



News

## Private sector home affordability strategies progress

The injection of private sector investment into pools of legacy assets via the PPIP is facilitating market-led initiatives to tackle home affordability issues. One such initiative that appears to be making some headway at present is SwapRent.

The aim of SwapRent is to provide a new alternative housing finance method by introducing a 'temporary own-rent switch' or 'economic renting' concept. SwapRent - which was developed in early 2006 - was never intended as a bailout tool. But its ability to offer true housing affordability and help distressed homeowners avoid foreclosures is coincidentally one of its potential applications relevant to PPIP fund managers.

As an example, an institutional fund manager could first temporarily act as an 'economic landlord investor' to offer monthly payment assistance to creditworthy homeowners and enjoy part of the future appreciation of their properties. The homeowners who may want to receive monthly subsidy assistance could be any property owners, regardless of whether they are good credits or not, because the SwapRent contract pricing will reflect their creditworthiness.

"As a free-market mechanism, SwapRent would eliminate the moral hazard of government bailouts," explains Ralph Liu, chairman and ceo of Advanced e-Financial Technologies, the firm behind the SwapRent concept. "Making it available to everyone, not only those who are underwater with their mortgage repayments, would in turn create much-needed demand for property which is vital for a property market recovery."

Conceptually similar to a debt for equity swap, the settlement of a SwapRent contract could be based on a choice of three methods - the real underlying property transaction price, a specific property appraisal or a property price index in the neighbourhood - and essentially isolates the economic value of property price appreciation. This can in turn be attached to a conventional mortgage, stripped out, traded in the secondary market and reattached to a different mortgage.

"The opportunity is in fund managers taking advantage of this short-term trading strategy. There is a profit-making motive inherent in the contract because by keeping borrowers in their homes rather than becoming delinquent or going through an expensive foreclosure, for example, the investors are adding value to the underlying legacy mortgage assets that they had bought," adds Liu.

He continues: "The PPIP represents the best channel to achieve this, as it incentivises the private sector to implement these value-adding trading strategies driven by their own profit-making motives. It is an opportunity to do well while doing good."

Fund managers can deliver the SwapRent monthly payment subsidy to homeowners in four ways: by connecting directly with the original borrower or implementing the agreement through the current mortgage servicer, another fee-earning financial intermediary or through a local government housing agency.

To better manage the counterparty credit risks with the homeowners, Advanced e-Financial Technologies has developed two additional concepts alongside the SwapRent contract. HELM (home equity locking mortgage) is a wrap-around package of the original first mortgage with a contingent second mortgage that essentially settles the payoff of the embedded SwapRent contract automatically as the new adjusted unpaid balance of the mortgage at contract maturity. There is also a co-ownership concept, FARM (flexible and reversible mortgage), which eliminates the need to foreclose in an alternative new housing finance system, according to Liu.

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## Structured Credit Investor

The PPIP framework has been criticised by some for not incentivising managers enough to make improvements to the troubled assets. But the programme's aim is to create purchasing power dedicated to legacy CMBS and RMBS; there are other government-led initiatives underway to tackle home affordability.

While there is a provision in the PPIP that requires managers to consent to loan modifications, it appears to be a soft criterion, John Pluta, svp of Declaration Management & Research, explains. "Where a lender opposes certain modifications that may hurt senior creditors, a PPIF manager is required to comply. If a manager owns 100% of a securitisation acquired for the PPIF, they are required to take the initiative in terms of modifications - but realistically they're unlikely to ever own the entire deal."

The objective of providing liquidity to legacy securities appears to be being achieved, according to Pluta. He concludes: "The PPIP will help improve market technicals, but not fundamentals. It's asking too much of PPIF managers to expend effort on fundamentals, given that the rationale of the programme is to put capital to work."

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