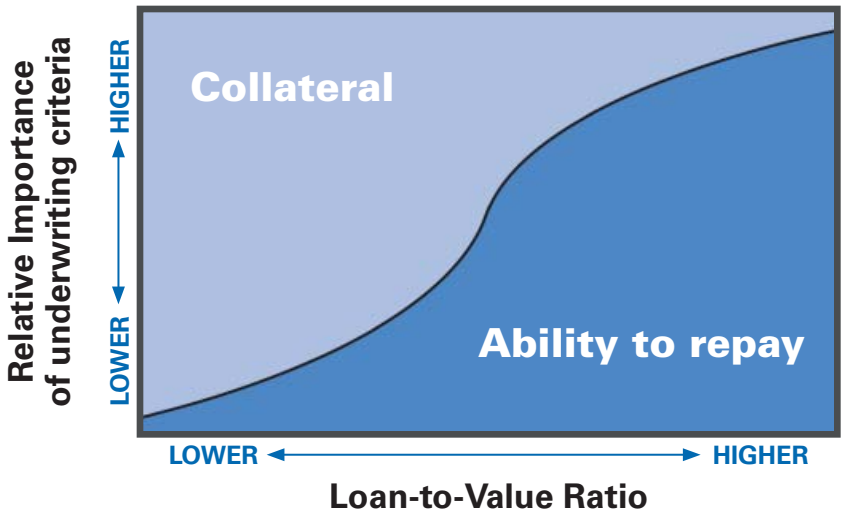
Ability to repay:
HLTV from the lender's perspective

What do Paul Prudent and Sam Subprime have to do with HLTV loans?

Simply this: Some lenders *may* be willing to approve borrowers with high debt loads, low incomes, or poor credit because they have the security of collateral worth more than the loan amount.

But HLTV loans are secured by collateral that may be worth *less* than the total amount of the loans against that property. So it's essential that HLTV borrowers have good credit and a disposable income that's high enough to justify lending up to 125% of a property's value.

This chart illustrates how lenders look at these two underwriting factors — ability to repay and collateral — at different LTV levels:



As you can see toward the left of the chart, when LTVs are relatively low, lenders can afford to be less selective about credit and income because the collateral can easily secure the loan.

But as LTV increases — moving toward the right of the chart — lenders must evaluate ability to repay far more stringently and carefully weigh credit scores, existing debt, and disposable income as criteria. In fact, the typical HLTV borrower has at least near-prime credit and a higher than average FICO score.

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A Financial Advantage:
How borrowers benefit from HLTV financing

What type of borrower would consider an HLTV loan or financing?

Although these products cost more than traditional mortgages, they offer borrowers with little or no home equity an additional choice for raising immediate cash, reducing debt payments, and improving monthly cash flow. The following examples show how:

Funding remodeling expenses:

Ann and Andy have just purchased a home for $250,000 with a 90% first mortgage of $225,000 that carries a monthly payment of $1,441. Now, they'd like to remodel their kitchen. That will cost $40,000, but their home equity is currently only $25,000.

They could take out a 5-year $40,000 personal loan at an interest rate of 10% or take a 20-year second mortgage at an interest rate of 11.7%. Here is how the two options would impact Ann and Andy's monthly expenses:

	Current	Funding with personal loan	Funding with 2nd mortgage
1st mortgage (360 months at 7.028% APR)	$ 1,441	$ 1,441	$ 1,441
Personal loan (60 months at 10% APR)		$ 830	
HLTV 2nd (240 months at 11.7% APR)			$ 432
CLTV	90%	90%	106%
Total monthly payments	**$ 1,441**	**$ 2,271**	**$ 1,873**

Even though adding a second mortgage raises the CLTV from 90% to 106%, Ann and Andy can fund their kitchen and cut their payments by $398 per month. In addition, some of the expense of the second mortgage may be tax deductible, generally up to the value of the property. (Consult a tax advisor for details.)

Consolidating credit card and other debt:

Consider Janice in Oregon. She has two mortgages plus a significant amount of credit card debt and student loan balances. Her monthly payments total $4,700.

With a home worth $320,000, she has only 13.5% equity, so under most traditional underwriting guidelines, she'd fail to qualify to refinance her credit card debt.

But with Janice's monthly income of $8,450 and an excellent credit score of 718, Irwin can fund a new second mortgage with a CLTV of about 98%. By using that second mortgage to pay off her credit card debt, she can cut her monthly payments:

	DEBT BALANCE		MONTHLY PAYMENTS	
	Before	After	Before	After
1st mortgage	$ 220,767	$ 318,096	$ 1,843	$ 1,843
2nd mortgage	$ 56,187	$ 92,000	$ 484	$ 760
Credit cards	$ 43,983		$ 919	
Student loans	$ 163,859	$ 163,859	$ 1,454	$ 1,454
Total	**$ 484,796**	**$ 476,626**	**$ 4,700**	**$ 4,057**

As you can see, Janice's monthly payments have been reduced by $643, or by more than 13%.

These case studies show how many of your customers might use flexible HLTV programs to consolidate debts or meet upcoming expenses with payments that are attractive when compared to credit cards or personal loans.

Qualifying HLTV Borrowers:
Why disposable income is so critical

Ability to repay:
Lender underwriting criteria

As you've seen, HLTV lenders such as Irwin don't serve the subprime market. Although an appraisal is usually required by HLTV lenders, more scrutiny is actually given to the financial characteristics of the borrower than on the collateral. Irwin's current criteria include:

- **FICO score:** 670 or higher, but a minimum score of 640 may be approved if the borrower has a fairly high disposable income.
- **Debt-to-income ratio:** Generally below 50%, but loans are available at a higher rate when DTI exceeds that level.
- **Loan amount:** Loans more than $85,000 may be approved, but at a higher rate.
- **Disposable income:** The amount of money a borrower has left at the end of the month after debt expenses such as mortgages, credit cards and car payments.

Of these criteria, the one that's probably least familiar to most mortgage professionals is disposable income. After all, traditional lenders usually weigh an applicant's debt-to-income ratio (DTI). In fact, many brokers wonder why HLTV lenders even evaluate income when the DTI information is readily available.

But HLTV lenders know that DTI ratios don't always provide a complete picture on a borrower's finances. An example shows how disposal income is far more useful in evaluating an HLTV application.

Disposable income vs. DTI:
Comparing two borrowers

The debt-to-income ratio provides important insight, but because it's expressed as a percentage, it can be misleading. A borrower with a fairly high DTI may have plenty of income for debt service, while a borrower with a low DTI may not have much discretionary income at all.

For example, consider these two applicants, Alice and Betty. Each have the same DTI and are applying for 125% financing for a line of credit with little existing home equity. Here are their profiles:

	Alice	Betty
FICO score	693	684
Loan-to-value ratio (LTV)	62%	68%
Debt-to-income ratio (DTI)	45%	45%

Which borrower is the better risk? At first glance, you might consider Alice to be the more qualified borrower. After all, while both have the same DTI, Alice has a better credit score.

But with additional information on income, an HLTV lender can estimate potential monthly cash flow. The chart below reveals more about Alice and Betty, specifically their disposable incomes, which is the amount left after making payments on mortgages, credit cards, car loans, and other debt:

	Alice	Betty
FICO score	693	684
Loan-to-value ratio (LTV)	62%	68%
Debt-to-income ratio (DTI)	45%	45%
Value of home	$176 K	$618 K
Monthly gross income	$3,000	$10,427
Mortgage and non-mortgage debt payments	$1,350	$4,677
Disposable income	**$1,650**	**$5,750**

As you can see, even with a lower credit score, Betty has a much higher disposable income, so she's in a more favorable position to continue to make her payments if she were to face financial difficulties.

And when you consider that disposable income does *not* include discretionary expenses such as food, utilities, transportation, etc., the comparison becomes even more revealing:

	Alice	Betty
Monthly gross income	$3,000	$10,427
Mortgage and non-mortgage debt payments	$1,350	$4,677
Disposable income	$1,650	$5,750
Discretionary expenses	$1,500	$1,500
Net leftover funds	**$150**	**$4,250**

If discretionary expenses total $1,500 for each borrower, you can see that while Alice has only $150 left over at the end of the month, Betty has $4,250 – more than 28 times as much as Alice.

So although Betty's credit score is lower — and they both have the exact same DTI ratio of 45% — an HLTV lender would be more likely to consider Betty a more qualified applicant.

HLTV Pricing:
The relationship between disposable income and credit scores

To see how important disposable income can be in evaluating your HLTV prospects, take a look at this sample rate chart for a 125% home equity line of credit. The chart shows the margin to be added to the prime rate (currently 8.25%) to calculate the full interest rate:

	Monthly disposable income			
Credit score	$ 4,250 +	$ 3,250 - $ 4,249	$ 2,250 - $ 3,249	Below $ 2,250
720 +	4.825	5.600	6.850	
700 - 719	5.450	6.200	7.600	
670 - 699	6.100	6.850		
655 - 669	6.350	7.100		
640 - 654	7.850			

Remember, disposable income is *not* gross income. It's the money left over after making required debt payments. With that in mind, this chart shows the relationship between credit score and disposable income:

- Although this product is available to a borrower with a credit score as low as 640, that borrower would require at least $4,250 in disposable income to qualify, regardless of their DTI ratio.
- Even with a disposable income of at least $4,250, a borrower with a credit score of 640 would pay a margin of 7.850, higher than the 4.825 margin a borrower with a credit score of 720+ would pay.
- A borrower with a 720+ credit score could qualify with a disposable income as little as $2,250.
- This product is not available *at all* to borrowers with a disposable income of less than $2,250.

You can see that 125% financing is generally *not* an option for subprime prospects, even though the rates may seem higher than for more traditional mortgage financing.

In Conclusion:
Stop passing up good opportunities

For most mortgage brokers, selling an HLTV product is the exception rather than the rule. That's because while the interest rates are higher, Irwin maintains strict borrower standards for 125% financing. Remember, these products are not subprime loans and are suitable only for those with good credit.

But there will be occasions when you'll meet a qualified prospect who could really benefit from HLTV financing. By keeping these programs in mind and understanding how to position them to your customers, you won't have to turn down opportunities simply because a borrower seems to have little or no equity.

To help you identify prospects and close more of these loans, Irwin Home Equity has published a guide on selling HLTV products. To get your copy, visit *www.ihepartners.com.* Or call our wholesale department at 1-888-704-7946 or correspondent department at 1-888-594-7946.

About Irwin:

Founded in 1994, Irwin Home Equity now manages a loan portfolio of more than $1.7 billion. Based just outside San Francisco in San Ramon, California, Irwin is a market-driven, consumer lender that originates, purchases, sells, and services a variety of home equity lines of credit (HELOCs), home equity loans (HELs), and first mortgages through correspondents, brokers, and strategic alliances.

Specializing in the HLTV market, Irwin introduced its 125% line of products in 1998. Despite market fluctuations since then, Irwin has proved that sound business policies and best-of-class credit and loan origination practices can make the 125% market a stable and profitable one.

Working with over 4,000 brokers and 70 correspondents, and servicing loans in all states, Irwin is dedicated to improving customers' finances responsibly and responsively through a product line that includes:

- **100% CLTV Home Equity Loan:** Fixed rate loan with terms from 5 to 25 years.
- **100% CLTV HELOC:** Variable rate revolving line of credit. Customers can draw on their lines for the first 10 years of the account and increase monthly cash flow with interest-only minimum payments. After the first 10 years, the credit line converts to a 10-year fully amortizing loan.
- **125% CLTV Loan:** Fixed rate loan with terms from 5 to 25 years.
- **125% CLTV HELOC:** Variable rate revolving line of credit. Many banks limit consumers to less than 100% of their home's value. In many cases, Irwin can extend a line of credit equal to 125% of a home's value, minus any existing first mortgage balance.
- **89.99% CLTV fixed-rate first mortgage:** Fixed rate refinance loan with terms from 10 to 30 years. May be used for rate/term refinancing, to consolidate debt, or to get cash out with no PMI required.

For more information on Irwin Home Equity, visit www.ihepartners.com. Contact our wholesale division at 1-888-704-7946 or our correspondent division at 1-888-594-7946.