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"We Buy Houses": A Foreclosure Rescue as the Solution to the Trapped Homeowner Equity Problem

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I. INTRODUCTION

Foreclosure rescue transactions are viewed widely as scams designed, among other things, to dupe poor, minority, and elderly homeowners out of the equity in their homes.[1] The transactions are frequently called "foreclosure rescue scams,"[2] "equity skimming schemes,"[3] or other derogatory terms. However, foreclosure rescue transactions come in many forms and, as an alternative to foreclosure, often maintain valuable options for homeowners that the homeowners otherwise would lose in the traditional foreclosure process.[4] For this reason, many of these transactions, though imperfect, should be preserved and supported.

This Article introduces one such foreclosure rescue transaction, the residential sale/leaseback/buyback ("RSLB") transaction, into the legal literature

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1. *See* Prentiss Cox, *Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem*, 39 CLEARINGHOUSE REV. 607, 609 (2005-2006); Nathaniel C. Nichols, *Home Alone: Home Mortgage Foreclosure Rescue Scams and the Theft of Equity*, 11 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 280, 280 (2002).

2. *See* Cox, *supra* note 1, at 609, 621; Nichols, *supra* note 1, at 280.

3. *See* Cox, *supra* note 1, at 607; Nichols, *supra* note 1, at 280.

4. *See generally* John Rao & Geoff Walsh, *Foreclosing a Dream: State Laws Deprive Homeowners of Basic Protections*, NAT'L CONSUMER L. CENTER (Feb. 2009), http://www.nclc.org/images/pdf/pr-reports/report-foreclosing-dream.pdf (finding that state foreclosure law facilitates the loss of homes and equity to big lenders during the foreclosure process by weak civil procedural protections, excessive fee schedules, and other means).

from the perspective of the rescue investors.[5] A basic RSLB transaction allows a homeowner facing foreclosure to sell his property to an investor and to lease the property back for a set period at a set rate, while retaining the right to buy the property back at a set price on a set date in the future (a call option).[6]

This Article unveils the logic of these transactions and provides market context, which is often misunderstood and under-appreciated by academics,

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5. This Article is the first of a series of articles about residential pre-foreclosure investing. Specifically, these articles introduce the *We Buy Houses* transaction and other RSLB transactions into the legal literature from the previously unheard perspective of the often demonized investors. The articles are the culmination of over one hundred hours of interviews with these investors, the bulk of which occurred in Fall 2012 and Spring 2013, including exclusive interviews and written correspondence with the first-ever white-collar defendant, an RSLB investor, sentenced under a Three-Strikes Rule to a potential life sentence for this type of transaction.

The anatomy of the transaction presented in this series of articles is a composite of their descriptions, theorized and converted into the language of lawyers and academics by the Author. To the extent that their versions or observations differ from the composite, or especially illuminate a point, individual investors' explanations or interpretations are highlighted as warranted.

The group which agreed to be interviewed anonymously for this project is comprised of eleven investors and three family members or office staff members of investors. They have completed transactions in six different states and have each done between "eight or nine" and "well over a hundred or two" similar transactions. Some use their own or family funds, whereas others use outside funds entirely. Over half do this or similar real estate transactions or construction full-time. The longest tenured investors have been in the business for over thirty years; the shortest real estate career has been seven years. Three of the investors were related to each other. Another two were a father and daughter duo. Three of the investors were known to the Author prior to the project.

Each investor was asked to describe the process of executing the RSLB transaction from start to finish, explaining the *how's* and *why's* of each step of the transaction. The investors were also asked what they thought were the good/beneficial and bad/problematic aspects of the transaction and the marketplace altogether. They were asked to describe their interactions with homeowners, other investors, and lenders. Finally, they were asked how they felt about recent prosecutions of investors and whether they were optimistic about this product. Each interviewee believed their marketplace is misunderstood by outsiders. This Article seeks to remedy that problem.

6. While there are several states where this transaction is prevalent, the Author primarily refers to California law because investors there are on the forefront of this transaction and because California has a good statute governing these transactions, which other states could use as a model. *See* CAL. CIV. CODE § 1695 (West, Westlaw through Ch. 16 of 2014 Reg. Sess.). Additionally, it was in California in 2012 that the first ever white-collar defendant, an RSLB investor, was sentenced to a 33.33 years-to-life sentence under California's Three-Strikes Rule for this transaction. *See* Stuart Pfeifer, *Housing Scam Brings Up to Life Sentence Under Three-Strikes Law*, L.A. TIMES (Apr. 28, 2012), http://articles.latimes.com/2012/apr/28/business/la-fi-0428-three-strikes-fraud-20120428.

judges, and the public, who do not understand the value of the transactions to the homeowners who use them and to the communities in which the transactions are popular.[7] Instead, the transactions are met with bias and negative assumptions.[8] Critics often present the exceptions as if they are the rules and falsely stereotype the homeowners in these transactions as elderly, frail, and uneducated.[9] As a result, these transactions are increasingly regulated by criminal law, with convicted investors subject to severe criminal sentences.[10] The effect of this trend will be to eviscerate the RSLB transaction completely.

Much of the limited scholarship on – and condemnation of – this transaction comes out of consumer protection jurisprudence, which has been slanted decidedly in favor of the homeowners, and has demonized the investors, who are generally small, entrepreneurial investors from the same communi-

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7. Foreclosure rescue activity encompasses a wide range of activities, which generally fall into four categories. Some may include provision of negotiation, consultation, or counseling services; others will include actual refinancing of loans with different terms than the loan being foreclosed; others involve outright sales of properties. This Article looks at a fourth one, the sale/leaseback/buyback transaction, which is a type of Pre-Foreclosure Investing (PFI). PFI refers to transactions designed to rescue a homeowner during the period *after* the lender publishes its intent to foreclosure, but *prior* to the completion of the looming foreclosure sale, meaning that RSLB transactions are executed between the homeowner and the investor. Other types of rescue transactions happen at other points in the process. Once the official proceedings have begun, the transaction would then involve the bank, and possibly the courts also.

8. The first line of California's statute governing these transactions, reflects the built-in biases and assumptions underlying these transactions. CAL. CIV. CODE § 1695(a) ("The Legislature finds and declares that homeowners whose residences are in foreclosure have been subjected to fraud, deception, and unfair dealing by home equity purchasers."). Such a declaration reflects the legal and social atmosphere in which these investors operate.

9. *See generally* NAT'L CONSUMER LAW CTR., FORECLOSURES § 15 (3d ed. 2010) [hereinafter FORECLOSURES]; Cox, *supra* note 1, at 607, 611, 618, 620 (offering numerous ways to go after alleged "acquirers" . . . and their "confederates," whom he accuses of "kicking someone who is down"); Nichols, *supra* note 1, at 280-81 (arguing that foreclosure rescue scams target vulnerable homeowners, yet failing to acknowledge the benefits the transactions bring to homeowners).

10. *See* Pfeifer, *supra* note 6; *see* Harold Brubaker, *25-Year Prison Term for Foreclosure-Rescue Scammer*, PHILA. INQUIRER, Oct. 3, 2012, http://articles.philly.com/2012-10-03/business/34219118_1_prison-term-demarco-rei-massive-mortgage-fraud; *see generally* Ellen Podgor, *Laws Have Overcriminalized Business Behavior*, N.Y. TIMES (Nov. 10, 2013, 7:01 PM), http://www.nytimes.com/roomfordebate/2013/11/10/prosecuting-executives-not-companies-for-wall-street-crime/laws-have-overcriminalized-business-behavior ("Attributing criminality to business-related activities is not always so easy. The line between criminal activities and acceptable business judgments can be fuzzy."); *see* United States v. Goyal, 629 F.3d 912, 922 (9th Cir. 2010) (Kozinski, C.J., concurring) ("Civil law often covers conduct that falls in a gray area of arguable legality. But criminal law should clearly separate conduct that is criminal from conduct that is legal.").

ties as the homeowners.[11] Another failing of the existing scholarship is that it neither explains the economics of the transaction and the transaction's role in the residential real estate market – which is important in assessing the value of these transactions – nor the step-by-step process of creating and executing the underlying contracts. Instead, in its efforts to target the investors, consumer protectionism tends to overstate the size of the problem. While there is opportunity for fraud in any industry, including foreclosure rescue transactions, the transactions themselves are not wholesale fraudulent. Additionally, none of the consumer protection scholarship has addressed the issue that the foreclosure rescue investors are as vulnerable to unscrupulous, disgruntled homeowners as the homeowners are vulnerable to the investors.[12] It also takes a paternalistic view of the homeowners and strips them of any economic sophistication.[13] However, consumer protectionists make some very good suggestions about how to curtail harmful conduct when it does occur in this marketplace.[14]

Currently, the RSLB transaction is being demonized and criminalized, with escalating numbers and severity of criminal charges and corresponding sentences.[15] This response is troubling because, although the transaction

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11. *See* Prentiss Cox, *Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem*, 39 CLEARINGHOUSE REV. 607 (2006), *available at http://heinonline.org/HOL/LandingPage?handle=hein.journals/clear39&div=72&id=&page=* (offering numerous ways to go after alleged "acquirers" and their "confederates," whom the author accuses of "kicking someone who is down"); *see also* NAT'L CONSUMER LAW CTR., FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 375-418 §§ 15.1-15.5.4.4 (John Rao et al. eds., 2d ed. 2007).

12. *See* Cox, *supra* note 1; FORECLOSURES, *supra* note 9.

13. *See generally* Ronald J. Mann, *After the Great Recession: Regulating Financial Services for Low- and Middle-Income Communities*, 69 WASH. & LEE L. REV. 729 (2012).

14. The National Consumer Law Center remains at the forefront of combating impropriety in foreclosure rescue transactions and publishes many manuals and materials for lawyers to deal with such cases. NAT'L CONSUMER L. CENTER, https://www.nclc.org/ (last visited May 26, 2014). Additionally, the homeowner protections of the Dodd-Frank Wall Street Reform and Consumer Protection Act have been strengthened by the homeowner-friendly Consumer Financial Protection Bureau's (CFPB) Consumer Financial Regulations, which are designed to preempt lender bad behavior. *See* 12 C.F.R. §§ 1024, 1026 (2013). However, these regulations still allow lenders the option to not refinance certain homeowners, which will leave some homeowners in the position of needing a last resort option, like RSLB, to save their homes. *See id.*

15. In one representative case, *Browner v. District of Columbia*, the defendant investors were convicted for loansharking, defined as lending money at a rate above six percent without a license. 549 A.2d 1107, 1109 (1988). Loansharking in the District of Columbia carried a maximum sentence of "imprisonment for thirty days, or a $200.00 fine, or both." *Id.* at 1111. The actual sentence was that they received "suspended jail sentences and were placed on probation and ordered to make restitution, pay fines and perform community service." *Id.* However, recent cases for very similar behaviors generate charges of fraud, burglary, theft and hosts of other charges.

allows some opportunities for abuse, it is a good transaction for numerous reasons. The rubric for a "good" transaction would involve the creation of options and opportunities for the parties which did not exist before, and which would not exist without the transaction. In other words, a good transaction leaves both parties better off across the averages. This Article will demonstrate that the RSLB transaction satisfies this rubric. Currently, the RSLB transaction is the only available solution for a persistent market failure, it is the market's own endogenous solution, and it makes the parties generally better off. RSLB also has protections built into the transaction for the parties and creates clear expectations between the parties. Where the transaction falls short of the rubric, it could easily be tidied up, and therefore should be supported. However, the current trend of criminal regulation with unpredictable sentences will have the opposite effect and will likely eliminate the RSLB marketplace – to the detriment of the homeowners.[16]

A second rubric can be introduced to evaluate the best way to regulate a marketplace. There are four institutions[17] available to regulate a marketplace and address its problems: a pure market-based regime, preemptive and market-facilitating regulation, the civil judiciary empowered with a full slate of contract doctrines and remedies, and the criminal court with its punitive sword.[18] One institution is "better" than another if it accomplishes desired outcomes or minimizes undesirable outcomes better than the alternative institutions.[19] A "good" legal outcome is one which promotes and supports efficient and wealth-maximizing outcomes with the least burden to society as a whole,[20] and which creates stability and a guide for subsequent parties. A good outcome also protects the parties from each other equally, concentrates costs between the parties, and creates incentives for the parties to resolve disputes within their contracts.

Cori Harvey, *"We Buy Houses": Market Heroes or Criminals?*, 79 MO. L. REV., Appendix (forthcoming 2014).

16. Mann, *supra* note 13, at 747-48.

17. Neil Komesar's comparative institutional analysis defines "institutions" as decision-making processes. ("In broad categories, these decision-making processes include the market, the political process, and the adjudicative process (the courts). Law in its most common form is the product of a decision-making institution – the adjudicative process. In turn, economics is the study of the functioning of decision-making processes most dominantly (but not exclusively) that set of processes roughly covered by the term 'market.'"). Neil Komesar, *The Logic of the Law and the Essence of Economics: Reflections on Forty Years in the Wilderness*, 2013 WISC. L. REV. 265 [hereinafter *The Logic of the Law*]. *See also* NEIL K. KOMESAR, IMPERFECT ALTERNATIVES: CHOOSING INSTITUTIONS IN LAW, ECONOMICS, AND PUBLIC POLICY 9 (1994).

18. *The Logic of the Law,* supra note 17.

19. *See id.* (arguing that the relative desirability of any institution over another must factor in the distribution of costs and benefits across the participants involved in the institutions).

20. *See* Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111 (2006).

For most of the problems in the RSLB marketplace, this Article argues that the best legal solution is to preempt the problems with market-facilitating regulation, thereby avoiding criminal or civil litigation altogether. Fortunately, due to the nature, size, and scope of this marketplace, many of the proposed regulations are minor and could be implemented at the level of the local jurisdiction or through local licensing requirements, instead of requiring sweeping regulatory reform.[21] To the extent that problems cannot be preempted, civil dispositions bring about the next best solutions. Civil dispositions are better than the current criminal dispositions because, based on the metrics stated above, criminal dispositions fail at every turn, whereas civil dispositions satisfy most of the metrics in the regulatory rubric.

Part II will describe the unique market failure that the RSLB transaction emerged to combat, which is coined here as the "trapped equity paradox," and explain why that failure exists. Part II will demonstrate the legitimate need for economic solutions to fill this particular void within the marketplace as well as explain why small investors are uniquely positioned to fill this void.

Part III will introduce and examine the market's own solution to the paradox, the RSLB transaction, and will present a previously unexamined view to demonstrate the logic and structure of the RSLB marketplace. This Part will also introduce the typical homeowner and investor,[22] and the role that RSLB transactions play in the market. Finally, Part III will show the actual, yet misunderstood, allocation of economic risks between the contracting parties, including an accounting of where the money goes. The prevailing wisdom in these cases is that the homeowners do not receive any meaningful benefit from these transactions. This Part will show that this argument is unfounded. Part III will also serve as the foundation for a series of articles on the RSLB transaction.

Part IV will extrapolate the benefits of RSLB transactions to homeowners and also identify where the obstacles in these transactions might emerge, in order to start a meaningful conversation about how best to avoid the obstacles while preserving the transaction. It is not the goal of this Article to present complete solutions to these problems.[23] Rather, the goal simply is to

21. Several jurisdictions (such as California and New York) already have statutory frameworks, called Equity Purchase Statutes, in place to govern transactions involving the sale of homes in foreclosure, which would include RSLB transactions. *See* CAL. CIV. CODE § 1695 (West, Westlaw through Ch. 16 of 2014 Reg. Sess.); N.Y. REAL PROP. LAW § 265-a (McKinney, Westlaw through L.2014, chapters 1 to 22, 50 to 60); MD. CODE ANN., REAL PROP. §§ 7-105 to -113, 7-301 to -325 (West 2014); MO. REV. STAT. §§ 407.935-.943; WASH. REV. CODE ANN. §§ 19.134.010-.900. These frameworks could be modified to effectuate the suggestions made in this Article.

22. Author interviewed several of these "typical" investors for this Article. *See supra* note 5.

23. For a thorough discussion of these potential problems as well as proposed solutions, see Harvey, *supra* note 15 (presenting a catalogue of more efficient, effective, and simpler solutions than criminal regulation).

take a good first step in that direction by making a thorough assessment of where the mines might be buried. As with any systemic problems, some will be easier to solve than others. Indeed, in the RSLB marketplace, there is a troubling market failure, a troubling market response to that failure, and a troubling regulation of that market response – all three of which need to be fixed.[24] However, this Article argues that most of these problems can be preempted quite easily to protect both homeowners and investors, and proposes that the marketplace for this transaction can be cleaned up without removing the transaction as a solution to very real problems. What follows is an illumination of why and how the market's own RSLB transactions are carried out.[25] The premise is that by understanding the transaction and the protections that are currently incorporated for homeowners and investors, academics will be better equipped to address problems arising from the transaction. It is easy to see how the protections could be strengthened if they are failing. It is also easy to see how additional protections could be built into the transactions to preempt problems and to support this marketplace in ways that would leave homeowners, investors, and society better off.

II. THE MARKET FAILURE

In America, there are two classes of people: those who have accessible, value-generating capital and those who have either inaccessible "dead capital"[26] or no capital at all. "Dead capital," a term used to describe unproductive capital such as that in the Third World, refers to capital that could generate value, but fails to do so due to a lack of market and legal processes to release that value.[27] The Third World, however, does not have a monopoly on dead capital. In America, something very close to this dead capital exists where, due to a lack of access to outside funding and credit mechanisms, some homeowners cannot access their internal capital, which is the equity in their homes. Home equity is the difference between the market value of a home and all encumbrances upon it.[28] Equity, once extracted as cash, can be

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24. Addressing the underlying market failure is outside of the scope of this Article. A subsequent article decries the institutional choice to use the criminal law, instead of contract law, to regulate this marketplace. *See id.*

25. For this reconstruction, Author relied on interviews with investors, court transcripts – which are the best existing versions of events from the homeowners' perspective, equity purchase statutes, publications from the National Center for Consumer Law, and investor training materials. *See supra* note 5.

26. HERNANDO DE SOTO, MYSTERIES OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE 15 (2000) (coining the term "dead capital" and defining it as assets which cannot be used to their fullest).

27. *Id.* at 36-38 (arguing that what distinguishes the West from the Third World is that capital in the West can be converted into value; whereas, capital in Third World countries is dead because the legal and market processes do not exist to liberate that value).

28. BLACK'S LAW DICTIONARY 443-44 (7th ed. 2000).

used to meet any cash needs the homeowners might have. These homeowners face the "trapped equity paradox."[29]

A. The Trapped Equity Paradox

The trapped equity paradox refers to the simultaneous conditions of having equity in one's home, needing cash, and not being able to access the equity to convert it to cash. This paradox can cause high equity homeowners to find themselves defaulting on their short-term debt payments – such as credit cards and auto loans – sometimes to the point of bankruptcy or vehicle repossession. In addition, these homeowners may face foreclosure because they cannot meet the monthly mortgage payments on the very home in which the equity is trapped.[30]

Although accessible under normal market conditions using ordinary banking and credit functions, as a result of the trapped equity paradox a homeowner's equity may remain trapped in the home as something similar to what scientists call "potential energy."[31] The equity cannot be released or put to work for lack of access to credit.[32] That credit could come in the form of a home equity loan or a mortgage refinance loan, which would allow a homeowner to extract that capital and put it to a higher value or higher priority use. Therefore, the potential energy within a home represents the home's dormant power to generate value and increased productivity for the homeowner.[33]

29. Author coins this term here.

30. To some extent, all homeowners have trapped equity, unless they have access to one hundred percent loan-to-value financing. The paradox arises when the homeowner also has a critical cash need that cannot be met. The paradox is like Samuel Taylor Coleridge's Ancient Mariner: "Water water, everywhere, Nor any drop to drink." *See* SAMUEL TAYLOR COLERIDGE, THE RIME OF THE ANCIENT MARINER 53 (Thomas Dilworth ed., Dufour Editions 2005) (1798).

31. "Potential" is defined as something that can develop or become actual. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 971 (11th ed. 2003) [hereinafter MERRIAM-WEBSTER]. "Energy" is defined as a vigorous exertion of power. *See id.* at 413. Therefore, potential energy is that which can develop into a vigorous exertion of power.

32. The lack of access to credit may be due to limited or no income, or a poor credit score. *See* Fin. Crimes Intelligence Unit, *2010 Mortgage Fraud Report Year in Review*, FED. BUREAU INVESTIGATION 6 (Aug. 2011) [hereinafter *2010 Mortgage Fraud Report*], http://www.fbi.gov/stats-services/publications/mortgage-fraud-2010/mortgage-fraud-report-2010 (citing *1st Quarter 2011 Community Outlook Survey*, FED. RES. BANK PHILADELPHIA, http://www.philadelphiafed.org/community-development/community-outlook-survey/2011/2011q1.cfm (last visited May 19, 2014)) ("low-income households still struggle to access credit[, and] . . . [t]he top three factors contributing to a lack of access to credit include lack of financial knowledge, underwriting standards/credit ratings, and lack of cash flow.").

33. *See* DE SOTO, *supra* note 26, at 42-50.

While not dead, trapped equity is sleeping capital and needs to be awakened so that its potential energy is changed into kinetic energy.[34]

Homeowners who suffer the trapped equity paradox are primarily asset-rich and cash-poor. Such homeowners own a valuable asset – their homes – often with significant equity, but few, if any, other liquid assets. Moreover, they lack access to credit, which is the main unifying characteristic of this group.[35] The homeowners' equity exists for one of two reasons: first, they may be long-time homeowners who purchased homes at lower past prices with lower mortgages than current market prices; second, the housing market may be rising quickly, creating large stores of equity in short periods of time, even for new owners. However, because these homeowners are credit-starved, they cannot access their own home-bound wealth for other beneficial uses through normal credit channels. That equity is inaccessible because when these homeowners cannot show both a means and a willingness to pay back their loans, either with current cash flow or other liquid assets, they cannot qualify for financing or refinancing to extract this equity.

B. The Trapped Equity Paradox and Pre-Foreclosure

The trapped equity paradox becomes especially salient when homeowners are in "pre-foreclosure" – having defaulted on their primary loans due to income stoppages – but have not yet lost their homes to foreclosure. Pre-foreclosure is the final period of non-payment before a foreclosure sale of the property and eviction.[36] At this point, lenders in most jurisdictions legally must notify homeowners that the homeowner is in default on the terms of the mortgage[37] and, subsequently, of the lender's intent to sell the property in a foreclosure sale[38] after a statutorily set period of time.[39] If it is not already too late, homeowners have several options to bring their loans current to avoid foreclosure, all of them problematic. Homeowners may try to refinance their loans using their own credit or through the illegal practice of borrowing the credit of friends or loved ones; they may find a cash windfall to make a

34. MERRIAM-WEBSTER, *supra* note 31, at 687 (defining "kinetic energy" as energy associated with motion); *see also* DE SOTO, *supra* note 26, at 42-50.

35. Lack of credit is the unifying characteristic because, if they had access to credit, their equity would not be trapped. Instead, they could get a loan to extract that equity as cash.

36. Prior to official pre-foreclosure, a homeowner is just in arrears.

37. This is often called a Notice of Default, which is sent to the homeowner and published. *See* CALIFORNIA RESIDENTIAL FORECLOSURES: THE COMPLETE GUIDE TO EQUITY PURCHASES AND THE LAWS GOVERNING DISTRESS SALES 155 (Fred Crane et al. eds., Zyrus Press 2007).

38. This is often called a Notice of Trustee's Sales, which is published. *See infra* note 69 and accompanying text.

39. *See* FORECLOSURES, *supra* note 9, app. E at 905-27 (providing a state-by-state summary of foreclosure laws, including notice requirements).

lump-sum payment; they may lease the property out if they can get a premium over the mortgage payment; or, they may sell their homes quickly.

Often, these homeowners' friends and families cannot or will not act as a stand-in to get credit for the homeowners – either because they know it is illegal or because they cannot afford to do so.[40] Additionally, while a perfectly timed windfall is possible, it is unlikely that these homeowners will suddenly find the cash needed to save their homes, which likely equals several months' worth of past due mortgage payments and late fees.[41] Leasing the home to a renter may generate enough income to cover the monthly mortgage payment.[42] However, it is unlikely that it will generate enough to pay the arrears on the mortgage in the short timeframe provided.[43] Leasing also requires that homeowners get their credit approved to rent elsewhere, to relocate themselves – at potentially great cost – and to pay monthly rent on their new homes, which they struggled to do on their previous homes.[44] Therefore, leasing out the home and trying to relocate may create more problems than it solves. Further, it would likely be difficult to sell their properties in the short timeframe provided for in the foreclosure notifications, except to quick-moving, savvy investors or cash buyers, who would likely have their pick of properties and would benefit from robust competition for their investment dollars. Moreover, even if the homeowners could sell their homes under these conditions, they would likely receive a low price relative to the actual value of the property.[45] Additionally, some homeowners waste a lot of time completing the refinance loan application process, only to be disappointed when rejected in the eleventh hour.[46] Finally, many homeowners lose valuable time in denial about exactly where they are in the foreclosure process.

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40. *See supra* notes 5 & 25.

41. *See supra* notes 5 & 25.

42. *See supra* notes 5 & 25.

43. *See supra* notes 5 & 25.

44. *See supra* notes 5 & 25.

45. However, there is a foreclosure rescue market for the outright sale of high-equity homes facing foreclosure. This may be a good option for people with homes in saleable condition, who just want to leave their homes and take some cash with them, while avoiding the harm to their credit and the humiliation of a foreclosure. This should be distinguished from sales of no-equity or negative-equity homes during foreclosure, which are most often seen in market slumps and are more complicated as they can require negotiations with a third party, the lending bank. No-equity and negative-equity transactions are not the focus of this Article.

46. Even with new CFPB mandates, banks can and will continue to decline a certain percentage of modification and refinance requests, leaving those homeowners in the situation described here – sans options. *See supra* notes 5 & 25. *See also* CONSUMER FIN. PROTECTION BUREAU, CFPB BULLETIN 2012-04 (FAIR LENDING) 1 (2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf (citing 12 C.F.R. § 1024-26 (2013); *see generally* Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. 723 (2013) (describing a myriad of obstacles to successful loan modifications).

C. The Efficient and Maximizing Voids[47]

The trapped equity paradox exists due to a void of supply in the rescue lending market.[48] Homeowners facing the trapped equity paradox would benefit from a rescue loan when facing a foreclosure. There is high demand amongst these homeowners for rescue loans. However, even where homeowners would take these loans at high rates, such rescue financing is extremely difficult to find.[49] Lenders, generally large banks, are unwilling to lend to these homeowners for risk-related reasons. Because they have defaulted on other commercially available original and backup loans and are already facing the foreclosure process, these homeowners are high-risk borrowers. And, because they are high-risk, they cannot obtain new financing through traditional or sub-prime channels. Traditional commercial lenders may avoid making such rescue loans because these homeowners have shown a willingness to default on loans, or because their credit-worthiness or incomes have fallen below what they were at the time of the original loans. Traditional lenders may also prefer not to serve this market because these homeowners have too many secondary loans on the properties. Sometimes, the lenders simply do not want to lend more money on homes that they feel are likely to end up in their inventories anyway,[50] especially if the equity of the homes

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47. Many of the propositions stated in this Part are supported by information from interviews conducted by the Author. *See supra* note 5.

48. Rescue lending is lending designed to save a drowning homeowner from foreclosure. *See generally* FORECLOSURES, *supra* note 9, § 2 (discussing pre-foreclosure workout and modification agreements). It may include traditional or non-bank refinance loans, modifications of existing loans, or newly originated loans. *See id.* at §§ 2.3-2.6 (describing workouts and modifications). It may also include various government programs designed to prevent foreclosure. *Id.* at § 2.3.3 (describing the federal, state, and local programs used to help homeowners in financial distress); *see also id.* at §§ 2.8-2.12 (describing programs used by the federal government). Rescue transactions may be offered by traditional banks, investors, friends and family, or government bodies. *See id.* at § 2.1.1.

49. *2010 Mortgage Fraud Report*, *supra* note 32, at 6. Providers of services for the credit-strapped have seen an increase in demand for their services. *Id.* Lack of access to credit is the biggest constraint on the expansion of the real estate market. *Id.*

50. A home can end up in a bank's inventory if the property fails to sell at the foreclosure sale/auction because there are no suitable outside bidders. BAXTER DUNAWAY, LAW OF DISTRESSED REAL ESTATE § 49:1 (2013). In that case, the property is known as "real estate owned" or "bank-owned." *Id.* At this point, the lender must try to resell the property and must bear the costs of maintaining the property in the meantime, including payment of taxes, utilities, and insurance. Chris Palmeri, *The Painful Cost of Foreclosure*, BLOOMBERG BUSINESSWEEK (May 8, 2008), http://www.businessweek.com/the_thread/hotproperty/archives/2008/05/the_painful_cos.html (describing how costs to the lender will include maintenance, taxes, vandalism, appraisals, legal fees, broker fees and more).

would be consumed by the expenses of foreclosure.[51] Many banks have a blanket rule that they do not lend to homeowners already facing foreclosure, regardless of other variables.[52]

Lenders are also unwilling to lend to these homeowners for operations related reasons. Banks may avoid this segment of the borrowing population because the segment's risk profile requires a large amount of individualized monitoring; large lenders are not equipped to monitor individual, high-risk customers.[53] Therefore, this group is operationally inefficient for banks to work with. Instead, large lenders gravitate to sectors that reward size, volume, expediency, and market power.[54] Rescue transactions, even where there is trapped equity, require small, nimble, and adept lenders who are on the ground and capable of managing individual transactions.[55] Large lenders would need to commoditize these impossible-to-commoditize transactions in order to serve this market.[56] Therefore, banks have abandoned this piece of the borrowing market, creating a void.[57] The efficiency of that void is debatable because the banks' categorical unwillingness to serve this market exacerbates the trapped equity paradox for these homeowners.

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51. The costs incurred by the foreclosing bank during the foreclosure process are charged to the homeowner and deducted from the equity in the home. FORECLOSURES, *supra* note 9, § 6.4.4.6 ("The lender has little incentive to minimize [foreclosure costs] because they can be passed on to the borrower.").

52. *See generally* Cassandra Jones Havard, *Democratizing Credit: Examining the Structural Inequities of Subprime Lending*, 56 SYRACUSE L. REV. 233 (2006) (describing how borrowers with "blemished" credit are often excluded from the traditional mortgage market).

53. *See* Mann, *supra* note 13, at 735 (describing the credit lending preferences of large banks).

54. *Id.* at 748 (arguing that, where it is unprofitable for banks to service certain households, we should "foster other institutions that might serve them" and that, instead of stomping these other providers out, we should "bring them within the tent of 'favored' financial providers.").

55. *Id.*

56. *See id.* at 735.

57. *Id.* The hole in the market exists because it is inefficient for large banks to fill it. Currently there is no efficient way to fill that void other than by using small, informal investors. The market has responded with the RSLB transaction. To fill the void any other way, including the ways contemplated by the judicial and legislative responses, requires big, clumsy banks to act small and nimble, or requires small, informal investors to formalize and scale up at great cost. Small investors can offer individualized solutions that are relationship- and contacts-based. NAT'L CONSUMER LAW CENTER, INC., WHY SERVICERS FORECLOSE WHEN THEY SHOULD MODIFY AND OTHER PUZZLES OF SERVICER BEHAVIOR 12, v-viii (2009), *available at* http://www.nclc.org/images/pdf/pr-reports/report-servicers-modify.pdf; *see* Ronald J. Mann, *After the Great Recession: Regulating Financial Services for Low- and Middle-Income Communities*, 69 WASH. & LEE L. REV. 729, 735 (2012) (describing the dearth of financial services for low-income people and their preferences for local, non-bank solutions); MICHAEL S. BARR, NO SLACK: THE LIVES OF LOW-INCOME AMERICANS 10, 15 (2012).

Deepening the paradox, this market failure also exists because, when there are large equity stores in properties, banks have another profit-maximizing, redistributive motivation not to provide new financing as well. In essence, the banks may want these homeowners to fail. Banks are able to recoup their full costs of foreclosure from the equity in the home; therefore, they have no incentive to keep their costs low when there is a lot of equity in the foreclosed home, thus redistributing the value of that equity from the homeowners to the banks themselves.[58] At the point of foreclosure, the bank has two options: (1) let the property be sold at a courthouse sale[59] to a buyer who will pay the bank at least the amount owed on the underlying mortgage; or, (2) place its own minimal bid on the property in a courthouse sale and retain possession of the property and most, if not all, of the trapped equity.[60] Unlike homes with little or negative equity, homes with substantial equity stores can be very profitable for banks to take back in the foreclosure process, especially in a robust market.[61] Therefore, the bank has no real incentive to lend to this group of high-equity, high-risk homeowners to help them avoid a foreclosure. Consequently, homeowners can easily watch their equity disappear as it is eaten up by fees and other liens, generally leaving the homeowners with none of the proceeds, despite the foreclosure sale taking place at a price above what they owe on the property.

III. THE MARKET'S ORGANIC SOLUTION: THE RSLB

Due to its inherent genius,[62] the market has developed its own responses to the trapped equity/pre-foreclosure market failure. The process of losing one's home to foreclosure is very messy and strips the homeowner of any

58. *See generally* Diane E. Thompson, *Why Servicers Foreclose When they Should Modify and Other Puzzles of Servicer Behavior*, NAT'L CONSUMER L. CENTER (Oct. 2009), https://www.nclc.org/images/pdf/pr-reports/report-servicers-modify.pdf.

59. A courthouse sale is the standard mechanism for disposing of foreclosed homes. DUNAWAY, *supra* note 50, § 16:40. It enables the foreclosing lender to liquidate the home, to recoup its cash investment and clear the property from its inventory. *See id.* § 16:33. Depending on the jurisdiction, the sale may be conducted on the courthouse steps or electronically. *Id.* § 16:40. These sales often fail, causing the home to revert to a bank's possession.

60. *Id.* § 16:39.

61. JOSEPH WILLIAM SINGER, PROPERTY LAW 893 n.7 (Vicki Been et al eds., 5th ed., 2010); Mortg. Bankers Ass'n, *Lenders' Cost of Foreclosure*, L. OFF. DAVID C. WINTON 5 (May 28, 2008), http://www.dcwintonlaw.com/wp-content/uploads/2010/06/Lenders-Cost-of-Foreclosure.pdf; Thompson, *supra* note 58 (arguing that loan servicers generally do not lose money on a foreclosure, whereas they lose money on modifications).

62. *See* DE SOTO, *supra* note 26, at 50 (crediting Aristotle with discovering that "2,300 years ago, [that which] you can do with things increases infinitely when you focus your thinking on their potential").

control.[63] Therefore, for homeowners wishing to save their homes and to retain some control over the process,[64] a solution of last resort becomes necessary, as the only remaining option is for the homeowners to lose their homes and, most likely, their equity, thereby having to relocate their families.[65] Inside this void of financing, there exists a group of small, informal investors willing to provide solutions of last resort to these otherwise abandoned homeowners. Small investors are ideally situated from both a risk-tolerance and an operational-efficiency standpoint to design a solution to fill this lending void.

One market solution is the RSLB transaction, which mobilizes dormant equity.[66] The RSLB is a non-bank financial transaction, which is popular among credit consumers who, for various reasons, either do not have access to or do not trust the established banking community.[67] Currently, the market solution to the supply and demand misalignment in the trapped equity paradox exists outside of conventional mortgage finance. Non-bank investors come into this arena to reconfigure the marketplace, realigning the relation-

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63. Part of why the foreclosure process is so disorderly, relative to a negotiated rescue transaction, is that the homeowner's status in the property is murky during foreclosure proceedings. Varying across jurisdictions, after the foreclosure proceedings a homeowner may be considered a trespasser, an occupant in adverse possession, or a lessee, and he likely has no idea how or when the next step in the legal process will commence.

64. Some homeowners in this position wish to save their homes for economic or emotional reasons; some homeowners merely wish to forfeit their homes, often for economic reasons. *See supra* note 5.

65. There have been a number of responses to the market failure that exists in the real estate rescue lending market – where there is demand for high interest rate rescue loans, but no supply. Something keeps the commercial rates from going up to their legal limits, like credit card rates do. There is a magical point at which traditional banks just stop lending in both weak markets (perhaps due to equity-risk) and strong markets (perhaps due to a particular borrower's default-risk or the bank's own profit-maximizing motives), unless there is some type of government intervention. *See supra* note 5.

66. These transactions are often called "equity purchases." *See, e.g.*, CAL. CIV. CODE § 1695.1 (West, Westlaw through Ch. 16 of 2014 Reg. Sess.). In an equity purchase transaction, an investor purchases the equity in a homeowner's home directly from that homeowner during the pre-foreclosure period. *See, e.g.*, *id.* This is one way a homeowner is able to access his equity. Essentially, the homeowner gives up his equity and receives something in exchange. *See, e.g.*, § 1695.3. Payment for that purchase can be in the form of cash or some other valuable benefit to the homeowner. That value would be negotiated between the investor and the homeowner. Sometimes, an equity purchase transaction involves a repurchase option as in the RSLB transactions described in this Article, where the homeowner has the ability to buy the property back later. For sample statutes, see CAL. CIV. CODE §§ 1695-1695.17; N.Y. REAL PROP. LAW §§ 265-266 (McKinney, Westlaw through L.2014, chapters 1 to 22, 50 to 60).

67. Mann, *supra* note 13, at 743.

ships between owners and lenders and extending or avoiding the foreclosure process by liberating trapped equity.

The RSLB transaction generally involves a homeowner,[68] a lender, an investor, and a secondary investor. The RSLB transaction becomes a viable option when a homeowner faces foreclosure proceedings because he is in arrears and cannot obtain any more financing to save his or her property due to income and/or credit restrictions – in other words, he faces the trapped equity paradox. Practically, the period of pre-foreclosure, which starts when the lender indicates its intention to foreclose, turns out to be the most efficient time to initiate this type of transaction. The period of pre-foreclosure begins after the homeowner has been in arrears for a period of time, and the lender finally publishes in a local newspaper that it is initiating the legal process that will culminate in the foreclosure sale of the property at the court on a set date in the near future.[69] The sale can be averted in the short period between the filing and the courthouse sale, if the homeowner can get help.

Prior to the public filings against a homeowner, which publicly announce the lender's intention to foreclose, investors have no way of identifying the homeowner as needing financial assistance without excessive search costs.[70] Additionally, trapped equity homeowners who are not facing foreclosure may still have other financial options. On the other side, for homeowners already in actual foreclosure and being evicted, the process is far more complicated as it involves undoing a legal process that is already underway and negotiating with a third-party mortgage lender. For this reason, RSLB and other pre-foreclosure transactions occur just before the original mortgage lender begins to take back possession of the home, along with a large chunk – or all – of the equity trapped in the property. Without such opportunities, a homeowner would definitively lose his home to foreclosure.[71]

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68. In California, the homeowner is an "equity seller" which means a "seller of a residence in foreclosure." CAL. CIV. CODE § 1695.1(c).

69. That publication is called a "Notice of Default" in California and other jurisdictions. *See* CALIFORNIA RESIDENTIAL FORECLOSURES, *supra* note 37, at 155.

70. Prior to this publication, homeowners have limited opportunity to find investors. At that point, homeowners would rely on word of mouth or respond to signs that say, "We Buy Houses," neither of which is organized or efficient. Therefore, publication serves as this market's informal matching function.

71. Recently, in response to the latest foreclosure crisis, large lenders have started trying to provide leaseback solutions similar to those provided by RSLB investors. However, this mis-response is a part of the problem this Article decries. Fannie Mae has launched its Deed for Lease program, which allows lenders to become landlords of individual foreclosed homeowners. *See Servicing Guide Announcement SVC-2012-25*, FANNIE MAE (Nov. 28, 2012), https://www/fanniemae.com/content/announcement/svc1225.pdf; Lisa Prevost, *The Rental Alternative to Foreclosure*, N.Y. TIMES, Sept. 27, 2012, http://www.nytimes.com/2012/09/30/realestate/mortgages-the-rental-alternative-to-foreclosure.html?_r=0 (describing Bank of America's and Citibank's clumsy efforts to become landlords of their foreclosed homeowners). None of these programs allow the buyback option and each requires the homeowner to be employed.

To execute an RSLB transaction, a homeowner contracts with a small, non-bank investor. Under that arrangement, the homeowner sells the home to that investor, rents the home back for a negotiated period of time – the "leaseback period" – at a negotiated rent, and, finally, buys the home back at a negotiated price on a negotiated date if the homeowner can and wants to.[72] This solution averts the foreclosure by liberating the homeowner's trapped equity.[73] However, the RSLB transaction is not without risk for the investor and the homeowner; many of these transactions result in a homeowner eventually losing the home. Nevertheless, the potential is there for a homeowner to salvage his home, which some homeowners indeed do.[74] And even for those homeowners who do not salvage their homes, they end up no worse off for having had the chance.

A. The RSLB Investor[75]

Who is the typical investor? The average RSLB investor operates outside of the traditional banking structure to provide rescue solutions for troubled homeowners, although he may have several ties to and relationships with larger banks. Real estate investors operate in specialized niches and under varying levels of formality, organization, and sophistication. A subset of investors, called rescue investors, operates in various phases of the pre-foreclosure and foreclosure process. A subset of rescue investors, RSLB investors operate in the pre-foreclosure phase specifically.[76]

An investor approaches the process of selecting possible investment opportunities using five nuanced criteria: niche development, portfolio management and diversification, availability of investible funds, his own market predictions, and a rough calculation of the value of the home versus the debt on the home. Keeping in mind his particular strengths and weaknesses, an investor seeks to work within particular niches where he has gained competence and competitive advantages. For example, one investor may specialize in downtown condos, another in large-lot properties with water rights on the

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72. CAL. CIV. CODE § 1695.1(a) defines an investor as an "equity purchaser," meaning a "purchaser of any residence in foreclosure [for investment purposes]."

73. In its purest form, the sale to a typical investor pays off the foreclosure and other existing liens at the closing table.

74. *See supra* note 5.

75. Many of the propositions stated in this Part are supported by information from interviews conducted by the Author. *See supra* note 5.

76. Lately, groups other than small private investors have entered the sale-leaseback marketplace. Specifically, community capital groups and private equity firms have begun to purchase foreclosed homes from banks in bulk after the foreclosure is complete; these investors then lease the homes back to the homeowners, instead of evicting the homeowners as would normally happen after the bank takes possession of and resells the homes. In this regard, these large capital groups prevent the homeowner from having to relocate, but do not save homeowners from the foreclosure process.

river, another in small or large suburban homes, and another in inner-city fixer-uppers. As these types of transactions involve a lot of negotiation with lenders, other investors, and homeowners, these investors develop and maintain long-standing relationships to facilitate the transactions. Understandably, investors dedicate substantial resources to achieving and maintaining their competitive advantages in certain niches.[77]

From a portfolio and risk management perspective, investors remain conscious of the scope of their existing investments, cash-flow projections, and current tolerance for risk. With that in mind, they make predictions both about the odds of any potential deal becoming productive and about how that deal would fit in with their current asset allocations. Investors are also acutely aware of their own financial positions. Because many investors engage in several transactions at once and work with several different funding groups, they must be aware of and accountable for how they commit their funds and what level of reserves they maintain to deal with problems as they arise.

RSLB investors share some similarities with traditional mortgage lenders, but are distinct in many other ways. Although these investors are not traditional mortgage lenders, they may be very organized and may live with some of the same risks and concerns when approaching potential investments as other investors of other sizes and sections of the marketplace. However, because they are not subject to traditional banking constraints, they are able to set their own standards of credit-worthiness, which benefits lower-credit homeowners. For example, a traditional lender may only consider the income of the homeowner in determining credit-worthiness to purchase or refinance a home; however, an RSLB investor – who is simply forming a lease with the homeowner – may also consider the income of a long-term, live-in mate, or

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77. Some critics of this transaction accuse these investors of seeking out poor, elderly, or minority homeowners, alleging that investors seek out these groups because these groups are the most vulnerable targets. *See* Nichols, *supra* note 1, at 280. This may be an erroneous conclusion because it finds a causal relationship where there may be only a corollary relationship. For example, if an investor sees himself as a substitute for traditional financing, he will be a good match with those who cannot get traditional financing, often due to poor credit, and those homeowners will likely be poor, working class, or temporarily impoverished. If an investor is a minority who is most familiar with minority neighborhoods, he may use these areas as his niche, and his targets will be from those areas. Finally, if investors seek to enable homeowners to mobilize their own equity to fund some of their transactions, they will contract with homeowners who have the most equity to mobilize. Those homeowners will tend to have owned their homes the longest, which will correlate with their being older than the average homeowner.

Another common accusation in these cases is that investors exploit religious, ethnic, or racial affinity. Affinity is shared between two people of a shared heritage, race, or religion. Again, that an investor and a homeowner share some attribute may reflect a corollary, not a causal, relationship. People of a particular demographic may have access to others of the same demographic that they would not have to members of other demographics. Investors may just have comfort and familiarity in their own neighborhoods or church communities.

that of an adult child living at the property with the homeowner, thus creating more options for a troubled homeowner.

B. *The RSLB Transaction*[78]

The RSLB transaction is a sale of a property to an investor, a leaseback of the property to the homeowner, a stabilizing resale of the property to a secondary investor, and a call option-*esque* right of the homeowner to buy the property back in the future.[79]

The process starts each morning, all across the country, when listing companies[80] aggregate and publish to their paid corporate subscribers – usually real estate investors and title companies – a list of all recent legal proceedings initiated by mortgage lenders, tax authorities, and other creditors against debtors in their area.[81] This publication is the first time investors learn of distressed homeowners, and it also serves as this market's efficient search and match function because it allows investors to identify homeowners easily and inexpensively.[82] Several investors are likely to contact a homeowner and offer an RSLB opportunity.[83] Because of the nature of the busi-

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78. Many of the propositions stated in this Part are supported by information from interviews conducted by the Author. *See supra* note 5.

79. It is important to distinguish these transactions from those in which a company charges homeowners a fee to negotiate a short-sale or modification with the homeowner's lender. These fee-based services have been addressed by the FTC's 2010 Mortgage Assistance Relief Services Rule (MARS Rule) and are not the subject of this Article. 12 C.F.R. §§ 1015.1-.11 (2013). It is important to note, however, that the FTC has already retreated from its enforcement of key sections of the MARS Rule (as per its own press release dated 07/15/2011), as the FTC realized that, in its haste, it created clauses which had unintended dampening effects on real estate brokers' ability to provide genuinely beneficial services to certain homeowners. Press Release, Federal Trade Commission, *FTC Will Not Enforce Provisions of MARS Rule Against Real Estate Professionals Helping Consumers Obtain Short Sales* (July 15, 2011), *available at* https://www.ftc.gov/news-events/press-releases/2011/07/ftc-will-not-enforce-provisions-mars-rule-against-real-estate.

80. Listing companies are companies that aggregate data from dockets in various courts and jurisdictions. *See* CALIFORNIA RESIDENTIAL FORECLOSURES, *supra* note 37, at 155. A listing company would offer its services in one or more particular jurisdictions as the process of gathering this data requires that the listing company have an employee physically standing at either a county courthouse or a city hall type place, where the data is first released to the public. *See id.*

81. These proceedings could be Notices of Default, Trustees' Sales of Deeds of Trust, Foreclosure Sales, Mechanics Liens, State and/or Federal Tax Liens, Sales of Bank-Owned Real Estate, etc.

82. Prior to publication of this list of homeowners, the only way for the parties to find each other is either through word of mouth in the community or for homeowner to respond to a sign on a tree that reads, "We Buy Houses," which is fairly inefficient.

83. The market is competitive and the number of competing offers may feel like an onslaught to a homeowner. *See* CALIFORNIA RESIDENTIAL FORECLOSURES, *supra* note 37, at 155. The reason for this is that all of the corporate subscribers receive the

ness, various investors go to the property to meet with the homeowner. The reason for this initial home visit is several-fold. First, it allows the homeowner to meet the many investors, which in turn allows the homeowner a chance to assess the investors' characters to make a better choice of contracting partner. Second, it allows investors a first look at the property in order to gauge the amount of work and repairs possibly required. Because the property being negotiated is a home, it makes sense that investors visit the home and that early negotiations take place there. Third, it allows the investors to determine the reason for the homeowner's foreclosure, including unforeseen expenses, drug problems, or other details that only an in-person interview would reveal. By the end of the day, the homeowner may have several tentative invitations in hand.[84] The investors leave their initial offers and other materials with the homeowner for the homeowner's review and family discussions. The homeowner then considers the various opportunities and the various terms and, at some point that day or shortly thereafter, selects the investor with whom he wants to contract. In choosing to work with any particular investor, the homeowner controls the process and uses his own selection criteria.[85]

Once the investor and homeowner have agreed to the transaction and negotiated the terms – including sale price, leaseback rate and duration, buyback price, and often a separate cash payment to the homeowner[86] – the parties sign the contract documents. Then the process is suspended for a statutory waiting period, which corresponds with the homeowner's statutory right of

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information at the same exact time and many will then contact the homeowner. The day before the publication, none of them knew that the homeowner existed, so the investors do not trickle in over time. *See id.*

84. They also often have several competing offers from multiple investors to choose among for the best offer.

85. One criticism of these terms is that the homeowners do not have a meaningful opportunity to negotiate the terms. However, these are not adhesion contracts; the investors are often small investors who are closer in size and market power to the homeowners than either of them is to the large lenders. That it is impossible to negotiate with these small neighborhood investors is unfounded. A second prong of this argument is that, while the RSLB investors may not be significantly larger in market power, they are more sophisticated in education and experiential power. Robert J. Shiller, *Historic Turning Points in Real Estate* 3, Cowles Foundation Discussion Paper No. 1610 (2007), http://cowles.econ.yale.edu/P/cd/d16a/d1610.pdf ("By some accounts, the greatest challenge for economic forecasters is to predict turning points" in the real estate and housing markets, which are "populated mainly [by] ordinary folk who do not react with the speed of professionals"). *But see* Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 756 (2008) (arguing that when products or their usage is not standardized, interpersonal learning is slower).

86. The amount of this payment is negotiated between the parties. A homeowner may use this cash payment to get current on other delinquent bills, such as car loans and other unpaid bills.

rescission.[87] The effect of signing these documents *prior* to the waiting period is threefold. First, it ensures that both parties are considering the same deal terms,[88] a written copy of which each party has in hand.[89] Second, it gives the homeowner at least some security that the investor is committed to helping the homeowner, meaning that the homeowner can stop entertaining other offers; it also gives the investor similar preliminary assurances that any resources expended during this period are wisely invested.[90] Finally, it means that what the parties are considering during the waiting period is whether to void the contract, not whether to sign the contract.[91]

During this waiting period, the homeowner has the time and opportunity to consider the contract and to have it reviewed by an advisor of his choosing. The three main terms in an RSLB transaction are the purchase price, the duration and rate of the lease,[92] and the buyback price and date. It is through the various, negotiable combinations of these three variables that the investor's premium is outlined and secured. Homeowners have a chance to negotiate these terms and to have a range of advisors review the terms, including family members, friends, and attorneys.[93] During this period, the investor and

87. The length of this statutory cooling-off period varies by state and is specifically designed for the seller to think about the transaction and to consult a lawyer. In California, for example, the statutory waiting period for this transaction, called an "Equity Purchase Agreement," is five days, which is longer than the statutory waiting period for a refinance transaction, which is three days, and the statutory waiting period for a standard home purchase mortgage, which is zero days. CAL. CIV. CODE § 1695.4(a) (West, Westlaw through Ch. 16 of 2014 Reg. Sess.).

88. *Id.* §1695.3.

89. *Id.* §1695.5(c).

90. *Id.* § 1695(d)(1).

91. Investors are accused of forcing homeowners to make these decisions and to negotiate these contracts under very tight time constraints. However, what these critics fail to recognize are two important factors that are outside of the investors' control. First, investors do not set the timeline. It is after seeing this list that investors contact the homeowners. It is not until the time of publication that investors know of the existence of homeowners; therefore, there is no way for investors to lengthen that time frame. Those time constraints are statutory and vary by jurisdiction. In California, for example, once a lender publishes his intent, a homeowner has fifteen days to avoid the foreclosure sale (the lender then can sell the property legally on the twenty-first day after the notice; however, the lender may take longer than that.).

92. The California statute states that the terms of the rental agreement must be included in the original agreement, which the homeowner must have prior to the waiting and attorney review period. CAL. CIV. CODE § 1695.3(f).

93. Some scholars and critics argue that those opportunities are irrelevant because certain homeowners, in practice, do not have the means to get legal counsel. That a homeowner may not or cannot take advantage of those opportunities reflects a larger societal problem and is not unique to RSLB transactions. That problem exists even as these homeowners both acquire and then lose their homes to foreclosure, as opposed to being a result of the actions of the RSLB investor. Perhaps Legal Aid could dedicate its resources to providing contract review sessions to these homeown-

homeowner cannot have any contact with one another, exchange funds, sign or execute any further documents, or escrow any funds.[94] The investor will use this period to do his due diligence and conduct title research on the property. After the waiting period, if both parties are still committed to the contract, they will move forward. At this point, the parties sign any remaining contracts, disclosure statements, and the residential lease,[95] often at an escrow company or lawyer's office.

The investor's first step after the waiting period is to purchase the home from the homeowner in order to stop the foreclosure procedure, often within the lender's statutory timeframe of mere days. At the closing, title transfers to the investor and the homeowner's underlying debts are paid off, including the mortgage and other liens attached to the property.[96] To provide the quick capital needed to buy the property and avert foreclosure, the investor has two options: he can obtain high-rate, short-term financing – called hard-money[97] financing – by tapping into his established hard-money lending relationships, or he can use his own pool of funds. The cost to the investor is either the hard money rate, often in the fourteen to eighteen percent range,[98] or his own cost of capital plus the other opportunity costs of using his private funds.

Once the investor has bought the home and the foreclosure has been stopped, the leaseback period begins. After the homeowner has settled into his lease, the investor resells the property to a secondary investor.[99] The sec-

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ers during the statutory attorney review period before the sale, instead of dedicating its resources to suing the RSLB investors after the fact.

94. CAL. CIV. CODE § 1695.6(a)-(b)(4).

95. The rent would likely be set at the amount the homeowner agrees that he can pay for the duration of the leaseback period. The homeowner will usually set this rent at a number that is below his current monthly payment, which he clearly cannot meet as he is in foreclosure already. If this negotiated rent is below the investor's holding costs, it will be subsidized by some of the mobilized equity. A more detailed discussion of the rent-setting process follows in a later section. If any material terms are changed, the statutory waiting period would be reinitiated.

96. Attached liens may include tax or other municipal liens, homeowners association dues, mechanic's liens, etc. *See, e.g.*, CAL. CIV. CODE § 2924(c). Often homeowners negotiate the payment of other debt, such as car loans, into the transaction with the investor.

97. A "hard money loan" is a short-term, high rate loan, usually provided by a non-banking institution or private investor. *Mortgages: Hard Money*, 40-MAR REAL EST. L. REP. 6, 6 (2011). These loans are not based on the borrower's creditworthiness. *Id.* Instead, they are based on the value of the home. *Id.* at 7. Investors use hard money loans as quick bridge financing that allows them to complete some short goal, such as a construction or rehab project, or a refinance application. *Id.* Due to the high-rate on the loan, hard money is expected to be short-term. *Id.* at 6.

98. *See supra* note 5.

99. Pursuant to California statute, a homeowner with any repurchase rights to the property must approve the transfer of the property from the investor to the secondary investor in writing. CAL. CIV. CODE §1695.6(e); *see also* Segura v. McBride, 5 Cal. App. 4th 1028, 1036-37 (Cal. Ct. App. 1992). Usually, this permission will be a part

ondary investor is a person or entity with access to more traditional sources of funding at widely available commercial or investment rates.[100] This resale does not affect the homeowner's right to buy the property back.[101] During the leaseback period, the investor may also act as the landlord, incurring the costs of property maintenance and renovation, taxes, and insurance. Although he now is the owner of the property, the secondary investor plays only a minor role in the property maintenance functions.[102]

As the end of the leaseback period approaches, the homeowner has several options. First, if he wishes to exercise his call option, he must obtain new financing to repurchase the home from the secondary investor. This buyback right may also be assignable depending on the negotiated terms and the jurisdiction.[103] Second, the homeowner can negotiate an extension of the buyback date, temporarily maintaining his buyback rights and giving himself more time. Third, the homeowner can decide under less frenzied and less stressful circumstances that he wishes to relinquish his buyback rights, let his repurchase option lapse, and cease to be a homeowner. In this case, he must either move out of the property or renegotiate to remain in the home as a renter under a leasehold estate, without any other interest in the home.

Clearly, both parties benefit from this transaction, and both are subject to significant risks. Neither party can predict how the overall housing market will perform during the leaseback period – a variable that greatly affects the relative value of the parties' interests and allocation of their risks – or whether the homeowner will buy the property back.[104] In effect, what the homeowner negotiated for and bought was three-fold. First, he bought some time, which enables him to get his finances back on track and gives him room to breathe so he can consider his options carefully. Second, he bought some

of the original contracts. A better idea would be to require that the call option be recorded at the county offices.

100. Charu A. Chandrasekhar, *Can New Americans Achieve the American Dream? Promoting Homeownership in Immigrant Communities*, 39 HARV. C.R.-C.L. L. REV. 169, 216 (2004). A secondary investor would be someone with investable capital. *Id.* at 216 n.41. It could be a small investment group, a lawyer, doctor, or businessperson looking for rental income, mortgage interest deductions, and capital gains. They would be looking for a two to four year opportunity, which is a perfect time-horizon for RSLB. *See infra* Part III.D.

101. The call option should be properly recorded to encumber the title, at which point, the burden of the option runs with the land to any subsequent buyers.

102. Whether the secondary investor is considered a "passive" real estate investor, for tax purposes, is outside of the scope of this Article and would vary by transaction and by investor.

103. T.P. Galanis, *The Future of Future Interests*, 60 WASH. & LEE L. REV. 513, 516-20 (2003). Although options historically have been inalienable, the majority of jurisdictions now permit alienation.

104. "By some accounts, the greatest challenge for economic forecasters is to predict turning points [in the real estate market . . . and] the housing market is populated mainly by ordinary people who do not react with the speed of [economic] professionals." Shiller, *supra* note 85.

reprieve from the carrying costs of the property and achieved a potentially below-market rental rate during the leaseback period. Finally, he bought a call option[105] on his own property; at the time of the buyback, the homeowner can either execute or not execute that call.

C. *Why the Sale/Leaseback?*

One of the benefits of real property ownership is that it serves several market functions for a homeowner. At various times it serves as a store of capital, as a reliable shelter, and as a potential source of rental income.[106] However, the availability of this bundle of benefits is dependent upon dynamic factors. When a homeowner's circumstances change so that the home is no longer able to provide those benefits, owning the home in fee simple becomes less valuable. In that case, a sale/leaseback can provide a superior bundle of benefits for the homeowner.[107] A sale/leaseback allows him to sell the property to an investor and lease the home back from the investor for a set period at a set rate. A homeowner would do a sale/leaseback when he would benefit both from liberating the stored value in a property by not owning it and from

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105. Simply, a call option allows the buyer of the call to purchase something at a certain date in the future at a certain price, called the strike price. Gregory G. Gosford, *A Primer on Real Estate Options*, 35 REAL PROP. PROB. & TR. J. 129, 190 (2000). In this instance, the homeowner buys the right to purchase the property back from the investor at a set point in the future at a set price. *Id.* Some sources define a call as "the right to make someone sell." *Id.*

106. *See* DE SOTO, *supra* note 26, at 7.

107. *But see* CAL. CIV. CODE § 1695.12 (West, Westlaw through Ch. 16 of 2014 Reg. Sess.) (creating the presumption of a mortgage, when a homeowner retains both the leaseback and the buyback after the sale). Traditionally, cases arising from these transactions have hinged on whether courts found the transaction to fit the characterization of a mortgage or not. The California statute creates this as a burden-shifting presumption. *Id.* If the courts find a mortgage loan instead of a lease, the investor and secondary investor may not be able to claim economic and tax benefits from the transaction.

Jurisdictions are split on this question. While some jurisdictions, like California, create a presumption of a mortgage; other jurisdictions may find an "equitable mortgage" where they find that the intention of the parties was to create a secured loan, not to make a sale. *See* Lawrence R. Ahern, III, *Types of Real Estate Security Devices: The Equitable Mortgage*, *in* 1 THE LAW OF DEBTORS AND CREDITORS § 8:5 (2014). Author disagrees with jurisdictions that characterize such transactions as mortgages, purporting to realign the contract with the "intent of the parties," because that presumption starts with the paternalistic assumption that the homeowners could neither have intended to sell nor understood that they were selling their homes under the circumstances in these transactions. However, this Article presents that, not only do these homeowners intend to execute these transactions, but that they are able to discern the myriad benefits they get from these transactions.

the continued use of the property,[108] the two most important factors to an owner facing foreclosure who wants to remain in his homestead.

Operationally, by changing his status from owner in fee simple to leaseholder, the homeowner has created a new arrangement that has other benefits for him. First, the sale was the only way to mobilize the homeowner's trapped equity to meet his current expenses. By mobilizing this store of equity, the homeowner is, in effect, purchasing a second chance at the American Dream. The sale to the investor pays off the underlying mortgage, thus averting the foreclosure. With that, the homeowner is spared the humiliation of eviction and of losing his home to foreclosure, gets his name out of the newspapers and off of the negative public records, and avoids bankruptcy. It allows the homeowner to stay in his home, keeping his kids in their schools and allowing the homeowner to remain a part of his community. By averting the foreclosure, the sale/leaseback saves what remains of the homeowner's credit and gives him a much-needed mental and emotional reprieve. The sale may involve a cash payment to the homeowner as well.[109]

Another benefit of the sale/leaseback is tax-related. Because he no longer owns the property, the homeowner becomes free from the property tax burden associated with homeownership. What the homeowner gives up in exchange – the mortgage interest deduction – may have been especially small for the homeowner, if he owned the home for a long time and carries a small, largely amortized mortgage. Both the mortgage interest and property tax deductions would also be of no value if the homeowner has limited income to offset.

The sale/leaseback reduces several other costs for the homeowner as well. With its built-in search and matching function, the RSLB transaction saves the homeowner the cost of finding a fast-moving buyer. In addition to the tax and interest carrying costs, the RSLB transaction shifts other carrying costs from the homeowner to the investor.[110] For example, as the landlord, the investor is now responsible for insurance,[111] maintenance and repairs, and

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108. Kyle Wells & Ryan Whitby, *Evidence of Motives and Market Reactions to Sale and Leasebacks*, 22 J. APPLIED FIN. 1, 1 (2012).

109. Homeowners usually negotiate with investors to extract cash from the original sale to pay other debts owed by the homeowners. This cash would be the difference between the price paid by the investor in the transaction, and the total amount that the investor agrees to pay towards liens on the property and other homeowner debts. Such cash would be used for credit card, auto loan payments, or anything else the homeowner needed. Author confirmed the cash payments that investors call "usual" through transcripts and court opinions. In certain cases, a homeowner may extract this cash and put it towards savings or use it to purchase another property. If this homeowner anticipates not being able to repurchase the home, he would view this as his last opportunity to extract equity before the home gets lost.

110. Stephen L. Hodge, Note, *Sale-Leasebacks: A Search for Economic Substance*, 61 IND. L.J. 721, 724 (1986). *But see supra* note 107.

111. Hodge, *supra* note 110, at 723. Homeowner may still choose to carry his own renter's insurance policy.

certain utilities, depending on the jurisdiction.[112] Additionally, the sale/leaseback exposes the investor and secondary investor to the homeowner's moral hazard risk as he has no incentive to make any improvements or to exercise extra care in the home during the leaseback period.[113] Instead, the homeowner would hold off on his efforts until he knew whether he would be willing and able to buy the property back.[114]

A sale/leaseback also provides an opportunity for a homeowner to hedge himself against real estate price risk.[115] Of the various ways he could save his home, a sale with a repurchase option is the best way for a homeowner to limit his downside. If a homeowner were to have successfully borrowed the money to avoid the foreclosure, or been able to refinance, he would still have borne the risk of carrying and having to service that debt during a subsequent market downturn.[116] The RSLB transaction gives him the ability to pass off that risk to the two investors after having his bills and debts paid off by his mobilized equity.[117]

As indicated above, the sale/leaseback transaction provides some very real economic and financial benefits for rational homeowners facing foreclosure with trapped equity. It also serves certain emotional and mental needs of homeowners.[118] One of the ways that this transaction is possible is by a cost-

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112. *Id.* Jurisdictions vary regarding which utilities must be provided by landlords. *See, e.g.*, 105 MASS. CODE REGS. 410.180-410.200 (2013) (requiring landlords to provide water generally, hot water, and heat, unless the lease states otherwise). Some require landlords to provide heat and water; others do not. *See, e.g.*, *id.*

113. Robert J. Shiller & Allan N. Weiss, *Moral Hazard in Home Equity Conversion*, NAT'L BUREAU ECON. RES. 1 (May 1998), http://www.nber.org/papers/w6552.

114. *See id.* In fact, homeowners who anticipate a market decline or know of some hidden defect in their homes have the greatest incentive to enter into RSLB transactions as it may be their last chance to pull any capital out before the market declines, before someone discovers the home's defect, or before they lose the house to foreclosure. *See* Hodge, *supra* note 110, at 723. Moral Hazard risk is reduced if the homeowner wants and believes himself able to buy the property back. *See* Shiller & Weiss, *supra* note 113. Even in that case, however, he still has incentive to push those costs onto the investor. *See id.*

115. *See* Shiller & Weiss, *supra* note 113, at 9-11.

116. *See* Hodge, *supra* note 110, at 723, 726-28.

117. *See* Nanch E. Shurtz, *A Decision Model for Lease Parties in Sale-Leasebacks of Real Estate*, 23 WM. & MARY L. REV. 385, 388-89 (1982).

118. Consumer protectionist paternalism fails to appreciate these benefits for homeowners and fails to acknowledge that homeowners are capable of identifying these benefits for themselves. For example, one way investors are accused of stealing money from homeowners is through contract documents which are too complicated for homeowners to understand, even if read, and which lead to consent which may not be valid. This argument has three prongs. *See* SINGER, *supra* note 61, at 811-12. One prong of the argument is that it cannot be assumed that the homeowner would read the contract. *See id.* at 811. Much attention has been paid to the ever-decreasing duty to read. Charles L. Knapp, *Is There a 'Duty to Read'?*, SOC. SCI. RES. NETWORK (2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330632.

lowering sale of the property to a secondary investor, who has different investment parameters than those of the primary investor.

D. Why the Sale to the Secondary Investor?[119]

The role of the secondary investor is both important and misunderstood. The secondary investor is an investor who is able to provide cash and credit to the deal in exchange for capital gains, income, and tax advantages.[120] It is common for the secondary investor to work in a field other than real estate or construction. Instead, he is likely a high net worth professional in an unrelated field who sees real estate as a portfolio opportunity.[121]

The second prong of this argument is that, even if homeowners read the contract, they cannot be expected to understand the nature of their commitments or the likelihood of being able to buy back their homes because they cannot understand the contract and, therefore, the transaction. *See* SINGER, *supra* note 61, at 811-12. The argument fails to appreciate that these documents are no more complicated than the original mortgage and subsequent refinance documents on the property as well as the important role of community knowledge and collective wisdom within communities where these transactions, and similar activities, are prevalent. It is most likely the case that these transactions are well-known and well-discussed in these communities.

The third precarious prong in this argument says that, after the homeowners' failure to read, and their failure to understand, the homeowners' consent can be neither knowing nor voluntary. *See* SINGER, *supra* note 61, at 812. Going a step further, some proponents of this argument argue that, where the harm is this great, meaning the risk of losing one's home is high, any consent given could not have been meaningful consent because no homeowner in his or her right and understanding mind would have consented to such a possible outcome. *See id.* The extension of this argument is that, if losing one's home were foreseeable and discernible, no homeowner would have agreed to it. *See id.* at 808. This conclusion equates consent with confusion. The "couldn't consent" argument says that, because the homeowner could not understand the contract, he *could* not have consented. *See id.* at 811. The "wouldn't consent" says that, given the possible negative outcome, the homeowner *would* not have consented.

119. Many of the propositions stated in this Part are supported by information from interviews conducted by the Author. *See supra* note 5.

120. *See* Wells & Whitby, *supra* note 108, at 56-69; Vivian Marino, *Reaping the Tax Benefits from Rental Properties*, N.Y. TIMES (Feb. 4, 2007), http://www.nytimes.com/2007/02/04/realestate/commercial/04sqft.html?pagewanted=all; Douglas Hsiao, *Tax Benefits of Owning Rental Properties*, WASH. POST: WHERE WE LIVE (Sept. 4, 2012, 5:30 A.M.), http://www.washingtonpost.com/blogs/where-we-live/post/tax-benefits-of-owning-rental-properties/2012/09/02/90acdff2-f53a-11e1-aab7-f199a16396cf_blog.html. *But see supra* note 107.

121. It may be easy to confuse secondary investors with "straw buyers." A straw buyer is a buyer who purchases something for someone else because that person cannot qualify to buy the thing for himself. United States v. Parish, 565 F.3d 528, 530 (8th Cir. 2009). Straw buying is common in real estate when a person cannot afford to buy a home and a straw buyer buys it for the person, using the straw buyer's own credit, as when a parent buys a home for a child. Brad R. Jacobsen & Michael Barn-

The sale to the secondary investor serves four key market benefits. First, the secondary investor is able to obtain financing at a rate that the homeowner could not possibly get on his own, lowering the cost of the deal to everyone involved. Lowering the cost of owning the property can pass through to the homeowner, allowing him to pay a rent that is usually negotiated to be lower than the monthly amount the homeowner was paying previously to service his various debts on the property. In the lease negotiation, the homeowner is asked what he can afford to pay for rent. That number is necessarily lower than the homeowner's current monthly payments, which he clearly is unable to pay as evidenced by the looming foreclosure.[122] Additionally, the rent negotiated is often below the market rent in the area due to the secondary investor's access to market-rate financing and his willingness to delay his gains until he resells the home, either back to the homeowner on the buyback date or on the open market thereafter. This stabilizing, cost-lowering transaction also creates an opportunity for the homeowner to establish a payment history with the investor or the secondary investor as creditor. That improved credit history increases the chances that the homeowner will later be able to obtain financing in his own name. If the homeowner cannot afford to pay a market rent or even cover the secondary investor's costs, the investor may subsidize the homeowner's monthly payments using some of the newly mobilized equity.[123] The agreed upon rent is a part of the package that the investor offers to the secondary investor before the secondary investor agrees to the transaction.[124] The two investors do all of this in exchange for a risk- and cost-related premium sell-back price later.

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hill, *Drawing the Short Straw-Mortgage Fraud and Straw Buyers*, 21 UTAH B. J. 9, 9-10 (2008). Straw buying is not illegal unless it involves fraud of some sort. A fraudulent straw purchase might be one in which the straw buyer represents to the lender that he or she would be the owner-occupant, knowing that to be false. In the RSLB scenario, the secondary investor is not a straw buyer. The secondary investor does not obtain financing as if for himself. In this scenario, the secondary investor does not deceive the homeowner or the bank that gives the secondary investor the mortgage. All parties are aware that the secondary investor is buying the property for investment purposes.

122. However, sometimes, the homeowner is able to make the current payment, or even a higher one, but cannot afford to catch up on the lump sum arrearages fast enough to stop the foreclosure.

123. In extreme situations, a homeowner may not be able to pay anything for the duration of the leaseback. In this instance, the entire rent would come out of the mobilized equity, resembling a reverse mortgage. *See* Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks, 74 Fed. Reg. 66,652, 66,656 (Dec. 16, 2009) (defining reverse mortgages as "non-recourse, home-secured loans that provide one or more cash advances to borrowers and require no repayments until a future time").

124. As with any investment, the secondary investor would choose to make the investment based on the bundle of benefits he would receive, such as monthly rent, duration of the investment, upfront cash required, risk-reward matrix, etc. The investor would market the transaction to the secondary investor either after negotiating

The second market benefit is that the secondary investor frees up the resources that the investor has tied up in the transaction. Due to the nature of this investment type, the secondary investor necessarily has a time horizon of at least two to four years. The time of the leaseback must be longer than the statutory redemption period in the jurisdiction.[125] That investment horizon is longer than the investor's desired timeframe because the investor may be executing several simultaneous deals, working with several secondary investors, and dealing with greater demands on his capital. The secondary investor frees up the investor's capital – or relieves the investor of the high-rate hard money obligation – to seek more deals or to make repairs, carry out property maintenance, and pay taxes and insurance on the property.[126] If it were maintained for the duration of the leaseback period, the high-rate, hard money loan that the investor got from his short-term lenders would make the deal prohibitively expensive for the homeowner, whose rent payment would be set to cover those expenses. Although the property remains with the secondary investor through the term of the leaseback period, the secondary investor would have limited contact with the homeowner and would leave the landlord function to the investor.

Third, the sale to the secondary investor serves his financial goals as well. The secondary investor uses this type of investment to diversify his portfolio of investments. In that regard, this transaction is an alternative to the stock market or other entrepreneurial opportunities that the secondary investor could pursue. The rental payments would be substitutes for equity dividend payments that he might achieve elsewhere; any increases in market value would be treated as capital gains.

Finally, from a market efficiency perspective, this sale shifts a previously underutilized tax advantage from the homeowner, who could not fully benefit from it, to the secondary investor, who could better utilize the tax bene-

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with the homeowner, or the investor might involve the secondary investor during the negotiation phase of the transaction. It is likely that the relationship between the investor and secondary investor exists prior to the negotiations with the homeowner because the transactions must be executed in a short timeframe and because a successful investor would maintain relationships with several potential secondary investors to complete deals as they arise.

125. In most jurisdictions, there is a statutory redemption period during which the homeowner could change his mind and buy back his home after a foreclosure or foreclosure-related sale, which is an RSLB transaction. *See, e.g.*, CAL. CIV. CODE § 1695.12 (West, Westlaw through Ch. 16 of 2014 Reg. Sess.). In California, for example, this is two years. *Id.* § 1695.14. It would be imprudent to structure this deal so that a homeowner must leave before his statutory right of redemption has expired because the homeowner could come back at any point during that period and say he wants the house back, in which case, the investors would be prohibited from reselling the home and might have to vacate another tenant. Even if the homeowner is evicted during the leaseback period, his statutory right of redemption remains unaffected.

126. *See generally* Marvin Milich, *The Real Estate Sale-Leaseback Transaction: A View Toward the 90s*, 21 REAL EST. L.J. 66, 67-68 (1992).

fit.[127] This benefit comes in the form of deductions for mortgage interest and expenses, property taxes, and depreciation.[128] Prior to this transaction, these deductions most likely went unclaimed because the homeowner likely did not have significant income to offset. After the second sale, the secondary investor can use those benefits more efficiently by offsetting his higher income.[129]

E. Why the Buyback Option?

With the buyback option, the homeowner retains his ability to regain the American Dream of homeownership. Although the homeowner could retain a statutory right of redemption[130] if he lost his home in foreclosure and his

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127. *See* Wells & Whitby, *supra* note 108, at 58 (arguing that, under the US tax code, a lessee with a lower marginal tax rate can shift his tax allowances to a higher rate lessor through a sale and leaseback of an asset and that a property owner could negotiate a lower lease rate in exchange for the tax deductions).

128. *Id.* at 58, 66.

129. *Id.* at 58 (arguing that a homeowner could negotiate a lower lease rate in exchange for the tax deductions to the secondary investor).

130. A statutory right of redemption exists only in certain jurisdictions and allows a homeowner who has been foreclosed upon to repurchase his home for a set period after the foreclosure sale, usually one year, for the sale price, plus foreclosure expenses, which can be excessive and may consume all of the equity in the property. Twenty-two states have statutes providing an absolute right of redemption. ALA. CODE § 6-5-248 (LexisNexis 2014); FLA. STAT. ANN. § 45.0315 (West 2014); 735 ILL. COMP. STAT. ANN. 5/15-1603 (West 2014); IND. CODE ANN. § 32-30-10-11 (West 2014); KAN. STAT. ANN. § 60-2414 (West 2014); KY. REV. STAT. ANN. § 426.220 (West 2014); ME. REV. STAT. ANN. tit. 14, § 6313 (West 2014); MICH. COMP. LAWS ANN. § 600.3140 (West 2014); MINN. STAT. ANN. § 580.23 (West 2014); MO. REV. STAT. § 443.410 (2012); N.J. STAT. ANN. § 2A:50-4 (West 2014); N.M. STAT. ANN. § 48-10-16 (West 2014); N.C. GEN. STAT. ANN. § 45-21.27 (West 2014) (providing the shortest redemption period at ten days); N.D. CENT. CODE ANN. § 32-19-18 (West 2013); OHIO REV. CODE ANN. § 5721.38 (West 2014); OKLA. STAT. ANN. tit. 46, § 43 (West 2014); R.I. GEN. LAWS ANN. §§ 34-23-2 to -3 (West 2013) (providing the longest redemption period at three years); S.D. CODIFIED LAWS § 21-47-23 (2013); TENN. CODE ANN. § 66-8-101 (West 2014); VT. STAT. ANN. tit. 12, §§ 4941, 4949 (West 2014); WIS. STAT. ANN. § 846.13 (West 2013); WYO. STAT. ANN. § 1-18-103 (West 2013). Nine states have laws providing a hybrid/conditional statutory right of redemption. ARIZ. REV. STAT. § 12-1281 (LexisNexis 2014); ALASKA STAT. ANN. § 34.20.090 (West 2014); CAL. CIV. CODE § 1931 (West 2014); CONN. GEN. STAT. ANN. § 49-20 (West 2014); IOWA CODE ANN. § 654.20 (West 2014); MASS. GEN. LAWS ANN. ch. 244, § 18 (West 2014); MONT. CODE ANN. § 71-1-228 (West 2013); UTAH CODE ANN. § 78B-6-906 (West 2013); WASH. REV. CODE ANN. § 61.24.050 (West 2014). The remaining states – Arkansas, Colorado, Delaware, Georgia, Hawaii, Idaho, Louisiana, Maryland, Mississippi, Nebraska, Nevada, New Hampshire, New York, Oregon, Pennsylvania, South Carolina, Texas, Virginia, and West Virginia, and the District of Columbia – do not provide a statutory right of redemption. *See The Right of Redemption*, ALLLAW.COM, http://www.alllaw.com/articles/nolo/foreclosure/right-of-redemption.html (last visited Apr. 23, 2014).

jurisdiction recognized that right, the sale/leaseback and repurchase option often can be the superior choice for the homeowner. When the homeowner sells the home to the investor, the homeowner retains the right to buy the property back at a set date in the future at a set and definitive price, without having to relocate. The role of the option contract is to provide certainty for the homeowner regarding when and at what price he can regain his home; alternatively, the foreclosure process keeps these two variables unknown and unknowable to the homeowner. In the foreclosure process, he has no control over when and at what price the lender will initiate the initial foreclosure sale, nor at what price the foreclosure buyer, often his original lender, will decide to resell the property, nor control over when the lender will evict him.

The future repurchase price will be higher than the current value of the home.[131] When the homeowner agrees to buy the property back in the future, that is evidence of his belief that the property value will rise in the interim. In fact, the buyback price is a direct quantification of the homeowner's and the investor's market expectations for the leaseback period. For example, if the home is worth ten dollars today, and the four-year repurchase price is twelve dollars, then the homeowner expects the value of the home to increase to more than twelve dollars over the next four years. If they are both right that the market is rising, each should be happy to execute the buyback transaction on or near the buyback date. In that case, the homeowner is reinstated back into his home and has captured any equity over the twelve dollar repurchase price. The investor and the secondary investor are able to liquidate the investment, having captured their share of the equity up to the twelve dollar repurchase price.

If, however, both parties are wrong, the value of the home will either remain flat or decline. If there is the expectation that the market is going to decline, the investors have no identifiable reason to enter into this transaction in the first place. Such examples are few and far between, and the failure to recognize the early whispers of a market downturn is the most costly mistake

This right of redemption is disfavored because it binds title for the entire period and discourages the new owner from making any improvements to the land or property for the duration of the right as the new owner does not know when or if he will ever actually own the property. *See, e.g.*, United States v. Stadium Apartments, Inc., 425 F.2d 358, 365 (9th Cir. 1970). Some jurisdictions also prohibit the buyer from moving in during the redemption period. This should not be confused with an equitable right of redemption, which is a homeowner's right to make the lump sum payment needed to buy himself out of foreclosure by bringing his loan current at any point leading up to the actual foreclosure sale.

131. However, sometimes, the future buyback price can be equal to or lower than the current value of the home or even identical to the amount owed on the foreclosure, depending on the negotiations of the homeowner. In these cases, what the investor gets is access to the equity for the time of the leaseback period at least, which he might agree to, if he believed he could make money with that money during the leaseback.

these investors can make.[132] However, an added benefit to the homeowner is that he benefits from doing the transaction whether he anticipates the market rising or falling. Even if anticipating a market decline, the homeowner still has an incentive to do the deal instead of facing foreclosure.

The homeowner's incentive comes from his ability to mobilize the equity in the home – often collecting at least some cash payment – and to live there for two to four years, even if he plans to leave shortly thereafter. Therefore, regardless of the homeowner's market expectations, he has the incentive to execute this transaction. The homeowner knows that, even if the market declines, he is still no worse off than he would have been had he lost the home to foreclosure. In the event of a market downturn, the homeowner either will not be able to get financing for the buyback due to a failing appraisal value or simply will not want to rebuy a home that is worth less than he agreed to pay for it.

Those are the same options available to the homeowner if he considered buying his home back through the statutory right of redemption, if it were available to him, all the while trying to guess what his buyback cost would be. If the homeowner is able to extract one dollar from this deal that would have been lost to foreclosure, he is better off having done the transaction than not having done it.[133] If, in fact, the market does decline during the leaseback period, a rational homeowner can walk away from the deal finding himself no worse off than had he never met the investor; in that case, he would have lost the property two to four years earlier in the foreclosure process, but would not have accessed any of his equity. The secondary investor, however, would be burdened with having to sell a leveraged property at a loss during a market correction.

There are many ways to frame this transaction. It could be analyzed using option theory; in that case, what the homeowner is buying with some of his newly mobilized equity is a call option.[134] The repurchase price would be the strike price.[135] If the home's value in the future is greater than the buyback price, then that call is "in-the-money" and the homeowner will exercise it.[136] If, however, the value in the future is below the strike price, the option

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132. *See* discussion *supra* note 104.

133. In addition to the one dollar, the homeowner would receive the value of avoiding the foreclosure and possible bankruptcy, which would benefit his credit-rating. Les Christie, *Bankruptcy Can Save Your House from Foreclosure*, CNN MONEY (July 24, 2010, 10:58 P.M.), http://money.cnn.com/2010/07/21/real_estate/bankruptcy_and_foreclosure/.

134. A call option, gives the option holder the right to buy an asset at a certain price and at a specified point in the future. *See supra* note 105.

135. The strike price is the price at which an option can be exercised. *See supra* note 105. Here, it would be the repurchase price of the property.

136. A call option is "in-the-money" when the value of the asset rises above the strike/buyback price of the option. If the call holder exercises an in-the-money option, he purchases the asset at the pre-negotiated price. Because that price is below

is out of the money and the homeowner should let it lapse. The RSLB can be framed as a property conveyance, from which the homeowner retains a leasehold estate and an executory interest,[137] which is his repurchase option. The buyback can be framed as merely a contractual relationship.[138] Effectively, they all have the same impact for purposes of this Article, and each creates something of value in the homeowner. Clearly, the homeowner's right to buy the property back should be recorded and may be assignable.

Recording the transaction and the repurchase option encumbers the title and, in that way, serves as an official form of retained property right for the homeowner and creates a burden that runs with the land. As a property right, that option to repurchase may be assignable to another possible buyer,[139] especially if it has intrinsic value. A call option has intrinsic value when the market value at the time of exercise is higher than the call's strike price; this is considered an "in-the-money" option. In that case, the moment the homeowner exercises his call option he captures the equity created between the buyback price and the then-prevailing market price. Therefore, the cash value of that call is in that automatic equity. The sale or assignment of the right

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the current market price, he automatically earns the difference between the price he agreed to pay and the current market price.

137. The exact classification of the right the homeowner has is debated in property circles. Some would argue that the homeowner sold the entire estate, and then simultaneously bought a future executory interest for himself; *see* JOSEPH WILLIAM SINGER, PROPERTY § 7.3, 308 (3d Ed., 2010) (explaining that, though executory interests are usually held by third parties, options are treated as executory interests, even if held by the grantor for other reasons). "Generally, executory interests vest an estate in the holder of the interest upon the happening of a condition or event . . . an executory interest cuts short the present estate [of the secondary investor]." Cent. Del. Cnty. Auth. v. Greyhound Corp., 588 A.2d 485 (1991).

138. Still others would argue that the homeowner sold his home in fee simple and bought a contract right for himself, which was the investor's promise to not sell the property before the homeowner's buyback date, and has no property right in the property at all. Either way, the repurchase option is something of value to the homeowner. Much of the argument against the traditional categorization of options as valid executory interests has centered on whether the option violates the Rule Against Perpetuities. This is not a consideration here as the options in RSLB transaction are of short (under twenty-one years), pre-defined duration. *See* William Berg, Jr., *Long Term Options and the Rule Against Perpetuities – Part II*, 37 CAL. L. REV. 235, 244 (1949); *see also* Phillips v. Tetzner, 53 A.2d 129, 131 (Penn. 1947); Rice v. Wood, 346 S.E.2d 205, 211 (N.C. Ct. App. 1986); In re Competrol Acquisition P'ship, L.P., 203 B.R. 914, 917-18 (D. Del. 1996); Bayer v. Showmotion, Inc., 973 A.2d 1229, 1242 (Conn. 2009); Harley v. Indian Spring Land Co., 3 A.3d 992, 1004-05 (Conn. Ct. App. 2010).

139. The transferability of the option is a term that is of no benefit to the secondary investor because it increases the chance that *somebody* will exercise the option when the market value is above the option strike price, thereby cutting off the secondary investor's access to the extra equity over and above the strike price; however, it is a balancing aspect of the transaction and it is a value-creating opportunity in this transaction for the homeowner.

to repurchase would generate additional capital for the homeowner, who could sell the option for any amount up to the difference between the strike price and the higher market value.

F. What Happens to the Equity?

There is significant misunderstanding about where the equity goes in RSLB transactions.[140] The following example demonstrates one possibility of how the funds may be distributed in an RSLB transaction, including the allocation of the investor's expenses, overhead, and payments on the homeowner's behalf.[141] Each party's possible reward reflects his potential risk.

Simple Mathematical Example[142]	
Starting Value of the Home:	$100
Past Due/Foreclosure Amount:	$ 70
1st Sale to Investor:	$ 80
2nd Sale to Secondary Investor:	$ 95
Buyback/Strike Price:	$110
Expected Value in Future:	$120

In this example, the homeowner has $30 ($100 minus $70) of trapped equity. Foreclosure would cost the homeowner most, if not all, of this equity. The RSLB transaction allows this homeowner to capture a negotiated portion of this equity – in this case $10 – plus non-cash benefits. The second sale to the secondary investor must be priced below the market value to be competitive. If this transaction were priced at market value, the secondary investor would be indifferent, at best, between this transaction and all other market-priced opportunities, which would not help this homeowner. Indeed, the secondary investor might disfavor this transaction because it can come with extra compliance requirements due to legislation regarding the sale of homes in foreclosure.[143] In order for the secondary investor to complete the stabilizing

140. Investors are accused of offering terms which are onerous to homeowners and which ensure that the property or the underlying equity will end up with the investors. The core of this criticism must be the general uneasiness that critics have with investors' taking what the critics perceive as too large of a share of the trapped equity. However, it is impossible to quantify what a fair price is in a market like this. It is clear that investors receive a large portion of equity in these transactions. If it can be accepted as a general starting point that these are high-risk transactions and high-risk homeowners, as evidenced by lenders' unwillingness to lend to these homeowners again, it is clear then that investors are going to engage in this socially-beneficial contract only if the reward premium at least matches the risk.

141. These numbers are hypothetical and are gross of any taxes to which the parties may be subject.

142. *See also infra* Figure 1 (presenting the calculation in a chart).

143. Equity Purchase statutes govern the behavior of investors in these transactions. *See, e.g.*, CAL. CIV. CODE §§ 2945.1-11, 1695.1-17 (West 2014) (outlining equity purchases procedures, including required language and content of documents

transaction at a below market price, the sale to the investor must be completed at a price even below that. The buyback price ($110) is set based on the parties' expectations of where the property value will be ($120) at the time of the buyback.

From these numbers, if the home goes up in value as expected during the leaseback period (to $120), the homeowner has several options from which to choose.[144] If he does not exercise the option, he gets his original $10 ($80 minus $70) and walks away. In addition, the homeowner will have benefited from a fully paid off mortgage, maintenance of his credit, a subsidized rent payment during the leaseback period, and other bills paid off. Sweetening the deal for the homeowner, if he chooses not to exercise his repurchase option he may still sell it to another buyer for up to $9.99, leaving the homeowner with $19.99 ($10 plus $9.99). An unrelated buyer would pay up to $9.99 for the option to buy the property at $10 below market price.[145] If the homeowner chooses instead to exercise the option, he will receive at least $20 (his original $10, added to $120 minus $110). If the home's value rises past $120, the homeowner also captures the entire gain above $120.

Whether the homeowner exercises the option or not, the investor gets a maximum of $15 ($95 minus $80, less costs). While the investor secures his payment early in the transaction, his upside is capped at $15. His downside is not limited and will depend on the carrying costs incurred during the leaseback period. For the leaseback period, the investor and the secondary investor will negotiate the split of the carrying costs and payment of fees related to the transaction. These costs will come out of their share of the mobilized equity. It is impossible to know the extent of the carrying costs at the time of the original sale from the homeowner. If they underestimate, the added costs are borne by the investors.[146] Additionally, some portion of the equity received by the investor and secondary investor would be distributed to their overhead and compliance costs, including staff and office space.

If the home value rises as expected (to $120) and the homeowner or an assignee exercises the option at $110, the secondary investor gets a maximum of $15 ($110 minus $95, less costs). If the option lapses instead, the secondary investor gets $25 ($120 minus $95, less costs). If the home's value rises past $120, the secondary investor enjoys the gain above $120. However, if the home remains flat during the leaseback period, the secondary investor

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used in the process); MD. CODE ANN., REAL PROP. §§ 7-105 to -113, 7-301 to -325 (West 2014); MO. REV. STAT. §§ 407.935-.943; WASH. REV. CODE ANN. §§ 19.134.010-.900.

144. If the property value remains flat or declines, it would be rational for the homeowner not to exercise the option.

145. This hypothetical excludes any transactions costs the buyer of the option would incur either in purchasing the option from the homeowner or in purchasing the property from the secondary investor.

146. These costs, if known, can be paid or set aside in escrow at the time of the original sale. If the costs are unknown and unforeseeable, investor or secondary investor will pay them from their share of the equity.

would sell the property and get a maximum of $5 ($100 minus $95, less costs). If the home declines in value or the leaseback carrying costs are excessive, the secondary investor risks an incalculable loss (if he is left holding a home with plummeting market value and stable or rising carrying costs).

Figure 1.

	Homeowner	**Investor**	**Secondary Investor**
Foreclosure[147]	$0	$0	$0
Declines Below $100	$10+Non-Cash Benefits *Won't Exercise*	$15-Costs	Incalculable Loss
Flat at $100	$10+Non-Cash Benefits *Won't Exercise*	$15-Costs	$5-Costs
Rises to Strike Price $100	HO Exercises: $10+Non-Cash Benefits HO Doesn't Exercise: $10+Non-Cash Benefits	$15-Costs	HO Exercises: $15-Costs HO Doesn't Exercise: $15-Costs
Rises to $120	HO Exercises: $20+Non-Cash Benefits HO Doesn't Exercise: $19.99+Non-Cash Benefits	$15-Costs	HO Exercises: $15-Costs HO Doesn't Exercise: $25-Costs
Rises Beyond $120	HO Exercises: $20+Non-Cash Benefits+Upside HO Doesn't Exercise: $19.99+Non-Cash Benefits	$15-Costs	HO Exercises: $15-Costs HO Doesn't Exercise: $25-Costs+ Upside

147. In the case of foreclosure, the homeowner would get $0 and the lender would get $50-plus, if the market value increased as expected. The lender would continue to profit until the market value fell below $70, at which point the lender would finally see a loss.

These values do not include the intangible benefits to the homeowner, such as foreclosure avoidance, credit maintenance, subsidized rent, tax benefits, insurance, and other carrying costs. These values should also be compared to the values if the homeowner did not have access to this transaction and lost the home to foreclosure instead. In that example, the homeowner, investor, and secondary investor would each get $0. The lender, however, would get $50-plus, if the market value increased as expected. The lender would continue to profit until the market value fell below $70, at which point the lender would finally see a loss. If the homeowner bought the home back under the statutory right of redemption – assuming that is available in his jurisdiction – he would have to pay back the foreclosure amount, as well as the fees and expenses of the bank.[148]

IV. BENEFITS AND CHALLENGES

A. Benefits

As demonstrated above, a homeowner can receive many tangible and intangible benefits in RSLB transactions. The immediate benefit to the homeowner is access to at least some of his equity, especially at a time when there is no other market mechanism available to him to access any of that equity. With the proceeds from the sale of the home going to the investor, a homeowner is able to avoid an immediate foreclosure as the mortgage is paid off at the closing table. Often homeowners also are able to avoid bankruptcy by using the cash extracted to get current on their consumer debts.

Avoiding the foreclosure allows the homeowner to regain stability and certainty: he can keep his children in their schools and avoid the cost and inconvenience of having to find new housing and relocate all of his family's possessions. The homeowner gets mental and emotional benefits as well. He is spared the humiliation of a foreclosure and eviction and is able to get his name off of the negative public records. In fact, even if he never repurchases the property, the homeowner will not have a foreclosure on his credit history. The RSLB allows a homeowner to retain what is left of his credit rating. Further, the homeowner is able to eliminate the stress and pressure of a looming foreclosure. The leaseback period gives the homeowner an opportunity to make important decisions in a less chaotic timeframe. He also avoids the cost and inconvenience of maintenance, insurance, and taxes during the leaseback period.

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148. The average foreclosure is estimated to cost $78,000 and to take two years to complete; *Bank of America Starts Foreclosure Rental Program*, ASSOCIATED PRESS (Mar. 23, 2012, 2:24 P.M.), http://www.suntimes.com/business/11489245-420/bank-of-america-starts-foreclosure-rental-program.html; *see also* Mortg. Bankers Ass'n, *supra* note 61 (putting the cost of foreclosure at thirty to sixty percent of the outstanding loan balance).

Another benefit to the homeowner is that he insulates himself against home price risk. Even if he could have avoided the foreclosure on his own, the homeowner has an incentive to do an RSLB because it allows him to shift price risk to the investors. If the homeowner expects the market to go down in the near future, he can satisfy two important goals – avoid the foreclosure *and* take out equity before the home value plummets. This is a strategy that, if correct, leaves the investor with property that is declining in value. If the homeowner thinks the market is going to increase in value, he is preserving a chance to regain his American Dream in the future under clearly spelled-out terms and conditions – certainty which he would not have in the event of a foreclosure and redemption attempt. That chance is a valuable one, which leaves him better off than not having had the chance, even if the repurchase does not come to fruition.

B. Challenges

Although the RSLB is generally a valuable transaction for homeowners and investors, there are aspects of it that can go wrong or that homeowners or investors can exploit to the detriment of the other.[149] In order to preserve this transaction as a viable option for certain homeowners, it is important to keep sight of where problems can arise in order to protect against these scenarios. However, most – if not all – of these possible pitfalls can be avoided relatively easily. The goal of this section is not to provide solutions to all of these problems; rather, it is to acknowledge them as areas that must be observed carefully and resolved to prevent problems.[150]

The problems fall into several broad categories: problems of (mis)understanding and inadequate counsel, landlord-tenant disputes during the leaseback period, actual and falsely alleged fraud, shortcomings in the governing statutes, and disempowered civil judges constrained by inadequate remedies due to weak contract doctrine.

The first major area of risk in these transactions for both homeowners and investors is lack of information, understanding, and disclosure. There is the risk that homeowners do not understand the contracts and inherent risks of the transaction, and that they overestimate the likelihood of being able to

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149. It is impossible to know what percentage of these transaction go well, leaving both parties satisfied, because those transactions are never exposed. Instead, the few problematic transactions surface and appear to represent the norm. Michelle Hoffman, *It's Scam Season: Scrambling to Avoid Foreclosure, More Owners Fall Prey to Rescue Fraud*, L.A. TIMES (Sept. 9, 2007), http://articles.latimes.com/2007/sep/09/realestate/re-foreclose9 (citing one 2007 estimate, in which a supervising investigator for the Los Angeles County Department of Consumer Affairs said that her office had seen about fifty cases involving some type of foreclosure scam, at a time when 4000 notices of default were published monthly, and the investigator expected the number of notices to triple over the following year).

150. For a more thorough examination of the possible problems, including suggested solutions, *see* Harvey, *supra* note 15.

repurchase their homes.[151] On the other hand, there is the risk that investors also may not understand the risks that they bear,[152] the laws in their jurisdictions regarding such purchases,[153] or the likely behaviors of the homeowners during the various phases of the contract.[154] There are often costly problems with the homes in terms of unknown title defects and other hidden maintenance defects that may be devastating for investors; some of these problems are known by the homeowners, but are not disclosed.[155]

The other closely related area of risk is the homeowners' and investors' lack of access to legal counsel and their reliance on inadequate advice. Although not a problem that is unique to RSLB transactions, access to counsel and the decision to obtain counsel is critical in this process for homeowners. Indeed it is a systemic problem from which homeowners suffer during the RSLB transaction, during the larger foreclosure process and during most transactions in which homeowners engage. If the statutory provisions built into the RSLB transaction still do not provide meaningful opportunity or incentive for homeowners to seek and obtain counsel, that problem must be addressed. Currently, it is undeniable that homeowners often do not take advantage of this opportunity. Homeowners need counsel prior to signing the contracts, at the time of the initial closing, during the leaseback period if there are landlord-tenant issues, and, potentially, after the contract concludes, whether or not the homeowner repurchases his home. Solutions to this problem would involve getting the best counsel and advice *prior* to the initial sale, as most of the allegations of investor wrongdoing pertain to actions taken prior to the signing of the original contracts. Solutions in this area must be preemptive. Currently, homeowners rely on the services of legal aid organizations and the prosecutor after the fact, which are both too late and too expensive.

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151. For a discussion of optimism bias, see Alan M. White, *Behavior and Contract*, 27 LAW & INEQ. 135, 159 (2009).

152. The risks inherent in RSLB transactions for investors are similar to the risks inherent in all equity-conversion products, such as reverse mortgages and shared appreciation mortgages, to name a few. The difference between the RSLB marketplace and those markets is that much economic and financial scholarship has been dedicated to addressing risk in those other markets, whereas RSLB has encountered very little scholarship. For a good discussion of the risks of the equity-conversion product market, see Shiller & Weiss, *supra* note 113.

153. Many jurisdictions have Equity Purchase Statutes, which govern the sale of properties that are in or approaching foreclosure. RSLB transactions would be governed by such statutes. It is within these statutory frameworks that this Article suggests the easiest changes to the RSLB transaction can be made. *See supra* note 143.

154. Two related, major risks to investors in these transactions are homeowner moral hazard and adverse selection. For a good discussion of these risks, see Shiller & Weiss, *supra* note 113.

155. As in any real estate sale, the seller has an incentive to not disclose known defects for fear of depressing the sale price. In this case, the incentive is even greater because homeowners may hope that the investor will be required to fix the defect as landlord during the leaseback period.

There also is, however, a lack-of-access problem suffered by the investors in these cases. Because these are generally small investment firms, they may be most likely to obtain legal advice through seminars and books. They may use form contracts, instead of customized contracts, due to the cost and the volume of transactions required to be profitable. Investors must also become educated to avoid mistakes related to overpromising, puffing, and aggressive salesmanship. Finally, small investors who face criminal or civil accusations brought by private or legal aid lawyers on behalf of homeowners are least able to afford defense counsel; such investors are likely to end up with public defenders, who may not be equipped to put on adequate defenses in complicated financial cases that allege fraud and are based on contracts and extra-contractual discussions. Solutions in this area would involve the investors developing legal strategies and pricing the cost of those strategies into their operations prior to entering into contracts with homeowners.

Landlord-tenant disputes are another source of risk in these transactions. Because the investors take over the maintenance and expense of the properties during the leaseback period, maintenance issues can become contentious. Additionally, if there is an eviction process at the end of the transaction, it can become hostile and expensive. Solutions here would come in the form of better leases with clearer parameters for maintenance and dispute resolution.

Allegations of fraud are perhaps the riskiest and most expensive threat to investors in these cases. However, homeowners are at risk in this area as well if they fail to make legally required disclosures at the time of the initial sale to the investors. While cases so far do not involve investor claims against homeowners, it is a wise bet that investors will start bringing such suits and countersuits as civil and criminal allegations against investors gain momentum. More pressing is the need to avoid this risk for investors. Allegations of fraud are not generally related to the terms of the written contract, nor do they tend to allege that the contract was not performed as written.[156] Instead, these charges usually involve allegations of extra-contractual conversations that promised or explained something other than what the contract said (*i.e.* – "He never told me I was selling my home and becoming a renter."). Because the factual underpinnings of these cases involve alleged conversations between the homeowner and investor, it is critical that solutions in this area involve stronger contracts, education of the homeowners and inves-

156. In the few cases in which the investors intentionally do not perform the contracts as written, those cases more closely resemble a fraudulent breach and may provide greater grounds for criminal regulation. One purely fraudulent example of not executing the contract as written occurs when investors promise that they will pay off the foreclosure at the time of the initial sale and then maintain that they have paid off the foreclosure for some portion of the leaseback period, but have not. In these fraudulent cases, the homeowner sometimes still catapults towards foreclosure unknowingly and criminal regulation may be warranted. However, even this problem can be easily preempted.

tors, clearer disclosures, pre-contractual access to counsel, and effective parol evidence standards.[157]

Another risk arises in the very way that homeowners in these cases are found. Generally, one homeowner goes into the offices of a legal services organization with a problem in his RSLB transaction – usually that he is facing eviction and cannot repurchase his property.[158] Suspecting fraud, that organization then typically conducts a search of the public records to find the other homeowners with whom the investor has transacted.[159] The legal aid group will often contact the additional homeowners and ask them to come in to have their cases reviewed for fraud. Without these calls, it is unlikely that these homeowners would bring charges; however, after the call, they have an interest and motive in alleging that they have been defrauded or that they did not understand what they were getting into. Solutions in this area must be preemptive and the ability of legal aid-type organizations to rally plaintiffs must be closely monitored.[160]

There are also general shortcomings in the governing statutes that could be resolved easily. For example, one problem in these transactions that has emerged is that the secondary investor might sell the property to a bona fide purchaser who is not aware of the homeowner's right to repurchase the home.[161] When the homeowner attempts to repurchase his home, he is told that there is a new owner, and that the new owner does not want to honor the homeowner's repurchase option.[162] This leads to problems that could be avoided if the statute required that the repurchase option be recorded as an encumbrance on title at the time of the original recording of the larger transaction. Unbelievably, recording is not always required.[163]

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157. If the criminal courts are to be effective in policing this area, they must be bound by the same parol evidence rules as the civil courts.

158. FORECLOSURES, *supra* note 9, at ch. 15.

159. Due to the transparency of real estate transactions and recording requirements, finding other homeowners is a very simple process.

160. *See* Robert L. Weinberg, Iqbal *for the Accused*, 34 CHAMPION 28, NACDL MAGAZINE (July 2010) (arguing that standards at least as high as the newly-heightened pleading standards given to civil defendants in *Twombly* and *Iqbal* should be used at the indictment and preliminary hearing stage to protect criminal defendants, who are "concerned with preserving liberty, not just assets").

161. CAL. CIV. CODE § 1695.14(b)&(c) (West, Westlaw through Ch. 16 of 2014 Reg. Sess.).

162. FORECLOSURES, *supra* note 9, at ch. 15. However, these cases show that some homeowners can and do wish to repurchase their homes after an RSLB transaction, although a common argument is that homeowners can never repurchase their homes due to the terms.

163. Currently, California does not specifically require the recording of the repurchase option, which, in effect creates a burden on the option holder to keep abreast of the recorded transfers of the property and to then notify subsequent purchasers that he holds that option. *See* CAL. CIV. CODE §§ 1695-1695.15. This burden is directly at odds with protecting homeowners.

The final major area of risk emerges because of the still unavailable contract doctrines needed to reach civil disposition of these cases. Civil judges must be empowered once again to provide adequate civil remedies for these homeowners as well as predictable frameworks for the investors.[164]

V. CONCLUSION

Despite the negative reputation of the *We Buy Houses* and other RSLB transactions, this Article demonstrates that the transactions fill two important market and social goals. First, the transactions are financially and socially beneficial to the homeowners and communities that use them. Specifically, the homeowner, whose only other option is foreclosure, receives more of his equity than he could in the foreclosure process, in which the bank likely would claim all of the equity as fees. This remains true even where the homeowner ultimately is unable to repurchase his home at the buyback date. Even with the most pro-homeowner legislation, large banks are still able to refuse to refinance certain homeowners. For this reason, there will always be an unfortunate group of homeowners who need a last-ditch solution.

Without RSLB investors, these homeowners would lose their homes and equity immediately and certainly. With the RSLB investor, the homeowner has at least a chance of salvaging his home and pulling out some of his equity. It is that chance for which a homeowner bargains and for which a homeowner pays. For the homeowner, in the simple mathematical example above,[165] the RSLB transaction gave him access to at least ten dollars of his equity, and possibly more; on the other hand, the foreclosure scenario left him with nothing. Ten dollars is not a bad outcome when compared to zero, and homeowners know this.

Second, the transactions play an integral role in the overall real estate market by filling voids that the large banks cannot fill. Large banks are constrained by operational realities based on their size that make managing such high-risk loans an inefficient undertaking for them. The RSLB marketplace allows small, nimble investors to service these homeowners instead.

While there may be legitimate problems with the transaction, the benefits of the transaction make the transaction worth salvaging instead of obliterating. The benefits of the transaction include, but are not limited to, access to otherwise inaccessible home equity, stability and autonomy, maintenance of one's credit rating, reduced stress, protection against home price risk, and benefits to reputation.

The challenges are that unscrupulous homeowners and investors can exploit one another. Compounding that problem, either side may not have meaningful access to counsel in the contract drafting phase of the transaction, leading to misunderstanding and unfair deal terms. Additionally, landlord-

164. Additionally, investors must be estopped from avoiding paying judgments through bankruptcy and other means.

165. *See supra* Figure 1.

tenant problems may arise during the leaseback period, for which either side again may not have adequate access to counsel. Indeed, the challenges can be easily dealt with using preemptive and remedial measures, which leave the parties and society better off.

This Article details the anatomy of the often misunderstood transaction, highlighting the value added from the transaction versus other options the homeowner may have. The Article also includes a sample accounting of the flow of dollars through the transaction, demonstrating how much better off the homeowner can be compared to the foreclosure that was avoided by doing the transaction. This accounting also shows that the biggest risk-taker in the transaction, the secondary investor, also rightly has the opportunity to reap the biggest reward. Finally, the Article outlines the benefits and challenges inherent in the RSLB marketplace, thereby laying a foundation for subsequent research on the topic.[166]

166. *See* Harvey, *supra* note 15, at Part IV.