The Homeowners Equity Corporation:

Democratizing Access to Home Ownership

Amidst increasing homelessness and home foreclosures, the price of owning a home is becoming unaffordable for many, especially first-time buyers. The dream of many Americans is being sold out to home-buying companies and private equity firms — the landlords of the 21st Century.

To address this growing problem, the **Homeowners Equity Corporation (HEC)**, a type of "rent to buy" arrangement, was created as a tenant-owned vehicle for democratizing home ownership. Rather than people buying homes directly, they would buy shares in the company that owns the homes (single family, duplex, apartments, *etc*.). Instead of making mortgage payments for their dwelling, the tenants would pay rent to the HEC. A portion of each rental payment would be used to purchase shares in the HEC up to the value of the dwelling they are renting. The balance of the payment would cover the costs of professional management of the HEC, property maintenance, and other operating expenses.

Because homes in the HEC's inventory would be sold to their tenants at cost (including renovation costs) and not necessarily the market value, acquiring a house could be much less expensive. The home-buying experience would also be less onerous, especially for first-time home buyers and those without a credit rating. Many people who fail to qualify for a personal home mortgage have no trouble renting.

Legally, tenants are not buying real estate, but shares in a real estate holding company. The difference is that the tenants themselves, not third parties, are the owners of the holding company (the HEC). The tenants therefore own as shareholders what the company owns in aggregate. Any profits may be used to accelerate principal repayment on home acquisition loans, distributed as dividends, or put into a reserve fund to cover operating expenses during economic downturns and other contingencies.

Advantages of a HEC for Home Buyers

One significant advantage buying a home through a HEC has over more traditional methods is that the HEC — not the tenant — is buying the house as a capital asset instead of as a consumption item. This means that although principal payments on acquisition loans are not tax-deductible as an expense by the HEC, the HEC is allowed to depreciate the houses it buys as revenue-generating assets. Thus, in accounting terms, the HEC pays out cash (payment of loan principal) that it cannot recognize as an expense, but also has an equal and offsetting expense (depreciation) that does not require a cash outlay.

If, therefore, the taxing authorities permit the HEC to match principal payments on house acquisition loans with the depreciation on those same houses, the net effect will be the same as if principal payments were tax-deductible. Where a typical real estate holding company would need to make a profit to satisfy investors and would thus charge market rents, a HEC would only have to cover costs.

Making a profit is not the primary goal of the HEC; enabling people to buy their homes is. Profits would either be 1) applied to accelerating repayment of principal, 2) retained in the HEC to build up a contingency fund for the future benefit of the tenant-shareholders, or 3) paid out as dividends to the shareholders — who happen to be the tenants — in effect giving them a rebate on their rent, further lowering the cost of owning a home.

The Tax Advantages of HEC Financing: An Illustration

The following example uses journal entries to show the tax benefits of matching payments on loan principal with an offsetting depreciation expense. Assuming the total acquisition cost is $1 million and renovation is $11 million, the purchase of a hundred homes would look like this:

Description	Dr	Cr
Houses	$ 1,000,000	
Renovation (Capitalized)	11,000,000	
Loans Payable		$12,000,000

Assume all houses are rented at $1,250 per month. Management fee is $500 per month per house:

Description	Dr	Cr
Cash	$2,100,000	
Rent Revenue		$1,500,000
Management Fee		600,000

Assume the acquisition and renovation loans are 20-year, 5%, equal principal payments:

Description	Dr	Cr
Loans Payable	$600,000	
Interest	600,000	
Management Fee	600,000	
Cash		$1,800,000

Assume depreciation expense and principal payments are matched:

Description	Dr	Cr
Depreciation Expense	$600,000	
Houses		$600,000

Assuming these figures, the first year of operations would leave a balance of $300,000 ($2,100,000 – $1,800,000) in cash. If the HEC can escape taxation on this amount as well as by matching the $600,000 principal repayment with the $600,000 depreciation expense, this cash can be used to build up a reasonable contingency fund. The fund amount will increase each year as the HEC's interest payments decrease. Once the target contingency fund amount is reached, surplus cash can be used to accelerate principal payments. Once all principal payments have been made, cash can be returned via a rebate or dividends to the tenants, or rents can be reduced.

Examples of How the HEC Can Democratize Home Ownership Opportunity

- The HEC could provide a means for people to purchase their first homes, with the advantage of trading up to other HEC-owned homes as they pay their rent and acquire shares in the HEC.

- The HEC could purchase foreclosed homes at the lower market price, enabling the former owners to remain in that dwelling and acquire shares in the HEC, paid for with lower monthly rent fees than their previous mortgage payments.

- Working with manufacturers of affordable homes, the HEC could purchase a number of houses, ideally in contiguous plots of land, to create a livable community with shared spaces for recreation or other community-determined uses.

- Such HEC-owned communities could be set up for people who are now homeless or are facing homelessness. Using housing vouchers, when tenants are unable to afford the rental payments, these "intentional communities" could be set up for and by struggling veterans, formerly incarcerated people, and other marginalized people. Having permanent addresses will help more people gain jobs, overcoming one barrier to gaining self-sufficiency.

- The HEC can be part of a comprehensive community redevelopment plan for democratizing ownership opportunity in land and infrastructure development, businesses, and home ownership. A pilot project, called "The Heart of America" (part of a national legislative initiative called "the Economic Democracy Act) is being developed in Missouri, starting in impoverished areas in St. Louis. This project was spurred by the adoption of Missouri HB 2400, which will create the world's first Citizen's Land Development Cooperative (CLDC). The CLDC will enable every adult and child to acquire free of charge a single, non-transferable, voting (by adults), dividend-payout share in a professionally managed land and infrastructure development company. As the land and infrastructure are prepared for businesses to locate in the community, special preference will be given to 100% S-Corp Employee Stock Ownership Plans. HECs will be set up to enable all residents to own homes in a high quality-of-life environment.

061423