

A new way to tap equity without going into debt

Homeowners can sell a share of future appreciation

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Bill and Elaine Nolan paid top dollar when they bought their Tiburon house a few years ago at the height of real estate frenzy. Now, of course, the market is cooling rapidly.

So Bill Nolan, who deals with money all day long as a partner in an investment management firm, wanted to diversify. He turned to a startup based on a new concept: Let homeowners tap their equity without taking on debt.

Nolan contracted with Rex & Co. to receive \$100,000 cash in exchange for a 10 percent stake of the home's future appreciation. When the Nolans sell their home, they'll pay Rex the \$100,000 plus 10 percent of their home's appreciation above its current value of \$2 million. For example, if the home sells for \$2.5 million, the Nolans would pay Rex \$150,000 -- the original \$100,000, plus 10 percent of the \$500,000 gain in value, or \$50,000. If the home were to depreciate, Rex would share in that loss as well.

(The Nolan house is atypical because of its high value; more typically, a \$100,000 Rex payment would be in exchange for a larger share of a house's appreciation.)

"It was an interesting opportunity to take some cash out of the house and hedge against any decline in home value," said Bill Nolan, who plans to invest the money in his business. "It was a way to hedge against the (real estate) market being flat or not performing as well as the equity market; to pull money and put it into something else I felt had a reasonable chance of outperforming the real estate market."

San Francisco's Rex & Co. (www.rexandco.com) -- the name stands for Real Estate Equity Exchange -- bills itself as the first company offering a way to make home equity liquid without incurring debt. It essentially buys a share of a home's future appreciation. Rex gives homeowners a large up-front cash payment -- up to 15 percent of a home's value, topping out at \$300,000 -- in exchange for a share of the home's future change in value -- up to 50 percent of its appreciation or depreciation.

No payments, no interest

When the home is sold, the homeowner returns the original investment to Rex plus the agreed-upon share of appreciation. The homeowner does not pay interest and does not make any payments until the sale.

"People, especially Baby Boomers, are sitting on a tremendous amount of equity," said Rex chief executive Thomas Sponholtz, a former Barclay's executive who co-founded the company with Ian Charles, formerly an investment banker at S.G. Cowen. "If you take on debt to unlock that value, you're paying to borrow your own money."

Sponholtz said many potential customers will want cash to meet specific needs, such as college tuition or retirement income.

He is quick to correct any reference to the Rex payment as a loan. The company prefers the terms equity co-share or equity co-investment.

Another way homeowners can take money out of their house without making monthly payments is through reverse mortgages, which are only available to people over age 62. Reverse mortgages, unlike the Rex system, are a form of debt. They provide either a lump-sum payment or regular monthly payments, and do not have to be repaid until the homeowner dies, sells or moves out for longer than a year. The loans accrue interest and come with hefty up-front fees.

Rex does not charge up-front fees, but the homeowner pays for standard real estate services. In originating a Rex deal, the homeowner would pay for an appraisal, an escrow fee to a title company and title insurance. The latter two are because the home's title would be amended to show Rex as having a lien against it. Rex offers some rebates on those fees.

Homeowners referred to Rex through financial advisers or mortgage brokers might be charged fees by those individuals, the company said. To discourage flipping, Rex charges an early exit fee for properties that are sold within five years. The exit fee is 25 percent of the cash advance in the first year and declines by five percentage points a year over the next five years. Homeowners can end their Rex arrangement at any time by paying the company the original investment plus Rex's agreed-upon share of the home's appreciation at that point (plus the early exit fee, if appropriate). The appreciation would be determined by an independent appraiser.

Rules to qualify

Nolan said he might consider ending his Rex deal if Tiburon houses go down in value, so that Rex would share in the loss on his home. "The beauty of it is that no one else can 'call' me on the option; I own the trigger point," he said. "No one else decides, 'This is an opportune time, home prices have risen, we'll call Mr. Nolan on our option to give us our 10 percent.' "

Only certain properties qualify for a Rex deal: They must be owner-occupied, detached, single-family homes. Condos, vacation homes and rental properties do not qualify. Owners must have at least 25 percent of the home's equity and must have good credit.

"We're looking to invest in the typical house in the neighborhood -- not castles," Sponholtz said. Rex will not buy shares in homes in the bottom 10 percent or top 10 percent by value in any given neighborhood.

Sponholtz said the company will do business in all metropolitan areas where it can get comparative price data and will not exclude areas where the housing market is struggling. But it will pay different prices for a share of future appreciation depending on its assessment of individual markets and homes, he said. That means if you have a well-maintained home in a desirable area, you're likely to land a better deal with Rex.

Rex's investors include AIG Financial Products Corp., part of insurance giant American International Group; San Francisco investment firm Hellman & Friedman; and Royal Bank of Scotland/Greenwich Capital.

Of the \$21 trillion worth of residential real estate in the United States, \$12 trillion is owned outright by

homeowners; the rest is debt owned by lenders. For most people, their home is both their biggest asset and their biggest vehicle for saving. Many financial experts warn consumers that they should diversify -- taking money out of their house and putting it in a financial product that will generate income, for example.

"Most people are over-invested in their home," said Christopher Thornberg, principal at Beacon Economics in Los Angeles. Selling "an equity stake in your home makes sense to me. Taking money out of your house and putting it in some other type of investment like stocks or bonds basically reduces the overall risk of your portfolio."

Thornberg said he wondered why Rex is starting now "considering that equity will go nowhere but down." Many experts think the real estate market might not bottom out for another year or two; Rex said that since it's aiming for a five-year-plus horizon, the immediate market is not a concern.

'A certain pizzazz'

Rex operates in nine states: California, New Jersey, Virginia, Florida, Illinois, Washington, Colorado, New York and North Carolina. It hopes to go nationwide within a couple of years. It considers California its biggest market.

Tim Chrisman, who runs Los Angeles executive-search and planning firm Chrisman & Co., did some work for Rex and said he was impressed by the concept. He ended up investing in the company.

"It has a certain pizzazz about it," said Chrisman, who is also chairman of the San Francisco Home Loan Bank Board, one of 12 such federally sponsored banks. "What is so novel about Rex, as the homeowner you can pull real dollars out of your home and you don't incur debt; that's the significant factor. When you get a home equity loan or pull out through (refinancing or reverse mortgages), you get the equity but you also incur more debt."

Chrisman said he could picture a scenario where Rex would turn its equity-sharing agreements into securities and sell them to other investors, just as mortgages are now routinely packaged and sold to Wall Street.

Meanwhile, obviously, Rex will not be generating cash flow for some time, because its contracts

encourage home buyers to stay put for at least five years.

Rex spokesman Wade Randlett said that is not an issue for the company. Rex's investors are seeking long-term returns and agree with the company's philosophy that the returns will ultimately be significant, he said.

While Randlett declined to say how much financing Rex has, he said: "We have sufficient credit to originate thousands of these (deals) across the United States. If we got to the point that the current credit facility was maximized, I am 100 percent confident we'd be able to increase that credit facility."

How Rex works

Here are potential ways a Rex deal might turn out, all based on the same premise: A homeowner with a \$750,000 house gets a \$100,000 cash advance from Rex in exchange for 50 percent of the future change in her home's value. In all cases, the homeowner would also pay third parties for real estate services such as appraisal, escrow fee and title insurance, although some of those would be rebated by Rex.

Scenario 1: After five (or more) years, the homeowner sells the house for \$900,000, a \$150,000 increase in value. The homeowner pays Rex \$75,000 (half of the appreciation) plus the original \$100,000.

Scenario 2: After five years, the house sells for \$675,000; it has lost \$75,000 in equity. Rex "owns" half of that, or a negative \$37,500. The homeowner pays Rex \$63,500 -- the original amount minus Rex's loss.

Scenario 3: After five years, the home sells for \$750,000. The homeowner pays Rex \$100,000, its original investment; Rex has neither made nor lost money on the deal.

Scenario 4: The homeowner decides to sell after just 11 months. The house sells for \$770,000. Rex is paid the original \$100,000 plus \$10,000 (half of the \$20,000 appreciation) plus an early exit fee of \$25,000 (25 percent of Rex's initial investment) for a total of \$135,000.

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