

Tenancy-in-common fractionalized loans weather the mortgage storm

By Carol Lloyd, Special to SF Gate

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With defaults rising like an interminable tide, cresting in foreclosures that crash upon our land, the blame has often focussed on lenders who took chances with "creative" loan products.

But there's one kind of home loan that is reporting a virtually perfect record. No defaults, no foreclosures, and according to some experts, not so much as a late payment. Ironically, this exceptional record is not associated with some Fannie Mae-underwritten conforming loan for single family homes, but a newfangled lending product that was thought to be so risky and so innovative that mainstream banks still won't touch it.

Such is the ironic success of the Tenancy in Common fractionalized loan. Although people have been getting joint TIC loans for decades, fractionalized TIC loans were created at the height of the mortgage madness to offer people the chance to buy into TIC homes without sharing a loan for the entire building. Circle Bank and Bank of Marin pioneered the products in 2005, then a half-dozen other lenders began their own fractionalized loan programs.

From the consumer's point of view, it was difficult to see how such programs would attract much business: After all, the loans typically added 1 percent to 1.5 percent to the interest rates of comparable condo loans. But they did—banks shelled out some \$500 million in these loans in the past couple of years, with surprising results.

At a recent conference where TIC lawyers, real estate agents and lenders had gathered to standardize the lending process, Tim Brown, a real estate agent who specializes in selling and developing tenancies in common, was surprised to hear a uniformly positive story from the lenders at the table "It was remarkable," he says, "When we went around the room everyone said they hadn't seen a single default since starting the program in 2005."

Of course this isn't the decade-long track record that might seduce bigger lenders to get into the TIC game, but hearing any good news from lenders these days is enough to start wondering what went right.

"We've not had any problem — and to my knowledge no lender has had a problem with defaults," says Pat McCarty, senior vice president for Circle Bank in Novato.

Sherry Hendrickson, of Bank of Marin, agrees that the TIC program has made her and her colleagues "happy campers."

"Not only have we not seen any defaults," she said, "We haven't seen a single late payment or late fee."

Why would such good fortune strike such small risk-taking lenders when all around them, titans are falling on their swords? McCarty sees it as partially a byproduct of the borrower profile for TIC units. "They are mostly younger professionals — well educated in their first or second job with good credit, though not a lot of net worth," he explains.

Another distinguishing feature is the requirement that TIC buyers occupy their home as a primary residence or second home and not turn it into a rental property. This clause was created to prevent complications for TIC buildings that had been hit with the Ellis Act— the state law that allows owners to evict their tenants, as long as the building is kept off the rental market for 10 years. Should a homeowner decide to ignore Ellis Act restrictions and use his property as a rental, he could end up being sued by former tenants, thereby leading him into default. The byproduct of the ownership-only clause is that the TIC loans do not attract investors, a group of property owners associated with high foreclosure rates.

But Hendrickson says that the loans' success is primarily the result of old-fashioned banking practices. The TIC loans were too innovative to be resold in the secondary markets on Wall Street, so the banks needed to keep the loans on their books. If such loans attracted lots of foreclosures, then they could be very damaging to the small regional lenders that were offering them.

"We designed these loans very conservatively," Hendrickson explains. "We required full documentation and employment verification, and we only financed up to 75 percent of the value of the property, so home owners were truly vested in this property. Borrowers had to qualify for the monthly payment now— not in the future after some crazy teaser rate. It speaks to good lending practices. I imagine other lenders probably wish they hadn't been quite so creative."

In the end, explains McCarty, the strict limits on the loans ensured that these were relatively low risk loans. In this sense, the TIC lending success story may be a model for other lenders looking to create new mortgage products. The bottom line is that someone pays — in this case it's homeowners paying a premium (through higher interest rates, higher credit scores and higher down payments) for the banks to assume the risk of underwriting fractions of properties. (But because TICs are valued at 10 percent to 15 percent lower than commensurate condos, those homeowners didn't pay the same premium as condo and single family home buyers on the purchase price.)

Ironically, the idea that making loans for TIC buildings entails more risk may be a mistake. McCarty, who says Circle Bank has been offering single loans on TIC buildings since 2000, explains that TICs have always offered a surprisingly good bet for bankers. "I don't know of any default on the joint loans either," he says. "If there are any problems with some homeowners not being able to pay their mortgage, they take care of that issue and the bank never knows about it. You've got the commitment of a single family home and the collateral of a multi-family building. There are a lot of repayment sources before it gets to the bank."

Unfortunately, the credit worthiness of TIC borrowers hasn't yet trickled down to the consumer in the form of lower interest rates. Although the communal spirit of shared housing might actually make for better credit risk, the idea of the single family home still carries an aura of security, not only for the homeowner but the lender as well.

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