

# SEP Fictions & Facts

*A handy guide to understanding these innovative home equity solutions*

The Coalition for Home Equity Partnership (CHEP) is a national non-profit association representing a collective of financial services companies that offer innovative, flexible ways to tap home equity, generally known as shared equity products (SEPs). Also known as home equity investments, home equity agreements, shared appreciation agreements or home equity sharing agreements, SEPs represent an innovative and increasingly popular form of home equity financing.

From time to time, CHEP encounters published descriptions of SEPs based on incorrect information or misunderstandings. The following information is provided to help clear up these misconceptions.

FICTION	FACT
<b>SEPs are mortgage loans.</b>	While it is true that in a handful of states regulators have chosen to regulate SEPs as a new type of mortgage loan, mechanically SEPs are very different from mortgage loans. Mortgage loans, as debt products, are based on the mechanics of debt: principal balances, interest rates, amortization, monthly payments, recourse and underwriting based on credit and income. SEPs have no principal balances, interest rates, amortization, monthly payments or recourse. Underwriting is primarily asset-based. As equity products, SEPs have a different set of mechanics, such as investment amounts, home value discounts, multipliers, sharing percentages and annualized cost caps. SEP providers purchase a fractional ownership interest in a residential property in exchange for a present-day lump sum cash payment to the homeowner(s). The fractional ownership interest in the property is based on a percentage of the home's future value or future appreciation. Homeowners have the right to settle the SEP at any time, subject to a maximum term. SEP transactions are not reported to the credit bureaus, and SEPs are generally easier to qualify for versus other forms of home finance.
<b>SEP are target marketed to non-prime homeowners and underserved communities.</b>	CHEP members do not specifically target non-prime homeowners. SEPs provide access to capital for homeowners across all demographics and credit scores, many of which aren't otherwise eligible for home financing. The value of financing with no required monthly payments is recognized by homeowners regardless of credit score, age, socio-economic standing or otherwise. Homeowners are free to use the money received at closing for whatever purpose they desire — paying off high-cost debt, home renovations, college tuition, starting a small business or creating additional flexibilities during retirement.

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<p><b>SEPs are high-cost, equity-stripping products with unconscionable investor returns (disproportionally high repayment amount compared to the initial upfront payment).</b></p>	<p>SEPs are priced fairly and provide significant convenience and value for homeowners. Cost depends primarily upon two factors: the future home value and the date on which the SEP settles — neither of which are known at the time of origination. The SEP investor has no guaranteed return and all CHEP members cap costs over the life of each SEP such that it is fair to both homeowners and investors. Depending on the homeowner’s credit score, future home value and when the homeowner chooses to settle their SEP, the cost of a SEP may turn out to be greater than or less than the APR on a mortgage loan of similar duration. In addition, a benefit unique to SEPs is the lack of monthly payments during the entire term. During the term of the SEP, homeowners typically continue to own meaningful percentages of their accumulated equity in their homes and directly reap the benefits of home price appreciation. Notably, the number one use of SEP proceeds is to pay off expensive debt. The interest rate on the debt paid off is typically much higher than the annualized cost of the SEP.</p>
<p><b>SEPs force most homeowners to sell their home to settle the contract or face foreclosure.</b></p>	<p>A homeowner may settle the SEP at any time with cash on hand, proceeds received from a “cash-out” mortgage loan refi, proceeds received from a SEP refi, or through a sale of the home. If these options are not available or not undertaken at the end of the SEP term, the investor may elect to obtain their agreed-upon fractional ownership interest in the property and then work with the homeowner to sell the property. Foreclosure is a last resort and is the least desired outcome because it may adversely impact the outcome for both parties. Some CHEP members may offer term extensions to certain homeowners facing hardships or other situations. Historically, SEP investor involvement in foreclosures has been limited to situations where a senior lien holder (i.e., the homeowner’s mortgage lender) has initiated a foreclosure action and the SEP investor is participating in that proceeding to protect their interest.</p>
<p><b>SEPs prevent homeowners from refinancing their mortgage loan.</b></p>	<p>SEPs do not prevent a homeowner from refinancing. SEP providers routinely subordinate to “rate/term” refinance loans, enabling homeowners to take advantage of interest rate reductions and lower their monthly mortgage payments. If a homeowner wishes to do a “cash-out” refinance loan, SEP providers require that the loan proceeds be used to settle the SEP. Notably, SEP providers treat these situations the same way HELOC lenders do. HELOC lenders also subordinate to “rate/term” refinances and typically refuse to subordinate to “cash-out” refinances.</p>
<p><b>SEPs should require an APR disclosure so homeowners can comparison shop and understand costs.</b></p>	<p>APR is a single number cost disclosure designed for loans that is primarily driven by the interest rate of the loan at origination. Because SEPs do not have an interest rate, and because the cost of a SEP depends on future home value and timing of settlement, neither of which are known up front, an APR cannot be determined at origination. Instead, homeowners are best served by SEP disclosures that provide a range of annualized cost estimates based on various assumptions for future home values and settlement timeframes.</p>

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<p><b>Ability to Repay (ATR) standards should apply.</b></p>	<p>ATR rules are a feature of the Truth in Lending Act designed to ensure that lenders assess a consumer's ability to meet monthly payment obligations. However, ATR does not apply to all home secured credit transactions. For example, home equity lines of credit and reverse mortgages are exempted from ATR because of the uncertainty around when the obligation will be repaid and the repayment amount. Similarly, ATR requirements do not make sense for SEPs. SEPs are a form of equity-based financing that do not require monthly payments or subject homeowners to recourse rights. SEPs have terms ranging from 10-30 years, and it is impossible to predict what a homeowner's financial situation will be that far in the future. Instead of ATR, CHEP members cap SEP costs and implement underwriting standards that limit the maximum available SEP financing to help ensure that homeowners retain a significant portion of their home equity after taking into account the potential ownership stake that a SEP provider may obtain at settlement.</p>
<p><b>Consumers are better off using traditional forms of home finance, like mortgage loans, HELOCs, or reverse mortgages, or financial services products like personal loans.</b></p>	<p>Mortgage loans, HELOCs, reverse mortgages, SEPs and other financial products are all useful. Any of these may be the best option for a consumer depending on the circumstances. Ultimately, consumers deserve the right to choose the financial product that best serves their needs and objectives. SEPs are a valuable tool for homeowners with substantial equity in their property who would like to tap that equity to solve a financial need without a monthly payment obligation. In addition, SEPs are available to homeowners, such as the self-employed or those with less than perfect credit, that may not be able to qualify for other products on terms that meet their needs. SEPs provide unparalleled value for homeowners that use SEP proceeds to eliminate debts and improve their monthly cash flow.</p>
<p><b>SEP companies provide confusing disclosures and contracts so homeowners do not understand the contract or the costs.</b></p>	<p>CHEP members are dedicated to providing homeowners with an education-oriented sales process that includes clear cost disclosures and tools to illustrate how a SEP works. In comparison to the typical sales process for a mortgage loan that effectively presumes a homeowner understands complex terms, SEP originators provide deep education through a range of interactive tools that enable homeowners to fully understand the benefits and risks of the product. In addition, homeowners are advised to seek the advice of legal and financial advisors prior to closing. All CHEP members provide homeowners with a three-day right of rescission or a three-day cooling off period to ensure that they have a meaningful opportunity to obtain such advice. CHEP fully supports standardized disclosures that express cost on both a dollar and annualized cost basis.</p>

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<p><b>SEP providers take no risk (the homeowner has the risk) and always are paid in full.</b></p>	<p>SEP providers bear the risk of losing their entire investment. Although SEP providers carefully evaluate each investment, numerous factors may result in a SEP provider receiving less than their anticipated investment return or even receiving less than the original investment amount. In addition to the risk of a general decline in housing values, in situations where a homeowner defaults on their mortgage loan, fails to pay their property taxes or fails to maintain their property, the remaining equity in the property may not be sufficient to cover the initial investment amount. Unlike a mortgage loan, because SEPs are non-recourse, the homeowner is not liable for this shortfall and the SEP provider bears the loss.</p>
<p><b>There is no limit on the amount a homeowner may have to pay their SEP provider at settlement.</b></p>	<p>All CHEP members adhere to a set of industry best practices that explicitly require a cap on the amount a homeowner may pay at settlement. All current CHEP members have always incorporated such caps into their agreements, ensuring that repayment obligations remain within defined and reasonable limits. Additionally, in jurisdictions where SEPs are classified as a type of mortgage loan, they are subject to relevant state cost caps.</p>
<p><b>SEPs use deceptive marketing to trick homeowners and SEPs are unregulated.</b></p>	<p>CHEP members are committed to educating homeowners and giving them the tools needed to fully understand the SEP before entering into an agreement. CHEP members consistently provide robust educational materials, multiple layers of disclosures, and clear explanations of the SEP's structure, costs, and implications. Importantly, SEP providers are subject to stringent federal and state laws prohibiting unfair, deceptive, or abusive acts or practices (UDAP), and to date, no SEP originator has been found in violation of these laws. Rather than misleading homeowners, CHEP members emphasize transparency and actively encourage questions to ensure homeowners make informed decisions based on a clear understanding of the terms.</p>
<p><b>Federal and state mortgage lending laws apply to SEPs.</b></p>	<p>Under federal law, SEPs are not considered a form of credit subject to TILA or a mortgage loan under RESPA. SEPs are regulated as a type of residential mortgage loan by statute in Connecticut, Illinois and Maryland. Financial regulators in several other states have applied certain residential mortgage lending and licensing laws to SEPs. In addition, SEPs are always subject to state and federal UDAP and privacy laws.</p>

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<p><b>SEP providers do not support regulation.</b></p>	<p>CHEP members are actively working with many state regulators to help implement SEP regulation. Because there are significant incompatibilities between many mortgage loan regulations and SEPs, it can be difficult or impossible for SEP originators to comply with many of those regulations. Therefore, CHEP's regulatory policy is focused on educating regulators, legislators and other stakeholders about the operation, terms and conditions, benefits, costs and risks of SEPs. CHEP advocates for a comprehensive, distinct regulatory framework that is tailored to be compatible with the unique structure of SEPs and designed to provide the same types of robust controls and protections provided under mortgage loan regulations, including:</p> <ul style="list-style-type: none"> <li>• Requiring licensure of SEP originators and empowering state financial regulators to supervise the SEP industry;</li> <li>• Establishing clear disclosure requirements;</li> <li>• Mandating certain homeowner protection features such as a cap on annualized cost, a right of rescission or cooling off period, independent valuations, and no prepayment penalties;</li> <li>• Imposing equity protective underwriting requirements to help ensure homeowners retain a portion of the equity in their property; and</li> <li>• Codifying operating requirements and identifying prohibited practices such as deceptive marketing.</li> </ul>
<p><b>SEPs are reverse mortgages.</b></p>	<p>For many of the same reasons why SEPs are not accurately characterized as a debt-based loan, SEPs are not reverse mortgages. SEPs have a stated maturity date, whereas reverse mortgages can only become due upon the death of the consumer, the transfer of the dwelling or the cessation of occupancy by the homeowner. In addition, SEPs are available for primary residences, second homes and even rental properties. Reverse mortgages are limited to “principal dwellings.” Reverse mortgages also typically have age restrictions, while SEPs do not.</p>



Visit our website to learn more about SEPs and determine whether they might be a fit for your financial goals.

[homeequitypartnership.org](http://homeequitypartnership.org)

