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A New Concept Aims to Help Resolve Problem Loans

By Bonnie Sinnock



Bonnie Sinnock

The SwapRent concept has been slow to find traction and faces some challenges, but its potential benefits make the case that there may be hope for it yet.

Among a host of benefits that could be realized from its large-scale implementation is its ability to address today's loan resolution problems, according to creator Ralph Liu, founder/chairman of consultancy Advanced e-Financial Technologies Inc. and a veteran of the derivatives and global financial markets.

SwapRent could allow borrowers to reversibly and flexibly sell some, but not all, of the equity in their property back to the lender in exchange for a reduction in payment.

Although Mr. Liu's ideas come from the derivative and swaps markets, which have come under fire during the recent financial crisis due to their complexity, in the case of SwapRent the concept is made simple for consumers.

"Everybody understands 'renting vs. owning,'" he said.

Say a consumer is struggling to meet payments in a market where it costs \$3,000 to own and \$1,000 to rent. Using SwapRent, consumers could have a third option of making a \$2,000 payment in which half the payment would be to rent the property and the other \$1,000 would be for the right to 50% of future appreciation. The "temporary rent-own switching" could buy the time needed for a depreciating property to appreciate again, make the property more affordable for the borrower as well as avoid the foreclosure process costs and potential damage to the property.

SwapRent also could be a stepping-stone to homeownership and an equity-based alternative to a mortgage. Dividing a property's "shelter value" from its "investment value" makes it easier to syndicate its financing and improve its affordability, Mr. Liu said.

And unlike a sale-leaseback situation, there wouldn't have to be an exchange of title that would add transaction costs, he added.

"Continued occupancy makes sense," said Jim Satterwhite, executive vice president and chief operating officer at Infusion Technologies, the corporate parent of National Quick Sale, when asked about the concept.

Roadblocks include its association with the use of leaseback programs, which has been limited, and efforts to share equity, which have not had the best track record, Mr. Satterwhite said, adding, "The problem with all of those is how do you account for it?"

"When servicing is transferred accounting for equity

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participations becomes complex, he said.

"Equity participation sharing" in terms of "shifting investment risk to somebody willing to take it" has been talked about for years and never been used in scale, agreed CoStar vice president Norm Miller.

To the extent that today we are going through a period during which "people realize real estate has risk" it may be a good time to introduce SwapRent, he said. Mr. Miller said past challenges to equity sharing efforts have been questions like "Who will manage it?" and "Will it be equitable?"

SwapRent aims to answer those questions and provide a blueprint for a new industry based on transparent trade of fully disclosed instruments, Mr. Liu said.

Among benefits such a system could provide: a new equity market-based way to fund real estate that would counterbalances the risks of the kind of more debt-based housing finance that has faltered of late, real estate financing helpful to markets in search of vehicles in compliance in Islamic prohibitions against interest-bearing debt, and an improvement on affordable housing efforts such as the equity sharing that originated with social housing in the United Kingdom.

The full list of benefits is so long Mr. Liu is filling a book with them. This sounds complex, but in the U.S. the syndication could be relatively quickly implemented through a limited liability company, he said.

Mr. Liu has introduced innovative concepts to the capital markets before. Bringing the interest rate swap to China at the end of 2005, when he was the chief investment officer and executive vice president of China Everbright Bank, is just one example of many of his achievements. In that situation, by using the new swaps and exchanging China's traditional floating rates for fixed rates, he was able to design and launch the first long-term fixed-rate residential mortgage offered by the bank.

It was in 2006, shortly after his success in China and during the boom period that proceeded the mortgage market's recent bust, that he began trying to introduce SwapRent in the United States. Several influential U.S. mortgage executives and financial markets professional in both the public and private sectors looked at it but ultimately never took decisive action, he said.

When asked if he thinks he will ultimately prevail with SwapRent in the United States the way he did in introducing the interest rate swap in China, Mr. Liu said this depends on his ability to get an influential decision-maker's backing.

"This could happen tomorrow. It could happen another year. I'm just going one step at a time," he said.

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