AltFin

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Business Law Section
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Ken Markison
Weiner Brodsky Kider PC
AltFin - Agenda

- The Need
- The Circumstances
- The Opportunity
- The Idea
- The Programs
- The Law
- Questions
The Needs

- The nation’s demographics and housing market factors are compelling
- 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
- 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 Circumstances

- Older generations are seeking to access equity in their homes
- People are living longer, but have not saved enough for retirement
- 55 year olds need access to home equity but are not reverse mortgage eligible
- So- 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)
  - Take out a HELOC and incur debt
  - Take out a reverse mortgage (debt, and age restrictions)
  - Option contracts
  - Investment contracts
  - Sales-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
    - Fortress bought RHP, Softbank bought Fortress
    - Fortress also owned Nationstar
      - Softbank sold Nationstar to KKR (Blackhawk)
    - Sam Zell – ELS (now publicly traded)
    - Apollo Management – owns 2 MH Community operators (wants more)
    - Singapore Sovereign Wealth Fund bought Yes! Communities
  - Mortgage Backed Securities ("Absolute Return"; Not a return on equity)
  - REITs (Mortgage or Equity REITs)
  - And more recently – "AltFin" (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
The Programs

- Debt Based
  - Home Equity Loans and Lines of Credit
  - Reverse Mortgages
  - Shared Appreciation Mortgages

- Equity Based
  - Buying a Share of a Consumer’s Home (Option Contracts)
  - Investment Contracts

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

- Equity Based
  - Buying a Share of a Consumer’s Home (Option Contracts)
    - Investor Buys an option to purchase a consumer’s home at a later date at a predetermined price
    - Option Premium = 10% (or More) of Value of Home
    - “Investor’s Share” at Option Expiration Date = 30-40% of Appreciation
    - Consummated with an Option Agreement, Memo of Option and Performance Deed of Trust
    - No Monthly Payments; Can be Used for Home Equity Access, or “Down Payment Assistance”
    - For “Down Payment Assistance” Programs, behind and Subordinate to Mortgage Loan
    - GSEs will buy 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
  - Investment Contracts
    - Functionally and Economically similar to Option Contracts
    - No Monthly Payments
    - Consummated with a (Shared Appreciation) Note and Mortgage
      - EquiFi, Equity Key
The Programs

- Other (Sales / Lease) Structures
  - Sale-Leaseback
    - Easy Knock, others coming
  - Lease with an Option to Purchase
    - Trio
The Programs

- 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
  - But see …
    - Fund Rise
    - Yield Street
    - Cadre
    - And so and so on …
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 – Some Thoughts

- 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 that “… 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 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 an 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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