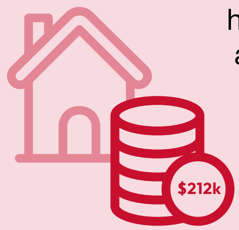
National Consumer Law Center
Fighting Together for Economic Justice

WHAT STATES CAN DO TO PROTECT HOMEOWNERS FROM

Home Equity "Investment" Loans

Home Equity "Investment" Loans are Predatory Equity-Theft Schemes

Predatory lenders are aggressively targeting homeowners, especially older adults with high equity, using deceptive "home equity investment" schemes. They are complex, high-cost mortgage loans marketed with the promise of fast cash and no monthly payments to lure and exploit homeowners.



48 million homeowners with a mortgage have available equity. The average homeowner holds **$212,000** in equity.

How They Work

Often misrepresented as "option contracts," these loans provide homeowners with an upfront cash payment in return for having to give the lender a percentage of their home's future value. This large lump sum is due upon a "triggering event," such as the sale of the home or the homeowner's death, and the amount is not known until this event occurs.

Despite having no monthly loan payments, homeowners remain responsible for all property taxes, insurance, and other fees. When the loan is due, the lender collects its substantial share, which can be an overwhelming and unaffordable lump sum amount.

Home equity "investments" are preying on the record-high levels of equity that U.S. homeowners currently hold.

Example of One Type of HEI loan Product

When Jane, an elderly homeowner, needed cash for overdue medical bills, a lender gave her **$35,000** (minus fees) and a complex 100-page contract. Five years later, Jane wanted to sell her home to move into assisted living. Jane's home sold for **$270,000**. She still owed money on her first mortgage. Jane didn't realize the HEI loan agreement required her to pay a large portion of the sale price to the lender. It wasn't until she consulted with an attorney, who spent considerable time analyzing the contract's confusing terms, that she learned **she owed the lender $84,000 out of the sales price**. This deal amounted to **an effective annual percentage rate (APR) of 20%**, far exceeding the conventional loan rates of less than 5% at the time. After paying her other mortgage, commissions, and fees, **Jane was left with very little money, making it impossible for her to afford assisted living and trapping her in her home**.

The Homeowner Can't Win

These lenders bypass lending laws by mislabeling the loans as "option contracts" in an attempt to avoid consumer protections and interest rate limits. This leaves homeowners vulnerable, and can lead to a substantial loss of their home equity, as the lenders will always exercise their right to claim their share.

Lenders manipulate a home's appraised value with a "risk adjustment," lowering the starting point for calculating appreciation. This lets them profit significantly from even a small market increase, often resulting in homeowners repaying much more than they originally borrowed.

Protecting Homeowners from Predatory HEI Loans

CONSUMER PROBLEMS	STATE SOLUTIONS
Companies deceptively claim HEI loans are not loans, in an attempt to avoid consumer protections.	**States should clarify that HEI loans are mortgage loans and subject to the same state laws, including foreclosure laws, mortgage protections, and any usury caps.**
HEI loans have hidden, subprime effective interest rates that borrowers cannot predict.	**Require all HEI loan contracts to include a cap on the maximum amount the homeowner will be required to pay, and disclose the maximum amount that the homeowner could be required to pay under the agreement.**
HEI loans often result in unaffordable lump-sum balloon payments at the end of the loan term, forcing homeowners to sell and lose their home.	**Require the lender to give the homeowner a new, market-rate mortgage at the end of the term if they cannot otherwise repay without selling.**
The complexity of HEI loan contracts makes them very hard for consumers to understand.	**Require the homeowner to engage in counseling with a HUD-certified housing counselor before the closing, and require uniform disclosures of terms and conditions consistent with federal mortgage laws RESPA and TILA.**
Companies target financially struggling consumers, exploiting their immediate need for cash.	**Increase state investigations and enforcement actions against companies that fail to comply with consumer protection and other applicable laws. Violations of HEI loan protections should constitute a violation of state unfair and deceptive practices and other consumer protection statutes.**

For more information, please see NCLC's Issue Brief Home Equity Investment Loans Are Subprime Mortgages or contact Andrew Pizor, apizor@nclc.org, or Andrea Bopp Stark, astark@nclc.org.

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