

How do Shared Equity Agreements Work?

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As discussed in the [last edition](#) of *This Week in Real Estate*, many homeowners are interested in shared equity agreements. Let's discuss how those agreements work.

Here are a few examples of shared equity agreements in action.

Scenario 1: Securing a down payment

Harry Homeowner wants to buy a home that costs \$250,000. To avoid Private Mortgage Insurance (PMI), he needs to put down \$50,000. He saved up \$25,000 but is not sure how to get the rest. He hears about a shared equity investment company and finds out they will lend him the other \$25,000. In exchange, they get an interest in his property and its future appreciation or depreciation. Harry's agreement sets the term at 30 years. That means he won't have to make a single repayment on the amount until he sells the home or thirty years have passed, whichever comes first. At the end of the agreement, Harry will repay the initial investment along with 35% of the property's gain or loss over the span of the agreement. Note that the amount of the company's interest in the gain is considerably more than the percentage of the initial investment.

Repayment

Fifteen years later, Harry is ready to sell his home. Depending on how the value of his home has changed, here's what could happen.

- If Harry's home has **increased in value** to \$350,000, he will owe the investor the initial investment of \$25,000 plus 35% of the \$100,000 gain (\$35,000). The total payment would be \$60,000.
- If the value of Harry's home **stayed the same**, he would owe the investor the initial investment of \$25,000 and nothing more.
- What if Harry's home **value drops** to \$200,000? He'll need to repay the difference between the initial investment (\$25,000) and the investor's percentage of the loss (35% of -\$50,000 = -\$17,500). The total repayment amount would be \$7,500.

Scenario #2: Cashing out some home equity

Ophelia Owner has a home worth \$500,000. She still owes \$300,000 on her mortgage and has \$200,000 in home equity. She wants to cash out \$50,000 and reaches out to an equity-sharing company to make it happen.

Equity sharing agreement

Ophelia agrees to sell \$50,000 of her equity in exchange for a 25% stake in her home's appreciation over the next ten years.

Repayment

When the 10-year term is up, it's time for Ophelia to pay, here are three possible outcomes:

- If Ophelia's home increases in value to \$550,000, she will have to repay the initial \$50,000 plus 25% of the \$50,000 appreciation, for a total of \$62,500. If she is not ready to sell her house, so she will have to pay out-of-pocket or refinance the debt.
- However, refinancing the debt will result in additional financing fees. And even if she sells her home, the \$37,500 she gains from the appreciation won't cover the full \$50,000 repayment. This outcome could be problematic for some homeowners.

Before making a shared equity agreement, check market trends and predictions to make sure you've got a good chance of gaining money instead of losing it.

Next week, we will examine who would truly benefit from a share equity agreement.