

**Entrepreneur Liu Sees A Derivative Solution For Homeowners**By **Lingling Wei**

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NEW YORK (Dow Jones)--Ralph Liu thinks he has come up with a solution to America's mortgage mess.

Fresh off helping introduce long-term fixed-rate home mortgages in China, the Corona, Calif.-based entrepreneur is pitching to Wall Street banks and U.S. home lenders his patent-pending product that he says would allow financially-stressed U.S. homeowners to swap some equity upside in their houses for a lower mortgage bill - for a period of time of their choice, thereby avoiding foreclosures.

"This could be a capitalism solution to help people hold on to their shelters," says the 48-year-old Taiwan native, who left Wall Street in the early 1990s to run the derivatives businesses in Asia for Chase Manhattan Bank, now JPMorgan Chase & Co. (JPM), and UBS AG (UBS). Liu alludes to the current debate between Democrats and Republicans in Washington about whether to offer government relief for homeowners facing foreclosures as low initial rates expire on more than two million adjustable-rate mortgages in the coming months.

The biggest challenge, of course, is getting lenders and investment banks to license and market the product to consumers. The benefit for the banks would be reducing costly foreclosures and potentially reinvigorate the housing market, says Liu, founder of Advanced e-Financial Technologies Inc. And some have already expressed interest in giving it the benefit of the doubt.

"It's a fabulous product, if you can pull that off," said Michael Perry, Chief Executive of Indymac Bancorp Inc. (IMB), in a recent interview. What would appeal to the home lender, he said, is the product's potential in helping first-time homebuyers squeezed by tightening credit. Liu says he is continuing discussions with Indymac, among other lenders and investors in mortgage-backed bonds, about launching the product.

How 'SwapRent' Works

Liu envisions the product, called SwapRent, as a tool homeowners can use to benefit from the future appreciation potential of their houses today as well as to hedge against a drop in their home value. Here's how it could help struggling borrowers to keep their houses:

Say the owner of a house with a current value of \$500,000 and a mortgage of \$450,000 is looking for ways to mitigate a \$500 jump in monthly mortgage payments starting next year. She could go to her mortgage lender and ask to convert her existing mortgage to the SwapRent product for five years. That would mean she would give up, say, 50% of any

appreciation potential in the value of her house during the period to an investor, through the lender, in exchange for a monthly payment from the investor.

In the meantime, she would pay a "synthetic" monthly rent to the investor, Liu says, but that payment would be lower than what the investor pays her each month as a result of her giving up the equity upside in her house. The difference then would be used toward her loan payments. She may choose to cancel or renew the contract at the end of the fifth year, depending on her financial position.

There is a key difference, Liu stresses, between SwapRent and the existing sale/leaseback arrangement - where homeowners sell their homes to pay off mortgage debts while simultaneously leasing them back until they can get a new loan to repurchase the houses: Users of SwapRent wouldn't give up the ownership of their houses during the entire contract. Such sale/leaseback transactions have become controversial after some scam artists tricked homeowners into those deals, only to scam them out of their homes.

#### Downside Protection

While the product would enable the homeowner to take immediate advantage of the potential equity buildup in her house during the contract period, it could also offer some downside protection. At the end of the contract period, the value of the house would be determined by a local house-price index such as those published by the Office of Federal Housing Oversight, Liu says.

One negative scenario for the homeowner: She might end up having to pay the investor the amount by which the market value of the house then exceeds the value of the house at the beginning of the contract. But Liu says the owner should be on a stronger financial footing by then - thanks to the increased property value - to come up with the payment, or she could opt to keep extending the contract.

On the other hand, if the house value were to decline by then, it would be the investor who would have to make up the difference for the homeowner, he says, thereby giving the homeowner the protection against the drop in home value.

Aside from homeowners, Liu says banks could reduce their credit risk with this product, investors like hedge funds could use it to bet on the movements of housing prices, and investment banks could build a business out of trading and marketing SwapRent. "Politicians could get to keep their jobs without the repeated attempts to resort to spending taxpayers' money for a federal or state bailout and turning America into a socialist society," he says.

It remains to be seen whether this concept can ultimately take off. After all, many innovators have tried to come up with different financial instruments to play the housing markets in the past. "Anything that gives homeowners a prudent exit strategy from loans they shouldn't have got is a good thing," says Nicolas Retsinas, director of the Joint Center for Housing Studies at Harvard University. "How big a niche this would be, I wonder."

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