Shared appreciation mortgage

A **shared appreciation mortgage** or **SAM** is a mortgage in which the lender agrees as part of the loan to accept some or all payment in the form of a share of the increase in value (the appreciation) of the property.

In the UK

A **shared appreciation mortgage** is a mortgage arranged as a form of equity release. The lender loans the borrower a capital sum in return for a share of the future increase in the growth of the property. The borrowers retain the right to live in the property until death.

Shared Appreciation Mortgages sold between 1996-1998 have not always turned out to be products beneficial to the borrowers who took them out. In the late 90s, Barclays Bank and the Bank of Scotland[1] sold about 11,000 shared appreciation mortgages, targeting pensioners, just before the sharp rises in the property market. Customers could borrow the equivalent of 25% of the value of their property interest free. The banks gain from receiving 75% of the increase in value of the customer's property once it is sold, alongside the original loan, which many customers were unclear about.

The last ten years have seen property prices increase by 3 to 4 times. Many customers who took out a shared appreciation mortgages now find themselves trapped.

An example : a property valued at £100,000 in 1997 is now worth £400,000 (2007). The client took out a SAM of £25,000 (or 25% of the 1997 value). The contract stated that, upon sale or death, the banks could claim 75% of the difference in value plus the original loan (75% x £300,000 + £25,000 = £250,000). Therefore the bank will receive, upon sale, £250,000 (62.5% of the current value) and the client £150,000. The problem arises when the customer wants to sell up and move home. With only £150,000 to play with, even downgrading to a smaller property half the size of their current house would cost £200,000 and as such would be unaffordable.

Thus, in a market where house prices are rising in the long-term, this type of deal is usually detrimental to the customer.[2] On the other hand, if a customer took out a SAM and house prices stayed steady or declined, the customer would effectively have a completely interest free loan with no downsides. On a 10 year mortgage of £100,000 at 6%, the customer would save £33,225 in mortgage repayments with no loss to the customer.

Many disgruntled SAM customers have got together to form the Shared Appreciation Mortgage Action Group (SAMAG). They hope to find a legal settlement for "victims" of shared appreciation mortgages and are pursuing legal remedies.

In the US

In Commercial Mortgages

A **shared appreciation mortgage** is a mortgage in which the lender agrees to an interest rate lower than the prevailing market rate, in exchange for a share of the appreciated value of the collateral property. The share of the appreciated value is known as the *contingent interest*, which is determined and due at the sale of the property or at the termination of the mortgage.

For instance, suppose the current prevailing interest rate is 6%, and the property was purchased for $500,000. The borrower puts down $100,000 and takes out a mortgage of $400,000 amortized over 30 years. The lender and the borrower agree to a lower interest rate of 5%, and to a contingent interest of 20% of appreciated value of the property. Because of the lower interest rate, the monthly payment is reduced from $2,398 to $2,147. However, this saving in monthly payments comes with a trade-off. Suppose the property is later sold for $700,000. Because of the agreement on the contingent interest, the borrower must pay the lender 20% of the profit, namely, $40,000.

By participating in the appreciation of the property, the lender takes an additional risk that is related to its value. Hence, whether this is a favorable trade-off depends on the conditions of the housing market. A shared appreciation mortgage differs from an equity-sharing agreement in that the principal of the loan is an unconditional obligation (to the extent collateralized by the property). Thus, if the property's value decreases, the borrower would still owe whatever principal is outstanding, and if the borrower sells the property for a loss, the contingent interest is simply zero.

Revenue Ruling 83-51 (1983) of the Internal Revenue Service specifies conditions under which the contingent interest in a shared appreciation mortgage may be considered tax-deductible mortgage interest. In particular, a shared appreciation mortgage must stipulate an unconditional obligation of payment of principal to avoid being recharacterized as an equity-sharing agreement, which may lead to different tax consequences. Because of the complexity of tax laws and terms tailored for individual situations, private, noncommercial mortgages involving shared appreciation should always be executed with the counsel of a real estate attorney.

In Affordable Housing (Subsidized Home Ownership)

Shared Appreciation clauses are also used by non-profits and local governmental agencies.[3] These shared appreciation loans are structured as second mortgages, but are considered "silent" in that borrowers make no payments until they sell the home (or, in some cases, refinance the first mortgage). At the time of sale or refinance, the family is required to repay the full amount of the loan plus a portion of the home price appreciation. [4] In this way, the amount returned to the subsidizing entity is based on increases in home prices, which helps to preserve the "buying power" of public subsidies.

One common approach to designing shared appreciation loan programs is to base the share of appreciation payable upon sale of the home on the share of the original purchase price that was subsidized.

For example, if a family received a $50,000 subsidy to buy a $250,000 home, the family would be required to give the community 20 percent ($50,000 divided by $250,000) of any home price appreciation at the time of sale, in addition to repaying the initial $50,000.

Examples include:

- The Downpayment Assistance Loan Program of San Francisco
- City of San Diego's Shared Appreciation Loan Program

References

1. www.mortgagesexposed.com by Michael Kelly (retrieved 13th Aug 2007)
2. Scotland on Sunday The appreciation society forgets its elderly members (retrieved 13th Aug 2007)
3. "Shared Appreciation Loans". NCB Capital Impact. Retrieved 2012-03-15.
4. "Shared Appreciation Loans". *Housing Policy Toolbox*. Center for Housing Policy. Retrieved 2012-03-15.

Source: http://en.wikipedia.org/wiki/Shared_appreciation_mortgage
April, 2014