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Non-Debt and Non-Bank Financing For Home Purchase: Promises and Risks

Shelby D. Green

NON-DEBT AND NON-BANK FINANCING FOR HOME PURCHASE: PROMISES AND RISKS

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"[H]ousing is the dominant source of wealth for most families, just as its twin — mortgage debt — is the chief liability."[1]

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1. Carlos Garriga & Aaron Hedlund, *Crises in the Housing Market: Causes, Consequences, and Policy Lessons* 1–2 (Econ. Rsch. Fed. Rsrv. Bank of St. Louis, Working Paper No. 2019-033A, 2019), https://doi.org/10.20955/wp.2019.033.

I. INTRODUCTION

The 2008 housing and financial industry crisis brought the world to the brink of economic collapse. While, in some of my earlier articles,[2] I told the story of this woeful time, here, by way of introduction, I will recount briefly some of the lapses in individual judgment and regulatory oversight by the main protagonists in the story, only as a backdrop to show how the conditions were ripe for the advent of novel forms of home purchase finance, the main focus of this article. I refer to these new forms as non-debt and non-bank financial companies, or NDNBs.[3] Novel financial instruments are not new. Indeed, the adjustable-rate mortgages ("ARM") and interest-only mortgages,[4] that factored so prominently in the events leading to the crisis,

2. *See* Shelby D. Green, *Testing Fannie Mae's and Freddie Mac's Post-Crisis Self-Preservation Policies under the Fair Housing Act*, 66 CLEV. ST. L. REV. 477, 479 (2018) [hereinafter Green, *Testing*]; Shelby D. Green, *Disquiet on the Homefront: Disturbing Crises in the Nation's Markets and Institutions*, 30 PACE L. REV. 7 (2009) [hereinafter Green, *Disquiet*].

3. *Infra* text accompanying notes 36–37 for a further description.

4. These concepts are defined more particularly *infra* text accompanying notes 88–

were novel at the time. Superficially, they were beneficial as they made home ownership manageable because the initial loan repayment amounts were low and within the borrower's means. What was troublesome and perhaps sinister was that they were foisted upon those who could not see that they would not stay manageable and the debt would increase by those who knew them well.[5] All the while, the regulators were not watching the changes in the market, *per se*, but only the sharp trajectory in the volume of transactions, housing prices and rates of homeownership.[6] In the aftermath of the crisis, many were skeptical of the public apology by the story's protagonists, that is, that their activities were based on an honest taken up desire to support the cause of advancing homeownership for all — a long-standing national policy. Nothing in the national policy called for the wholesale abandonment of underwriting principles, which were designed to protect both lenders and consumers of mortgage credit. Lenders chose to ignore the concern of the creditworthiness of mortgage applicants, instead blindly taking the applicant at her word, as to her income, assets, and credit history[7] and made one hundred percent loans on contrived appraisals of value. The low or no-documentation loans, some with a one hundred percent loan-to-value ratio, at one point accounted for more than two-thirds of certain loans made by two of the largest banks — Countywide Financial and Washington Mutual — that collapsed under the weight of their improvidence in the crisis.[8] That default was more likely by a borrower whose dreams of homeownership were larger than his financial ability, was not unforeseeable.

The homeownership goals thrown up by the improvident lenders began around the Great Depression when the Roosevelt administration declared the national goal of the greatest level of home ownership.[9] That goal would be

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5. I discuss the cohort of those holding ARMs *infra* text accompanying notes 236–42.

6. *See* Robert J. Samuelson, *Rethinking the Great Recession*, WILSON Q., Winter 2011, at 16, 19.

7. *See* FINANCIAL CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 160 (2011) [hereinafter FCIC FINAL REPORT], https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf; *see also id.* at 3, 12. We can see this as lenders recognized the increased risk of loss by precarious borrowers and accounted for it through higher interest rates and adjustable rate mortgages. Even more sinister was that lenders knew that when defaults happened, those losses would fall on those who purchased the mortgages on the secondary market. For a description of the secondary market, see *infra* note 16.

8. *See* FCIC FINAL REPORT, *supra* note 7, at xxiii, 107–09. *See generally* Green, *Disquiet*, *supra*, note 1 at 9 n.9, 10 n.14 (describing how risky loans and government encouragement of mortgage loans contributed to the crisis).

9. *See FDR and Housing Legislation*, FRANKLIN D. ROOSEVELT PRESIDENTIAL LIBR. & MUSEUM, https://www.fdrlibrary.org/housing (last visited Nov. 19, 2021). I

achieved by a host of federal policies and programs.[10] The first came in the form of mortgage insurance offered by the Federal Housing Administration ("FHA") — under which the federal government insured the repayments of mortgage loans made to borrowers of modest means.[11] The significant advantage to the borrower was that the maturity of loans was extended from the traditional five years with a balloon payment at the end, to a twenty-five-year, fully amortized loan.[12] And, with a low down-payment,[13] homeownership came within the reach of many. Other federal policies since adopted to make home purchase affordable, are found in the tax laws — for example, the deductibility of mortgage interest[14] and the exclusion of gain of up to $500,000 for a couple filling jointly, in the sale of a personal residence.[15]

At first, the loan originators' ability to make loans was limited by the rate of savings deposits they had on hand. But the creation of the secondary mortgage market[16] changed these dynamics. In 1949, Congress established the Federal National Mortgage Association ("Fannie Mae") and in 1970, the Federal National Mortgage Corporation ("Freddie Mac"). Both are federally-chartered, but privately-owned entities ("Government Sponsored Entities" or "GSEs") whose mission was to buy up mortgage loans from loan originators, thereby creating liquidity for more loans to would-be

discuss the rates of home ownership *infra* text accompanying notes 39–45.

10. *See generally* Shelby D. Green, *The Search for a National Housing Policy: For the Cities' Sake*, 26 FORDHAM URB. L.J. 69 (1998) (examining federal policies and development of homeownership).

11. 12 U.S.C. § 1709(b). The idea was that by providing mortgage insurance, lenders would increase their levels of lending. In addition, the federal insurance program imposed interest rate ceilings, established uniform lending criteria, required lower down-payments, and introduced longer mortgage terms. The analogous program created for Veterans, under the then Veterans' Administration, not the Department of Veteran's Affairs, ("VA"), guaranteed loans on behalf of Veterans.

12. *Id.*

13. The required down-payment for an FHA loan is now 3.5% as opposed to non-FHA loans which typically require 20%. VA loans can be 100% loans. *See* 12 U.S.C. § 1709(b)(9)(A) (requiring a down-payment of not less than 3.5%).

14. *See* I.R.C. § 163(h). Until the Tax Cuts and Jobs Act of 2017, interest paid on mortgage loans of $1 million was deductible, but after, the maximum loan was reduced to $750,000.

15. *Id.* § 121.

16. In contrast to the primary mortgage market, consisting of loan originators, the secondary mortgage market is made up of participants who buy mortgages from loan originators and sell investments in those mortgages to private and public investors. *See* Daniel J. McDonald & Daniel L. Thornton, *A Primer on the Mortgage and Mortgage Finance Market*, 90 FED. RSRV. BANK OF ST. LOUIS REV., Jan–Feb 2008, at 31, 34–36, https://files.stlouisfed.org/files/htdocs/publications/review/08/01/McDonald.pdf.

homeowners.[17] Soon, private actors entered the secondary mortgage market.[18] While these were all truly laudable programs, something went wrong as perverse incentives took hold. Loan originators profited from packaging loans and because the risks of default traveled with the mortgage now owned by FNMA or FHLMC, or the private purchaser, the originators made loans to almost anyone — if he could sign the mortgage papers.[19]

A host of factors can be discerned as the major culprits in practices leading up to the crisis. First, the seeming wholesale abandonment of safe underwriting practices in favor of short-term profits by loan originators. Second, there was the indiscriminate purchase by the GSEs and private actors of poor-quality loans, many based on inflated appraisals of the property. Third, there was the inevitable default by a borrower, whose ARM interest rate had increased by several percentage points, but whose financial circumstances had not. The Financial Crisis Inquiry Commission, authorized by the U.S. Senate in May 2009, was the result of one of two things — either the borrowers never could fulfill their obligations under the loan or never intended to.[20] The effects on the markets were yet the same either way.

It was a toxic mix of excess and cupidity, whose impact fell heavily not just on the actors (the financiers and borrowers), but on the nation and the world. There were millions of foreclosures with no end in sight.[21] Homeownership rates took a nose-dive,[22] businesses shuttered and factories

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17. *See id.* Later, the Government National Mortgage Association ("Ginnie Mae"), 12 U.S.C. § 1716-23(h), was created to purchase loans made to veterans. Ginnie Mae "guarantees" principal and interest. These GSEs issued debt securities to raise funds for their purchases.

18. Decades later, private investment companies achieved a large presence in the secondary market. *See* OFF. OF FED. HOUS. ENTER. OVERSIGHT, A PRIMER ON THE SECONDARY MARKET, MORTGAGE MARKET NOTE NO. 08-3 2–3, 7–8 (2008), https://www.fhfa.gov/PolicyProgramsResearch/Research/PaperDocuments/20080721_MMNote_08-3_N508.pdf. At the time that the famed Lehman Brothers collapsed in September 2008, it was the largest private holder of mortgage-backed securities with $619 billion in debts. *See Lehman Brother-Fall From Grace*, CFI, https://corporatefinanceinstitute.com/resources/knowledge/finance/lehman-brothers (last visited Nov. 19, 2021).

19. While the purchase agreements often provided recourse against the originator in case of defective loans, those cases are still shaking out in the courts. *See, e.g.*, *In re* Part 60 Put-Back Litig., 165 N.E.3d 180 (N.Y. 2020) (enforcing the sole remedy clause in securitization contract).

20. *Id.*

21. *See* FED. DEPOSIT INS. CORP., CRISIS & RESPONSE: AN FDIC HISTORY 2008–2013 xii (2018) [hereinafter CRISIS & RESPONSE] (reporting 2.8 million mortgage loans in foreclosure in the first quarter of 2008, more than four times the number in 2005).

22. *See infra* text accompanying note 39.

closed,[23] retail sales plummeted,[24] and hundreds of commercial banks failed.[25]

Alas, it was only after the horses got out that the regulators acted to close the barn door. The immediate rescue reaction came from the federal government under the Troubled Asset Relief Fund — a nearly $3 trillion cash infusion to failing investment banks.[26] Fannie Mae and Freddie Mac were also put under conservatorship under the Housing and Economic Recovery Act of 2008 ("HERA"),[27] their role as the primary protagonist in the secondary mortgage markets, curtailed. And lenders had little sympathy for the beleaguered borrower as filings for foreclosures were almost automatic. Indeed, a practice of "robo-signing" of default papers arose, where the same individual from the loan servicer would attest to hundreds of defaults within the context of a single day, in many cases, without any verification of the status of the loan, leaving the borrower to sort things out later in court.[28] When this practice became known, several of the larger banks — Chase, Bank of America, Wells Fargo — entered into consent decrees with the United States Department of Justice, which among other things, required them to verify defaults and have staff available to speak to beleaguered borrowers.[29] On the state level, as courts became overwhelmed by foreclosure complaints, some adopted moratoria on foreclosures and mandatory meditation programs.[30]

When the waters began to calm, Congress and state governments set out to learn what happened and to examine the conditions that created the nightmare. Among the prominent findings of the Financial Crisis Inquiry

23. *See* CRISIS & RESPONSE, *supra* note 21, at xii–xiii (stating that 8.8 million jobs were lost, having a $10 to $14 trillion economic effect).

24. Robert J. Samuelson, *Revisiting the Great Depression*, WILSON Q., Winter 2012, at 36, 38, 41.

25. *See* CRISIS & RESPONSE, *supra* note 21, at xiii, xix–xxiii (reporting that the FDIC closed 500 banks, 12% of all insured banks, at a cost of $73 billion).

26. *See infra* text accompanying notes 63 and 84.

27. Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (codified at scattered sections of 12, 15, 26, 37, 38 and 42 U.S.C.).

28. Anna Louie Sussman, *Ex-mortgage Document Exec Pleads Guilty in 'Robo-signing' Case*, REUTERS (Nov. 20, 2012, 7:56 PM), https://www.reuters.com/article/robosigning-plea/ex-mortgage-document-exec-pleads-guilty-in-robo-signing-case-idUSL1E8ML0C120121121.

29. Press Release, U.S. Dep't of Just., $25 Billion Mortgage Servicing Agreement Filed in Federal Court (Mar. 12, 2012), https://www.justice.gov/opa/pr/25-billion-mortgage-servicing-agreement-filed-federal-court.

30. *See, e.g.*, *Foreclosure Mediation Programs by State*, NAT'L CONSUMER L. CTR., https://www.nclc.org/issues/foreclosure-mediation-programs-by-state.html (last visited Nov. 19, 2021) (directing the reader's attention specifically to the Nevada foreclosure mediation rules).

Commission, was that there was an utter lack of ethical principles guiding either face-to-face transactions or corporate decision making.[31] As such, the first regulatory response was to reign in some of the more pernicious deeds through the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[32] ("Dodd-Frank"). This comprehensive legislation purported to deal with systemic risk. There were also amendments to the Truth in Lending Act of 1968[33] for greater disclosures about the costs of borrowing and new standards for mortgage loan origination. Moreover, many states followed with legislation that aimed to protect borrowers from lending abuses.[34] Regrettably, Dodd-Frank only offered prospective relief and did not operate to undo the millions of foreclosures that had already occurred or were in the pipeline.[35] Some foreclosed homeowners were relegated to entering into installment land contracts to buy back their homes.[36] While I discuss below, in more detail, the need for and promises of the regulatory constraints imposed by Dodd-Frank upon lenders, for the moment, as the lead into the main point of this Article, I will note that perversely, rather than making fair loans more readily available, the legislative and regulatory responses made it more difficult for the average borrower to obtain a mortgage loan. As new stringent underwriting standards became mandatory and as lenders were required to retain some of the risks, many withdrew from mortgage lending altogether. Enter the non-banks and non-debt financial companies ("NDNBs"), these entities, while not entirely new on the homebuying scene, are gaining ground. They cover the entire homebuying experience — from selling an existing home to providing down payment assistance to long-term financing. The great benefit of some of these models is that they offer a way past the seemingly insurmountable barrier — the twenty percent down payment — that often puts homeownership out of reach for many. The

31. For a discussion of the FCIC's findings, see *infra* text accompanying notes 68–72.

32. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. §§ 5301–5641).

33. 15 U.S.C. § 1601.

34. *E.g.*, N.Y. BANKING LAW § 590 (McKinney 2021); NEV. REV. STAT. § 645B (2020); MASS. GEN. LAWS ch. 255F (2021).

35. Many states, though, enacted foreclosure relief measures, and there were more than a few suits filed against lenders under the original version of TILA and other consumer protection laws. *See* Tami Luhby, *Predatory-Lending Lawsuits on the Rise*, CNN MONEY (Oct. 9, 2009, 7:19 AM), https://money.cnn.com/2009/10/08/news/economy/Predatory_lending_lawsuits_increase/index.htm; *see also* U.S. GEN. ACCT. OFF., FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING (2004), https://www.govinfo.gov/content/pkg/GAOREPORTS-GAO-04-280/html/GAOREPORTS-GAO-04-280.htm.

36. *See* Green, *Testing*, *supra* note 2, at 526.

national median home price in 2020 is nearly $350,000[37] and a twenty percent down payment, $70,000, would take a lifetime to save for a household having the median national income of $62,000. For some, NDNBs are the only path toward realizing the American dream. For many — the sophisticated millennials, at ease with technology in everyday affairs, NDNBs are perfectly fine. But for the cohort that figured so prominently among the losers in the housing crisis — the less well-educated, less sophisticated, the more risk averse — the rise in NDNBs is concerning. Because some of the NDNBs do not implicate traditional mortgages, they are not subject to the lending regulations aimed to help homebuyers make informed choices and to protect against abuses, although they could run afoul of regulations against fraudulent and deceptive practices. But this is a very broad standard. Even as all the contours of the programs are laid bare, they may yet pose undue risks to vulnerable consumers that are not mitigated by any regulation — they portend novel forms of ownership rights that threaten to disturb the existing taxonomy of property interests that may not be justified by any discernable societal interests in efficiency and low information costs. Whether these inventions and new forms of homeownership assistance serve to facilitate a promise of security and autonomy or a nightmare in another guise remains to be seen.

This Article explores the phenomenon of the NDNBs in home purchase and finance that has gained a growing presence in the mortgage marketplace since the 2008 crisis. Part II offers a deeper discussion of the risk-prone practices leading to the 2008 housing crisis and the regulatory and industry responses for recovery. Parts III and IV describe the emerging new models of home purchase. Part IV explores some of the apparent and hidden risks in these transactions. Part VI concludes with suggestions for assessing and managing risks and for reforms.

II. RISK-PRONE HOME PURCHASE AND LENDING PRACTICES LEADING TO 2008 HOUSING CRISIS

In this Part, I will highlight some of the more striking aspects of the 2008 housing crisis, about which so much has been written.[38] There seems little

37. *Median Sales Price of Houses Sold for the United States*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/MSPUS (last visited Nov. 19, 2021).

38. *E.g.*, *Financial Crises and Recovery: Financial Crises Timeline*, PACE UNIV., https://libraryguides.law.pace.edu/financialcrisis (last visited Nov. 19, 2021); U.S. DEP'T OF HOUS. & URB. DEV., REPORT TO CONGRESS ON THE ROOT CAUSES OF THE FORECLOSURE CRISIS (2010), https://www.huduser.gov/portal/publications/Foreclosure_09.pdf; Patricia A. McCoy, *The Housing Mortgage Financial Crisis: Lessons Learned* (Joint Ctr. for Hous. Stud., Working Paper No. HBTL-01, 2013), https://www.jchs.harvard.edu/sites/default/files/hbtl-01_0.pdf; William R. Emmons et al., *The*

disagreement among the commentators on its consequences — that it left the nation shaken to its economic core, fearful, and distrustful of the traditional markets and market makers. Despite rising nearly twenty-five percentage points from thirty four percent in 1934 to just under seventy percent in 2003, during the crisis, the rate of homeownership plummeted to 67.5% in just five years.[39] Reports revealed a slow climb back up to 67.9% in the second quarter of 2020.[40] The effects of the crisis were felt more sharply by certain populations within our society. For African-Americans, whose homeownership rates have always lagged behind whites, in the fourth quarter of 2008, it stood at only 46.8% only to rise to 47% in 2020.[41] There are similar disparities for Latino households (historically at 48.5%, but rising to 51.4% in 2020).[42] For Asian-Americans and Native Hawaiian and Pacific Islanders, the homeownership rate was (61.4% in 2020).[43] These numbers

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Foreclosure Crisis 2008: Predatory Lending or Household Overreaching?, REG'L ECONOMIST, July 2011, at 12, 12, https://core.ac.uk/download/pdf/6575498.pdf; Julie L. Stackhouse, *Lessons Learned from the Financial Crises*, FED. RSRV. BANK OF ST. LOUIS (Sept. 11, 2011), https://www.stlouisfed.org/dialogue-with-the-fed/lessons-learned-from-the-financial-crisis.

39. *See* Dean Baker, *Subprime Borrowers Deserve an Own to Rent Transition*, 5 ECONOMISTS' VOICE 1, 2 (2008), http://www.bepress.com/ev/vol5/iss1/art5; *see also* OFF. OF FED. HOUS. ENTER. OVERSIGHT, REPORT TO CONGRESS (2008), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/OFHEO_Report_Congress-2008.pdf.

40. U.S. CENSUS BUREAU, CURRENT POPULATION SURVEY/HOUSING VACANCY SURVEY, 6 tbl. 14 (2021) [hereinafter CENSUS POPULATION SURVEY], https://www.census.gov/housing/hvs/data/histtabs.html.

41. The St. Louis Federal Reserve Bank Research Series is the source for comprehensive rates of ownership by demographics and over time. *Homeownership Rates by Race and Ethnicity: Black Alone in the United States*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/BOAAAHORUSQ156N (last visited Jan. 18, 2022). A post-crisis analysis confirmed what many suspected while it was happening. *Helping Families Save Their Homes in Bankruptcy Act of 2009, and the Emergency Homeownership and Equity Protection Act: Hearing on H.R. 200 and H.R. 225 Before the H. Comm. on the Judiciary*, 111th Cong. (2009). That is, the rate of foreclosure for African-American and Latinx homeowners over age 50 was nearly double that for white homeowners in all age groups and roughly double the rate of minority homeownership. *See id.* at 71–72 (statement of David M. Certner, Legal Counsel and Legislative Policy Director, AARP, Washington, D.C.). The precise numbers are stark: Older African-American homeowners held only 6.8% of all first mortgages, but suffered 14.4% of all foreclosures; for Latinx homeowners, those numbers were 7.5% and 15.9% respectively. *Id.* For homeowners over the age of 50, there was nearly a 17 times greater likelihood that there loans were subprime. *Id.*

42. *Homeownership Rates by Race and Ethnicity: Hispanic (of Any Race) in the United States*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/HOLHORUSQ156N (last visited Nov. 19, 2021).

43. *Homeownership Rates by Race and Ethnicity: All Other Races: Asian, Native Hawaiian and Pacific Islander*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/ANHPIHORUSQ156N (last visited Nov. 19, 2021).

stand in contrast to the rates for whites: 74.8% in 2008, rising to 76% in 2020.[44] The causes of disparate rates of homeownership are in no small measure due to discriminatory mortgage lending practices as well as exclusionary land use practices.[45]

As the crisis set in, the estimated number of foreclosures was predicted to continue to rise to four to five million in the next two years — absent drastic intervention[46] — and later studies by the Congressional Research Office revealed that many mortgage holders were not inclined to engage in foreclosure avoidance courses, instead immediately invoking their contract rights to recourse in the property.[47]

A. The Housing Markets Before and After the Crisis

Although the real estate market is peculiarly subject to booms and busts,[48]

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44. *Homeownership Rates by Race and Ethnicity: Non-Hispanic White Alone in the United States*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/NHWAHORUSQ156N (last visited Nov. 19, 2021).

45. Discrimination in mortgage lending, from disparate lending terms to outright redlining, continues to burden borrowers of color. *See* Press Release, U.S. Dep't of Just., Justice Department Reaches Settlement with Wells Fargo Resulting in More Than $175 Million in Relief for Homeowners to Resolve Fair Lending Claims (July 12, 2012), https://www.justice.gov/opa/pr/justice-department-reaches-settlement-wells-fargo-resulting-more-175-million-relief. Discriminatory zoning only makes the problem more onerous as rates and terms of lending reflect the demographics of the loan area. *See* AMY DENINNO, THE ROLE OF ZONING REGULATIONS IN THE PERPETUATION OF RACIAL INEQUALITY AND POVERTY: A CASE STUDY OF OAKLAND, CALIFORNIA (2019), https://www.lincolninst.edu/sites/default/files/amy_narrative_final.pdf.

46. OFF. OF THRIFT SUPERVISION, MONTHLY MARKET MONITOR 8 (Jan. 22, 2009); *Meeting on Priorities for the Next Administration: Use of TARP Funds under EESA, Before the H. Comm. on Fin. Servs.*, 111th Cong. 18 (2009) [hereinafter *Use of TARP Funds under EESA*] (statement of John F. Bovenzi, Deputy to the Chairman and Chief Operating Officer, FDIC). In the midst of the crisis, it was feared that the number of foreclosures would rise to more than 10 million. *See also* Emmons et al., *supra* note 38, at 12; *Federal Deposit Insurance Corporation on Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and Efforts to Mitigate Foreclosures*, 110th Cong. (2008) (statement of Michael Krimminger, Special Advisor for Policy for Fed. Deposit Ins. Corp.), https://archive.fdic.gov/view/fdic/1581; *Use of TARP Funds under EESA*, *supra* note 46, at 17 (statement of John F. Bovenzi, Deputy to the Chairman and Chief Operating Officer, Fed. Deposit Ins. Corp.). The rate of foreclosures rose in 2008 to 1.84% and continued upward to 2.23% in 2010; not leveling off until 2019, when the rate dipped to .36%. *Foreclosure Rate in the United States from 2005 to 2020*, STATISTA, https://www.statista.com/statistics/798766/foreclosure-rate-usa/ (last visited Nov. 19, 2021).

47. EDWARD VINCENT MURPHY, CONG. RSCH. SERV., RL34653, ECONOMIC ANALYSIS OF A FORECLOSURE MORATORIUM 9–10 (2008).

48. *See* Jeffrey P. Cohen et al., *The Boom and Bust of U.S. Housing Prices from Various Geographic Perspectives*, 94 FED. RSRV. BANK OF ST. LOUIS REV. 341, 360 (2012), https://research.stlouisfed.org/publications/review/2012/09/04/the-boom-and-bust-of-u-s-housing-prices-from-various-geographic-perspectives.

for most of history, the price of homes kept pace with the rate of inflation. However, from 1995–2006, house prices diverged from other economic trends and increased dramatically, by eighty percent.[49] But, this rise was unsustainable — the leverage by borrowers with questionable credit holding subprime loans could not form the pillars for long-term stability.[50] Because many of the loans were 100% loans, as most of the early payments are allocated to interest, it would take many years into the loan before the homeowner would see any equity. When faced with the disruptions in the market, absent equity, there would be no safe exit by these borrowers.[51]

The prevailing lending practices also drove housing supply, with record or near-record levels of homes on the market.[52] High supplies, exacerbated by high foreclosure rates, would necessarily force down housing prices,

49. In 2001, home prices were at their highest ever and in 2006, home prices were double what they were ten years earlier. *See* Becky Sullivan & Ari Shapiro, *10 Years After Housing Crises: A Realtor, A Renter, Starting Over, Staying Put*, NPR (Apr. 28, 2018, 7:03 AM), https://www.npr.org/2018/04/28/603678259/10-years-after-housing-crisis-a-realtor-a-renter-starting-over-staying-put; *see also All-Transactions House Price Index for United States*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/USSTHPI (last visited Nov. 19, 2021).

50. The "subprime market" is so defined because the median FICO is substantially below that for prime loans (620 as compared to 723) and the loans carry high loan-to-value ratios. To control for the high risk of default given these characteristics, subprime loans typically have adjustable interest rates, often with a balloon payment of principal and negative amortization, under which the principal of the loan is not reduced on a schedule, but rather increases over the term. Under the 2/28 loans, the initial rate is typically very low and fixed for two years; thereafter, the rate adjusts periodically, in accordance with some index agreed to in the mortgage for the rest of the term. Depending on what is happening in the economy, the first adjustment could be a shocker if the borrower's financial means did not experience the same increases. *Cf.* Berghaus v. U.S. Bank, 360 S.W.3d 779, 784 (Ky. Ct. App. 2012) (rejecting claim of predatory lending and violations of federal disclosure requirements on account of lender's failure to disclose "potential for an enormous rate increase"). The related "Alt-A" market was also suffering. The Alt-A market consists of borrowers who are typically self-employed and consequently have unpredictable income streams. Even so, as their credit scores are a bit stronger, lenders made loans with little documentation and often with a high debt-to-income ratio. *See* SUMIT AGARWAL & CALVIN T. HO, COMPARING THE PRIME AND SUBPRIME MORTGAGE MARKETS 1–2 (2007), https://fraser.stlouisfed.org/files/docs/historical/frbchi/fedletter/frbchi_fedletter_2007_241.pdf. If lenders hoped for different results in the case of the Alt-A borrower, they were sorely mistaken.

51. *See* LEXISNEXIS, SUBPRIME LENDING: AN UPDATE OF THE ISSUES AND APPROACHES 23 (2007); *see also* Steven L. Schwarcz, Systemic Risk and the Financial Crisis: Protecting the Financial System as a 'System' 16 (Feb. 12, 2014) (unpublished manuscript) (on file with the University of California Berkeley School of Law), https://www.law.berkeley.edu/files/bclbe/Schwarcz_Paper.pdf.

52. *See Monthly Supply of Houses in the United States ("MSACSR")*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/MSACSR (last visited Nov. 19, 2021) (tracking housing supply by month).

which continued to drop through 2010 only to stabilize beginning in 2011.[53] These declining prices and stalled markets created the phenomenon of underwater mortgages; at one point, more than a third of all mortgages in the country had this characteristic.[54] As home values plunged and foreclosures skyrocketed, local governments were taxed to provide emergency shelter and social services to the displaced former homeowners and to shore up communities against blight and instability.[55]

Market participants appeared to deliberately target the vulnerable to lure them into burdensome mortgage transactions, without warning of their eventual costs.[56] Subprime loans were the financing forms de jour for

53. *See All-Transactions House Price Index for the United States*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/USSTHPI (last visited Nov. 19, 2021) (depicting housing prices from 1975–2021).

54. The state of being "underwater" exists when the amount owed on the mortgage loan is greater than the market value of the home. FANNIEMAE, KEYS TO RECOVERY (2008), https://www.fanniemae.com/media/28871/display; *see also* ASHLYN AIKO NELSON, BAILING OUT UNDERWATER MORTGAGES (2010), https://oneill.indiana.edu/doc/research/mortgages_nelson.pdf (reporting that the percent of underwater mortgages in the country reached nearly 40% by 2009).

55. *See, e.g.*, Bank of America Corp. v. Miami, 137 S. Ct. 1296, 1300–02 (2017) (seeking recovery for increased costs of municipal services after many foreclosures of subprime mortgages); Oakland v. Wells Fargo, 972 F.3d 1112, 1117 (9th Cir. 2020) (seeking damages under the Fair Housing Act for reduced tax revenues because of a high rate of foreclosure of predatory loans).

56. *See* Christopher Kent, Assistant Governor (Financial Markets) of the Reserve Bank of Australia, Address to the Housing Industry Association Breakfast: The Limits of Interest-Only Lending (April 24, 2018), https://www.bis.org/review/r180426f.htm (discussing the risks of interest-only and negative-amortization loans). It was no surprise that these loans accounted for the large percentage of delinquencies in the crisis. *See* James Bullard et al., *Systemic Risk and the Financial Crisis: A Primer*, 91 FED. RSRV. BANK OF ST. LOUIS REV. 403 (2009), https://research.stlouisfed.org/publications/review/2009/09/01/systemic-risk-and-the-financial-crisis-a-primer/ (examining how subprime loans affected the larger housing market); Christopher Palmer, Why Did So Many Subprime Borrowers Default During the Crisis: Loose Credit or Plummeting Prices? 1 (Apr. 14, 2015) (unpublished manuscript), https://files.consumerfinance.gov/f/documents/P5_-_CPalmer-Subprime.pdf ("The subprime default rate — the number of new subprime foreclosure starts as a fraction of outstanding subprime mortgages — tripled from under 6% in 2005 to 17% in 2009. By 2013, more than one in five subprime loans originated since 1995 had defaulted."); Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Rsrv. Sys., Remarks at the Federal Reserve Board of Chicago's 43rd Annual Conference on Bank Structure and Competition: The Subprime Mortgage Market (May 17, 2017), https://www.bis.org/review/r070522a.pdf (stating that for subprime "mortgages, the rate of serious delinquencies . . . rose sharply during 2006 . . . about 11 percent, about double the recent low seen in mid-2005 . . . . In the fourth quarter of 2006, . . . subprime mortgages accounted for more than half of the foreclosures."); MORTG. BANKERS ASS'N, NATIONAL DELINQUENCY SURVEY 3 (2007), https://fcic-static.law.stanford.edu/cdn_media/fcic-docs/2008-03-00%20MBA%20National%20Delinquency%20Survey.pdf (reporting that in "the fourth quarter of 2007, the foreclosure inventory rate increased 17 basis points for prime loans (from 0.79

borrowers of color, in diverse neighborhoods, irrespective of credit standing.[57] This was all the more heinous because "yield spread premiums" were rewards from creditors to mortgage brokers who locked borrowers into higher-cost loans.[58]

B. The Regulators Were Watching God[59]

In the years leading up to the crisis, the regulators did not see that the rise in mortgage loan originations — up to $2 trillion in 2007 — would eventually come crashing down.[60] Indeed, after the collapse, they shrank to less than a fraction of that level, to $1.4 trillion, and did not recover until 2012.[61] The regulators also did not see the tsunami of defaults at the market's edge.[62]

When the storm was full upon the nation, the regulators reacted with a variety of measures — including cash infusions into the market (the Troubled Assets Relief Program or "TARP"),[63] interest rate cuts, and eventually regulatory reforms, most significantly Dodd-Frank.[64] Before

percent to 0.96 percent), and increased 176 basis points for subprime loans (from 6.89 percent to 8.65 percent)"); SHARON L. STARK & ZHONG YI TONG, QUARTERLY MARKET MONITOR QMM 5-09 (OFF. OF THRIFT SUPERVISION) 5 (May 7, 2009).

57. *See* Emily Badger, *The Dramatic Racial Bias of Subprime Lending During the Housing Boom*, BLOOMBERG CITYLAB (Aug. 16, 2013, 6:54 AM), https://www.bloomberg.com/news/articles/2013-08-16/the-dramatic-racial-bias-of-subprime-lending-during-the-housing-boom.

58. *See* FCIC FINAL REPORT, *supra* note 7, at xxii; Shelby D. Green, *Shadowing Lenders and Consumers: The Rise, Regulation, and Risks of Non-Banks*, 37 BANKING & FIN. SERVS. POL'Y REP., Sept. 2018, at 12, 13; *see also* Green, *Disquiet*, *supra* note 1, at 9 n.9, 10 n.14.

59. ZORA NEALE HURSTON, THEIR EYES WERE WATCHING GOD 235 (1937). In the midst of a fierce hurricane, the people seemed to stare into the dark, perhaps resigning themselves to idea that only the almighty could save them.

60. *See* Samuelson, *supra* note 6, at 19; Greg Buchak et al., *Fintech, Regulatory Arbitrage, and the Rise of Shadow Banks* 11 (Nat'l Bureau of Econ. Rsch., Working Paper No. 23288, 2018), http://www.nber.org/papers/w23288.

61. Buchak et al., *supra* note 60, at 11.

62. Both lenders and borrowers, at best miscalculated, or at worst simply ignored, their risks. *See* CRISIS & RESPONSE, *supra* note 21, at xxiv–xxv, xxxvi.

63. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

64. *See* Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Rsrv. Sys., Speech at the Women in Housing and Finance and Exchequer Club Joint Luncheon: Financial Markets, the Economic Outlook, and Monetary Policy (Jan. 10, 2008), https://www.federalreserve.gov/newsevents/speech/bernanke20080110a.htm (describing the effects of the housing market on the U.S. economy and response); *see also* Glenn Hubbard, *Financial Regulatory Reform: A Progress Report*, 95 FED. RSRV. BANK OF ST. LOUIS 181, https://files.stlouisfed.org/files/htdocs/publications/review/13/03/181-198Hubbard.pdf (noting how regulators failed to act to avoid the

discussing Dodd-Frank in some detail, I will take a moment to comment on the efficacy of the regulators' immediate responses. Some say that their most regrettable error was letting Lehman Brothers fail in September 2008.[65] Because rather than staunch the hemorrhaging in the market, that bankruptcy sent out dramatic waves of more panic, which led to the total absence of trust. No one would lend, which in turn meant no one was spending or hiring, which ultimately led to the need for the rescue of many other companies.[66] Moreover, the regulators failed to employ the available regulatory tools to curb the rising housing market and the credit surge — increased interest rates, caps on loan-to-value ratios, and greater capital retention by banks.[67] Instead, by allowing the market to operate unconstrained, the regulators left market participants susceptible to the slimmest changes in market dynamics.

When the waters calmed and Congress was able to discern the lapses, the Dodd-Frank legislation that followed the emergency responses was largely prophylactic in nature. Dodd-Frank resulted from the findings of the Financial Crisis Inquiry Commission, as part of the Fraud Enforcement and Recovery Act.[68] The Financial Crisis Inquiry Report was issued in January 2011, and in scathing terms made plain that had the regulators been watching things on the ground — the explosive growth in subprime lending, securitization, and the unsustainable rise in housing prices — the crisis might not have happened.[69] In addition, the report noted, as the Federal Reserve failed to set prudent mortgage-lending standards, banks, both investment and depositary, bought and sold mortgage securities without scrutinizing them

crisis).

65. At the same time as Lehman Brothers was allowed to fall down, following measures adopted during the Great Depression, several states enacted moratoria on foreclosures. *See* PEW CHARITABLE TR., DEFAULTING ON THE DREAM: STATES RESPOND TO AMERICA'S FORECLOSURE CRISIS 3 (2008), https://www.pewtrusts.org/en/research-and-analysis/reports/2008/04/16/defaulting-on-the-dream-states-respond-to-americas-foreclosure-crisis; *see* Frank S. Alexander et al., *Legislative Responses To The Foreclosure Crisis In Nonjudicial Foreclosure States*, 31 REV. BANKING & FIN. L. 341, 365 (2012). Now and during that earlier frightful period, states passed legislation that gave borrowers rights to redeem the foreclosed property after sale and limited or precluded deficiency judgments. *See* David Wheelock, *Changing the Rules: State Mortgage Foreclosure Moratoria During the Great Depression*, 90 FED. RSRV. BANK OF ST. LOUIS REV. 569, 569, 570, 574 (2008).

66. *See The Origins of the Financial Crisis: Crash Course*, THE ECONOMIST (Sept. 7, 2013), https://www.economist.com/schools-brief/2013/09/07/crash-course.

67. *See id.*

68. Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617.

69. *See* FCIC FINAL REPORT, *supra* note 7, xi, xv–xxviii (summarizing the findings and conclusions of the Commission).

for their quality; some even knew they were rubbish.[70] Not seeing the trends, the federal policy makers — the Treasury, the Federal Reserve Board, and the Federal Reserve Bank of New York — were ill-prepared to respond in a meaningful way to arrest or at least to minimize the crisis, instead, they were resigned to let it burn itself out.

It was not just the regulators who defaulted in their oversight responsibilities, but corporate boards, who at the first line, abandoned sound decision-making principles and risk evaluation, prudence and ethics, ignored the long-view and instead were driven only by prospective gain from the deal on the table in the moment. This fixation left them ill-prepared even for the most minor shocks in the market.[71] Lax loan origination policies, inflated appraisals, and dishonest ratings of mortgage-backed securities by the ratings agencies, Moody's, Standard & Poor's, and Fitch, (who were paid to give high ratings) were some of the more pernicious practices that created a powerful recipe for implosion and collapse.[72]

Dodd-Frank outlawed these practices. The legislation aimed to establish new morals of the marketplace and to protect consumers and lenders in their loan transactions.[73] Recognizing that the work of the then five regulatory agencies might sometimes overlap or reveal gaps, Dodd-Frank created the Financial Stability Oversight Council ("FSOC") to identify "systemically important financial institutions" ("SIFI") and to monitor them for practices as would threaten the financial stability of the industry.[74] Those institutions would then be subject to heightened regulatory constraints and disclosure-based obligations.[75]

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70. *Id.* at xvii–xx.

71. *Id.* at xxii–xxiii. The report found that investment banks operated on only veneers of capital. For example, at the end of 2007, Bear Stearns was frantically borrowing up to $70 billion in the overnight market, when it had only $11.8 billion in equity and faced $383.6 billion in debt. This "was the equivalent of a small business with $50,000 in equity borrowing $1.6 million, with $296,750 of that due each and every day." *Id.* at xx. In the six years from 2001 to 2007, "national mortgage debt nearly doubled, and the amount of mortgage debt per household rose more than 63% from $91,000 to $149,500, even while wages were essentially stagnant." *Id.*

72. *Id.* at xxv, 125–26.

73. Before the 2008 financial crisis, consumer financial protection was largely performed by the U.S. Department of Housing and Urban Development and the Federal Trade Commission. The Dodd-Frank Act invested much of this authority into a new Consumer Financial Protection Bureau ("CFPB"), but bank regulators still supervise many consumer activities of their chartered firms. Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617.

74. *See* Hilary J. Allen, *Putting the "Financial Stability" in Financial Stability Oversight Council*, 76 OHIO ST. L.J. 1087, 1113–20 (2015) (describing the structure and mandate of FSOC).

75. The process of labeling a company as "systemically important" has been a fraught one. When the FSOC designated the insurer MetLife as "systemically important"

Under Dodd-Frank, "too big to fail" would become but a song. Instead, firms would be monitored for unsafe practices and be required to disinvest of certain assets — those that posed "grave threat[s] to the financial stability of the United States."[76] Portfolios would be required to be diverse[77] and institutions would be required to maintain minimum capital levels.[78] These requirements would be evaluated by regular "stress tests" to ensure that firms could survive a variety of economic shocks in the market.[79] There would be prophylactic limits on consolidations and mergers of companies reaching certain liability thresholds.[80] Otherwise, SIFIs would be allowed to fail and need "living wills" for an orderly liquidation in case of improvident demise.[81] No longer would the Federal Reserve make emergency loans to specific firms, but "only to participants in a program or facility with broad-based eligibility designed for the purpose of providing liquidity to the financial system";[82] no longer would the Federal Deposit Insurance

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in 2014, MetLife challenged the designation in court, and the district court subsequently struck down the designation, finding the FSOC failed to conduct a cost-benefit analysis. *See* Ryan Tracy, *MetLife Asks Appeals Court to Uphold Removal of "SIFI" Label*, WALL ST. J. (Aug. 16, 2016, 10:38 AM), https://www.wsj.com/articles/metlife-asks-appeals-court-to-uphold-removal-of-sifi-label-1471355267. While the case was on appeal to the D.C. Circuit Court of Appeals, the parties agreed to a dismissal.

76. Dodd-Frank Act, 12 U.S.C. § 5331(a).

77. *See* FDIC, RMS MANUAL OF EXAMINATION POLICIES § 3.2 (2020), https://www.fdic.gov/regulations/safety/manual/section3-2.pdf.

78. Josh Morris-Levenson et al., Does Tighter Bank Regulation Affect Mortgage Originations? 6–7 (Jan. 20, 2017) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2941177, explains that minimum levels of capital serve to enable firms to absorb market shocks and otherwise to control economic losses. The new regulations require certain banks to hold enough liquid assets to survive periods where refinancing is not possible. *Id.* at 7.

79. *See* Prasad Krishnamurthy, *Regulating Capital*, 4 HARV. BUS. L. REV. 1, 3 (2014) (noting that these enhanced capital requirements for SIFIs accord with international standards). For an in-depth discussion of how stress tests work in practice, see Robert Weber, *A Theory for Deliberation-Oriented Stress Testing Regulation*, 98 MINN. L. REV. 2236, 2290–301 (2014).

80. 12 U.S.C. § 1852(b) (providing that "a financial company may not merge or consolidate with . . . another company, if the total consolidated liabilities of the acquiring financial company upon consummation of the transaction would exceed 10 percent of the aggregate consolidated liabilities of all financial companies"); *see also* DAVIS POLK & WARDWELL LLP, PROPOSED DODD-FRANK LIMIT ON FINANCIAL INSTITUTION M&A TRANSACTIONS (2014), https://www.davispolk.com/sites/default/files/05.27.14.DoddFrank.Concentration.Limit_.on_.Financial.Institution.MA_.pdf (discussing the concentration limit proposal).

81. *See* Nizan Geslevich Packin, *The Case Against the Dodd-Frank Act's Living Wills: Contingency Planning Following the Financial Crisis*, 9 BERKELEY BUS. L.J. 29, 39 (2012) (explaining the liquidation planning required by Dodd-Frank).

82. Extensions of Credit by Federal Reserve Banks, Loans, 80 Fed. Reg. 78,959 (Dec. 18, 2015) (to be codified 12 C.F.R. pt. 201). *See generally* MARC LABONTE, CONG.

Corporation ("FDIC") offer emergency loan guarantees.[83] The TARP would be the first and last bailout.[84] Instead, the FDIC would move to liquidate failing financial firms.[85] By these measures, Dodd-Frank aimed to remove the incentive to act recklessly with the bravado of impunity.

i. Protections for the Hapless Borrower

Dodd-Frank created the Consumer Financial Protection Bureau ("CFPB") to adopt rules for the entire lending process — from loan origination to loan servicing.[86] The rules would apply to depository institutions and non-banks

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RSCH. SERV., R44185, FEDERAL RESERVE: EMERGENCY LENDING (2020), https://fas.org/sgp/crs/misc/R44185.pdf (examining the use of Section 13(3) of the Federal Reserve Act).

83. For a discussion of the problematic incentives of emergency loan authority, see Anthony J. Casey & Eric A. Posner, *A Framework for Bailout Regulation*, 91 NOTRE DAME L. REV. 479 (2015).

84. See Gary Lawson, *Burying the Constitution Under a TARP*, 33 HARV. J.L. & PUB. POL'Y 55, 57–58 (2010) for a lively critique of TARP.

85. *See* CRISIS & RESPONSE, *supra* note 21, at 190–93 (explaining the process of bank receiverships); 12 U.S.C. § 5390(n).

86. In the aftermath of the crisis, many states adopted a myriad of protections for borrowers at the initial contracting stage and when facing foreclosure. These protections include limits on the terms of high-cost loans and required counseling in advance of taking the loan. The failure to comply with these requirements could be onerous for lenders. *See, e.g.*, LaSalle Bank, N.A. v. Shearon, 850 N.Y.S. 871 (Sup. Ct. 2008) (canceling the entire debt upon violations of banking law on a high-cost loan). In some states, settlement conferences are required before a foreclosure complaint may proceed, with the aim of allowing time to cure a default or averting foreclosure altogether. *See* Abigail Lawlis Kuzma, *Foreclosure in the Heartland: What Did We Learn?*, 49 VAL. U. L. REV. 39 (2015); *see also 2008 Enacted Foreclosure Legislation*, NAT'L CONF. STATE LEGIS., https://www.ncsl.org/research/financial-services-and-commerce/foreclosures-2008-enacted-legislation.aspx (last updated Jan. 21, 2009) (summarizing recently enacted foreclosure laws across the fifty states); NEGOTIATED ALTERNATIVE TO FORECLOSURE ACT (UNIF. L. COMM'N 2017) *see also, e.g.*, N.Y. BANKING LAW § 6-1 (McKinney 2021). *See generally* Geoffrey Walsh, *State and Local Foreclosure Mediation Programs: Can They Save Homes?*, NAT'L CONSUMER L. CTR. (Sept. 2009), https://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-state-mediation-programs.pdf (considering the efficacy of mitigation programs in to prevent homes from being foreclosed); NEV. REV. STAT. § 107.086(3) (2021) (discussing mediation); ALON COHEN, CTR. FOR AM. PROGRESS, WALK THE TALK: BEST PRACTICES ON THE ROAD TO AUTOMATIC FORECLOSURE MEDIATION 2 (2010), https://www.americanprogress.org/wp-content/uploads/issues/2010/11/pdf/walk_the_talk.pdf (highlighting the benefits of foreclosure mediation); Aleatra P. Williams, *Foreclosing Foreclosure: Escaping the Yawning Abyss of the Deep Mortgage and Housing Crisis*, 7 NW. J. L. & SOC. POL'Y 454 (2012) (arguing for regulations to encourage homeownership and safeguard homeowners); Frank S. Alexander et al., *Legislative Responses To The Foreclosure Crisis In Nonjudicial Foreclosure States*, 31 REV. BANKING & FIN. L. 341 (2011) (examining states' legislative response to increased foreclosures during the 2008 crisis).

alike, to ensure fair lending laws market-wide.[87] In my view, the most significant invention of the CFPB is the ability to repay ("ATR") rule.[88] Under this rule, lenders must make an affirmative determination of a borrower's ability to repay the loan, and not just at the initial rate, but over the loan's full term in the case of an adjustable-rate mortgage.[89] This means that borrowers must be given a good faith estimate of the monthly payment amount *after* it adjusts or resets,[90] and must be given six months' notice that the mortgage changed from fixed to adjustable.[91] To make the ATR determination, lenders must review hard evidence of creditworthiness, such as pay stubs and bank accounts.[92] Accordingly, "no- or low-doc" loans cannot be extended.[93] The CFPB also adopted the "Qualified Mortgage," a safe harbor for lenders whose loan meets the ATR requirements[94] and satisfy specific conditions meant to reduce risk. The loan:

- may not contain the onerous features (negative amortization, adjustable rates);[95]
- cannot have a term longer than 30 years;[96]
- cannot charge points and fees that exceed a specific threshold;[97] and
- cannot be made to borrowers with a debt-to-income ratio greater than forty-three percent.[98]

For loans that are not qualified, lenders may not assess prepayment penalties for adjustable-rate and higher cost mortgages nor may they push

87. *See* Truth in Lending, 73 Fed. Reg. 44,522 (July 30, 2008) (to be codified at 12 C.F.R. pt. 226).

88. 12 C.F.R. § 1026.43(c) (2021); *see* Patricia A. McCoy & Susan M. Wachter, *Why The Ability-To-Repay Rule Is Vital To Financial Stability*, 108 GEO. L.J. 649, 649 (2020) (asserting that the "ability-to-repay rule acts as a circuit breaker that will help prevent poorly underwritten loans from fueling a future bubble in housing prices that creates the risk of financial collapse").

89. Dodd-Frank, 15 U.S.C. § 1639c(a); 12 C.F.R. § 1026.43(c)(4).

90. 12 C.F.R. 1026.20(d).

91. *See id.*

92. *Id.* §1026.43(c)(3)–(4).

93. *See id.* § 1026.43(c)(3)(i), (c)(4) (noting the verification requirements).

94. *Id.* § 1026.43(e)(2), (e)(4).

95. *Id.* § 1026.43(e)(2)(i).

96. *Id.* § 1026.43(e)(2)(ii).

97. *Id.* § 1026.43(e)(3).

98. *Id.* § 1026.43(e)(2)(v); Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z): General QM Loan Definition, 85 Fed. Reg. 86,308, 86, 308 (Dec. 29, 2020) (to be codified at 12 C.F.R. pt. 1026) ("For General QM's, the ratio of the consumer's total monthly debt to total monthly income . . . must not exceed 43 percent.").

loans with prepayment penalties even if fixed rate, over ones without.[99] In no case may lenders finance worthless credit or other insurance.[100] New rules also require homeownership counseling.[101] And, this is telling of the practices pre-crisis, for loan soundness, the CFPB rules require that the property is appraised before any deal is closed for higher priced loans,[102] and that the appraiser adhere to industry standards in preparing a report, including inspecting the interior of the property.[103]

To make the loan process less opaque, the CFPB substituted the long-used, but sometimes inscrutable federal mortgage forms, the HUD-1 Settlement ("HUD-1") and Truth-in-Lending Disclosure ("TIL") statements, with two plain-speaking more accessible forms — the Loan Estimate and Loan Closing Disclosure Statement.[104] The amendments also prohibited deceptive advertising, banned lenders and brokers from influencing appraisers, and barred servicers from engaging in unfair servicing practices related to fees and billing.[105]

C. Control of Government-Sponsored Enterprises by the Federal Housing Finance Agency

The crisis could not have caught on without the support from GSEs.[106] Fannie Mae and Freddie Mac, although government-chartered, acted as any other profit-seeking entity. At their peak, they amassed investment

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99. 12 C.F.R. §§ 1026.43(g)(1)(ii)(A); 1026.43(g)(3).

100. *Id.* § 1026.36(i). Before Dodd-Frank, it was common to charge steep premiums for unnecessary credit life insurance and to finance these premiums as part of the mortgage loan.

101. *Id.* § 1026.34(5); *see id.* § 1026.36(a)(5). There are also prohibitions on: 1) compensation to loan originators by persons other than the borrower, *id.* § 1026.36(d)(2); 2) the payment of a "yield spread premium" to brokers for selling high-cost loans to borrowers, *id.* § 1026.36(d)(1); 3) the steering of borrowers into certain loans, *id.* §1026.36(e); 4) the mandatory arbitration and waivers of consumer rights, *id.* §1026.36(h); and 5) the making of negative amortization loans to first-time borrowers without counseling, *id.* § 1026.36(k).

102. *See id.* § 1026.35(a)(1) (defining "higher-priced mortgage loan").

103. *Id.* § 1026.35(c)(3).

104. *See TILA-RESPA Integrated Disclosures*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/compliance/compliance-resources/mortgage-resources/tila-respa-integrated-disclosures (last visited Nov. 20, 2021) (linking the Loan Estimate Form and the Closing Disclosure Form).

105. *See* Green, *Testing*, *supra* note 2, at 492; Linda Singer et al., *Breaking Down Financial Reform: A Summary of the Major Consumer Protection Portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 14 J. CONSUMER & COM. L. 2, 4–6 (2010).

106. *See* INT'L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT 111, 131 (2011); *see also* Theresa R. DiVenti, *Fannie Mae and Freddie Mac: Past, Present, and Future*, 11 CITYSCAPE: J. POL'Y DEV. & RES. 231, 231–33 (2009).

portfolios of more than $1.5 trillion. Because the portfolios were undiversified, consisting almost entirely of home mortgages and securities backed by them, the GSEs were particularly vulnerable in the crisis, as more than twenty percent of these mortgages were in default.[107] HERA was enacted to avert their impending collapse. HERA created the Federal Housing and Finance Agency ("FHFA"), to oversee and essentially control GSE's business activities and determine what other activities they would be allowed to engage in, what assets to hold, and what capital to reserve.[108] No sooner than it was created, the FHFA placed Fannie Mae and Freddie Mac in "voluntary" conservatorship to shield them from claims and to monitor their activities.[109]

III. RISE OF NON-BANKS IN HOME PURCHASE FINANCE

The post-crisis regulatory constraints on banks, seem to have provided the opening for "shadow banking,"[110] that is, financial transactions by "non-banks."[111] The precarious fiscal state of commercial banks, along with Dodd-Frank's heightened capital requirements crippled many banks' ability to lend.[112] Many retreated from the loan origination market altogether, thinking that the industry was too costly,[113] especially because of new regulations requiring lenders to have some skin in the game by holding onto some of their loans on their balance sheets and the new liquidity requirements.[114] These constraints seemed to make loan origination

107. GLOBAL FINANCIAL STABILITY REPORT, *supra* note 106, at 12; *see also* Green, *Testing*, *supra* note 2, at 480.

108. Green, *Testing*, *supra* note 2, at 483 (describing the expansive role of the FHFA to prevent the GSEs from accumulating debt).

109. In *Testing*, I recount how after the conservatorship was imposed, the missions and policies of Fannie Mae and Freddie Mac changed — from that of making housing available to the greatest number, to a matter of self-preservation, with sometimes heart-rendering impacts on the hapless borrowers, whose mortgages were bought and foreclosed by the GSEs. *See id.* at 495.

110. "*Shadow banking*" has alternative meanings. In some contexts, it refers "to the funding of loans through securities markets instead of banks — or to the funding of banks through securities markets instead of deposits." EDWARD V. MURPHY, CONG., RSCH. SERV., R43087, WHO REGULATES WHOM AND HOW? AN OVERVIEW OF U.S. FINANCIAL REGULATORY POLICY FOR BANKING AND SECURITIES MARKETS 9 (2013). In other contexts, it "refer[s] to financial activity that is ineligible for a government backstop," i.e., deposit insurance and access to the Federal Reserve's discount window. *Id.*

111. *Id.* at 21.

112. AMIN RAJAN, THE RISE OF PRIVATE DEBT AS AN INSTITUTIONAL ASSET CLASS 3 (2015).

113. *Id.* at 4; *see also* Morris-Levenson et al., *supra* note 78, at 2, 7 (making the connection between the decline of banks in the loan origination markets and Dodd-Frank capital and liquidity requirements).

114. *See* Morris-Levenson et al., *supra* note 78, at 7 (detailing the effects of the

economically unprofitable, since the higher capital requirements meant lost business opportunities as less funds were available for lending.[115] With lower loan-to-value ratios, tightened underwriting standards, and the absence of government agency guarantees,[116] it seemed safer to stay out of the business altogether rather than risk liability for regulatory lapses.[117] The retreat occurred more often by larger banks[118] creating a perfect entry point for non-banks.[119] Non-banks took advantage of historically high yields and acquired "legacy residential mortgage exposure at very high levels."[120]

As the term suggests, non-banks are not depositary institutions, thus their operations are not at the core of bank regulation. Yet, they have a presence in all aspects of the credit markets, from mortgage loan origination to payday lenders.[121] Their sui generis character makes them ineligible for government guarantees, such as deposit insurance, and the Federal Reserve's emergency discount window. As I discuss below, the very fact that they are untethered from the traditional banking system, should prompt us to look for meaningful reins.

A. Novel Business Models: A Janus Effect

NDNBs are "two-faced," but not something altogether ugly, as that term suggests. Instead, the increased market liquidity and diversity of funding sources aligns well with current financing philosophy and promises to allocate risks to investors more efficiently. The technology-driven business models that obviate the need for brick-and-mortar establishments, and

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liquidity coverage ratio).

115. *See id.*at 7–8.

116. Joshua Anderson & Tom Collier, *Earning an Illiquidity Premium in Private Credit*, PIMCO (July 7, 2015), https://www.pimco.com/en-us/insights/investment-strategies/featured-solutions/earning-an-illiquidity-premium-in-private-credit/.

117. *See* Buchak et al., *supra* note 60, at 2 (suggesting the path for the entry of fintech was made by the retreat of banks from the market); *see also* Julapa Jagtiani & Catharine Lemieux, *Fintech Lending: Financial Inclusion, Risk Pricing, & Alternative Pricing* 2, 22–23, 26, 38 (Fed. Rsrv. Bank of Chi., Working Paper No. 17-17, 2017) (noting that the use of novel algorithms and data sources risks diverging regulations); Kathleen Pender, *Why Big Banks are Losing Out to Nonbank Lenders in Mortgages*, S.F. CHRON., https://www.sfchronicle.com/business/networth/article/Why-big-banks-are-losing-out-to-nonbank-lenders-6106027.php (last updated Feb. 28, 2015).

118. Morris-Levenson et al., *supra* note 78, at 2.

119. Anderson & Collier, *supra* note 116, at 3.

120. *Id.*

121. *See* Stanley Fischer, Vice Chairman, Bd. of Governors of the Fed. Rsrv. Sys., Speech at the Central Banking in the Shadows: Monetary Policy and Financial Stability Postcrisis, 20th Annual Financial Markets Conference: Nonbank Financial Intermediation, Financial Stability, and the Road Forward (Mar. 30, 2015), https://www.federalreserve.gov/newsevents/speech/fischer20150330a.htm.

humans for that matter, are very twenty-first century. They have been dubbed "fintech"[122] as they employ digital tools that operate autonomously and are thought to produce greater efficiencies for the entity and ease of use for customers.[123] While there will be some losses from the lack of human judgment in transactions, fintech's use of alternative metrics for assessing risk has made home financing more available to a different cohort of borrowers — those who appear under traditional criteria to be financially marginal, but under eccentric gauges, not.[124]

These same characteristics might describe the other, perhaps dark side of NDNBs — in particular their growing market and their heavy reliance on the FHA to insure their loans.[125] In 2020, of the top five lenders, three were non-banks, Quicken Loans, United Wholesale Mortgage, and Penny Mac.[126] The market share of non-banks rose nearly three-fold from fourteen percent in 2008 to over fifty percent in 2017.[127] The share continued to rise thereafter, from 58.9% in 2019 to 68.1% in 2020.[128] Non-banks sell most of their

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122. *See infra* Part III.B.

123. *See* Buchak et al., *supra* note 60, at 2–3 (stating that advances in technology allow fintech firms to save labor costs, utilize advanced screening processes for loan applicants, and provide better products and convenience to customers).

124. I discuss these new metrics *infra* text accompanying notes 133–39.

125. *See* You S. Kim et al., *Liquidity Crises in the Mortgage Market*, BROOKINGS PAPERS ON ECON. ACTIVITY, 348, 348 (2018), https://www.brookings.edu/wp-content/uploads/2018/03/KimEtAl_Text.pdf (linking the number of lenders engaged with the FHA and VA to government vulnerabilities to nonbank lenders); Martin N. Baily et al., *The Origins of the Financial Crisis*, INITIATIVE ON BUS. & PUB. POL'Y AT BROOKINGS 14–15 (2008), https://www.brookings.edu/wp-content/uploads/2016/06/11_origins_crisis_baily_litan.pdf (identifying that "[i]n 2001 there were $2.2 trillion worth of mortgage originations with 65 percent of these in the form of conventional conforming loans and Federal Housing Administration (FHA) and Department of Veteran Affairs (VA) loans").

126. *See* Alicia Phaneuf, *The Growing Market Share of Nonbanks and Alternative Financing in the Online Mortgage Lending Industry*, BUS. INSIDER (Jan. 19, 2021, 10:40 AM), https://www.businessinsider.com/alternative-nonbank-mortgage-lending; John Bancroft, *The Battle for Origination Supremacy: Nonbanks at 63% Market Share*, INSIDE MORTG. FIN. (Jun. 25, 2020), https://www.insidemortgagefinance.com/articles/218443-the-battle-for-origination-supremacy-nonbanks-at-63-market-share. *See generally* Kayla Shoemaker, *Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period,* 13 FDIC Q. 51 (2019), https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article3.pdf (discussing mortgage trends since the 1970s).

127. *See* Kathryn Fritzdixon, *Bank and Non-bank Lending Over the Last 70 years*, 13 FDIC Q. 31, 34 (2019), https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article1.pdf; *see also* Pedro Gete & Michael Rehr, Mortgage Securitization and Shadow Bank Lending 1, 4 (June 2020) (unpublished manuscript), https://ssrn.com/abstract=2921691 (discussing the market share of nonbanks in mortgage origination).

128. Orla McCaffrey, *Nonbank Lenders Are Dominating the Mortgage Market*, WALL

mortgages to the GSEs, since nearly eighty percent carry FHA insurance, which makes them eligible for purchase.[129] As market shares have increased, the requirements on the borrower's side of financing have changed — the average down-payment has dropped to 11.4% from 20%[130] and FICO scores have dropped to a median of 710 out of 850,[131] very close to the subprime cutoff.[132]

B. How the Fin-Tech Non-Banks Operate

As the term suggests, fintech is computer-driven technology with standards and protocols for manipulating and transmitting data.[133] These firms use complex algorithms that purport to assess credit risk, based on an analysis of a variety of data — from citizenship or residence status, social security accounts, and bank account records.[134] While FICO scores factor prominently in this assessment, instead of a credit score,[135] non-banks assign the would-be borrower a credit grade,[136] which is calculated based on the

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ST. J. (June 22, 2021, 9:11 AM), https://www.wsj.com/articles/nonbank-lenders-are-dominating-the-mortgage-market-11624367460.

129. As an example, by the end of 2017, the non-bank share of Ginnie Mae's purchases was nearly 60%. Kim et al., *supra* note 125, at 352.

130. Sara Ventiera, *Where Buyers Are Making the Lowest and the Highest — Down Payments*, RELATOR.COM (Mar. 18, 2020), https://www.realtor.com/news/trends/lowest-down-payment-cities/. This is explained in part by the FHA loan insurance that allows down-payments as low as 3.5%. *See* 12 U.S.C. § 1709(b)(9)(A).

131. *What's the Average Credit Score in America?*, CAPITALONE (June 10, 2021), https://www.capitalone.com/learn-grow/money-management/average-credit-score-in-america/ (reporting an average FICO score of 710 for 2020). FICO scores are plotted on a scale of 300 to 850 points. Kevin Outlaw, *What is a Good FICO Score?*, BANKRATE (Jan. 11, 2017), https://www.bankrate.com/finance/credit/what-is-good-fico-score.aspx.

132. Eight years after the crisis, the Federal Reserve Bank of Cleveland reported that the subprime loan was back; in 2014 26% of FHA loans originated from FICO scores under 660, with 40% between 661–700, which is "near-pime." Marshall Lux & Robert Greene, *What's Behind the Non-Bank Mortgage, Boom?* 22 (Harv. Kennedy School, Mossavar-Rahmani Ctr. for Bus. & Gov., Working Paper No. 42, 2015), https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working.papers/42_Nonbank_Boom_Lux_Greene.pdf.

133. *See* J. Christina Wang, *Technology, the Nature of Information, and FinTech Marketplace Lending* 2 (Fed. Rsrv. Bank of Bos., Working Paper No. 18–3, 2018), https://www.bostonfed.org/publications/current-policy-perspectives/2018/technology-nature-of-information-fintech-marketplace-lending.aspx (explaining how Fintech platforms operate).

134. *Id.*

135. Credit scores are compiled by the three credit bureaus and are used by the GSEs in mortgage lending.

136. Wang reports that fintech company, Lending Club, assesses credit risk using up to 35 subgrades. Wang, *supra* note 133, at 10. She goes on to comment on studies that show that these subgrades are seen as an accurate measure "of the relative credit risk, as evidenced by its rising and now high correlation with the average ex-post default loss

same factors used by banks, but also on atypical things, such as information collected from social media accounts, which are used to confirm basic information on a loan application, such as employment.[137] Perhaps most concerning about the use of social media data is the idea that it helps these non-banks to discern the would-be borrower's "character."[138] If this is meant to refer to the borrower's willingness to pay her debts as inferred from payment records, it is of no significance. But, if this is meant to discern political leanings or cultural affinities, then that is a different matter. For the lay person, the correlation between social media and credit responsibility is not obvious, but fintech quants who think in terms of game theory or regression analysis find this information compelling. The idea is that the cold, dispassionate algorithms operate to assess a borrower's likely propensity for honesty and responsibility, without the influence of human bias.[139] To be sure, human assessment can tilt either way — to deny access to credit, either intentionally or subliminally.[140] However, while an automated lending system may not be influenced by implicit biases, it may overlook a case for sympathy, exception, or context.

C. The Regulation of Non-Banks

Should we worry about rise of non-banks in the mortgage loan origination market? The same impetus — regulatory myopia, cupidity for lenders and investors, and naiveté by both borrowers and lenders — that led to increased regulation of banks following the crisis should animate responses to non-banks. This concern was raised by the previous Vice Chairman of the Federal Reserve, Stanley Fischer, when he pointed to the non-banking sector as a potential weak link in the chain of sound market transactions.[141] In

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rate." *Id.* at 11; Julapa Jagtiani et. al, *Fintech Lending and Mortgage Credit Access* 24–25 (Fed. Rsrv. Bank of Phila., Working Paper No. 19-47, 2019), https://www.philadelphiafed.org/-/media/frbp/assets/working-papers/2019/wp19-47.pdf.

137. Wang, *supra* note 133, at 13.

138. *Id.* at 13 n.26. In fact, Wang reports that in 2011 through 2012, Lending Club relied so heavily on its algorithms for deriving credit grades that it essentially ignored credit data, such as income, employment status, and length of employment provided by the loan applicants. *Id.* at 12.

139. *Id.* at 14.

140. *See* Jagtiani et. al, *supra* note 136, at 4, 11 ("In fact, . . . fintech lenders discriminate less than traditional, face-to-face lenders.").

141. Fischer, *supra* note 121, at 1–2. Fischer highlighted the case of New Century, the second-largest non-bank originator, which collapsed and set in motion waves of disruptions throughout the financial industry. Even before the crisis, non-banks were subject to the existing Truth in Lending Act standards and the Fair Debt Collection Practices Act; however, these laws proved ineffective in avoiding unfair and unsafe lending. *See* Eric S. Belsky & Nela Richardson, Understanding the Boom and Bust in Nonprime Mortgage Lending 107 (Sept. 2010) (unpublished manuscript),

enacting Dodd-Frank, Congress had some awareness of this vulnerability and the need for shoring up, but not subjecting non-banks to specific capital requirements.[142] Instead, it named non-banks as "covered persons,"[143] which by focusing on the particular activities in which they engage, their enterprise comes under federal scrutiny for market risk,[144] bringing both banks and non-banks into alignment for purposes of consumer protection regulations.[145]

Yet, even knowing the CFPB is watching, some non-banks still cross the line. Recently, two mortgage companies were caught defrauding potential

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https://www.jchs.harvard.edu/sites/default/files/ubb10-1.pdf; Michael Flaherty & Howard Schneider, *U.S. Regulators Struggle in Effort to Tackle Shadow Banking*, REUTERS (Apr. 1, 2015, 1:31 PM), https://www.reuters.com/article/us-usa-fed-shadow banks/u-s-regulators-struggle-in-effort-to-tackle-shadow-banking-idUSKBN0MS51X 20150401; Ryan Tracy, *SEC Official: 'Not Clear' Bank Regulation Has Made Economy Safer*, WALL ST. J. (Apr. 1, 2015), http://blogs.wsj.com/moneybeat/2015/04/01/sec-official-not-clear-bank-regulation-has-made-economy-safer (reporting that "Fed Vice Chairman Stanley Fischer floated several ideas for regulating shadow banks, some of which might take SEC action to implement"); *see also* U.S. TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITY: ASSET MANAGEMENT AND INSURANCE 63 (2017); IRIS H.Y. CHIU ET AL., RESEARCH HANDBOOK ON SHADOW BANKING: LEGAL AND REGULATORY ASPECTS 7 (Iris H.Y. Chiu & Iain MacNeil eds., 2018) (mentioning generally what shadow banking is and the regulatory challenges that come with it); Yesha Yadav, *Too Big to Fail Shareholders*, 103 MINN. L. REV. 587, 589–91 (2018) (discussing the overall "scant" regulatory attention given to banks).

142. *See* KARAN KAUL & LAURIE GOODMAN, NONBANK SERVICER REGULATION 3 (2016), https://www.urban.org/sites/default/files/publication/78131/2000633-Nonbank-Servicer-Regulation-New-Capital-and-Liquidity-Requirements-Don%27t-Offer-Enough-Loss-Protection.pdf (noting how nonbanks "have not been subject to the same level of supervisory financial regulation and capital requirements" as larger banks).

143. Under 12 U.S.C. § 5514(a)(1)(C), the CFPB has the authority to supervise any covered person it "has reasonable cause to determine, . . . is engaging, or has engaged, in conduct that poses risks to consumers concerning offering or provision of consumer financial products or services." This authority extends to

> (1) nonbank covered persons of any size that offer or provide: (a) origination, brokerage, or servicing of loans secured by real estate for use by consumers primarily for personal, family or household purposes, or loan modification or foreclosure relief services in connection with such loans, (b) private education loans, and (c) payday loans; and (2) 'larger participant[s] of a market for other consumer financial products or services, as [the Bureau defines] by rule . . . .'

Procedural Rule To Establish Supervisory Authority Over Certain Nonbank Covered Persons Based on Risk Determinations, 78 Fed. Reg. 40,352 (July 3, 2013) (to be codified at 12. C.F.R. pt. 1091).

144. *See* CONSUMER FIN. PROT. BUREAU, 2014 CFPB DODD-FRANK MORTGAGE RULES READINESS GUIDE 3–7 (3d ed., 2014), https://files.consumerfinance.gov/f/201409_cfpb_readiness-guide_mortgage-implementation.pdf (providing a list and interpretation of newly enacted mortgage loan origination and servicing rules).

145. *See* U.S. TREASURY, REFORMING WALL STREET PROTECTING MAIN STREET 9 (2012), https://www.treasury.gov/connect/blog/Documents/20120717_DFA_FINAL.pdf (displaying a graphic showing both nonbanks and traditional banks under enhanced federal supervision).

customers, service members and veterans with intentionally distorted advertising regarding the company's VA guaranteed loans.[146] One company advertised credit terms it had no intention of offering, while failing to clearly disclose the terms of the loans it did provide.[147] In refinancing loans, the company misrepresented how much cash it was willing to give.[148] The other company falsely characterized adjustable rate loans as fixed rate to get borrowers to apply and falsely represented that impossibly low FICO scores would qualify for the best interest rates.[149] The company's advertisements also falsely implied that it was a government affiliate.[150]

IV. EMERGING NEW MODELS FOR HOME PURCHASE FINANCE

A. Installment Land Contracts

Leaving non-banks' practices for the moment, let us go on to discuss the alternative models — some old and venerable and some novel — being employed by these entities to assist in achieving home ownership. The use of installment loan contracts for a home purchase is not new, but what is new is using them to repurchase homes lost in foreclosure during the housing crisis. Despite a long history in property law, these devices became very popular after the 2008 crisis, when speculators were buying up properties at foreclosures as an investment strategy.[151] An "installment land contract," also known as a "contract for deed," had long-been viewed as an attractive financing device for those with poor credit or who are unable to save the

146. *CFPB Settles with Two Mortgage Companies Over Misleading VA Loan Advertisements*, BUCKLEY (Aug. 25, 2020), https://buckleyfirm.com/blog/2020-08-25/cfpb-settles-two-mortgage-companies-over-misleading-va-loan-advertisements#page=1.

147. *Id.*

148. *Id.* The ads violated CFPA, Mortgage Acts and Practices — Advertising Rule (MAP Rule), and Regulation Z. Both cases were settled. "In addition to a $260,000 civil money penalty, the consent order require[d] the company to enhance its compliance functions, [including] to designate a compliance official to review mortgage advertisements for compliance with consumer protection laws, and comply with certain enhanced disclosures requirements." *Id.* In the second case, in addition to a $150,000 civil money penalty, the consent order required the appointment of a compliance official to ensure mortgage advertisements comply with consumer protection laws. *Id.*

149. *Id.*

150. *Id.*

151. *See* Ryan Dezember, *After the 2008 Housing Crisis, a Lot of People Made Big Money Buying Up Foreclosed Homes and Renting Them Out and It Shows One Response to a Financial Crisis*, BUS. INSIDER (Aug. 4, 2020, 9:20 AM), https://www.businessinsider.com/after-2008-housing-crisis-people-bought-and-rented-foreclosed-homes-2020-8.

traditional 20% down payment for a mortgage loan.[152] Crisis investors have taken advantage of the confluence of tightening credit and housing shortages to sell these newly foreclosed homes through the contract for deed at substantial markups over the foreclosure purchase price[153] and sometimes selling them back to the foreclosed owner. As with mortgage loan origination, some parties on the other side of these deals were targets for unscrupulous practices. African-American and Latino homebuyers,[154] those unsophisticated and inexperienced, have been the prime market for these deals.[155] Ostensibly innocuous devices, the contract for deed and the related rent-to-own scheme,[156] come with significant risks, all the while lacking the required disclosures (e.g., physical defects or the presence of lead paint) and limits on terms that come with mortgage financing (e.g., maximum interest rates, balloon payments, prepayment penalties, or protections in case of default).[157]

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152. *See* Cystal Myslajek, *Risks and Realities of the Contract for Deed*, FED. RSRV. BANK MINNEAPOLIS (Jan. 1, 2009), https://www.minneapolisfed.org/article/2009/risks-and-realities-of-the-contract-for-deed.

153. Fannie Mae has asserted that "the bulk sale program for hard-to-sell homes accounted for a small fraction of the 900,000 homes it has sold since the financial crisis," many of them run-down and sold at bargain prices. Matthew Goldstein & Alexandra Stevenson, *Market for Fixer-Uppers Traps Low-Income Buyers*, N.Y. TIMES (Feb. 20, 2016), https://www.nytimes.com/2016/02/21/business/dealbook/market-for-fixer-uppers-traps-low-income-buyers.html.

154. In *'Contract for Deed' Lending Gets Federal Scrutiny*, N.Y. TIMES (May 10, 2016), https://www.nytimes.com/2016/05/11/business/dealbook/contract-for-deed-lending-gets-federal-scrutiny.html, reporters Matthew Goldstein and Alexandra Stevenson, recount the case of Harbour Portfolio, which bought more than 6,700 single-family homes for an average of $8,000 each in Ohio, Michigan, Illinois, Florida, Georgia, Pennsylvania, and a handful of other states since 2010, for the purpose of reselling them by contract for deed. Most of the homes were burdened by mortgages held by Fannie Mae but sold in bulk after the crisis. *See also* JEREMIAH BATTLE ET AL., TOXIC TRANSACTIONS: HOW LAND INSTALLMENT CONTRACTS ONCE AGAIN THREATEN COMMUNITIES OF COLOR (2016); JAMES H. CARR ET AL., STATE OF HOUSING IN BLACK AMERICA (2016).

155. *See, e.g.*, Matthew Goldstein & Alexandra Stevenson, *How a Home Bargain Became a 'Pain in the Butt,' and Worse*, N.Y. TIMES (July 7, 2017), https://www.nytimes.com/2017/07/07/business/dealbook/how-a-home-bargain-became-a-pain-in-the-butt-and-worse.html (reporting on a 2017 suit filed by the Atlanta Legal Aid Society, against Harbour Porfolio, claiming that the firm "targeted African-American communities to sell contracts for deed on at inflated prices").

156. Discussed *supra* text accompanying notes 122–55 and *infra* text accompanying notes 157–89.

157. *See* Alexandra Stevenson & Matthew Goldstein, *Seller-Financed Deals Are Putting Poor People in Lead-Tainted Homes*, N.Y. TIMES (Dec. 26, 2016), https://www.nytimes.com/2016/12/26/business/dealbook/seller-financed-home-sales-poor-people-lead-paint.html (reporting that many of the homes sold by Harbour Portfolio were in severe states of disrepair). For an interesting discussion of the plight of homeowners in Detroit, among other cities, facing tax foreclosures, see Bernadette

For some foreclosed homeowners, buying back their property through an installment land contract is the only way of regaining homeownership, since the right to redeem the property at foreclosure, has been frustrated by rules adopted by the GSEs that prohibit not-for-profit entities from purchasing property in foreclosure on behalf of the foreclosed owner.[158] Legal challenges to these rules have all failed.[159] In other cases, would-be home buyers are unable to obtain a bank loan or come up with a down payment so they enter into a long-term contract for purchase.[160]

Despite their important role in facilitating home ownership for would-be buyers living paycheck to paycheck, installment land contracts are difficult to embrace warmly because they are fraught with risk on both sides of the transaction. However, these risks are primarily present on the buyer's side. While the buyer has the immediate right to possess, during the long executory period, so much could go wrong. The buyer having only equitable title, bears the risk of loss from casualties — acts of God and woman.[161] The seller, holding legal title could encumber it exposing the buyer to loss by a prior claimant.[162] Moreover, because the buyer is usually charged with maintaining the property, in case of a default, as traditionally conceived, she stands to lose everything — all the payments, all the improvements and all the appreciation in value. Additionally, the usual forfeiture clauses mean no restitution.[163] In the case of purchasers of foreclosed properties, there were

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Atuahene & Christopher Berry, *Taxed Out: Illegal Property Tax Assessments and the Epidemic of Tax Foreclosure*, 9 U.C. IRVINE L. REV. 847 (2019) (reporting on a study of tax assessments in Detroit, during the period after the housing crisis of 2008, showing that from 2011 to 2015, Wayne County, Michigan foreclosed on approximately 100,000 Detroit properties for unpaid property taxes, which was more than a quarter of all properties in the city); *see also* Bernadette Atuahene, *Predatory Cities*, 108 CAL. L. REV. 107 (2020) (describing how through practices such as improper tax assessments, many cities are systematically and illegally, taking property from residents only to vest in public coffers).

158. *See* Green, *Testing*, *supra* note 2, at 500.

159. *See* Green, *Testing*, *supra* note 2, at 530–31.

160. *See* Amy Fontinelle & Rachel Witkowski, *Land Contract: What It Is & How It Works*, FORBES (May 25, 2021), https://www.forbes.com/advisor/mortgages/what-is-a-land-contract/ (explaining how these contracts work and how a would-be home buyer can still move towards home ownership without the same challenges of traditional home purchasing).

161. SARAH MANCINI & MARGOT SAUNDERS, LAND INSTALLMENT CONTRACTS: THE NEWEST WAVE OF PREDATORY HOME LENDING THREATENING COMMUNITIES OF COLOR 10 (2017), https://www.bostonfed.org/home/publications/communities-and-banking/2017/spring/land-installment-contracts-newest-wave-of-predatory-home-lending-threatening-communities-of-color.aspx.

162. *Id.*

163. *Id.* (explaining that without a clause providing protections otherwise, a buyer's default leads to "punitive forfeiture of all amounts paid").

additional worries about the properties' physical condition. These sales are typically "as is," and with no right to inspect other than from the sidewalk, putting the risks of defects and the restoration burden on the buyers. Finally, as buyers under contracts for deed often fail to record their contracts, they are at risk of losing all of their investments to a subsequent purchaser without notice of the contract.

But the general evolution in the law as it pertains to deals in real property, such as the implied warranty of habitability in landlord-tenant relations and the abandonment of caveat emptor in favor of disclosures by sellers of defects, has not entirely bypassed parties to installment land contracts. Indeed, in the last several decades, there has been a steady movement to reconceptualize the contract for deed away from that of an executory contract toward one that comports more with its essence, a conveyance of an interest in land.[164] After all, the buyer in possession with the contractual obligation and self-interest to maintain it and pay taxes, looks very much like an owner.[165]

Looking to the essence of that deal, then employing a legal fiction based on the maxim that *equity regards substance and not form*, courts and legislatures are treating the former vendor/vendee relationship as a mortgagor/mortgagee relationship, with the seller retaining the legal title, merely for purposes of security —just like a mortgage. As a mortgagee, the vendee becomes required to extinguish the vendee's interest, not simply by declaring a default and forfeiture, but by foreclosure.[166] Just as in the traditional mortgage context, a foreclosure by sale is hoped to generate a sum to compensate the vendor for what remains on the debt and possibly to create a surplus, which would go to the vendee. Even as some courts do not reconceptualize the nature of the parties' transaction, they apply contract tools and equitable powers to reach a fair and equitable result.[167] Rather than

164. Fontinelle & Witkowski, *supra* note 160 (highlighting the importance of negotiating for protection clauses and other provisions to safeguard the buyer's property interest).

165. Sometimes contract for deed programs are successful. Two programs, one in Minnesota, Bridge to Success, and one operating in sixteen states, Battery Point Financial, buy properties in foreclosure to resell by contracts for deed. Both Bridge to Success, which utilizes pre-purchase counselling, and Battery Point Financial, which rehabilitates homes and sells them under 20-year contracts, comply with CFPB regulations for high-cost mortgages.

166. *See, e.g.*, Skendzel v. Marshall, 301 N.E.2d 641 (Ind. 1973) (finding it inequitable, that, if forfeiture were to be enforced, the defaulting defendants would lose over half of their purchase price and the right to possess the home); Bean v. Walker, 464 N.Y.S.2d 895 (App. Div. 1983) (reversing the lower court's holding that the defaulting vendee lacked rights); Eric T. Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 DUKE L.J. 609 (1988).

167. Associated Bank-Milwaukee v. Wednt, No. 00-0483, 2001 Wisc. App. LEXIS

allow forfeiture, courts permit a beleaguered vendee to cure a default; some vendees may be awarded restitution of amounts paid in excess of the land value.[168] Some borrowers may be entitled to reinstatement of the contract after default by paying what was owed at the time.[169] These inventions were long-coming and reveal a much needed reform in the law. Yet, because they only operate after the deal has been consummated and performance is well underway, they do little to help the naïve borrower before undertaking the obligation in the first place. [170]

B. Rent to Own and Seller Financing

In a rent to own model of home purchase finance, tenants/buyers have the option to purchase the home they are renting from the landlord/seller, usually within a specified amount of time. This arrangement gives the tenant/buyer an opportunity to see the value of the home and neighborhood up close and operates as a hedge increases in home prices. It is one of the few home purchase options for renters with less than stellar credit. Typically, the rent payments will be applied as a down payment on the home and the renter will seek a traditional mortgage for the balance.[171] Sometimes, the seller offers to finance the purchase with the renter signing a promissory note, along with a purchase money mortgage, in favor of the seller.[172]

On the surface, rent-to-own plans seem to be a good thing, but more often than not, they serve to pass off a property otherwise unsellable because of its physical condition. That was the case in *Rainbow Realty Group, Inc. v. Carter.*[173] There, Cress Trust offered four alternatives to consumers interested in its housing stock: "straight sale, straight rental, land contract,

192, at *3 (Wis. Ct. App. Feb. 7, 2001) (stating that "foreclosure actions are subject to equitable considerations").

168. *See, e.g.*, Peterson v. Hartell, 707 P.2d 232 (Cal. 1985); Rosewood Corp. v. Fisher, 263 N.E.2d 833 (Ill. 1970).

169. *Peterson*, 707 P.2d at 234 (holding that even after a willful default, a vendee can redeem her right to the property by making all payments due); *Rosewood*, 263 N.E.2d at 837–40 (holding that the Forcible Entry and Detainer statute does not apply to purchasers under land sale contract).

170. The FHFA is conducting a review of some of the terms of deals between investors and purchasers of GSE property, and the CFPB has begun to look into consumer protection violations by these companies. This could result in Fair Housing Act violations if the investors are targeting a particular cohort based on race or ethnicity and if the forfeiture provisions operate to make housing unavailable. *See Fannie Targets 'Abusive Seller Financing' Sales*, DAILY REAL EST. NEWS (May 25, 2017), https://www.iprore.com/news/fannie-targets-abusive-seller-financing-sales.

171. Jean Folger, *Rent-to-Own Homes: How the Process Works*, INVESTOPEDIA, https://www.investopedia.com/updates/rent-to-own-homes/ (last updated Oct. 12, 2021).

172. *Id.*

173. 131 N.E.3d 168 (Ind. 2019).

and rent-to-buy contract."[174] A married couple with a good monthly income but a poor credit history entered into the "rent-to-buy contract," signing a "Purchase Agreement Rent to Buy Agreement," for a single-family house.[175] The agreed price was $37,546, payable at $549 per month to be paid over the course of thirty years with 16.3% interest.[176] Under the agreement, the couple took the property as is, acknowledging that it was not in "livable condition," that it was their responsibility to "make it habitable" prior to moving in, and that their renovations and improvements would thereafter be considered attached to the real property.[177] The agreement stated that the parties intended to execute the sale and clarified that the payments for the first twenty-four months would be considered "rental payments."[178] After these payments, a "Conditional Sales Contract (Land Sale)" would be entered into for twenty-eight years.[179] The house was in miserable condition — toilets were missing, plumbing and electric wiring were defective; there were no door locks; windows were broken; the basement stairs were unusable; and carpets were destroyed beyond repair.[180] There was virtually no flooring; trash was everywhere and animals had taken up nests inside.[181] When the couple failed to make payments as agreed, Cress Trust sued to evict in small-claims court.[182] The couple counterclaimed, alleging injury from Cress Trust's failure to make the premises habitable as required by the landlord-tenant statute.[183] The trial court ruled for defendants on the counterclaim, but the court of appeals reversed.[184] The Indiana Supreme Court agreed with the trial court. It explained that even though the agreement was designated "a contract" and contained attributes of a contract of sale — stating the home was purchased "as is," with no warranty of condition, and labeling the transaction a "sale" — the form and labels did not determine the legal status of the deal.[185] The court observed that if the agreement were a contract of sale, the couple were homeowners and thus, not subject to eviction in small-claims court, where the landlord brought its action.[186] Most

174. *Id.* at 171.
175. *Id.*
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.* 171–72
181. *Id.*
182. *Id.* at 172.
183. *Id.*
184. *Id.*
185. *Id.* at 173.
186. *Id.*

telling was that the agreement referred to "rental payments" for the first 24 months, which the landlord was entitled to keep on eviction.[187] Because a landlord-tenant relationship had arisen, the landlord had a duty to make the premises habitable.[188] The result in this case was an enlightened one, but there may be many other courts who are less sympathetic, leaving the renter/owner at the mercy of the deal they made.

C. Alliances and Joint Ventures Between the Borrowers And Financers

As the above discussion shows, the primary attractive feature of installment land contracts and the rent-to-own arrangements is that they facilitate initial entry into homeownership. Nevertheless, there are discernable limits on that ownership. For the installment land contract, the buyer holds only an equitable title until the full purchase is paid. In the case of rent-to-own agreements, the renter holds only an option to buy if she is somehow later able to find traditional financing. The new models discussed below purport to help the buyer acquire full and immediate title. However, the investments made by NDNBs may result in novel claims and rights that may not fit within the existing taxonomy of ownership rights. Below, I discuss specific NDNBs in turn and offer an analysis of their shape and content later.

i. Fleq

The Fleq™ website states: "You get one life. Own it. At Fleq, we believe home ownership is attainable without a large down payment. Without difficult credit standards. Without taking on massive amounts of debt. And without long-term commitments."[189] Fleq is just one of a growing number of NDNBs that have emerged since the 2008 housing crisis.[190] On their face, these firms seem to achieve the twin goals of homeownership with little risk. The name, Fleq, suggests its model: "flexible" and "equity."[191] It "partners" with homebuyers into an "alliance" to purchase a home,[192] making the homebuyer both owner and tenant. The process of acquiring a home and

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187. *See id.* at 172.

188. *Id.* at 177.

189. FLEQ, https://fleq.com/ (last visited Nov. 20, 2021).

190. *See* Kelsey Ramirez, *Startup Explains Its New, No-Mortgage Homeownership Model*, HOUSINGWIRE (Jan. 6, 2020), https://www.housingwire.com/articles/startup-explains-its-new-no-mortgage-homeownership-model/ ("Many firms are trying to improve the affordability of homes and the attainability of mortgages . . . .").

191. *See* FLEQ, *supra* note 189.

192. *Id.*

forming the alliance is described in these steps.

- The would-be homebuyer finds a home, sometimes using a broker recommended by Fleq.
- Credit and background checks are made, then Fleq forms an "alliance" with the homebuyer. The costs — the monthly payment, which is comprised of rent, ownership costs, and fees, and the initial equity contribution to the alliance — are calculated, an appraisal is ordered, and an inspection of the property's physical condition is conducted.
- The respective percentages of ownership are determined as well as the amounts required for increasing those shares, but rent paid by the homebuyer cannot be used to acquire additional equity in the home.
- After payments of the initial equity contribution, a membership fee and part of the closing costs, the purchase closes. [193]

D. Equity Sharing: The Spoils of Appreciation

In the equity sharing arrangement, a financer is an investor in the transaction and purchases a portion of the homeowner's equity. In return, the homeowner accepts a contractual limit on her equity appreciation. When the value of the property changes, there is a risk and reward trade-off for both the borrower/homeowner and the lender/investor.

i. How the New Equity Sharing Models Work

a. Haus

The Haus program, offering a "co-investment partnership," is available to both current homeowners (for tapping into homeowner equity) and would-be homebuyers.[194] Like other "co-investors," Haus advertises that the funds are not a mortgage or debt but an investment in the home.[195] These are the components of the Haus model:

- After approval, Haus determines how much the buyer must initially put down and funds the balance of the purchase price.
- The buyer makes monthly payments to buy back the equity from Haus.
- The monthly payments include the "monthly equity purchase, a fee, homeowners' insurance, and property taxes." The

193. *Id.*; Ramirez, *supra* note 190. Fleq may further assist the homebuyer in managing title issues, arranging for homeowner's insurance, and setting up escrows.

194. HAUS, https://haus.com/faq (last visited Nov. 20, 2021).

195. *Id.*

homeowner is free to increase the amount of equity payments during the term but must maintain a minimum percentage of ownership. The homeowner is allowed to "cash out," by selling back equity to Haus for personal use, and the monthly payment is adjusted accordingly.

- Payments are fixed for ten years.[196]
- After ten years, if the homeowner has bought back all of Haus's equity, the home is owned outright. If the homeowner has not purchased all of the equity, they can choose to renew the partnership, buy-out the remaining Haus equity, or sell the home to a third party.[197]

b. Noah

The newest fintech firm engaged in home purchase finance is Noah, another form of equity-sharing arrangement.[198] Noah's technological platform develops "a full financial profile of [its] homeowner partners," even for those in marginal financial circumstances, proclaiming itself the "the financing source of last resort."[199] Noah's prequalification process is not unlike that for traditional mortgage refinance, where the terms depend on the market value of the property, available equity, and the homeowner's credit standing. It is all done online through Noah's customer portal. The process is fast and can be completed in as few as fifteen days. Despite the outward similarities, Noah's financing is not secured by a "mortgage" on a home loan, rather it is described as a "debt-free investment agreement."[200] Homeowners do not make monthly payments or interest, but a one-time lump sum to Noah at any time during the relationship.[201] Noah uses a holistic approach, considering more than just an applicant's credit score, to determine the value and terms of the arrangement.[202]

Suppose Noah co-invests $100,000 in the purchase of a home, this is how

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196. *Id.* Haus claims that, compared to a traditional mortgage, these payments are 30% less. *Haus Raises $7.1M to Bring Flexibility and Affordability to Homeownership*, BUSINESSWIRE (July 18, 2019, 11:17 AM), https://www.businesswire.com/news/home/20190718005549/en/Haus-Raises-7.1M-to-Bring-Flexibility-and-Affordability-to-Home-Ownership.

197. HAUS, *supra* note 194.

198. Benjamin Horney, *Home Equity Financing Fintech Noah Nabs, $150M In Funding*, LAW360 (April 22, 2020), https://www.law360.com/articles/1266276/home-equity-financing-fintech-noah-nabs-150m-in-funding.

199. *Id.*

200. *Id.*

201. *How it Works*, NOAH, https://www.noah.co/how-it-works (last visited Nov. 20, 2021).

202. *Id.*

the plan operates:

- It first determines the Adjusted Home Value.
- It then offsets risk through a valuation adjustment, which typically ranges from 10% to 20%.
- This adjustment reduces Noah's exposure to downturns and amplifies its returns in a rising market.
- As Noah's co-investment of $100,000 was contingent on receiving a 30% equity share, if the home's value increases to $1,343,916 at the end of the ten-year term, Noah's payout is $233,175; it's a gain of $133,175, at an annualized return on investment of 8.83%.[203]

c. Unison

Perhaps seeing what was over the horizon, Unison entered the home finance business in 2004, just before the worries about a crisis began to take shape. Like the GSEs and other private participants on the secondary market, Unison is funded by institutional investors, such as pension plans and university endowments.[204] It offers to "partner" with homebuyers, not by making a loan, but instead by making a co-investment in the buyer's home — such as by providing part of the down payment and sharing in the homes appreciated value.[205] The Unison partnership makes homeownership possible as it eases the down payment burden — the buyer paying as little as five percent, while Unison pays the balance of the traditional twenty percent.[206] The loan to value ratio (eighty percent) under the Unison model is the same as under the traditional borrowing scenario and Unison sets specific qualifications to ensure that the home is a good long-term investment that is likely to appreciate.[207] Unlike a mortgage, no interest is charged on Unison's down payment contribution, and the homebuyer does not make monthly repayments. Instead, Unison recoups its investment on

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203. This is a hypothetical based on the Noah concept. *See also* Colin Robertson, *Noah: A Home Equity Sharing Product*, TRUTH ABOUT MORTG. (Apr. 1, 2020), https://www.thetruthaboutmortgage.com/noah-review-a-home-equity-sharing-product/ (explaining how the Noah model works).

204. *Where Does Unison Get Its Funds?*, UNISON (Mar. 20, 2019), https://www.unison.com/article/about-unison-funding.

205. Robert Farrington, *Unison Review: Uniquely Use the Equity in Your House*, COLLEGE INV., https://thecollegeinvestor.com/24159/unison-review/ (last updated Nov. 18, 2021).

206. Liz Brumer, *Unison Review: Capturing Home Equity Through Shared Appreciation*, MILLIONACRES (Nov. 20, 2019), https://www.fool.com/millionacres/real-estate-financing/unison-review-capturing-home-equity-through-shared-appreciation/ (last updated May 19, 2021).

207. *See id.*

the eventual sale of the home. In this partnership, Unison stays in the background, assuring the homebuyer that she is sole owner of the home and that Unison is merely an investor with "no rights of occupancy" or control.[208]

Besides enabling the initial purchase, Unison also helps homeowners tap into the equity of their existing homes. Unison will give cash for a part of the equity, in exchange for a percentage share of the home's future appreciation.[209] For example, Unison will convert up to $500,000 or 17.5% of a home's value to cash in exchange for a portion of its value when the homeowner decides to sell.[210] Unlike a home equity loan from traditional lender, the Unison "co-investment" does not encumber the property with more debt, nor does it require contemporaneous repayment as the cash out is only repayable at the end of the partnership agreement, which is the earlier of the sale of the home or thirty-years from signing. Unison is not in these deals for charity; instead, it may earn a substantial profit if the value of the home increases during the life of Unison's "investment."[211]

There are certain restrictions and tangential costs attached to both the "HomeOwner" and "HomeBuyer" programs. For instance, as part of the agreement, Unison sets a "Maximum Authorized Debt Limit," meaning that any future refinancing will be subject to limitations.[212] Homeowners must pay all third-party closing costs as well as a 2.5% origination fee[213] and are subject to periodic credit checks.[214]

d. Point

Point is another business model that invests in the equity of existing homes. While there are surface similarities to Unison in the sense that Point does not lend money, as would require monthly repayments, Point is different in several structural respects: buyout, caps on points return, and rights to rentals. These are the features of Point:

- Homeowners are required to own at least thirty percent of the

208. *How It Works for a Homeowner*, UNISON, https://www.unison.com/how_it_works_homeowner (last visited Nov. 20, 2021) ("If I partner with Unison, who owns the home? You own the home!").

209. Brumer, *supra* note 206.

210. *Id.*; UNISON, *supra* note 208.

211. Brumer, *supra* note 206; UNISON, *supra* note 208.

212. UNISON HOMEOWNER PROGRAM GUIDE 48 (2017), https://seekingalpha.com/uploads/2017/11/11/5068968/Unison_HomeOwner_Program_Guide.pdf.

213. Brumer, *supra* note 206.

214. Unison requires a certain FICO score, which is the same as a credit check. *Your Homeowner Questions Answered*, UNISON, https://www.unison.com/faq_homeowner (last visited Nov. 20, 2021). As another example, Hometap is an equity sharing company that is very similar to Unison. *The Smart Way to Tap into Your Home's Equity*, HOMETAP, https://www.hometap.com/ (last visited Nov. 20, 2021).

equity in the home.

- The homeowner has the right to buy out Point or pay off the investment by sale of the home at any time during the thirty-year term with no pre-payment penalty.
- Point's return is capped at a set amount, usually twenty-five to forty percent of the appreciation value.
- The homeowner has the right to rent out the property, upon payment of a "small rental premium" to account for any decreases in value of the home from wear and term from use, such as the natural depreciation from a renter's presence.[215]

ii. Other Alternative Financing Models

a. P2P Mortgage Loans

Peer-to-peer ("P2P"), lending helps homebuyers by making available loans from groups of individual lenders, who desire to help those that otherwise lack the means for accessing capital. In this respect, P2P lenders tend to operate in underserved markets — making loans to borrowers with marginal credit standing; even so, P2P loans typically carry lower interest rates than those charged by traditional lenders.[216] They are open to hearing the borrower's "story," which purports to capture all aspects of the borrower's circumstances as would allow a fully, and perhaps sympathetic assessment of the borrower's application for capital. This wide-ranging application process does come with the cost of a much slower procedure. P2P loans offer the flexibility of a "mix-and-match option," under which borrowers can use a P2P loan for the down payment and seek a conventional loan for the balance of the purchase price.[217] While reports show that more than thirty percent of Americans have used P2P lending, many banks are reluctant to accept P2P funds as a down payment on a conventional loan.[218] The reasons for this hesitancy are not clear. It seems that what might be the main concern, priority of claim, could easily be addressed by an agreement

215. *Most Popular FAQs*, POINT, https://help.point.com/collection/1-homeowner-faq (last visited Nov. 20, 2021); *see also* Hal M. Bundrick, *Shared Appreciation: Tapping Home Equity Without Taking a Loan*, NERDWALLET (Aug. 9, 2019), https://www.nerdwallet.com/blog/mortgages/shared-appreciation-tapping-home-equity-without-taking-out-a-loan/.

216. Bob Schneider, *Peer-to-Peer Lending Breaks Down Financial Borders*, INVESTOPEDIA (Jul. 25, 2019), https://www.investopedia.com/articles/financial-theory/08/peer-to-peer-lending.asp.

217. *Id.*

218. *See End of the IOU: P2P Payments the New 'Social Norm'*, BANK OF AM. (May 11, 2017), https://newsroom.bankofamerica.com/press-releases/consumer-banking/end-iou-p2p-payments-new-social-norm.

under which the P2P loan would be subordinate to the bank loan.[219] This is typically how these arrangements are handled. Ostensibly, P2P lending looks like purchase-money mortgages.[220]

While this form of lending is not necessarily a "non-debt" means of financing a home, it is certainly a non-conventional option.[221] The process can be compared to "crowdfunding," a popular platform used to invite contributions for sympathetic causes or to launch some invention.

iii. Novel Home Purchase Assistance Programs

a. "Alternative" iBuyers

As the homebuying experience can seem inscrutable at worse and time-consuming at best, companies have emerged to make the whole process worry- and stress-free. For customers needing to sell an existing home while looking to purchase a new one, Homeward is the answer. Acting for the homebuyer, Homeward purchases the new home, usually all-cash, while the customer hires an agent to sell the existing home.[222] In the interim, the customer enters into a lease with Homeward for the new home until the old home is sold (typically for periods up to six months).[223] The customer will acquire a new mortgage to purchase the new home from Homeward at the original price plus a two to three percent convenience fee, but this may vary

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219. *See* Frank Addessi, *The Risks and Rewards of P2P Lending*, SMARTASSET (Mar. 14, 2018), https://smartasset.com/personal-loans/the-risks-and-rewards-of-p2p-lending.

220. *See id.*; Jim Probasco, *P2P Mortgage Loans A Growing Trend*, INVESTOPEDIA (Apr. 9, 2021), https://www.investopedia.com/articles/personal-finance/071515/p2p-mortgage-loans-growing-trend.asp.

221. Jean Folger, *5 Problems With Buying a House With a Friend as an Investment*, INVESTOPEDIA, https://www.investopedia.com/articles/investing/073015/5-common-problems-buying-house-friend.asp (last updated June 29, 2021), offers some caution for friends purchasing a home together: the credit status of the friends will be tied together; exiting the relationship may be difficult without a prior agreement; and the friendship may be tested as disagreements over use or transfer arise. *See also* Rachel Stults, *What to Do When Buying a House With a Friend And Why You Probably Shouldn't*, REALTOR.COM (Jan. 27, 2016), https://www.realtor.com/advice/buy/how-to-buy-a-home-with-friends-and-why-you-probably-shouldnt/. For an example of a "successful" friendship buying experience, see a case detailed by Julie Beck, *The Case for Buying a House with Friends*, THE ATLANTIC (Dec. 13, 2019), https://www.theatlantic.com/family/archive/2019/12/how-buy-house-friends-without-going-crazy/603538/.

222. Mary A. Azevedo, *Homeward Secures $371M to Help People Make All-Cash Offers on Houses*, TECHCRUNCH (May 27, 2021, 9:00 AM), https://techcrunch.com/2021/05/27/homeward-secures-371m-to-help-people-make-all-cash-offers-on-homes/.

223. *Id.*

depending on location.[224] The whole process purports to be risk-free, as Homeward guarantees to purchase the old home at the predetermined price if it has not sold on the market within the period agreed to.[225] This guarantee appears to remove much of the risk of a stagnant market and helps the homeowner avoid having to take out a second mortgage loan while the first home is awaiting sale.[226]

V. PROMISES AND RISKS FROM ALTERNATIVE BUYING AND FINANCING MODELS

A. The Lure into the Shadows: Muddy Rights and Remedies

We should worry about the novel practices and non-banks in the home purchase world,[227] for the promise of low down payments and no monthly payments are but surface appeals, with real risks lurking beneath. I lay out several kinds of risks that exist.

i. Costs

The non-debt models are not without monetary costs. They specify

224. *Id.*

225. *Id.*

226. *See* Mary A. Azevedo, *Austin-Based Real Estate Startip Homeward Secures $105M in Debt & Equity*, CRUNCHBASE NEWS (May 14, 2020), https://news.crunchbase.com/news/austin-based-real-estate-startup-homeward-secures-105m-in-debt-equity/. Several other companies, like Offerpad and Opendoor, offer similar services to make the homebuying experience seamless, with their "one stop shops" through their "iBuyers" programs. *See* Jeff Andrews, *The Real Estate Transaction is Broken. Tech Companies Want to Fix It*, CURBED (Mar. 21, 2019), https://www.curbed.com/2019/3/21/18252048/real-estate-house-flipping-zillow-ibuyer-opendoor; Jeff Andrews, *These Startups Make Selling Your House as Easy as Possible*, CURBED (Apr. 12, 2018), https://www.curbed.com/2018/4/12/17221178/opendoor-offerpad-sell-house-online-offers; Courtney Read, *What is an iBuyer?*, OFFERPAD (Dec. 21, 2017), https://blog.offerpad.com/what-is-an-ibuyer/; Joe Gomez, *What is an iBuyer How It Works and Is It Worth It?*, OPENDOOR, https://www.opendoor.com/w/guides/what-is-an-ibuyer (last visited Nov. 20, 2021). Another company, Knock, while not an iBuyer, also uses "data science and local experts to set a list price on your home," which then becomes the "trade-in price" of the home. While the homeowner pays these costs, Knock will advance up to $25,000 for upgrades to improve the marketability of the home. KNOCK, https://www.knock.com/faq (last visited Nov. 20, 2021). When the transactions are completed, Knock earns a 6% commission from the homeowner and a 3% commission from the seller of the new home.

227. *See generally* FIN. STABILITY OVERSIGHT COUNCIL, 2019 ANNUAL REPORT (2019), https://home.treasury.gov/system/files/261/FSOC2019AnnualReport.pdf (examining risks to financial stability in the United States in various markets and sectors); Debra Kamin, *Is iBuying Here to Stay?*, N.Y. TIMES (Nov. 19, 2021), https://www.nytimes.com/2021/11/19/realestate/ibuying-ilending.html (describing risks and potential drawbacks of using ibuying and ilending).

maximum investment amounts ranging from \$400,000 (Hometap) to \$500,000 (Unison).[228] The minimum share of investment ranges from \$25,000 (Point) or 17.5% (Unison), with maximums from 20% (Point) to 70% (Unison).[229] The stated investment terms are either ten years (Hometap and Noah) or thirty years (Point and Unison).[230] The fees assessed are 1) 3% of the financing amount, appraisal, and third-party fees (Hometap); 2) Servicing Fee of \$2,000 or 3% of the financing amount, whichever is higher, underwriting, appraisal, and third-party fees (Noah); 3) 3%-5% of the financing amount, appraisal, and third-party fees (Point); and 4) 3% of the financing amount, which includes appraisal and third-party fees (Unison).[231]

When maturity arises after thirty years or if the homeowner sooner sells the property, Unison claims a share of the appreciation as valued from the date of the transaction. The share will vary depending on the deal but could be as high as "the original co-investment plus or minus their share of the home's change in value."[232] That payment to Unison may be greater than the homebuyer would have paid in interest to a traditional lender. This is how the numbers add up. For 10% of the down payment, Unison earns 33.3% of the change in value as determined by an independent appraisal when the homeowner chooses to end the relationship, either at sale of the property, buy out of Unison, or at the scheduled termination point, i.e., 30 years. For 15% of the down payment, Unison would earn 49.5% of the increase in value.[233]

If the homeowner decides to sell the home within three years, Unison may invoke a "Special Termination" payment, which is the original investment plus an investment option, starting around 3.3% of the property value.[234] If the homebuyer does not maintain the property, she may be subject to a "Deferred Maintenance Adjustment."[235]

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228. *Frequently Asked Questions*, HOMETAP, https://www.hometap.com/faqs/ (last visited Nov. 20, 2021); UNISON, *supra* note 214.

229. UNISON, *supra* note 214; POINT, *supra* note 215.

230. UNISON, *supra* note 214; Point, *supra* note 215; *Still have questions? We've got answers*, NOAH, https://www.noah.co/faq (last visited Nov. 20, 2021); HOMETAP, *supra* note 228.

231. *See supra* note 230.

232. UNISON, *supra* note 214.

233. *See id.*; *What is an Option Contract*, UNISON (Apr. 11, 2019) (on file with author) (demonstrating how the option contract with Unison works).

234. UNISON, *supra* note 214.

235. *Id.* In its FAQ, Unison describes ordinary wear and tear as allowed, but that damage exceeding ordinary wear in tear is "assessed by one or more appraisals, inspections or repair estimates obtained from independent third-party providers who are used to determine the amount of the Deferred Maintenance Adjustment" and defines a Deferred Maintenance Adjustment as "allocating the loss in value due to improper

How does Unison compare in terms of cost to a traditional mortgage? It depends on whether the property appreciates in value, in which case, the Unison investment — the down payment and eventual share — will cost more. Conversely, a traditional mortgage loan does not involve sharing of equity with the lender. But, if the value of the property declines, Unison is the better deal. In summary, the Unison model makes sense for the budget-stressed homebuyer — as initial payments are low — who expects to be better off financially in the future. It also makes sense for homebuyers in markets experiencing modest gains in appreciation, in which case the down payment assistance and comparatively low monthly payments will mean most of the gain is kept by the homebuyer.

ii. Contracting and Consumer Protections

As explained above, mortgages given to an institutional lender are subject to a host of federal and state regulations designed to protect banks from excesses, the markets from systemic risks, and borrowers from their improvidence.[236] Adherence to the ATR regulations and loan disclosure is critical if we are to avoid another housing crisis.[237] But, as the structure of financing offered by the equity sharing partners and alliances does not involve a "mortgage" per se, none of these protections are available. There are no disclosures about the economics of the deal, nor even about the financer's business model.

The appeal of the benefits seems like the same lures that drew in buyers to ARMs leading to the crisis.[238] Then, as now, homebuyers may be inclined to overlook the downsides in favor of the immediate satisfaction of homeownership. Just as subprime loans were made to credit-risky borrowers or exposed borrowers to greater risks because of adjustable interest rates and interest only terms, equity-sharing arrangements use less stringent standards for evaluating an applicant's credit worthiness. Although FICO scores for first time borrowers have been dropping in recent years even for mortgages,[239] the metrics used by the non-banks are unconventional and

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maintenance to [the homeowner]." *Id.* There are otherwise no standards for determining where to draw the line.

236. *See supra* Part II.B.

237. *See* McCoy & Wachter, *supra* note 88, at 649.

238. *See generally* Eric S. Belsky & Nela Richardson, Understanding the Boom and Bust in Nonprime Mortgage Lending (Sep. 2010) (unpublished manuscript), https://www.jchs.harvard.edu/sites/default/files/ubb10-1.pdf (explaining the appeal secondary benefits had to buyers).

239. Aly J. Yale, *Lenders are Loosening the Reins; What FICO Credit Score Do You Need to Get a Mortgage?*, MORTG. REPS. (Dec. 25, 2017), https://themortgagereports.com/34667/mortgage-fico-scores-drop.

unproven. Indeed, the "co-investment" business model is unchartered territory and raises a host of issues that could trap even the economically savvy millennial.[240] Many of these businesses are not forthcoming with the specific terms of the agreements and borrowers do not appear to be encouraged to consult with an attorney. Instead, several of them suggest borrowers speak with an in-house consultant to make sure the borrower is "fully informed" prior to signing the agreement.[241] Additionally, while "co-investment" businesses advertise that they are sharing in "all" the risk, the fine print indicates that for platforms such as Point and Unison borrowers are required to pay back some or all of the initial investment, at the very least, even if the home depreciates in value. [242]

iii. Novel Forms of Rights

The Fleq Alliance and equity sharing arrangements suggests new forms of ownership, defying numerus clausus.[243] Under numerus clausus, only certain forms of property rights are recognized as such by the legal system. This limited recognition circumscribes the private parties' ability to craft novel rights and obligations.[244] The main reason asserted for this principle is the interest in "'optimal standardization,' that is, balancing economic and social demand for different types of property interests against the need to economize on information costs imposed on third parties that have to accommodate to such diversity, in view of the *in rem* nature of property rights."[245]

Professors Arruñada and Lehavi explain:

240. *See* Larry Kochard, *Commentary: Overcoming the 4 Most Common Co-Investment Obstacles*, PENSIONS & INVS. (Sept. 3, 2019), https://www.pionline.com/industry-voices/commentary-overcoming-4-most-common-co-investment-obstacles (discussing the difficulties of the "co-investment" strategy).

241. NOAH, *supra* note 230; POINT, *supra* note 215; HOMETAP, *supra* note 228; UNISON, *supra* note 214.

242. *See supra* note 241.

243. *See* FLEQ, *supra* note 189.

244. Benito Arrunada & Amnon Lehavi, *Prime Property Institutions for a Subprime Era: Toward Innovative Models of Homeownership*, 8 BERKELY BUS. L.J. 1, 19 (2010) (citing UGO MATTEL, BASIC PRINCIPLES OF PROPERTY LAW: A COMPARATIVE LEGAL AND ECONOMIC INTRODUCTION 39 (2000)).

245. *Id.*; *see* Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 24–42 (2000). Some maintain that information and transaction costs from novel forms can be controlled through the requirement that parties seeking to use them give some sort of public notice, and through the adoption of rules to guide our understanding of the arrangements. *See* Henry Hansmann & Reinier Kraakman, *Property, Contract, and Verification: The Numerus Clausus Problem and the Divisibility of Rights*, 31 J. LEGAL STUD. 373, 395–409 (2002).

> This does not necessarily mean that recognized types of property rights included in the "closed list," such as ownership, should essentially adhere to a single blueprint, i.e., an indivisible fee simple interest in both the land and the home.[246] At the same time, for new models that "rearrange" ownership to become formally institutionalized, the new format needs not only to become *de facto* familiar to various stakeholders, but should also be supported by enabling legislation and regulation. This support and familiarity would allow actors such as lenders to fully understand the nature of the property configuration and the type of collaterals, and consequently to be willing to extend credit.[247]

While there may be good reasons for not rigidly adhering to this principle, such as where its rationale is not implicated,[248] that is not the case with these new inventions. The structure and nature of their claims to an interest in the property are not readily apparent from the ground. Because the relationships may not be evidenced by a recordable instrument, discovering the claims may not be possible, and the resulting claims against the property may not fit within the traditional regime, from which there are specific rights, remedies, and schemes for resolving conflicts.

a. Property or Contract Rights

Rights in property acquired under these new models may be limited in idiosyncratic ways. In the Noah model, the relationship is described as an "equity-sharing contract," that refers to "homeowner partners."[249] Fleq

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246. Other writers have pointed out practical and normative differences in the concept of traditional property rights across different social contexts and different types of resources. *See* Hanoch Dagan, *The Craft of Property*, 91 CAL. L. REV. 1517, 1558–70 (2003) (discussing "institutions of property" ranging from those regulating arms-length market transactions to marital property); Amnon Lehavi, *The Property Puzzle*, 96 GEO. L. J. 1987, 1997–2000 (2008) (noting that different values implicate the ordering of rights to various resources).

247. Arrunada & Lehavi, *supra* note 244, at 19.

248. In *Community in Property: Lessons From Tiny Homes Villages*, 104 MINN. L. REV. 385 (2019), Professor Lisa T. Alexander challenges the *numerus clausus* proposition by offering the phenomenon of the tiny homes village as a new kind of property interest. The contours of this new form of housing tenure or property relation is complex and nuanced. As she describes it, the interest in tiny homes villages lacks a "formal title," yet operates much like traditional rights, in the sense of some security of tenure and the obligation and self-interest to maintain. While there are limits on the right to alienate, some tiny villages allow participants some share in the appreciation in value when they decide to leave. In Professor Alexander's view, the absence in this stewardship model of all those attributes normally associated with ownership (unqualified rights to exclude and to alienate) does not disqualify it from the canon of property interests.

249. NOAH, *supra* note 230.

purports to create an "alliance," that refers to a "joint venture."[250] If we treat them as they are denominated, then the rules of business associations should apply. This means equal participation in management, sharing of liabilities, formalities for dissolution, and fiduciary duties. As contracts, then the rights and remedies are measured in some ways by default rules — implied covenant of good faith and fair dealing, anticipatory repudiation, impossibility — but subject to bargain. It is unlikely that there will be much bargaining between the would-be homebuyer and financer, as the arrangements suggests an etched in stone character. In any case, the usual remedies will mean actions against the parties, but not against the property as would be the case with property interests.

As property interests, the lines are equally blurred. If the deed, the written evidence of ownership, names parties other than or in addition to the homebuyer, then all the rights of ownership are diminished, as the homebuyer will lack the apparent ability freely and unilaterally to transfer title or to give lesser rights. A deed that names parties in addition to the homebuyer will give those parties rights of possession and perhaps rights to veto decisions by the homebuyer over the use and changes to the home. Under the Unison model, the homeowner is typically not permitted to rent out the property and must keep the home in good condition.[251] Who decides on the quality and extent of improvements and repairs? If they are co-owners of joint venture property, can the homeowner seek partition? The Fleq Alliance does not specify relative claims and rights in the context of a divorce proceedings between married homebuyers or where the homebuyers fall into a bankruptcy proceeding. How do the financers protect their interests in case of involuntary transfers? There is a risk on the other side as well — what if the investor is in bankruptcy? Is the house an asset of that debtor's estate? These seem to be the same kinds of risks facing a vendee under an installment land contract, but at least there, the vendee, if she is in possession, can give notice by that possession of her equitable claim to the property to later purchasers. In the title examination phase, the non-possessing co-investor may be willing to accept risks of title, thought unsuitable by a single homebuyer? The non-possessing co-investor may be content with title insurance proceeds if defects manifest themselves later, but a possessing owner, may not want the risk of losing ownership.

b. A Mortgage by Another Name

The equity sharing company, Unison, states that it does not offer loans but

250. FLEQ, *supra* note 189.

251. UNISON, *supra* note 214.

options for investment.[252] Because it is not a loan, the homeowner is not required to make monthly payments to retire it, nor is she obligated to pay interest. Because Unison enables the homebuyer to make a larger down payment, private mortgage insurance may be avoided, and the monthly mortgage payments are smaller.[253] But, where does Unison's investment stand in terms of priority of claims? What are Unison's rights in case the homebuyer doesn't fulfill his side of the bargain? The claim clearly does not fit the traditional notion of a mortgage.[254] All the usual recourses and protections, notice of default, right to cure, and to redeem in case of a default, leaves homebuyers quite exposed. At the same time, the NDNB lacks those recourses available to a traditional mortgagee in case the co-venturer fails to fulfill his part of the deal.

i. Shared Appreciation Mortgage Comparison

One ready comparator to the shared equity investor model is the shared appreciation mortgage ("SAM"), which emerged in 1980.[255] SAMs enable reduced monthly payments, which in turn means less annual income

252. *See* Brumer, *supra* note 206.

253. *See* UNISON, *supra* note 214 (explaining Unison's services and comparing Unison to alternatives such as a second mortgage, an FHA loan, or a gift fund).

254. *See generally* David Waddilove, *The "Mendacious" Common-Law Mortgage*, 107 KY. L.J. 425 (2019) (examining the critiques of the "common-law mortgage" and interpreting the common-law mortgage in the context of the seventeenth century and judicial interventions to the doctrine since then). The first mortgages took the form of a fee simple subject to a condition subsequent, under which the borrower transferred legal title to a lender, which title would terminate on *law day* when the debt was repaid. The conveyance was structured with this language: "To lender, but if borrower pays by September 1530, borrower has the right to reenter and retake the land." However, this arrangement put the borrower at great risk. If on *law day*, the borrower was unable to repay the loan — he fell off his horse — the failure to repay, meant forfeiture of all payments made to that point as well as of the land. Borrowers appealed to equity for relief and the courts obliged by offering the "equitable right of redemption" — borrowers could thus pay late. But, because the courts of equity did not specify a date by which late payments must be made, this left lenders in a very precarious position. They in turn appealed to equity and this appeal gave rise to "strict foreclosure," that is, that the borrower was required to pay by a date certain or forever lose the property. Eventually, courts came to see that strict foreclosure was too very harsh, such that they required foreclosure by sale on the theory that a public auction might generate funds to repay the lender as well as some surplus to the borrower. Alas, that was only the theory, as studies over the centuries reveal that rarely do public sales generate any surplus to the borrower, but only minimize her ultimate liability to the lender. However, in several states, lenders are denied any deficiency judgment against the borrower. *See* GRANT NELSON ET AL., REAL ESTATE FINANCE LAW 199–210 (6th ed. 2015); RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES §4.1 cmt. a (AM. L. INST. 1997); Bennett v. Bank of E. Or., 167 Idaho 481 (2020).

255. Shared Appreciation Mortgage, 45 Fed. Reg. 66801 (proposed Oct. 8, 1980) (to be codified at 12 C.F.R. 545.6-4(b)).

necessary to buy a home. It does this through a two-tiered system of interest: a) a fixed, below-market interest, payable for the term and b) "contingent interest," payable as a percentage of the appreciation in the value of the property, either at loan maturity or on sale or transfer of the property.[256] The percentage of value is determined at the inception of the loan and may not exceed forty percent of the net appreciation.[257] That appreciated value is the difference between the sales price as market value and the costs — original costs (purchase price, closing costs, including real estate commissions, title insurance, appraisals, inspections); capital improvements; and outlays for the appraisals to calculating appreciated value.[258] While the SAM is amortized as a forty year loan, the actual term is much less, only ten years.[259]

While there are superficial comparisons between the SAM and the equity sharing home financing models, there are significant differences on several points:

- **Required disclosures:** At bottom, a SAM is a mortgage that is memorialized in an instrument that contains language to give notice of its claim to part of the value of the property, and in closing the loan, lenders must make disclosures to the borrower on the economics of this financing device.[260] With a SAM, the lender must show the borrower how the mortgage aligns with a fixed-rate mortgage in terms of cost, based on the fixed interest as well as the contingent interest. To do this, the lender must make an honest representation of the anticipated rate of appreciation of the property.[261] None of these requirements exist for the equity sharing models; only the percentage of appreciation is specified in the closing documents.
- **Economic Benefits:** The SAM benefits the lender if the rate of appreciation is as great as the contingent interest rate is fixed at the inception. But the borrower remains obligated to pay the principal of the loan, no matter if the value declines. Conversely, under the Unison model, the risk of the home not appreciating in value, falls entirely upon Unison and Unison's expectation of gain

256. Stanley L. Iezman, *The Shared Appreciation Mortgage and the Shared Equity Program: A Comprehensive Examination of Equity Participation*, 16 REAL PROP. PROB. & TR. J. 510, 515 (1981); *see also* ANDREW CAPLIN ET AL., FACILITATING SHARED APPRECIATION MORTGAGES TO PREVENT HOUSING CRASHES AND AFFORDABILITY CRISES (2008).

257. CAPLIN ET AL., *supra* note 256, at 8–9.

258. Iezman, *supra* note 256.

259. *Id.*

260. *Id.* at 516.

261. *Id.*

can be short-circuited if the homeowner sells the property or buys it out after five years,[262] in which case, any future gain goes exclusively to the homeowner.

- **Consequences at the end of the term:** Under both models, if the borrower is unable to sell the property profitably, she may have to refinance the loan at then prevailing interest rates and if she is unable to find a loan that is affordable, she might find herself in a forced sale, where all parties stand to lose. On this point, the two models, equity sharing and the SAM, are alike in terms of the dire consequences confronting the homebuyer at the end of the loan or investment period. They both may require a substantial payment of unrealized appreciation, even as the homebuyer or borrower may lack the liquid funds to make this payment.[263] In both cases, the choices of the obligor are limited — take out a new conventional loan, and incur substantial transactions costs (fees, time, lost opportunities), or sell the property. The potential loss of home looms large in both scenarios.[264]
- **Liability upon death of the homeowner:** The obligation to repay a SAM continues to burden a borrower's estate after his death. While the Unison model requires the heirs or the estate of the homebuyer to settle the Unison agreement after a 180-day grace period, it is not clear how Unison enforces this right.[265]

c. Landlord-Tenant

As described above, Fleq forms an alliance with the homebuyer who becomes both an owner and a renter, with the option to buy equity in the

262. *What is an Option Contract*, UNISON, *supra* note 233. As stated earlier, the buyout amount is the sum of Unison's original investment plus a share of the change in value of the home, which is determined by an independent appraisal. While the homeowner is entitled to a "Remodeling Adjustment" for improvements that add value to the home, improvements cannot be made during the first five years of the agreement.

263. *See* Arrunada & Lehavi, *supra* note 244, at 34 (suggesting that at the end of a loan period under the shared-appreciation mortgage, a borrower may lack liquidity and force her to take a conventional loan or sell the house).

264. *See id.*

265. *Your Questions, Answered: Advanced Topics*, UNISON (last visited Nov. 21, 2021), https://www.unison.com/ (lacking a clear answer to this issue); *see also Creative Financing for Home Purchases: What's Available Now?* MCKISSOCK (Feb. 17, 2017), https://www.mckissock.com/blog/appraisal/18584/; *Is Unison Home Co-investing Legit?*, CLARK (June 6, 2019), https://clark.com/homes-real-estate/unison-home-co-investing/; James Rufus Koren, *This Company Will Help With a Down Payment, But It Wants a Stake in Your New Home*, L.A. TIMES (Jan. 6, 2017, 3:00 AM), https://www.latimes.com/business/la-fi-home-equity-investments-20170106-story.html.

property.[266] While the outward appearance may be the classic landlord-tenant relationship, with the "tenant" having exclusive possession, Fleq does not assume the role of landlord, with the significant obligation of making sure the premises remain habitable under the implied warranty of habitability, instead placing that burden on the tenant. Most courts do not allow a waiver of the warranty.[267] The court in *Rainbow* saw through the contract label and evaluated the relationship for what it was, a landlord-tenant relationship.[268] Is "the alliance" a landlord-tenant relationship in disguise? If it is, what form of tenancy is it — tenancy for years or tenancy at will? What happens when the tenant fails to make the rental payments? Does Fleq have the right to terminate the tenancy and seek possession in a summary proceeding?

B. Remembrance of Looming Systemic Risks

The growing power and means to control the housing finance market by non-banks is cause for concern. Studies show that the growth of non-banks poses risks to borrowers, communities, and the U.S. government alike.[269] And because of the identified weaknesses in their business models, they remain just as vulnerable to a significant and sustained macroeconomic shock.[270] The same lax underwriting standards indicted as large contributors to the 2008 crisis, since circumscribed by bank regulations, now define the holdings of non-banks.[271] In general, mortgage loans from non-banks are of poorer quality than those originated by banks, and are being made to homebuyers with less income and wealth, and less business sophistication, [272] than those originated by banks.[273] And this seems to be the consciously

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266. *Frequently Asked Questions*, FLEQ (last visited Nov. 21, 2021), https://fleq.com/faqs/.

267. *See, e.g.*, Rainbow Realty Grp., Inc. v. Carter, 131 N.E.3d 168, 174 (Ind. 2019) (holding that the agreement met the statutory requirements to subject the parties to a landlord tenant relationship, including warranty of habituality).

268. *Id.*

269. *See, e.g.*, Kim et al., *supra* note 125, at 349 (outlining the vulnerabilities of non-banks).

270. *See id.* at 387.

271. Lux & Greene, *supra* note 132, at 7.

272. Kim et al., *supra* note 125, at 390; *see also* Neil Bhutta et al., *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances*, FED. RSRV. (Sept. 28, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.htm (describing various trends in homeownership by race, ethnicity, and socio-economic status).

273. Kim et al., *supra* note 125, at 390.

adopted business model.[274] Recent reports show that non-banks originated a significantly higher share of mortgage homes loans to minority borrowers and in low- to moderate-income neighborhoods,[275] than the number made by large banks.[276] By the objective measure of FICO scores, the loans made by non-banks carry lower expectations of performance — more than half were to borrowers whose FICO scores were below the 660 benchmark for demarcating prime from subprime loans.[277] While this presence in underrepresented communities might otherwise be applauded, we should worry if these efforts are the same kind of setup that led to so much economic and psychological grief in these communities during the crisis.[278]

Just as before, the GSEs and banks are playing a large role in this new drama — the GSEs purchasing most non-bank loans and banks making them warehouse loans[279] in the background. Despite the apparent constraints imposed by the conservatorship under HERA, the GSEs are heavily invested in loans originated by non-banks.[280] These loans are not much different from those that were the culprits in the financial crisis and are still more costly

274. The Quicken Loan ads for its "rocket mortgage" and the Lending Tree pajama-clad puppet aim to put viewers at ease about borrowing.

275. Kim et al., *supra* note 125, at 390.

276. As stated, the good part about this new world of lending is that loans are accessible to Black and Hispanic borrowers and as they live in low-or moderate-income tracts, *see id.* at 351, yet, there are some troubling underwriting dynamics still operating. This cohort of borrowers is less likely to have college degrees and have less income and wealth. *Id.* at 390. They have a higher debt-to-income ratio, at the same time, having a FICO credit score lower by five points for GSE pools and twenty-five points for Ginnie Mae, making the chances of default significantly higher. *Id.* at 392.

277. Lux & Greene, *supra* note 132, at 22.

278. Buchak et al., *supra* note 60, at 19–20 (finding that fintech and shadow bank loans are more than .02% likely to go into default than traditional bank loans).

279. *Id.* at 11. Warehouse lenders typically fund 95% of the mortgage balances, lending $40 billion at the end of 2016. *Id.* at 12–13. *See generally* Peter Rudegeair et al., *Big Banks Find a Back Door to Finance Subprime Loans, Lending to Nonbank Financial Firms Surges to Record as Banks Avoid Direct Exposure*, WALL ST. J. (Apr. 10, 2018, 7:18 PM), https://www.wsj.com/articles/big-banks-find-a-back-door-to-finance-subprime-loans-1523352601 (stating that while banks describe this new lending approach as "safer than dealing directly with consumers with bad credit . . . [it] mean[s] that banks are still deeply intertwined with the riskier loans that they say they swore off after the financial crisis"). Heavy reliance upon warehouse lending by non-banks puts them in a precarious existence if their loans are called in on margin or are subject to market-to-market reevaluations.

280. FHFA, RECENT TRENDS IN THE ENTERPRISES' PURCHASES OF MORTGAGES FROM SMALLER LENDERS AND NONBANK MORTGAGE COMPANIES 16 (2014) ("[N]on-banks accounted for 26.3 percent of agency purchase mortgage loans originated in December 2012, by December 2014, that number had grown to 48.37 percent."); *see also AEI Housing Center*, AEI, www.housingrisk.org (last visited Nov. 21, 2021).

than those from banks, despite the support of the GSEs and Ginnie Mae.[281] Because they are dependent on short-term credit to finance their operations, they may experience losses from contraction if these sources become more expensive or non-existent in a tight financial market.[282] Moreover, because their business model is novel and decentralized, they are challenging to monitor and constrain,[283] and due to their small size, they may regard the effects of excessively risky activities as merely abstract.

As with all technology-dependent operations, hacking — in recent times, carrying huge ransom demands — is an ever-present threat.[284] The new technology employed by NDNBs to assess credit risk may not lead to better assessments but would instead mask risk factors.[285] This point should not be rejected out of hand as the ravings of a luddite. The algorithms developed to evaluate applications that use unorthodox sources and types of data, such as insurance claims, utility bills, social networks, data from Amazon purchases, and eBay transactions may only reveal frequencies of occurrence, but not necessarily meaningful correlations.[286] After all, how does buying a classic Burberry raincoat on eBay predict whether one is likely to make timely mortgage payments? It may show that the would-be borrower is frugal, buying used and not new, or it might just as well show him to be profligate — a store brand coat would keep the rain away just as a classic one. This is not to say that a human assessment of creditworthiness is better, but only that we should not take technology as infallible. While these algorithms have not yet been tested in times of market turmoil, at least in

281. In fact, despite the strong market support offered by the GSEs and Ginnie Mae, non-bank loans carry interest rates that are 3.7 basis points higher than loans made by banks. Buchak et al., *supra* note 60, at 21–22; *see also* Neil Buchak & Aurel Hizmo, *Do Minorities Pay More for Mortgages, Finance and Economic Discussion Series* (Fed. Rsrv, Finance and Economics Series No. 2020-07, 2020), https://www.federalreserve.gov/econres/feds/do-minorities-pay-more-for-mortgages.htm (concluding that minority borrowers pay more for mortgages).

282. *See* Kim et al., *supra* note 125.

283. William Magnuson, *Regulating Fintech*, 71 VAND. L. REV. 1167, 1172 (2018); *see also* Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232, 235 (2018) (describing the risk implications of fintech in consumer finance).

284. Magnuson, *supra* note 283, at 1201–02; *see* Nicol Turner Lee et al., *Algorithmic Bias Detection and Mitigation: Best Practices and Policies to Reduce Consumer Harms*, BROOKINGS (May 22, 2019), https://www.brookings.edu/research/algorithmic-bias-detection-and-mitigation-best-practices-and-policies-to-reduce-consumer-harms/.

285. Jagtiani et al., *supra* note 136, at 5. Those who borrow from the Lending Club have a higher risk of becoming delinquent. Jagtiani & Lemieux, *supra* note 117, at 31.

286. Jagtiani & Lemieux, *supra* note 117, at 2, 26–28.

other areas of trading, it is widely believed that algorithmic high-speed trading has contributed to instability in markets.[287]

C. Untethered and Operating in the Shadows

As I suggested at the beginning of this paper, non-banking is sometimes referred to as "shadow banking," and this is for good reason. In many ways, they operate outside of the larger regulatory regime which places a premium on disclosures — to consumers[288] — and on public scrutiny. This is so because of non-banks' decentralized structure, consisting of a series of dispersed networks with discrete functions.[289] The asymmetric systems of information access make it difficult to monitor them and anticipate industry harm.[290] In such a scenario, there is little incentive to look out for or avoid relationships whose risks are apparent or could be discovered with a little investigation.[291]

Unlike depository institutions, non-banks do not have Community Reinvestment Act ("CRA")[292] obligations; nor an affirmative legal obligation to lend in any specific geographic area, but they are enjoined from engaging in practices that discriminate. Recently, the CFPB brought the first-ever redlining complaint against a non-bank, in *Bureau of Consumer*

287. The Long-Term Capital Market Program, at its debut, was widely celebrated because of its leveraged trading strategies premised on computer models. However, the models lacked the judgment required to abandon the strategies before it was too late, leading to the eventual collapse of the hedge fund, threatening billions in losses, but it was bailed out by the government. *See* Adam Hayes, *Long-Term Capital Management (LTCM)*, INVESTOPEDIA (May 3, 2021), https://www.investopedia.com/terms/l/longtermcapital.asp.

288. *See* Mary Jo White, Chair, SEC, Opening Remarks at the Fintech Forum (Nov. 14, 2016), https://www.sec.gov/news/statement/white-opening-remarks-fintech-forum.html.

289. Magnuson, *supra* note 283, at 1169.

290. *See From the People, for the People*, THE ECONOMIST (May 7, 2015), https://www.economist.com/news/special-report/21650289-will-financial-democracy-work-downturn-people-people (describing peer-to-peer lending companies, such as Lending Club).

291. Magnuson, *supra* note 283, at 1213 (discussing the balance of long-term and short-term interests). Magnuson posits that fintech may have long-term incentives to maintain a reputation for providing high-quality, reliable loans and investment opportunities; but, where the long-term interests of the company and the short-term interests of the managers of the company diverge, it is far from clear that the long-term interests will win out. *See id.*

292. 12 U.S.C. § 2901. The Act requires depository institutions to designate an assessment area or assessment areas. Then, the depository institutions must act to serve the credit needs of the entire area — including low- and moderate-income areas, which typically will overlap with predominantly minority areas. *See* 12 C.F.R. § 25.41 (2022); *see also* Jagtiani et al., *supra* note 136, at 2 (stating that in CRA assessment areas with fewer than ten banks, fintech loans are more prevalent than loans from other nonbanks).

Financial Protection v. Townstone Financial Inc.[293] The CFPB alleged that Townstone engaged in redlining by acts calculated to discourage applications based on race, including staff making disparaging comments about Black residents and certain minority populated areas, failing to market in those areas, and failing to employ non-whites as loan officers.[294] The CFPB has tried to overcome the hurdle posed by the absence of CRA obligations by "leveraging the concept of a Reasonably Expected Market Area ("REMA")"[295] or a "Proper Assessment Area," as a basis for evaluating claims of redlining.[296]

VI. CONCLUSIONS: NECESSARY REFORMS AND CONTROLS

It is fair to ask whether the regulations coming out Dodd-Frank went too far, particularly as we see that tighter lending standards made loans largely unavailable to many in marginal economic circumstances. The new regulations sensibly called for greater scrutiny in extending credit to protect both the borrower and the lender, but they should not disqualify them wholesale.

While the NDNBs present many differences from the financing tools that were prevalent prior to the 2008 housing crisis, ARMs were not at all novel when they were used. It was the indiscriminate deployment that led to the crisis. Then, as now, there is the need for controls on both sides of the transactions. NDNBs should be regulated by rules precisely calibrated to their particular features,[297] be subject to registration procedures that are simple,[298] and be subject to centralized regulation.[299] What this might look like must come from both imagination to design different kinds of legal relations, and fear of relieving a dark period in our financial history. At a

293. Complaint, Bureau of Consumer Fin. Prot. v. Townstone Fin., Inc., No. 1:20-cv-04176 (N.D. Ill. July 15, 2020). The CFPB alleged violations of the Equal Credit Opportunity Act, Regulation B. 15 U.S.C. 1691(a). *Id.*

294. *Id.* at 4–13.

295. The FDIC has offered guidance to banks on how to determine the appropriate geographic area to avoid charges of redlining. *See Are You at Risk for Redlining? Understanding Your Reasonably Expected Market Area (REMA) and CRA Assessment Area*, FDIC DIV. OF DEPOSITOR & CONSUMER PROT. (Mar. 14, 2018), https://www.fdic.gov/news/events/sf-region/2018-03-14-rema-cra-presentation.pdf.

296. *Id.*

297. *See* Dale A. Oesterle, *Intermediaries in Internet Offerings: The Future Is Here*, 50 WAKE FOREST L. REV. 533, 547–49 (2015).

298. *See* Gregory Scopino, *Preparing Financial Regulation for the Second Machine Age: The Need for Oversight of Digital Intermediaries in the Futures Markets*, 2015 COLUM. BUS. L. REV. 439, 505–06.

299. *See* Kevin V. Tu & Michael W. Meredith, *Rethinking Virtual Currency Regulation in the Bitcoin Age*, 90 WASH. L. REV. 271, 300–13 (2014).

minimum, the capital requirements applicable to banks should apply to non-banks as well. As former Vice Chairman Fischer has suggested, they should be required to "maintain buffers of highly liquid assets that are sized according to the risk that their liabilities will run off quickly in a stress[ful] situation."[300]

On the substantive side of the transactions, the use of untested and unconventional criteria for assessing creditworthiness should be allowed only as a comparative measure. The surface appeal of non-debt financing seems well-calculated to mask the genuine risks not just to the homebuyer, but to the partner in the alliance or co-venturer. Homebuyers in these arrangements — particularly, equity sharing arrangements — need the same kind of cost of finance disclosures as borrowers from banks. To head off systemic and ripple market effects when the market turns bad, these finance companies should be required to make the same ATR determination as lenders. As I suggested in my earlier work, financial ability is not a static, fixed thing, but ebbs and flows with the economic tides. This means that the assessment of risk should anticipate that life happens. The best responses to life changes that make it impossible to meet financial obligations cannot handily be addressed by moratoria on foreclosures and stimulus checks.[301] Instead, we need to build in mechanisms for systemic or market adjustments — ones that perhaps index payments to the events in the economy, indeed to personal circumstances.

The merits of NDNBs, novel creatures in many respects, must be evaluated for their hidden and obvious threats before they take root that is too deep to pull up. As their place in the taxonomy of common law property is not clearly established, the contours of rights and obligations may need legislative definition. The result may be something sui generis in terms of category, but with bright lines fixed that delineate contours. NDNBs must not be allowed to operate on the edges, but must be brought squarely within the established, tested regime and held up against safety and soundness measures calibrated to the risk inherent in financing home purchases in the shadows.

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300. Fischer, *supra* note 121, at 7.

301. The HUD Single-Family Housing Policy Handbook includes "residual income" as a compensating factor in calculating the allowable DTI ratio. U.S. DEP'T OF HOUSING & URB. DEV., HANDBOOK 4000.1, FHA SINGLE FAMILY HOUSING POLICY HANDBOOK 339–43 (2021).

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