Home Equity Sharing Agreement Inquiry Report

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I. INTRODUCTION AND SCOPE OF THE DEPARTMENT'S INQUIRY

Home Equity Sharing Agreements (HESAs), and similar shared equity products, provide consumers with an up-front payment in exchange for a share of the future equity or value appreciation of the consumer's home. During the 2024 legislative session, House Bill (HB) 2081 and Senate Bill (SB) 5968 were introduced to further clarify that HESAs are residential mortgage loan products subject to the Consumer Loan Act, chapter 31.04 RCW, and its rules, chapter 208-620 WAC (Act). Several HESA providers testified during the 2024 legislative session that while they are amenable to regulation of HESA products, HESAs should not be regulated as residential mortgage loans.

While HB 2081 and SB 5968 ultimately did not pass, the Washington legislature passed Engrossed Substitute Senate Bill (ESSB) 5950, which included a supplemental budget proviso that appropriated funds to the Department of Financial Institutions (Department) for the purpose of studying "nontraditional financial services such as home equity sharing agreements, and their effect on communities of color, seniors, and other vulnerable populations."[1]

On May 1, 2024, the Department announced an inquiry into HESA products as Phase One of the study required through ESSB 5950.[2] On May 2, 2024, the Department sent a HESA Inquiry Outreach Letter to several HESA providers.

While narrow in scope, the intent of the Department's inquiry was to better understand the HESA products being offered to Washington consumers. A second report, Phase Two, on this subject and other nontraditional financial services is forthcoming. Due to public interest, the Department submits this report, which contains the general results of the inquiry. This report is based on the information submitted to the Department by certain HESA providers. Thus, the Department cannot, and does not, purport to substantiate the veracity of the responses received.

II. HESA INQUIRY

A. Inquiry Recipients

Using complaint data from the Department, and information received from the HESA providers during the 2024 legislative session, the Department identified ten HESA providers that appeared to be engaging in business in Washington State. The Department sent an Inquiry Outreach Letter to:

1. Redwood Trust, Inc. d/b/a Aspire HEI
2. Balance Homes, Inc.
3. HomePace, Inc.
4. Home Equity Partners, LLC d/b/a Hometap

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[1] ESSB 5950, 68th Leg. (Wash. 2024).
[2] Wash. Dept. Fin. Inst., DFI Launches Inquiry into Home Equity Sharing Agreements (HESAs) (May 1, 2024), https://dfi.wa.gov/consumer-loan-companies/dfi-launches-inquiry-home-equity-sharing-agreements-hesas.

5. Point Digital Finance, Inc.
6. Quantum One, Inc. d/b/a QuantumRE
7. Real Estate Equity Exchange, Inc. d/b/a Unison
8. Splitero Funding, Inc.
9. Unlock Technologies, Inc.
10. EquiFi Corporation, PBC d/b/a EquiFi

B. Response to the Department's Request for Information

The Department's Inquiry Outreach Letter requested information about each HESA provider's product offerings in Washington, business practices, key terms of their agreements, and HESA transaction data for Washington consumers.

Of the ten HESA providers:

- Two companies provided complete responses.
- Six companies provided partial responses.
- One company responded that it does not offer HESAs to Washington consumers.
- One company did not respond to the Department.

The HESA providers generally assert that partial responses to the inquiry are due to confidential, proprietary, and/or trade secret information. Some of the HESA providers also refused to provide the transaction data requested in the inquiry letter on the grounds that the information is protected under the Gramm-Leach-Bliley Act. The Department notes that several of the HESA providers subject to this request for information previously testified to the Legislature that they welcomed the opportunity to cooperate with the Department.

III. HESA TERMS

A. Summary of Home Equity Sharing Agreements

HESA products are typically marketed as an alternative to traditional mortgage loans like a refinance of a first mortgage loan, home equity loan, or home equity line of credit that allows the borrower to borrow against the equity in their home. Often advertisements for HESA products state a HESA requires no monthly payments, interest, or increased debt.[3] In most cases, HESA providers structure their agreements to include an "option" feature. HESA products typically have a term between 10 and 30 years but may terminate early due to a sale of the property, breach of contract, or buyout of the HESA.

In exchange for an advance of funds, often referred to as the initial payment, the homeowner grants the HESA provider the ability to purchase a specified percentage of interest in the

[3] How Much Home Equity Could You Access?, Real Estate Equity Exchange Solutions d/b/a Unison Agreement Corp., https://www.unison.com/access-equity/; Unlock Your Home's Equity, Unlock Technologies, Inc., https://welcome.unlock.com/apply4; Home Equity Investment: Get up to $500K, Point Digital Finance, Inc. d/b/a Point, https://point.com; Aspire, https://aspirehei.com.

homeowner's primary residence at a future date. Upon expiration of the agreement's term, sale of the property, or other triggering event, the HESA provider can choose whether to exercise its option to purchase its interest in the property. In approximately 98 percent of HESA transactions, upon termination of the HESA, the homeowner must pay the HESA provider a share of the equity or appreciation accrued over the term of the agreement.

The process for obtaining a HESA product is the same mortgage lending process Washington consumers experience when obtaining a traditional home loan.[4] Washington homeowners must apply, undergo a credit check, provide documentation regarding their income, pay origination fees, transaction fees, closing costs, appraisal costs, and any other associated costs.

Many HESA products include provisions discounting the starting value of the property by applying a risk adjustment, placing limitations on a homeowner's ability to refinance, as well as placing limitations on the use of the property. Further, many HESA products are structured to allow HESA providers to collect proceeds that, when annualized, are at exponentially higher rates than a traditional mortgage lender may collect under the Act.

For example, a HESA provider does not pay the actual dollar value of the percentage of interest in the property at the time the HESA is executed. Stated plainly, the initial payment the HESA provider makes to the consumer is not equivalent to the percentage of interest the HESA provider is taking in the property. For example, a HESA provider may pay a consumer $50,000 for a 50 percent future interest in the property. However, if the property value at the start of the transaction is $350,000 and the HESA provider were to provide an equivalent percentage, the initial payment to the consumer would be $175,000. This model reduces the HESA provider's risk while preserving the HESA provider's claim to the full value of the property's appreciation and gives the HESA provider the benefit from the time value of the money.

HESA products are almost always secured by a deed of trust on the homeowner's primary residence, granting the HESA provider the ability to foreclose on the value of the homeowner's entire property, and not just on a portion of the primary residence equivalent to the value of the advanced funds. As such, homeowner's who have entered HESAs do not benefit from the loss mitigation and foreclosure protections under the existing Act.

B. Origination and Servicing of Home Equity Sharing Agreements

The Department's HESA Inquiry Outreach Letter requested a detailed business plan detailing each step in offering and providing HESA products and services to Washington consumers.

[4] RCW 19.144.010(8).

1. Advertising and Marketing

The Department received information regarding advertising methods from seven HESA providers.[5] Generally, HESA providers reported using direct-to-consumer marketing channels or partnering with third-party financial marketplace companies to advertise to Washington consumers. Accordingly, consumers may encounter advertisements for HESA products via direct mail, e-mail, search engine results, credit monitoring services, online editorials, social media, podcasts, radio, TV, and online videos. However, one HESA provider indicated that it does not engage in any cold calling, e-mail marketing, or direct mailing, and only contact consumers once they have submitted their contact information to the HESA provider. Only two HESA providers referred to an actual established advertising policy in their responses to the Department.

2. Applications

Seven HESA providers detailed their application processes. Some HESA providers indicated that the application process begins with an initial inquiry form that obtains contact information, self-reported information about the consumer's property, and consent to a soft credit pull.[6] In addition, at least five of those HESA providers require a social security number, date of birth, monthly income, debt obligations, and employment information as part of their application. All HESA providers indicated that their application is available online. One HESA provider also takes applications over the phone.

Applicants for traditional mortgage products are required to provide personal information, employment and income information, assets and liabilities, information regarding other real estate, loan and property information, supporting documentation and must attest to the accuracy of the information provided. At least two HESA providers use an application that mirrors the Uniform Residential Loan Application used by traditional mortgage lenders.

Other HESA providers utilize an online application flow that requires most if not all of the same information that would be required in the traditional mortgage lending context. Only one application reviewed by the Department did not require information regarding liabilities in the initial application. However, it is unclear as to whether that information is required by the HESA provider at a later juncture.

3. Underwriting

Seven HESA providers detailed their underwriting processes. Two HESA providers with the highest minimum credit requirements used Fannie Mae underwriting guidelines, while the other HESA providers followed very similar underwriting criteria, with exception to the

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[5] One of these providers indicated that they are not advertising to Washington consumers at this time.

[6] A soft credit pull or soft credit check happens when you authorize someone to check your credit report. However, because this review of your credit report is not yet associated with a specific application for credit it does not impact your score. *See* Louis DeNicola, What Is a Soft Inquiry?, Experian, https://www.experian.com/blogs/ask-experian/what-is-a-soft-inquiry/.

minimum credit score requirement. [7] To determine a consumer's eligibility for a HESA product, all HESA providers assess a consumer's ability to repay the obligation or their ability to maintain the property, conduct a debt-to-income ratio analysis, and require the property to meet certain property restrictions similar to traditional mortgage underwriting. HESA providers generally reviewed the following elements to determine eligibility:

- The consumer's credit score;
- The consumer's credit history, including credit utilization, the number of accounts, payment history; bankruptcies, foreclosures, legal judgments, and charge offs;
- The consumer's debt-to-income ratio;
- The consumer's current mortgage and any other liens on the property to determine the loan-to-value ratio; and
- The property, including the property value, condition, characteristics, title, and location.

4. Appraisals and Valuations

Seven HESA providers produced information regarding their appraisal or valuation processes. Generally, all HESA providers reported that they require an initial appraisal or valuation to determine the starting value of the property. However, the method by which an appraisal or valuation is conducted may vary.

Several HESA providers indicated that they utilize a licensed or registered independent third-party appraiser via an appraisal management company, like traditional mortgage lenders. One HESA provider stated they allow the consumer to select a qualified appraiser of their choice. Three HESA providers reported that they use a combination of appraisal and valuation methods including automated valuation models, broker price opinions, or hybrid appraisals.

5. Determining HESA Terms for Disbursement and Repayment

Seven HESA providers produced information regarding how their company determines the terms for disbursement and repayment. Generally, HESA providers indicated that a combination of different factors determine the amount of the initial payment. The initial payment is either a set dollar amount, or percentage of the appraised value of the home. Below are several factors considered for the initial payment:

- Current market rates;
- The value of the property;
- Historical and projected home price appreciation;
- The consumer's current level of home equity;
- The amount requested by the consumer;
- The maximum amount available to the consumer based on underwriting; and
- The occupancy or intended property use.

[7] Depending on the HESA provider the minimum credit score to qualify is between 500-650.

Factors that HESA providers considered for determining repayment include:

- The current value of the property;
- The agreed upon percentage of equity or appreciation; and
- The application of any rate cap or proceeds cap.

6. Disclosures

The Department received detailed disclosure information from six HESA providers. Most HESA providers utilize loan estimates and closing disclosures modeled off the mortgage disclosures required under the Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) Integrated Disclosure rules.

Three of the six providers reported that they have a mandatory knowledge component which requires consumers to review the important features of their HESA product. In addition, one HESA provider stated they offer financial counseling from a HUD-approved financial counselor and require borrowers aged 62 and older to complete a one-hour counseling session with a HUD-approved housing counselor. The counseling is offered at no cost to the consumer.

7. Execution and Funding

Seven HESA providers reported that execution and funding of their HESA agreements are via title or escrow companies, like traditional mortgage loans. Three HESA providers indicated that upon execution and expiration of the waiting period, like the right of rescission under TILA,[8] funds will be wired to the consumer or other parties to be paid from the initial payment. Several HESA providers reported that they fund their agreement the same day as executing the HESA agreement.

8. Servicing

Some activities that are considered loan servicing include collecting and receiving payments, collecting fees, collecting data to make decisions regarding the loan, and finalizing collection through the foreclosure process.[9] Seven HESA providers described their practices for servicing their HESA products. Three HESA providers stated that they contract with licensed mortgage loan servicers to conduct servicing activity, including general account management, monitoring insurance and property tax payments, monitoring for property values, bankruptcy and natural disasters, providing payoff information, processing settlement requests and handling consumer complaints or inquiries, among other servicing activities. Four HESA providers indicated that they perform servicing in-house.

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[8] 12 C.F.R. §1026.15.

[9] RCW 31.04.015(29).

Four HESA providers stated that as part of servicing their HESA product, they or their servicer provide consumers with periodic statements including information regarding the HESA terms, the current estimated property value, and possible repayment scenarios.

9. Termination

HESA providers reported that the termination of a HESA can occur in one of three ways: sale of the home, expiration of the term, or early termination/buyout. One HESA provider indicated consumers could also terminate their HESA by entering into a new HESA.

The amount due to the HESA provider can differ under each of these scenarios, but all depend upon the value of the property at the time of termination. Generally, the following steps occur when terminating a HESA transaction:

- Occurrence of an event specified in the contract or terms of service, resulting in termination of the HESA;
  - Sale of the property. If due to a sale of the property, the following criteria must be met:
    - The sale is approved by the HESA provider;
    - The sale is an arms-length transaction;[10] and
    - The sales price must be at least 90% of the fair market value as determined by an appraisal or valuation.
  - Early termination or buyout. If due to early termination/buyout an appraisal must be conducted to determine current value of the property.

- HESA provider determines the amount of the settlement/payoff using the agreed upon formula and issues a settlement/payoff statement to the consumer showing the amount due upon termination. The settlement/payoff amount depends on:
  - Timing of the settlement;
  - Method of settlement;
  - Sale amount or current value of property;
  - Application of any rate or proceeds cap if included in the agreement; and
  - Any other terms affecting the amount due at repayment.

- Payment of settlement/payoff amount to HESA provider; and

- Reconveyance of the deed of trust.

[10] An arms-length transaction is where the parties to the transaction are unaffiliated and are acting in their own self-interest, ensuring that the sale is at fair market value.

10. Consumer Inquiries and Complaints

Generally, all seven HESA providers appear to have some mechanism for receiving and logging complaints either internally or via their licensed mortgage loan servicer. Six HESA providers indicated that they have an established complaint policy setting a process for tracking and responding to complaints from consumers and regulators.

11. Third-Party Sales and Securitization

A typical practice in the residential mortgage industry is mortgage providers selling their loans to be pooled as mortgage-backed securities. Mortgage-backed securities are created when mortgage loans "are purchased from banks, mortgage companies, and other originators and then assembled into pools" and then sold as securities.[11] While there are different mortgage-backed security structures, generally an investor receives "a pro-rata share of all principal and interest payments made on the pool of mortgage loans."[12]

Two HESA providers indicated that they have not securitized any of their HESAs to date. Other HESA providers reported they either originate HESAs with the intent to sell and securitize or sell and securitize their HESAs on a case-by-case basis. It is unclear whether HESA providers engaged in selling and securitizing their HESA products comply with federal disclosure requirements under the Securities Act and the Securities Exchange Act.

C. Common Home Equity Sharing Agreement Terms

The Department's HESA Inquiry Outreach Letter requested a detailed explanation of the common contract terms for HESA products and services being offered to Washington consumers.

1. Risk Adjustments

Risk adjustment is a process by which a HESA provider reduces the appraised value of the property by a specific percentage to account for potential risk the HESA provider is undertaking by entering a HESA transaction with a consumer. The result is that the value used to enter into the HESA agreement is lower than the stated market value at the time of the valuation or appraisal. Thus, if the consumer's property were to decrease in value and the consumer chose to terminate the HESA, the HESA provider would not share in the full decrease in value.

Conversely, it appears that HESA providers who apply a risk adjustment to determine the agreed starting value of the property do not apply a risk adjustment credit at termination. Accordingly, if the consumer's property were to increase in value over time and the consumer chose to

[11] *See* Mortgage-Backed Securities and Collateralized Mortgage Obligations, U.S. Sec. Exch. Comm'n, https://www.investor.gov/introduction-investing/investing-basics/glossary/mortgage-backed-securities-and-collateralized.
[12] Id.

terminate the HESA, the HESA provider shares in the increase in value *plus* the risk adjusted amount.

Two HESA providers stated that they do not apply a risk adjustment to the appraised value of the home for purposes of establishing an agreed starting value for the HESA. Of the HESA providers that apply risk adjustments:

- Three HESA providers indicated that they have a set risk adjustment, one at 29 percent, one at 15 percent, and the other at 5 percent;
- One HESA provider indicated that the risk adjustment that it charges is dependent upon several factors specific to the transaction and could range anywhere from 3 to 18 percent; and
- One HESA provider stated it no longer applies a risk adjustment, but previously it ranged from 8 to 20 percent.

See Section D, *Calculations for Home Equity Sharing Agreements*, for additional information on risk adjustments.

2. Deed of Trust, Lien, or Other Security Instrument

A deed of trust is a legal document that is used by residential mortgage lenders to secure a real estate transaction. A deed of trust requires a borrower to agree to repay the mortgage loan pursuant to the terms of the note, maintain insurance, comply with occupancy requirements, maintain the property, pay taxes, etc. If a borrower defaults on the loan or otherwise fails to comply with the requirements under the deed of trust, the lender may pursue certain remedies to protect their interest in the property, up to and including, foreclosing on the deed of trust pursuant to the Deeds of Trust Act of Washington.[13]

All seven HESA providers stated their HESA product is secured by a deed of trust. However, most HESA providers specified that the deed of trust used to secure the HESA is different than a traditional deed of trust used for residential mortgage loans. HESA providers refer to the deed as a “performance deed” because there is no obligation in the deed that requires the consumer to repay the initial payment received at execution of the HESA. But for repayment, the “performance deed” requires a consumer to comply with certain obligations like maintaining the property, keeping the property insured, and complying with occupancy and use requirements, while a traditional deed of trust also requires repayment of an obligation. However, at least one HESA provider acknowledged that the performance required under the deed of trust includes amounts due and punctual payment of the amount due upon termination of the HESA.

[13] Chapter 61.24 RCW.

3. Shared Appreciation or Proceeds Caps

Shared appreciation or proceeds caps place a maximum limit on the amount of future equity or the total amount due upon termination of a HESA transaction. Only one HESA provider reported that it does not place a shared appreciation or proceeds cap on its HESA product. The remaining HESA providers use a varying shared appreciation or proceeds cap formula that depends upon various transaction factors. These caps ranged from 12 and 25 percent.

See Section D, *Calculations for Home Equity Sharing Agreements*, for additional information on shared appreciation or proceeds caps.

4. Origination Fees and Other Costs

All seven HESA providers reported charging origination fees and other costs. The amount ranged from 3 to 4.9 percent of the transaction amount. Most HESA providers reported that the origination fees and other costs are not paid by the consumer out of pocket but deducted from the initial payment to the consumer upon execution of the HESA. Similar to traditional mortgage loans, consumers acquiring HESAs must pay appraisal, escrow/settlement, inspection, and county recording costs.

5. Prohibitions on Refinancing or New Loans

All seven HESA providers' contracts contain provisions limiting a consumer's ability to refinance their existing mortgage or taking out new loans. Each HESA provider has a number of requirements that must be met before they would potentially approve a refinance or new loan on the property. Prohibitions may include:

- Consumers cannot obtain a refinance or new loan without prior written consent from the HESA provider;
- Consumers cannot obtain a loan or other property interest secured by a lien on the property that would result in the consumer's equity falling below the minimum amount;
- Consumers cannot obtain a loan that would result in the debt on the property exceeding the agreed upon maximum authorized debt;
- Consumers cannot obtain a cash out refinance of their existing mortgage, unless the proceeds are used to settle the HESA transaction; and
- Consumers cannot obtain certain types of products including reverse mortgage loans, shared appreciation loans, mortgage loans with negative amortization features, private or non-institutional loans, investments in the equity or appreciation of the property, or an unrecorded loan secured by the property.

6. Prohibitions on Use

Like with traditional mortgages, all seven HESA providers' contracts address occupancy requirements and prohibit certain uses of the property. Generally, HESA providers require that the property be used for residential purposes only. Five HESA providers will allow consumers to rent all or a portion of the property subject to the HESA provider's approval and other conditions like pricing changes and additional insurance policies.

7. Maintenance Requirements

Similar to traditional mortgages, all seven HESA providers' contracts address maintenance requirements. Generally, all consumers are required to maintain the condition of the property at the consumers' expense, and keep the property in good condition, and in no worse condition than when the HESA was executed. In addition, consumers must notify their HESA provider of any issues requiring restoration or repairs, and provide documentation related to the work to be completed.

At least one HESA provider indicated that they offer remodeling adjustments if the consumer makes material modifications to the property that rise above maintenance and repairs. The consumer must document the repairs with before and after photos and an appraisal will determine the added value of the improvements. The consumer can then receive full credit for the added value of the improvements.

8. Scenarios Requiring Repayment of the Initial Payment

All seven HESA providers state that their HESA products do not require repayment of the initial payment made to the consumer upon entering a HESA agreement. The providers assert that because the HESA agreement and deed of trust do not specifically state that the consumer must repay the initial payment made to the consumer, the HESA product is not a loan. However, at least three HESA providers described certain situations in which the HESA provider may recover the initial payment from the consumer.

The most common instance requiring repayment of the initial payment is early termination of the HESA. In these instances, the consumer must pay the greater of the amount that would be due at termination as calculated pursuant to the agreement or repay the initial payment. One HESA provider also indicated that in instances of default a consumer may be required to repay the initial payment.

9. Insurance

Like with traditional mortgage loans, all seven HESA providers' contracts contain insurance clauses requiring the consumer to obtain and maintain property and appropriate hazard insurance for the property, at their own expense. Further, those insurance policies must list the HESA provider on the policy. It does not appear that any HESA providers contribute to any costs of hazard or home insurance. In addition, at least six HESA providers' contracts allow the HESA provider to force place insurance on a consumer's property if the HESA provider determines that the consumer is underinsured or failed to maintain their property insurance.

10. Indemnification

All seven HESA providers' contracts contain provisions indemnifying and holding the HESA provider harmless against claims, damages, demands, losses, expenses (including attorney's fees), judgments, liabilities, penalties, etc., arising out of a breach of contract, acts or omissions, or damage to the property. At least two HESA providers' contracts contain the following limitation on their liability:

> IN NO EVENT SHALL INVESTOR'S AGGREGATE LIABILITY ARISING OUT OF OR RELATED TO THIS AGREEMENT OR THE PROPERTY EXCEED THE AMOUNT OF THE INITIAL CASH PAYMENT.

11. Survivability Upon Death of Consumer

Like with traditional mortgage loans, all seven HESA providers' contracts contain provisions that ensure the survivability of the HESA transaction upon the death of the consumer. The language typically employed by HESA providers include provisions which state that the HESA transaction constitutes a covenant running with the land and that the HESA transaction will be binding upon the heirs and the estate of the deceased.

D. Calculations for Home Equity Sharing Agreements

The Department's HESA Inquiry Outreach Letter requested a detailed explanation of the various calculations HESA providers use to determine certain terms for their products.

1. Calculating the Risk-Adjusted Value of the Home

For the seven responding HESA providers, there appear to be two primary methods for calculating the risk-adjusted value for the property. The first method is a flat percentage deduction from the appraised value to determine the agreed starting value of the home. The second method appears to be based upon a number of weighted factors in the underwriting process that ultimately determines the risk adjustment percentage that is then deducted from the appraised value to determine the agreed starting value of the home.

2. Calculating the percentage of Future Equity

There was no clear continuity amongst HESA providers as to how they determine their take of the future equity in any given transaction. However, several expressed that the amount depends on a number of different transaction factors like the amount of the initial payment to the consumer, the risk adjusted value of the home, various underwriting factors, and consideration of where the property is located, and historical home value trends in that location.

3. Calculating the Shared Appreciation or Proceeds Cap

There was no clear continuity amongst those HESA providers that apply shared appreciation or proceeds caps as to how or if they apply such cap. Three HESA providers explained their method for calculating the shared appreciation or proceeds cap. Factors that may influence the shared appreciation or proceeds cap include:

- The consumer's FICO score
- The consumer's current loan-to-value ratio;
- The initial payment to the consumer relative to the value of the property;
- The amount of existing debt collateralized by the property;
- Historical price fluctuation in the area the property is located; and
- The estimated future change in the value of the property.

4. Calculating the Initial Payment

HESA providers weigh various factors to derive the amount of the initial payment made to the consumer. Many of the factors used to calculate the initial payment are the same factors considered in the underwriting process including, but not limited to, the value of the property, the consumer's current level of equity, the amount requested by the consumer, and the consumer's credit history.

It does not appear that there is a proportional relationship between the amount of the initial payment made to the consumer and the percentage of future equity that the HESA provider takes in the property. One HESA provider indicated that a consumer could receive up to 15 percent of the property's starting value. If the consumer were to choose to take 15 percent, the HESA provider would be granted a 60 percent future interest in the property.

5. Calculating the Amount Due at Termination

Generally, no two HESA providers calculate the amount due at termination in the exact same manner. Three HESA providers gave relatively straightforward answers for how they calculate the amount due at termination which can be summarized as the provider's percentage interest multiplied by the ending property value, and if applicable, subject to the proceeds cap.

Other providers have more complicated processes. For example, one HESA provider referred the Department to a two-page ancillary document to their contract with nine defined terms necessary to explain their calculation method. Another HESA provider reported the amount due at termination is determined by a number of factors and thus the HESA provider utilizes several different calculations depending upon the circumstances.

IV. WASHINGTON HESA ACTIVITY

The Department reviewed geographic data, active HESA transaction data, and terminated transaction data. *See* Appendix E.

Based on data from the Office of Financial Management and Federal Reserve Bank of St. Louis, home prices in Washington appear to increase for long periods of time with short periods of decline. While home prices decreased slightly in 2023, the most recent period in which home prices in Washington State declined significantly appears to be during the Great Recession.[14] Typically, HESA providers only offer their products in metropolitan areas, where appreciation has been significant.

A. Geographic Data

The Department received general geographic data from seven HESA providers. HESA providers reported a total of approximately 2,466 Washington transactions.[15] While offered in all but 3 counties in Washington state, the majority of HESA transactions were originated in King, Pierce and Snohomish counties.

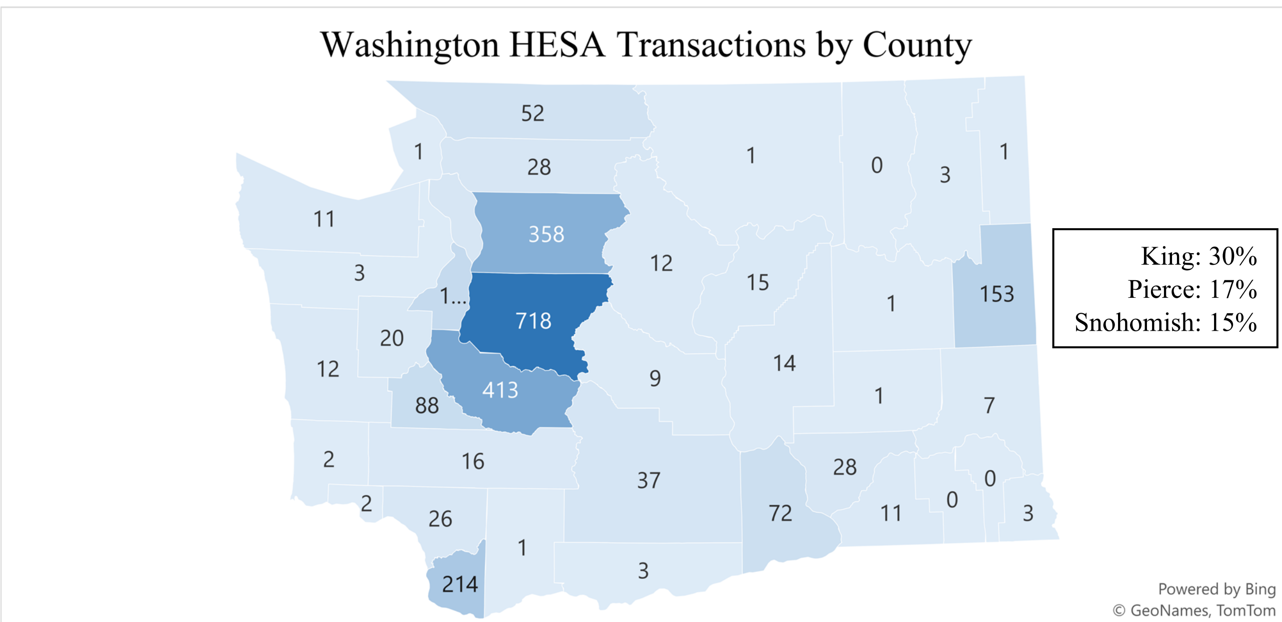

Figure 1. Washington HESA Transactions by County.

[14] Office of Financial Management, *Median Home Prices*, https://ofm.wa.gov/washington-data-research/statewide-data/washington-trends/economic-trends/median-home-price; Federal Reserve Bank of St. Louis, *All-Transactions House Price Index for Washington* (for 1975 – January 2024), https://fred.stlouisfed.org/series/WASTHPI#; shaded section indicates recession.

[15] This number is approximate and is likely higher than reported as some HESA providers did not provide transaction level data. Further, some HESA providers did not distinguish between active and terminated transactions in their data while others listed their terminated transactions separately. In an effort to prevent duplicative data, the number provided is the more conservative approximation.

Of the approximate 2,466 Washington transactions, the Department received zip code data for 1,704 transactions from five HESA providers. These HESA transactions were distributed across 289 different Washington zip codes with an average home value of $656,988.98, increasing in value an average of 4.45% over the last year.[16]

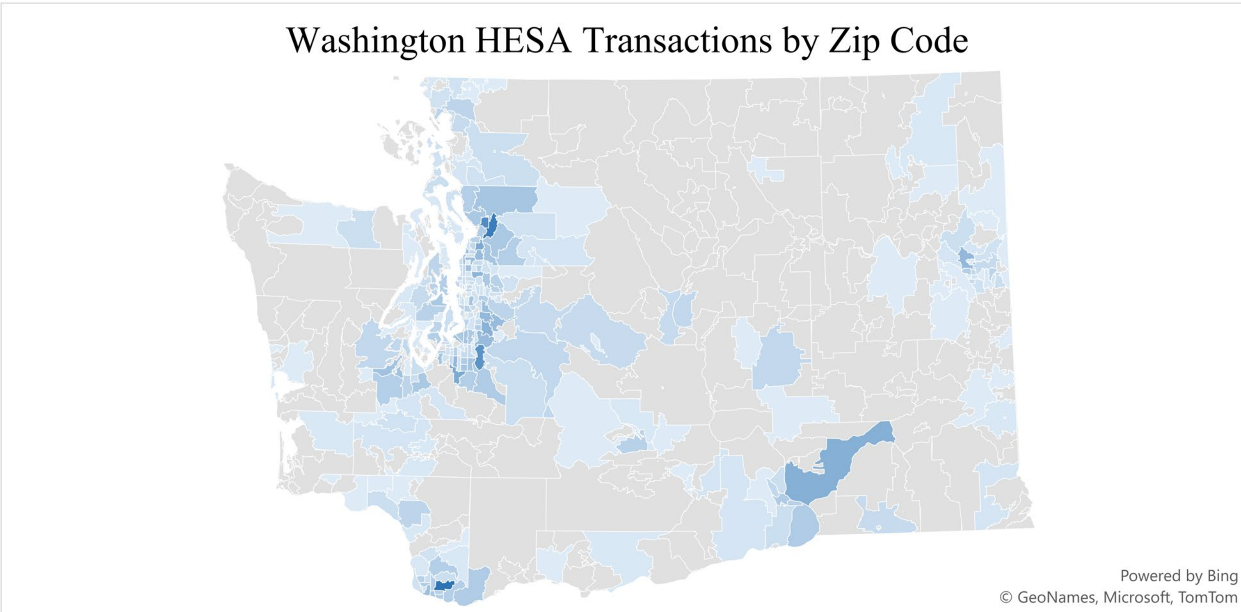

Figure 2. Washington HESA Transactions by Zip Code.

The following zip codes had the highest frequency of HESA transactions:

- **98682:** The average home value in this area of Vancouver is $501,202. Home values in this area have increased 3.3% over the past year.[17]
- **98258:** The average home value in this area of Lake Stevens is $713,916. Home values in this area have increased 8.2% over the past year.[18]
- **98270:** The average home value in this area of Marysville is $629,657. Home values in this area have increased 7.2% over the past year.[19]

[16] Average home values and increase/decrease percentages were obtained from the Zillow Home Value Index (ZHVI). For additional information regarding the ZHVI methodology see Zillow Home Value Index Methodology, 2019 Revision: What's Changed & Why, Zillow Research, https://www.zillow.com/research/zhvi-methodology-2019-highlights-26221/.
[17] 98682 Housing Market Information as of July 23, 2024, https://www.zillow.com/home-values/99961/vancouver-wa-98682/.
[18] 28258 Housing Market Information as of July 23, 2024, https://www.zillow.com/home-values/99667/lake-stevens-wa-98258/.
[19] 98270 Housing Market Information as of July 23, 2024, https://www.zillow.com/home-values/99676/marysville-wa-98270/.

- **98391:** The average home value in this area of Bonney Lake is $678,092. Home values in this area have increased 5.6% over the past year.[20]
- **98208:** The average home value in this area of Everett is $767,166. Home values in this area have increased 8.6% over the past year.[21]

B. Active HESA Transaction Data

The Department received useable transaction level data from five HESA providers.[22] Below are the range and averages for several key components of Washington HESA transactions:

- **Agreed starting value:** the agreed starting value for purposes of structuring the HESA ranged from $126,000 to $5,600,000, with an average agreed starting value of $585,928.28.
- **Payment to consumer:** the initial payment made to consumers in HESA transactions ranged from $17,500 to $658,824, with an average initial payment of $100,734.09.
- **Percentage of equity/appreciation:** the percentage of future equity or appreciation ranged from 3.89% to 73%, with an average percentage of future equity or appreciation of 40.46%.
- **Term length:** term lengths ranged from 10 years to 30 years with, an average term length of 21.08 years.
- **Transaction fees:** transaction fees ranged from $0 to $22,792, with an average transaction fee of $3,659.36.

C. Terminated HESA Transaction Data

The Department received useable terminated transaction level data from four HESA providers[23] for approximately 456 terminated HESA transactions. These transactions were terminated either by sale of the property or buyout of the HESA agreement. Below are the range and averages for several key components of terminated transactions:

- **Actual term length:** the actual term length of a HESA transaction ranged from one month to 173 months, with the average of 20.42 months.
- **Amount due at termination:** the amount due at termination ranged from zero to $589,550.00, with an average of $111,716.21 due at termination.

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[20] 98391 Housing Market Information as of July 23, 2024, https://www.zillow.com/home-values/99775/bonney-lake-wa-98391/.

[21] 98208 Housing Market Information as of July 23, 2024, https://www.zillow.com/home-values/99631/everett-wa-98208/.

[22] A sixth HESA provider submitted transaction data to the Department but refused to provide the specific data points requested in the Department's Inquiry Outreach Letter. Accordingly, the Department did not include the HESA provider's data as it was not in a format that was comparable to the other data sets.

[23] A fifth HESA provider submitted some terminated transaction data but failed to provide all the data points requested in the Department's Inquiry Outreach Letter. Accordingly, the Department did not include the HESA provider's data as it was incomplete.

- **Percentage growth:** the percentage growth between the initial payment and the amount due at termination ranged from zero to 563.54 percent, with an average of 59.74 percent.

Figure 3 below shows a sample of the lowest and highest amount due at termination for each HESA provider that provided terminated transaction data. Three of the four HESA providers applied risk adjustments to the agreed starting value of these transactions. Based upon the data provided it is unclear what, if any, rate cap has been applied to these transactions.

Term (mos)	Starting Value	Ending Value	Change in Value	Provider %	Initial Payment	Amount Due	Risk Adj.
5	$ 1,469,071.00	$ 1,420,000.00	$ (49,071.00)	29.95	$ 440,000.00	$481,951.00	N
8	$ 297,743.00	$ 506,928.00	$ 209,185.00	7.35	$ 21,896.00	$ 24,847.00	N
6	$ 1,251,025.00	$ 1,535,000.00	$ 283,975.00	62.00	$ 345,000.00	$382,648.61	Y
4	$ 358,600.00	$ 456,000.00	$ 97,400.00	21.8	$ 24,000.00	$ 26,298.85	Y
6	$ 472,294.00	$ 579,503.00	$ 107,209.00	41.41	$ 80,000.00	$ 88,602.92	Y
3	$ 288,750.00	$ 305,000.00	$ 16,250.00	70	$ 68,870.00	$ 73,740.91	Y
68	$ 2,189,000.00	$ 3,248,000.00	$ 1,059,000.00	35	$ 218,900.00	$589,550.00	Y
62	$ 355,000.00	$ 250,000.00	$ (105,000.00)	50	$ 45,615.00	$ 2,115.00	Y

Figure 3. Lowest and Highest Amount Due at Termination for Four HESA Providers.

Several overall themes emerged in the terminated transaction data. Many of the terminated transactions had a relatively short term, indicating that HESA products may be used as an alternative to high-cost bridge loans. Also, 98 percent of the terminated transactions resulted in HESA providers receiving payment upon termination of the HESA transaction. Of those transactions requiring payment, HESA providers received more money than initially paid to the consumer in 95 percent of transactions, ranging from $407.00 to $370,650.00 more than the initial payment to the consumer, with an average of $45,504.78.

D. Losses and Foreclosures

The Department received information from seven HESA providers regarding losses and foreclosures of HESAs in Washington. One HESA provider reported one partial loss of $2,567 out of 68 terminated transactions over a four-year period, an overall loss of 1.4 percent. A second HESA provider reported two partial losses of $6,534.83 and $5,416.34 out of 233 terminated transactions over an eight-year period, an overall loss of 0.8 percent. A third HESA provider's transaction data appeared to show a total of eight complete losses and 11 partial losses out of 149 terminated transactions over a 17-year period, an overall loss of 12 percent.[24] When averaged across all HESA providers there is a loss rate of less than five percent.

The Federal Reserve publishes modeled loss rates for various loan types including domestic first-lien residential mortgages. The below chart (Figure 4) shows the projected first-lien mortgage portfolio loss rates and the 25th and 75th percentile ranges by loan and borrower characteristics. The chart shows that, depending on borrower and loan characteristics, the average loss rates

[24] This is the only HESA provider that was operating during the 2008 financial crisis.

over a two-year period for first-lien mortgages ranged from 0.7 to 6.6 percent.[25] Based upon a comparison of the data, it appears that the average loss rate for HESA providers is no greater than the loss rate for traditional mortgage lenders.

Loan-to-value at origination	Credit score (FICO® score) 1	Loan-level loss rates (percent)			Portfolio-level loss rates (percent)
		25th	Median	75th	Average
80% or less	Under 680	1.0	2.1	4.0	3.0
80% or less	680–739	0.6	1.1	2.0	1.7
80% or less	740 and over	0.2	0.4	0.7	0.7
Greater than 80%	Under 680	1.9	3.8	7.3	6.6
Greater than 80%	680–739	1.5	2.7	4.8	4.2
Greater than 80%	740 and over	0.5	1.0	1.9	1.8

Figure 4. Model Loss Rates for first lien mortgages.
Source: Dodd-Frank Act Stress Test Publications[26]

Only one HESA provider reported ever foreclosing on a property. In that case, the property was not located in Washington. While HESA provider foreclosures appear to be rare, such foreclosures would likely not be reflected in reports showing various foreclosure data and statistics, such as those provided by the Federal Reserve.

V. THE DEPARTMENT'S FUTURE STEPS

At this time, the Department continues to engage with HESA providers to seek additional information on industry practices and to monitor the industry's impact on Washington consumers. In addition, the Department is presently working with the Evans School of Public Policy and Governance at the University of Washington to study HESA products and their effect on communities of color, seniors, and other vulnerable populations pursuant to ESSB 5950.

[25] Loan-level loss rates are calculated as cumulative nine-quarter losses on a given loan divided by the principal balance amount as of 2021:Q4. Portfolio-level loss rates are calculated as the sum of the cumulative nine-quarter losses divided by the sum of principal balances as of 2021:Q4. The set of loans presented in this table excludes loans held for sale or accounted for under the fair-value option, loan observations missing data fields used in the model, loans that were in default or had no unpaid balance remaining as of 2021:Q4, loans that were purchased credit-impaired, and other types of loans that are not modeled using the domestic first-lien mortgage model (e.g. commercial loans).

[26] Board of Governors of the Federal Reserve System, *Dodd-Frank Act Stress Test Publications,* https://www.federalreserve.gov/publications/2023-june-supervisory-stress-test-methodology-modeled-loss-rates.htm