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Opposing HB 1464

Relating to Home Equity Sharing Agreements
before the
State of Washington
House of Representatives
Consumer, Protection, and Business Committee

February 14, 2025

Good morning. My name is Andrew Pizor and I am a Senior Attorney at the National Consumer Law Center. Thank you for the opportunity to testify on HB 1464.

1. Introduction

We *oppose* this bill because home equity sharing agreements (HESAs) pose a significant risk to homeowners—especially seniors and lower-income homeowners—and HB 1464 does not do enough to protect them. HESAs are becoming increasingly common nationwide, especially in hot housing markets. Their marketing is very tempting for distressed borrowers. But they are very difficult for consumers to understand or compare with alternatives, and they have the potential to be extremely expensive.

HESAs were created by sophisticated Wall Street investors for the purpose of giving them low-risk access to homeowner equity. But the risk to the homeowner is unreasonably high. For that reason, we urge you to vote against this bill.

2. 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. If the homeowner defaults, the lender can foreclose. Reverse mortgages also provide the homeowner with money upfront, but no payment is due on the loan until the homeowner ceases to live in the house. Forward and reverse mortgages are subject to extensive state and federal regulation to protect consumers.

High-cost forward mortgage and FHA reverse mortgage borrowers must undergo HUD-approved counseling before closing.[1] 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.

HESAs offer homeowners money up front in return for a share of the home's future value.[4] HESA borrowers are usually not required to make any payments to the company until the earlier

[1] 15 U.S.C. § 1639(u); 12 U.S.C. § 1715z-20(d)(2)(B).

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 HESAs to help buy a home, while others are offered to existing homeowners who might otherwise seek a traditional home equity loan or reverse mortgage.

HESAs 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.

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.**

For example, Unison, one of the first and largest HESA companies, has described itself as an "institutional investment management firm,"[2] with sophisticated "model, systems, and processes [it] build[s] to make investments,"[3] including "a 10-year forecast on every house in America."[4] Unison uses a "very sophisticated data infrastructure and pricing structure" to "turn[] a house into a security" in order to "build[] nationwide portfolios for the benefit of the institutional investor."[5] In its marketing to investors, Unison explains that its products have "unlimited upside and limited downside" as well as "low volatility and high risk-adjusted net returns compared to other major asset classes,"[6] including traditional home secured loans.

Foreclosures on HESAs are rare,[7] and no greater than traditional mortgage loans. According to a report commissioned by the Washington legislature, Washington's Department of Financial Institutions found "that the average loss rate for HESA providers is no greater than the loss rate

[2] Podcast Transcription Session No. 103 – Thomas Sponholtz & Jim Riccitelli, https://www.fintechnexus.com/wp-content/uploads/2022/09/Podcast-103-Unison-Founders.pdf (last visited June 13, 2024).
[3] Unison IM, https://www.unisonim.com/ (last visited June 7, 2024).
[4] Podcast Transcription Session No. 103 – Thomas Sponholtz & Jim Riccitelli, https://www.fintechnexus.com/wp-content/uploads/2022/09/Podcast-103-Unison-Founders.pdf (last visited June 13, 2024).
[5] *Id.*
[6] Unisom IM, https://www.unisonim.com/about-us (last visited June 7, 2024).
[7] According to the Wash. State Dep't of Fin. Institutions, only one of the companies contacted reported ever foreclosing on a property. Wash. State Dep't of Fin. Institutions, Home Equity Sharing Agreement Inquiry Report at 20 (Sept. 12, 2024).

for traditional mortgage lenders."[8]

One of the reasons HESAs pose a risk to homeownership is that HESA lenders do not underwrite for ability to repay. Instead of ensuring that the borrower has enough income to repay the debt, they count on the value of the property as the source of repayment.[9] So, if the borrower ultimately cannot repay the HESA lender from their savings or by refinancing with a traditional mortgage, they will lose their home. HESAs are currently an unregulated example of asset-based lending—a high risk form of lending that is disfavored in the residential context and that has contributed to multiple foreclosure crises.[10]

In practice, HESAs function very much like subprime mortgages with tremendous balloon payments. The consequences for consumers are the same too. If they are able to pay, they will lose a massive amount of equity. And if they cannot pay, they will lose their home to foreclosure. In fact, the payment structure for the typical HESA makes it highly likely that most borrowers will be forced to sell their home to make the payment due.

3. Problems with HB 1464

Rate Cap is Too High: HB 1464 proposes a 25% annual rate cap on HESA rates. That is obscenely high—more like an unsecured credit card than a debt secured by your house. Yet, despite the high cost and the risk of foreclosure, the homeowner protections in this bill are far weaker than those for an equivalent mortgage loan. Consider that the prime rate for a 15-year mortgage (close to the 10-year term for most HESAs) is currently a little over 6%.[11] At current rates, a 15-year mortgage becomes subject to federal enhanced protections for high cost loans[12] when the APR exceeds roughly 13%.[13]

Wrongly declares that HESAs are not loans: This bill declares that HESAs are not loans.[14] But, as explained above, that is contrary to reality. Despite the claims of HESA originators, HESAs operate no differently than single-payment mortgage loans. Three other states—

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[8] Wash. State Dep't of Fin. Institutions, Home Equity Sharing Agreement Inquiry Report at 20 (Sept. 12, 2024).

[9] *See* 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. The property value is the main focus for predicting repayment because it is the primary source of funds to satisfy the obligation.")

[10] *See generally*, OCC, Comptroller's Handbook, Asset-Based Lending (Jan. 27, 2017), available at https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/asset-based-lending/pub-ch-asset-based-lending.pdf.

[11] For the week of Feb. 6, 2025, Freddie Mac reports the Primary Mortgage Market Survey rate for a 15-year fixed-rate loan as 6.05%.

[12] I.e. the Home Ownership and Equity Protection Act (HOEPA), codified at 15 U.S.C. § 1639.

[13] HOEPA is triggered when the APR for a mortgage exceeds the average prime offer rate for a comparable loan by more than 6.5 percentage points on a first mortgage, or 8.5 for a second mortgage. *See* National Consumer Law Center, *Truth in Lending* § 9.6.3.1.1 (11th ed. 2023).

[14] HB 1464 §§ 1, 2.

Connecticut,[15] Illinois,[16] and Maryland[17]—have adopted laws declaring that these products are loans. And Morningstar DBRS, one of the nation's largest bond-rating agencies, considers HESAs (which it calls "home equity investments") similar to reverse mortgages.[18]

We are especially concerned about the risk to older homeowners, who may mistakenly think this is a safe alternative to a reverse mortgage, and lower-income homeowners who are unlikely to be able to afford the tremendous balloon payment that HESAs normally require.

Allows deceptive valuation methods: Section 11 of the bill allows valuation practices that are unfair to the homeowner, including the use of affiliated appraisers—compromising appraiser independence—and manipulating the starting value of the property.

- HB 1464 allows the lender to use an affiliated appraiser, meaning an appraiser with whom it has a pre-existing business relationship. This is problematic because the appraiser will have an incentive to skew the valuation in the lender's favor.
- This is compounded by common HESA contract terms that discount the appraised value at origination, but use the actual appraised value to calculate the borrower's payment due. Under most HESA contracts, the payment due at maturity is calculated as a percentage of the difference between the appraised value at maturity and the value at origination. Then, by using the actual value at maturity, the lender is able to guarantee a profit even if the market value of the property remains flat or even declines.
    - For example, imagine a situation like what many homeowners faced in the last foreclosure crisis: a homeowner must sell due to a job loss and their home has not appreciated in value, so they have no equity. If they signed a HESA that gives the lender 50% of their equity when the house was worth $100,000, the borrower would owe nothing if the house was still only worth $100,000 at sale, because 50% of zero is zero. But if the lender is allowed to discount the starting value to $75,000, the borrower will owe $12,500. This is one of the deceptive ways that some HESA lenders guarantee a profit. It is unfair and should be prohibited.

Other problems and missing protections:

- The bill does not require consumers to get independent advice from a HUD-certified housing counselor. HESAs are very complex and potentially very expensive. For that reason, pre-consummation counseling should be mandatory.
- The bill neither caps the maximum dollar amount the homeowner may owe nor requires the lender to disclose the maximum possible dollar payment. Federally required

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[15] 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").

[16] 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").

[17] 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").

[18] *See* Morningstar DBRS, Rating and Monitoring U.S. Reverse Mortgage Securitizations, App'x 3 (July 2023) (discussing their methodology for rating HEI securitizations).

disclosures for traditional mortgages require the lender to disclose the highest possible payment. Without such a disclosure, consumers cannot comparison shop or determine whether the loan is affordable.

- The remedies for violations are unclear and insufficient. The bill refers to the Consumer Protection Act, but does not expressly authorize courts or regulators to void HESAs when appropriate, and there is no provision for statutory damages.

4. Conclusion

Homeownership is important because it gives families a chance to build wealth. But it is more important because it provides a home. Unregulated HESAs can take that away.

We think the best approach to regulating HESAs is to treat them as mortgage loans and give state regulators the authority to make appropriate rules. Connecticut, Illinois, and Maryland have already done so and we urge Washington do the same. HB 1464 will expose Washingtonians to dangerous loans that may steal their equity and the roof over their heads.

We urge you to oppose HB 1464.

Thank you for your time.