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Re: Shared Appreciation Agreement Disclosures
Sec. 25 of S.B. 1257, Sen. Cal. No. 0146, File 181, LCO 8308

Dear Senators:

I am a Connecticut resident and a Senior Attorney at the National Consumer Law Center. We recently learned about this bill and would like to express some concerns.

First, however, we would first like to compliment Connecticut on being a national leader in protecting consumers from abusive shared appreciation agreements (SAAs), also known as "home equity investment loans" or "shared appreciation mortgages." Over the past few years, we have seen companies increasingly market these loans to seniors and low-income homeowners. Clarifying that these products are residential mortgage loans, as Connecticut recently did, is vital to ensuring that existing consumer protection laws apply.

Sec. 25 of S.B. 1257 is an important next step, but we are concerned that it omits important protections and may not be enough to warn consumers about what they're getting into. I have enclosed an issue brief that includes our recommendations. But this letter also highlights some of the most important recommendations for this bill:

1. The bill should mandate a rate cap.

As drafted, there is no limit on what a consumer may ultimately be required to pay. To protect seniors and low-income homeowners from losing unconscionable amounts of their home equity, Connecticut should require all SAA loans to include a contractual cap, limited by the bill, on the maximum amount a homeowner will be required to repay.

Not only does the absence of a rate cap expose homeowners to an unpredictable and potentially huge bill, it also makes the proposed disclosures much less effective. The bill requires repayment and APR disclosures based on different market scenarios. While it is important to provide sufficient information so homeowners can make an informed decision, we believe this may cause "information overload." We have reviewed many SAA contracts from different companies, and they are usually over 100 pages long. Some of them even include the proposed disclosures. But the consumers we have spoken to still didn't understand what they were getting into.

That is because even the best contracts do not disclose the maximum possible payment and the maximum APR for that payment. Consumers need a single clear number to understand what is at risk. That number should be disclosed clearly and prominently so that it stands out from all the other information consumers will receive. Otherwise, the proposed disclosures will just be more paper.

2. The bill should authorize the Banking Commissioner to adopt regulations modifying the required disclosures as needed to keep up with market developments. We have been following the SAA industry for several years now and found that practices are quickly evolving. If the Commissioner does not have authority to make changes, any disclosures the legislature adopts risk quickly becoming obsolete. We also encourage giving the Commissioner the funds and authority to design a mandatory disclosure based on consumer testing. This will help ensure that the disclosures are effective.

3. The bill should mandate independent counseling at the lender's expense. SAA contracts are horribly complex. Consumers will not properly understand the risks if they don't get advice from a qualified expert. We are already seeing lawsuits around the country from consumers who would not have signed their contracts if someone had fully explained them in advance. Federal law already requires counseling before signing a reverse mortgage—and reverse mortgages have far more statutory protections. We recommend prohibiting mortgage lenders from consummating an SAA unless the borrower has met with an independent advisor to review the contract terms at least a week before consummation. The advisor could be an attorney or a HUD-certified housing counselor.

In conclusion, there should be a set cap on what a lender can collect upon payoff of the loan and that cap should be clearly included in the contract so consumers can be warned about the maximum payment they may have to make in the future. We are concerned that the proposed disclosures will be overlooked in the morass of paper that consumers already receive. Consumers will be better served by prominent disclosure of the maximum possible payment. A housing counselor will help confirm that the consumer understands what they are getting into. And authorizing the Banking

Commissioner to modify regulations as needed will better ensure that Connecticut can keep up with industry changes and protect its residents.

Thank you for your attention to this matter. If you have future questions, I can be reached at 203-570-4249 or apizor@nclc.org.

Respectfully,
/s/Andrew Pizor
Andrew G. Pizor
Senior Attorney

Encl.

National Consumer Law Center
Fighting Together for Economic Justice

Home Equity Investment Loans Are Subprime Mortgages:

Federal and State Policymakers Should Update Rules to Protect Consumers

October 2024

Summary:

- Home equity investment (HEI) loans work the same way as traditional home equity loans and reverse mortgages, so they are subject to the same consumer protections as traditional mortgage loans.
- To the extent that any federal or state laws are ambiguous, regulators should issue guidance clarifying that HEIs are covered.
- Industry claims that these contracts are not loans are deceptive statements based on overly complex fine print that attempts to mask how these transactions truly operate.
- Enforcement of consumer protection laws is essential to protecting homeowners, families, and the economy from the financial shock that will result from unscrupulous HEI companies' exploitation of the country's $35 trillion home equity market.

Homeowners in the United States collectively have trillions of dollars of equity in their homes. Most plan to use it for a wide range of goals, including paying for retirement or at-home care, leaving money to their children, paying down debts, paying for college, making home repairs, starting a business, and other nonpurchase reasons.

The traditional tools for accessing this equity are highly regulated home equity loans (including reverse mortgages). But some people who want to access their equity without selling the home lack the income or credit to qualify for a traditional mortgage.

In recent years, new business models have emerged offering products that purport to help people access their equity without a loan. These products come in different forms, but the basic transaction provides homeowners with a cash advance in exchange for a share of the future value of their home. For-profit companies market these products in various ways, calling them "shared appreciation contracts," "option contracts," or home equity sharing agreements.[1] Wall Street calls them "home equity investments."[2] Some have also called it "home equity stealing."[3] For the purposes of this issue brief, we will refer to these contracts as home equity investment loans, or "HEIs."

Whatever this product is called, it is a loan masquerading as obligation-free cash. The companies that market and sell them often use deception to lure financially struggling consumers into unconscionable, high-priced loans. The time has come for policymakers to protect homeowners from the risks this product poses and those who may abuse it. HEI loans are really just another form of mortgage and should be regulated like other forms of mortgage credit.

It's the details of an HEI loan that matter. If the contract requires the homeowner to turn over too much of their equity or home value, it's not a wealth-building product. While some products may expand cash-out or home-retention opportunities, they may also prevent homeowners from refinancing when interest rates go down, and they almost always result in unaffordable balloon payments.

HEI loans are structured differently from traditional loans but are just old wine in new bottles.

In a traditional "forward" mortgage loan, a lender provides the homeowner cash up front, and the homeowner agrees to repay it in predictable installments, no matter what happens to the value of the home. Even with adjustable-rate mortgages, the payments are relatively predictable, and honest lenders won't make a loan unless they reasonably believe the borrower can afford the payments. If the homeowner defaults, the lender can foreclose and recover the amount owed by selling the home. In some states, the lender can also sue the borrower for any remaining balance. Laws regulating consumer mortgages protect homeowners from certain unfair lending practices, and many states regulate foreclosures carefully.

Reverse mortgages are also subject to important consumer protections, such as mandatory HUD-approved counseling before closing and certain disclosures. Most importantly, reverse mortgage borrowers have the right to stay in their homes indefinitely, as long as they remain current on their property insurance and taxes.

HEI loans offer homeowners money up front in return for a share of the home's future value.[4] HEI loan borrowers are usually not required to make any payments to the company until the earlier of a maturity date specified in the contract or when they transfer the property.[5] Then they must make a balloon payment calculated as a percentage of the home's value. If they do not pay by maturity, they face foreclosure. Some companies offer HEI loans to help buy a home, while others are offered to existing homeowners who might otherwise seek a traditional home equity loan or reverse mortgage. In this paper, we only focus on the kind of HEI loan offered to existing homeowners by for-profit companies.

HEI loans are confusing and complex. Most are designed to look like option agreements where the company claims to buy an option to purchase a share of the consumer's house in the future. Companies point out that if they never exercise the option, the consumer will not owe anything on the contract. Based on this premise, the company claims it is not making a loan—just buying an option. But, in reality, the company almost always exercises the "option." When it does so, it becomes a co-owner of the home.

When the company exercises the option, the homeowner must put the house up for sale (if the homeowner has not already done so) or buy the company's share back. By this time, the company's share will typically be worth far more than what the homeowner originally received for it—typically tens or hundreds of thousands of dollars more. This substantially reduces the homeowner's share of the equity in their own home.

Understanding the cost and benefits of an HEI loan is sometimes made even more difficult by contract terms that discount the initial value of the house.[6]

Companies often advertise that the transaction is not a loan and that the homeowner will not owe anything if the home loses value. But companies use sophisticated projection models to predict home values and securitization to insulate themselves from bearing any risk. **In practice, these companies will almost always get repaid.**

As with other mortgages, if homeowners can't make their payments, they lose their home.

When the time comes (at the end of the term or sooner), the homeowner must pay the company a share of what the house is worth. Most people will do so in one of three ways: by selling the home, by using money from savings, or by getting a traditional mortgage. If the homeowner does not, or cannot, do any of these, the contract may authorize the company to sell the home out from under the borrower. **Because these contracts do not treat the transaction as a loan, the company might not follow state foreclosure laws.** For the homeowner, however, the end result is the same as a foreclosure—the homeowner gets evicted.

There are no clear limits on how much equity a company can take.

The percentage the company takes, and how much cash it is willing to offer the homeowner, vary and are usually determined by the investor's analysis. Homeowners may be attracted by a large payment now in return for an unspecified bill in the distant future. But when the time comes, that may leave the homeowner owing far more than they originally received. One court refused to void a 50-year contract transferring 100% of the future increase in value.[7] And another court enforced a contract that gave the funder a 2,000% return on the amount initially paid to the homeowner.[8] Such unconscionable contract terms take advantage of loopholes in the law and prevent the homeowner from using their equity as they originally planned.

Imagine a 10 or 30 year mortgage with only one payment that's due at the end, but nobody can tell you what the interest rate is or what the payment will be until it comes due.

That's what you get when you sign a home equity investment contract.

Do existing consumer protections or disclosure requirements apply?

Yes. Many states have consumer protection laws against unfair and deceptive acts and practices that apply to HEI loans, as well as lending and disclosure laws that should apply. In truth, HEIs are mortgage loans. But companies offering HEI loans claim they are not making loans and that mortgage laws do not apply. They claim the terms and conditions in their contracts place them beyond the reach of disclosure and lending laws.

Despite such claims, it is important to analyze these transactions based on how they function, rather than what they purport to be.

Because mortgage loans are complicated and put a consumer's home at risk, state and federal laws require lenders to provide disclosures that summarize and emphasize the most important terms. This helps consumers understand how much the loan will cost, how long it will last, and whether they can get a better deal somewhere else. There are also extensive federal and state laws restricting certain abusive loan terms and lending practices.

Without the application of mortgage laws, consumer protections for HEI loans are far more limited, despite the extreme complexity and risk in these transactions. Homeowners may even be prevented from defending their home in court, because these contracts often include forced-arbitration clauses—something that would be prohibited if these contracts were treated as mortgages.[9]

In reality, home equity investment contracts are subprime mortgage loans.

Some companies claim these transactions are not loans because the company is not obligated to exercise the option. They say the consumer might not owe anything if the property value goes down. But in reality, companies only offer these products for homes that are almost certain to increase in value. And the contract terms are often structured in a way that almost guarantees that the company will get its original payment to the consumer back.

As a result, it is almost certain that the consumer *will* have an obligation to pay. Industry participants argue that they do not always exercise the option, and they do sometimes lose money. But, while there is little public data, available evidence suggests that this is very rare. Instead, industry losses on HEI loans are probably comparable to defaults on mortgages. And nobody would argue that a mortgage isn't a loan just because the lender sometimes loses money.

From the consumer's perspective, HEIs are loans—the consumer gets money upfront and the lender expects repayment later.

Three states have already recognized this. Connecticut,[10] Illinois,[11] and Maryland[12] have passed laws declaring that these equity products are, in fact, loans. As explained in our recommendations, other states should too.

Option-based equity products are unfair to homeowners.

HEI loans have the potential to be grossly unfair to homeowners. While the contracts vary widely, problems include:

- **Hidden, subprime effective interest rates.** Although the contract does not specify an interest rate, like a traditional loan, the difference between the balloon payment and the upfront payment to the borrower acts like interest. As a result, a rapid increase in property values becomes a double-edged sword for the homeowner. Yes, the homeowner gets more equity, but they have to pay more to the investor, resulting in what is effectively a hidden subprime interest rate.

- **Borrowers cannot predict what they will owe.** There's no way for the borrower to predict what they will owe, and companies don't accurately disclose their own projections to borrowers.

- **Companies do not provide information for comparison to traditional mortgages.** Because companies claim their products are unregulated, they do not disclose an annual percentage rate (APR). As a result, consumers cannot compare the cost to traditional mortgage financing, which is normally much cheaper and comes with consumer protections.

- **Home equity investments are asset-based lending.**[13] The transaction is based solely on the value of the property. There is no underwriting for whether the homeowner can afford the balloon payment at maturity. Instead, the investor expects the homeowner to pay by selling or mortgaging the house. **Asset-based mortgage lending has long been recognized as a form of predatory lending.** It is prohibited by the Home Ownership and Equity Protection Act (HOEPA)[14] and has contributed to many foreclosures.[15]

- **HEI loans include restrictions on using your own home.** HEI loans usually restrict what consumers can do with their home during the contract term. They may be prohibited from renting the home out if they decide to move. Their ability to use the property for a business may be limited. And they usually cannot get a traditional second mortgage for home improvements, repairs, or any other purpose without the company's permission. Refinancing to a lower interest rate is also nearly impossible because it would require paying out a portion of the equity.

- **HEI loans are very hard to understand.** HEI loans involve legal and economic concepts that are not easily explained to someone without experience in the law or finance. Understanding the range of what the consumer will potentially owe on the contract requires making economic predictions that professional economists struggle with, including the future value of real estate appreciation and the rate of inflation a decade in advance.

- **Companies mislabel the product as an "option contract."** The typical consumer understands what a loan is. But very few have experience with so-called option contracts. As a result, they are at the mercy of a financially sophisticated counter-party that will have targeted them using complex mathematical models to maximize their profit. Moreover, because the company almost always exercises the option, labeling it as an option hides the truth—that the contract is really a mortgage loan.

- **Contracts often restrict access to justice.** Many HEI loans restrict the homeowner's ability to protect their rights in a court of law by using forced-arbitration clauses that would be prohibited by the federal Truth in Lending Act (TILA) if these contracts were recognized as mortgages.

- **There is no standardized HEI loan form** (as there is for traditional mortgages), so it is necessary to read every word of the deal documents to know what the consumer's obligations are. But the typical contract and associated agreements can be more than 100 pages long. These transactions also exploit aspects of consumer psychology that can trap even financially sophisticated people.[16]

Recommendations For Federal and State Policymakers

Caveat emptor will not work here. These contracts are so complex that consumers cannot spot the risks or unfair terms. Because the cost of these contracts is so hard for consumers to predict, and because of basic human psychology, most consumers will under-estimate how much they will owe in the future and will be shocked when the bill comes due. The cost of these contracts will rob homeowners of their most valued asset—the equity in their home. State and federal policymakers should take the following steps to protect buyers:

States should:

- Clarify that HEI loans are mortgage loans, that create a debt, and that they are subject to the same state laws as other residential mortgages, including state foreclosure laws and other mortgage protections, as well as state usury caps.
- Impose limits on contract terms:
  - Limit the maximum term for HEI loans to 10 years, to limit home equity loss.
  - Require all HEI loans to include a contractual cap, limited by statute to a reasonable amount, on how much the homeowner will be required to pay when payment is due.[17]
  - Declare that a contract shall be automatically void if it lacks a cap or exceeds the statutory cap.
- Require the consumer to be represented by an independent attorney of the consumer's choice and at the lender's expense at closing.
- Require the lender to pay all closing costs.
- Require the lender to give the homeowner a new, market-rate mortgage at the end of the contract term if the homeowner cannot otherwise repay the debt without selling the property.
- Specify that any violation of the HEI loan protections recommended here constitutes a violation of the state deceptive practices statute.
- Ramp up state investigations and enforcement actions against companies when they fail to comply with consumer protection and other applicable laws.

The Consumer Financial Protection Bureau (CFPB) should:

- Clarify that HEI loans are mortgage loans and a form of credit that is subject to the same federal laws as other mortgage loans, including:
  - The Truth in Lending Act (TILA) (including its ban on forced arbitration in residential mortgages and the Home Ownership and Equity Protection Act);
  - The Real Estate Settlement Procedures Act; and
  - The Garn-St. Germain Act (which allows heirs to assume loans on the family home).
- Issue guidance stating that an HEI loan is unfair and abusive[18] if it lacks a cap on how much the consumer must pay under the contract;
- Amend TILA's Regulation Z by:
  - clarifying that the definition of credit includes HEI loans;
  - amending the commentary to Reg. Z § 1026.2(a)(14) by eliminating the exemption for option contracts secured by a consumer's residence; and

- requiring HEI loan transactions to be disclosed according to a new model disclosure that is based on the following assumptions:
    - the loan amount is the amount paid to the consumer at origination;
    - the amount financed is the loan amount, plus any borrower-paid closing costs excluded from the finance charge under Regulation Z;
    - a balloon payment will be required at maturity, amounting to the lesser of the maximum amount allowed by the cap stated in the contract or state law;
    - the lender exercises any option provision in the contract;
    - the total finance charge should be the difference between the amount financed and the balloon payment, plus any other charges required by the creditor;
    - the annual percentage rate will be calculated assuming the transaction is a single-advance, single-payment loan.

- Issue guidance clarifying that HEI loans are unfair, abusive, and deceptive where they do not provide protections, such as those discussed here, to promote informed decision making.

For further discussion, please contact National Consumer Law Center Senior Attorney Andrew Pizor at apizor@nclc.org.

Endnotes

1. *See, e.g.*, Sujeet Indap, Financial Times, Private credit's latest contraption (Oct. 4, 2024), available at https://www.ft.com/content/ca1b67a0-c95f-40f3-8dd1-ca6a583a14c6; Washington Dep't of Fin. Inst., Home Equity Sharing Agreement Inquiry Report (Sept. 12, 2024), available at https://dfi.wa.gov/news/press/dfi-issues-report-home-equity-sharing-agreement-inquiry (hereinafter "Wash. DFI Report").

2. Morningstar DBRS press release, Morningstar DBRS Assigns Provisional Credit Ratings to Unison Trust 2024-1 (May 24, 2024), https://dbrs.morningstar.com/research/433261/morningstar-dbrs-assigns-provisional-credit-ratings-to-unison-trust-2024-1.

3. Senate Bill Rpt SB 5968, Wash. Sen. Business, Financial Services, Gaming & Trade (Jan. 25, 2024), available at https://lawfilesext.leg.wa.gov/biennium/2023-24/Pdf/Bill%20Reports/Senate/5968%20SBR%20BFGT%20OC%2024.pdf.

4. Wash. DFI Report at 4-5.

5. Contracts may have other triggers too, such as death of the owner or failure to comply with the contract terms.

6. Wash. DFI Report at 5, 10 ("Many HESA products include provisions discounting the starting value of the property by applying a risk adjustment . . . ."); Sujeet Indap, Financial Times, Private credit's latest

contraption (Oct. 4, 2024), available at https://www.ft.com/content/ca1b67a0-c95f-40f3-8dd1-ca6a583a14c6.

7. Foster v. EquityKey Real Estate Investments, 2017 WL 1862527, at *2 (N.D. Cal. May 9, 2017).

8. Comstock v. Steinbergh, 2004 WL 3120554 (Mass. Super. Dec. 16, 2004).

9. 15 U.S.C. § 1639c.

10. Conn. Gen. Stat. Ann. § 36a-485(27) ("'Residential mortgage loan' means any loan, including a shared appreciation agreement, primarily for personal, family or household use that is secured by a mortgage, deed of trust or other equivalent consensual security interest on a dwelling or residential real estate upon which is constructed or intended to be constructed a dwelling"); Conn. Gen. Stat. Ann. § 36a-485(30) (defining "Shared appreciation agreement").

11. Ill. Gen. Assembly, Public Act 103-1015, § 5 (eff. Jan. 1, 2025) (amending 205 ILCS 635/1-4(f)) ("'Mortgage loan', 'residential mortgage loan', or 'home mortgage loan' includes a loan in which funds are advanced through a shared appreciation agreement."); *id.* (amending 205 ILCS 635/1-4(ccc) to define "Shared appreciation agreement").

12. Md. Code Ann., Fin. Inst. § 11-501(m)(2) (""Mortgage loan" includes a loan in which funds are advanced through a shared appreciation agreement."); Md. Code Ann., Fin. Inst. § 11-501(r) (defining "Shared appreciation agreement").

13. Morningstar DBRS, Rating and Monitoring U.S. Reverse Mortgage Securitizations at 24 (July 2023) ("Like reverse mortgage loans, the HEI underwriting approach is asset-based, meaning there is greater emphasis placed on the value of the underlying property than on the credit quality of the homeowner.").

14. 15 U.S.C. § 1639(h).

15. *See* Hasa A. Kingo, Preying on the American Dream: The Argument for Hoepa Reform Amidst Predatory Lending's Dire Effects on the Elderly Poor, 17 Geo. J. on Poverty L. & Pol'y 335, 353 (2010) ("asset-based lending is among the most harmful of predatory lending practices. . . . [L]oans based on borrowers' equity in their homes and not their ability to repay are more likely to result in foreclosures, which directly injure homeowners being displaced, and indirectly hurt their surrounding communities.").

16. Specifically, these contracts exploit hyperbolic discounting, "the tendency to overweight the immediate consequences of a decision and to underweight those that will occur in the future, mak[ing] it difficult for consumers to make rational disclosure decisions." Ari Ezra Waldman, Cognitive Biases, Dark Patterns, and the "Privacy Paradox," 31 Current Opinion in Psychology 105, 106 (2020).

17. This requirement is similar to the existing federal requirement that adjustable rate mortgages have an interest rate cap. *See* 12 U.S.C. 3806(a).

18. Pursuant to 12 U.S.C. § 5531(d)(1) and (2)(A)-(B).