AltFin

American Bar Association
Business Law Section
September 2019

Ken Markison
Weiner Brodsky Kider PC

Jim Riccitelli
Former Co-CEO, Unison
AltFin - Agenda

- The Needs
- The Question
- The Opportunity
- The Idea
- Alt Fin Programs
- The Law
- Questions
Agenda

- What we won't cover ... today

  - Use of Blockchain technology to create small investable pieces of real estate for (retail) investors

    - REIT dividend partial exclusion
    - Professional Corporations Managing Real Estate (20% exclusion from AGI, subject to AGI phase outs)
    - Enterprise Opportunity Zones
The Needs

- The nation’s demographics and housing market factors are compelling
- Home purchase
  - Younger generations are forming households and need housing
  - Affordability has become an enormous problem in key population centers
  - Millennials are hard pressed to come up with a down payment
- Unlock equity
  - Millions of families are struggling with too much debt
  - People are living longer, but have not saved enough for retirement
  - Millions of borrowers do not qualify for existing products (cash-out refi, HELOC, reverse mortgage) due to age, debt load or income
- Historically low mortgage rates are not enough
- Beyond single-family housing, there are other residential and non-residential projects that can use additional resources
The Question

- How do you access home equity without taking on monthly payments or debt?
  - Sell your home and move (and sometimes let it become a McMansion)
  - Reverse mortgage (debt and age restrictions)
  - Option contracts
  - Investment contracts
  - Sale-leaseback
  - Other …?

- And how do you serve other needs?
The Opportunity

- There is a strong appetite for investment in U.S.-based real estate:
  - Commercial
  - Multi-Family
  - MH Parks
  - Mortgage Backed Securities (“Absolute Return”; Not a return on equity)
  - REITs (Mortgage or Equity REITs)
  - And more recently – “Alt Fin” (or equity based home equity access contracts)
The Idea

- Alternative Financing or Alt Fin Programs
- These are not reverse mortgage programs …
- But there are overlaps with and analogies to reverse mortgages
- Section 255 of the National Housing Act (codified at 12 U.S.C. § 1715z-20)
  - HECM Counselors must discuss with HECM applicants home equity loans and sales leaseback program
Alt Fin Programs

- Equity Based
  - Option Contracts (right to buy a share of a consumer’s home upon sale)
  - Investment Contracts

- Other Structures
  - Sale-Leaseback
  - Lease with an Option to Purchase
Alt Fin Programs

- **Equity Based Option Contracts**
  - Investor buys option to purchase a portion of a consumer's home at a later date at a predetermined price
  - Option Premium (upfront investment) ranges from 5-20% of home value (typically 10-17.5%)
  - “Investor Share” upon exercise = 20-70% of change in value (varies with upfront investment amount)
  - Consummated with Option Agreement, Covenant Agreement, Memo of Option and Deed of Trust
  - Not debt, so no monthly payments
  - Use cases: 1) Home Equity Access (pay for any life need); 2) Down Payment Assistance (home purchase)
  - Lien recorded behind and subordinate to new or existing mortgage loan
  - GSEs have purchased loans with these Option Contracts “behind” the loan (they like the products – view them as “risk-free” credit enhancement)
  - First Rex (Unison); Point; Figure, NestWorth and others coming
Equity: A Simple But Profound Financial Innovation

Investor co-invests in the home alongside the owner

Owner receives a lump sum of cash

Not a loan

No interest or monthly payments

Use the money for up to 30 years
Equity: A Simple But Profound Financial Innovation

Owner decides when to sell

If value rises
Investor shares the appreciation

If value falls
Investor shares the loss
Equity: A Simple But Profound Financial Innovation

**Owner**
- Receives lump-sum cash payment
- Is sole owner, keeps full use and tax benefits of property, pays all housing expenses, makes no payments to investor
- Sells home or buys back the agreement

**Investor**
- Receives exposure to change in home value
- Is not a co-owner, receives leverage, taxes, insurance, upkeep & management at no cost, receives no payments

**At The Start** (co-investment)

**During** (up to 30 years)

**At The End**
- Receives initial investment +/- share of change in value
Game Changer

- Young family, currently renting & eager to become a first-time buyer
- Starter homes in their area are priced at $500,000
- Can pull together about 10% for a down payment
- Loan pre-approval results in maximum purchasing power of $420,000 (DTI limit)
- Without Unison, they would need to save for another 5 years. Where will home prices and rates be then?

Purchasing power increased by $80,000!

Client partners with Unison and buys a home today priced at $500,000.
Debt-Only Low-Down Payment Solution
- Borrow 90% versus 80%
- Pay mortgage insurance
- Increases monthly payment by 15-20%
- Assuming income is fixed, decreases purchasing power by 15-20%

Debt + Equity Solution
- Borrow 80%
- No mortgage insurance
- Increases purchasing power by 15-20%

Purchasing power increased by $80,000!
Deal Structure

5% Down Structure Increases Purchasing Power By Up To 30%

- 10% Down
- 10% Unison
- 80% Loan

Unison share 35%

- 5% Down
- 15% Unison
- 80% Loan

Unison share 52.5%

Investor gets embedded structural leverage of 3.5x
Benefits

• Borrow 80% of your home’s value, instead of 90% or 95%
• Only need a down payment of 5-10%
• Can combine with gift funds (subject to minimum buyer 5% down)
• Avoid costly mortgage insurance
• Monthly payment is 15-30% lower
• Purchasing power is 15-30% higher (much more for cash constrained high earners)
• Retain some of your cash for other purposes or for peace of mind
• Show a stronger offer (20% down)
## Basic Option Contract Math

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### Home Purchase (Year 0)

- **$50,000** Unison Investment
- **$50,000** Buyer Down Payment
- **$400,000 (80%)** First Mortgage

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[thewbkfirm.com](thewbkfirm.com)
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$600,000 (80%)
First Mortgage

$100,000 Increase In Value

$50,000 Unison Investment

$50,000 Buyer Down Payment

Home Sale (Year 10)
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- **Home Sale (Year 10):**
  - **Unison Share:** $35,000 (35%)
  - **Buyer Share:** $65,000 (65%)
  - **Unison Investment:** $50,000
  - **Buyer Down Payment:** $50,000
  - **First Mortgage:** $400,000 (80%)
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### Home Sale (Year 10)
- **$35,000 (35%) Unison Share**
- **$65,000 (65%) Buyer Share**
- **$50,000 Unison Investment**
- **$50,000 Buyer Down Payment**
- **$85,000 Increase In Home Equity**
- **$315,000 Balance On First Mortgage**

Total: **$600,000**
Basic Option Contract Math

Purchase Price | $500,000
Mortgage Loan (80%) | $400,000
Buyer Share Of Down Payment | $50,000
Unison Share Of Down Payment | $50,000
Buyer Share Of Change In Value | 65%
Unison Share Of Change In Value | 35%

Home Sale (Year 10)

$315,000 Balance On First Mortgage

$35,000 (35%) Unison Share
$65,000 (65%) Buyer Share
$50,000 Unison Investment
$50,000 Buyer Down Payment
$85,000 Buyer Equity

$600,000
**Basic Option Contract Math**

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- **Home Sale (Year 10)**
  - $35,000 (35%) Unison Share
  - $65,000 (65%) Buyer Share
  - $50,000 Unison Investment
  - $50,000 Buyer Down Payment
  - $85,000 Buyer Equity

- **If Buyer Pays First Mortgage Off Entirely**
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- **Home Sale (Year 30):**
  - $35,000 (35%) Unison Share
  - $65,000 (65%) Buyer Share
  - $50,000 Unison Investment
  - $50,000 Buyer Down Payment
  - $85,000 Buyer Equity

If Buyer Pays First Mortgage Off Entirely

**Total:** $600,000
**Basic Option Contract Math**

- **Purchase Price**: $500,000
- **Mortgage Loan (80%)**: $400,000
- **Buyer Share Of Down Payment**: $50,000
- **Unison Share Of Down Payment**: $50,000
- **Buyer Share Of Change In Value**: 65%
- **Unison Share Of Change In Value**: 35%

**Home Sale (Year 30)**

- **Unison Share**
  - **$35,000 (35%) Unison Share**
  - **$50,000 Unison Investment**

- **Buyer Share**
  - **$65,000 (65%) Buyer Share**
  - **$50,000 Buyer Down Payment**

- **$400,000 Buyer Equity**

**Total Sale Price**: $600,000
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Home Sale (Year 30)

- $40,000 Value Increase From Improvements
  - $35,000 (35%) Unison Share
  - $65,000 (65%) Buyer Share
- $50,000 Unison Investment
- $50,000 Buyer Down Payment
- $40,000 Buyer Equity

Total: $640,000
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Home Sale (Year 30)

- $40,000 Buyer Equity From Improvements
- $640,000
- $400,000 Buyer Equity
- $65,000 (65%) Buyer Share
- $35,000 (35%) Unison Share
- $50,000 Unison Investment
- $50,000 Buyer Down Payment
Basic Option Contract Math

- Unison’s return on investment comes **only** from sharing the change in home value due to market price movement.
Basic Option Contract Math

- Unison’s return on investment comes only from sharing the change in home value due to market price movement.
- Unison does NOT share in:
  - Equity created by paying down the loan
  - Equity created by remodeling the home
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**Up**: $500,000 → $600,000

↑ $100,000

+ $35,000

$85,000

$50,000 invested

+ $35,000 profit
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Alt Fin Programs

- Equity Based Investment Contracts
  - Functionally and economically similar to Option Contracts
  - No monthly payments
  - Consummated with a (shared appreciation) note and mortgage
  - EquiFi, Equity Key
Alt Fin Programs

- Other (Sales / Lease) Structures
  - Sale-Leaseback
    - Easy Knock, Irene, Figure, others coming
  - Lease with an Option to Purchase
    - Trio
The Rise of Alternative Home Financing Programs: You Get a Home! And You Get a Home!

Steven Sharpe
Legal Aid Society of Southwest Ohio/National Consumer Law Center
Access to Credit vs. Access to Fair Credit

• Under the guise of access to credit, we’ve seen significant harm from predatory land installment contracts and lease-option contracts.
• We have not seen evidence that these facilitate homeownership.
• This should serve as a caution.
Predatory Land Installment Contracts

- Inflated prices and large down payment
- Puts families in homes they cannot afford to fix
- High interest rates
- Targeting vulnerable populations
- Failure to disclose true conditions
- Quick evictions
Predatory Lease Option to Purchase

➢ Making tenants responsible for repairs
➢ Inflated prices
➢ Large down payments
➢ Quick evictions
➢ Failure to disclose conditions
➢ Code orders on properties
Reports


• Federal Reserve Reports
The Law

- What are these home equity access programs?
  - They do differ.

- What Law applies? What “Box” do they fit within?
  - Can you pick a Box?
  - If so, can you choose your regulator?

- A Sale is a Sale, and a Loan is a Loan.
- Is a Lease a Lease, or something else?
- What law governs?

- Risk of re-characterization from sale to loan?
The Law

- A Sale or A Loan?
  - The Law of Equitable Mortgages
    - “…in every case, where a real estate transaction claiming on its face to be a sale, a sale and lease back, or a conditional sale, the court’s threshold question is whether the transaction was meant simply as security for a preexisting or contemporaneous debt.”
    - See Conway’s Ex’rs and Devisees v. Alexander, 11 U.S. 218, 237 (1812) (The court sought to determine whether decedent had entered into a conditional sale, or a mortgage of real property. The court found that a mortgage could not be found where the mortgagee has no remedy against the person of the debtor. It articulated the pivotal issue “… the inquiry in every case must be, whether the contract in the specific case is a security for the re-payment of money or an actual sale.” The court ultimately held it to be a conditional sale).
The Law

- A Sale or A Loan?
  - The Law of Equitable Mortgages
    - “…where there is no prior or contemporaneous debt, there can be no equitable mortgage, and where there is a prior or contemporaneous debt between the parties, the transaction is likely to be a mortgage”
    - See *Johnson v. Johnson*, 183 Va. 892, 905 (Va. 1945) (“[i]t is essential to a mortgage that there be a debt to be secured[.]” Court found an equitable mortgage, based in part, on mortgagee’s admission that rents from property being used to reduce mortgagor’s indebtedness).
    - *Magee v. Short Key*, 168 Va. 361, 368 (Va. 1937) (“… upon the whole investigation, it shall appear that a security for money was intended, it is a mortgage, whatever may be its terms[.]”).
    - *Holladay v. Willis*, 101 Va. 274, 279 (Va. 1903) (distinguished equitable mortgages from conditional sales on the following basis, “… the difference between them being defined to consist in this: that the former is a security for a debt, while the latter is a purchase.”).
The Law

▪ A Sale or A Loan?
  ▪ No single factor is dispositive, and because the introduction of parol evidence contradicting the terms of a written agreement is in derogation of the general rule against such, such evidence must be strictly construed. [See Holladay, 101 Va. at 278-79.]
  ▪ Further, no subsequent debt or occurrence can change the nature of the agreement, whether a sale or mortgage, as that agreement’s nature is fixed at the time of its creation. [See Magee, 168 Va. at 369.]
  ▪ In actually deciding equitable mortgage cases, courts often consider the financial position of the seller, or equitable mortgagor, at the time the transaction was consummated, as the relative bargaining strength of the parties is an animating force behind the equitable mortgage doctrine.
  ▪ Where a court fails to find an equitable mortgage, it appears neither state nor federal lending laws, including state usury laws, will apply.
    ▪ Clemons 530 F. Supp. 2d at 810 ("The Mortgage Lender and Broker Act … incorporates the disclosure requirements contained in the TILA. Accordingly, Clemons also seeks damages and attorney’s fees under this state statute. The MLBA defines a ‘mortgage loan,’ in part, as ‘a loan made to an individual, the proceeds of which are to be used primarily for personal, family, or household purposes, which loan is secured by a mortgage or deed of trust upon any interest in … residential owner-occupied property located in the Commonwealth.’ As set forth above, the Court finds that the instant transaction was not a loan. Because the conveyance was an absolute sale to which the MLBA does not apply, …["] (internal citations omitted).
The Law

- A Sale or A Loan
  1. Intention of the parties (what does the contract say?)
  2. Adequacy of consideration
  3. Retention of possession by the Grantor
  4. Prior or Contemporaneous Debt and Survival or Satisfaction of the debt
  5. Financial position of the Seller, or Equitable Mortgagor, at the time the transaction was consummated, as the Relative Bargaining Strength of the Parties

Where a court fails to find an equitable mortgage, it appears neither state nor federal lending laws, including state usury laws, will apply. *Clemons*
The Law

- Leases or Installment Sales Contracts Sales (Loan Contracts)
- Courts in the past have re-characterized lease-to-own programs as land sale contracts when certain factors are present. These factors include:
  - Tenant has an obligation or may purchase property at the end of the lease term for a nominal amount.
  - The term and rent payments under the lease are tied to the term and debt service under a mortgage loan.
  - Substantial amounts of rent are prepaid at the commencement of the lease.
  - Rent payments exceed the fair rental value.
  - Landlord does not retain the normal risks and obligations normally associated with ownership of the property (taxes, insurance maintenance).
  - Term of the lease is unusually long.
The Law

- Where a court fails to find an equitable mortgage, it appears neither state nor federal lending laws, including state usury laws, will apply. *Clemons*

- State Law
  - Licensing
    - Mortgage Lending Licenses; Real Estate Broker License, or Other?
    - Pick a “Box” and Stick to It!
  - Contracts
    - Option / Investment Contracts; Notes & Mortgages
    - Purchase and Lease back; Leases with options to Purchase
  - Disclosures
    - Program Descriptions, Videos, Disclosures, Acknowledgments, Tests
The Law

- Where a court fails to find an equitable mortgage, it appears neither state nor federal lending laws, including state usury laws, will apply. *Clemons*

- Federal law
  - Alphabet soup
    - TILA
    - RESPA
    - HMDA
    - ECOA
    - FCRA
    - Fair Housing Act
The Law

- **TILA**
  - TILA and Regulation Z requirements are applicable to consumer credit transactions. Under TILA and Regulation Z, the operative part of this phrase, “credit,” is defined at section 103(e) of TILA as “the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment”. 15 U.S.C. § 1602(e); 12 C.F.R. § 1026.2(a)(14).
  - Creditor – a person to whom debt is repayable in more than 4 installments (must be in writing) or where a finance charge is assessed (need not be in writing) 12 C.F.R., Cmt. § 1026.2(a)(17)(i).
  - [TILA can apply to installment sales contracts of real estate – if a lease is re-characterized as installment sales …]

- **RESPA**
  - Federally related mortgage loan is a loan, …. made by a “creditor”, as referred to in section 103 of TILA. 12 U.S.C. § 2602(1).

- **HMDA**
  - “Mortgage loan” is defined, in turn, as a loan that is secured by residential real property or a home improvement loan. 12 U.S.C. § 2802(1).

- **ECOA**
  - Credit – the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment or to purchase property or services and defer payment therefor. 15 U.S.C. § 1691a(d).

- **FCRA**
  - Triggered by ordering a credit (consumer) report

- **Fair Housing Act**
  - Applies to the purchase and sale of real estate
Questions

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