

A new type of housing finance products without foreclosure possibility - FARM

A home seeking person could start out as a regular renter for a residential property in a location of his choice. The bank will purchase the property into a trust or simply in a co-ownership legal structure for him. In the trust, the person could buy into a portion of the legal ownership between 0% to 100%. Either 5%, 10% or 20% could be a good starting point depending on the issuing bank's credit standard. He could buy into more of the legal ownership vehicle now or later at the then prevalent market price. Meanwhile through these new "economic owning" or "economic renting" concepts, this new home occupier could make proper arrangements with the bank to become an "economical owner or renter" for whatever proportion of the total value of the property any time in a totally flexible and reversible manner (either buying or selling) for whatever length of time through making SwapRent transactions at REIDeX.com.

Being a renter gives a person the rights to occupy and use of a property. Being an owner will give him the right for the financial gains if there is future appreciation by the time he decides to sell, in addition to the same rights to occupy and use that a typical renter would have during his ownership. Of course he will also have to bear the risk of depreciation if he has to give up ownership at any given time pre-maturely. To put it in a very simplified way, the cost differential between the cost to rent and the cost to own will determine whether a person will be entitled to the future financial gains of the appreciation and the responsibility of bearing the risk of loss due to depreciation, meanwhile he could continue to occupy and use the property regardless what the financial value of the property is.

For simplicity reasons, let's use the same numerical example for the \$800,000 house as illustrated in the attached SwapRent presentation slides. Since the real physical rental rates may be higher or lower than the SwapRent rates (especially the short term rates) depending on the market conditions in each country, let's assume a real rental rate of the property is 1.5% per annum (\$1,200 per month). It could certainly be lower or higher, say 2.5% at other times as the market supply and demand forces dictate. The corresponding SwapRent for a 5 year contract may be 2% (\$1,600 per month) and cost of ownership (e.g. MFC or Mortgage Funding Cost, in Western financial system) may be 5% per annum (\$4,000 per month). The cost difference between economically renting and owning in this 5-year SwapRent contract example is \$2,400 a month.

Therefore upon agreeing to pay \$1,200 a month real rental payment the person could occupy and use the property for the next 5 year say in this 5 year contract example. He could decide to reversibly buy into the economic ownership units of between 0% to 100% of the home value with a price tag of between \$0 to \$2,400 more a month in additional monthly payments, on top of the rental payments (\$1,200) he is already paying in his legal rental agreement, through Generic SwapRent contracts traded at REIDeX.com. He could also sell freely the number of units of economic ownership for the remaining maturity of the contracts that he already bought before for whatever reasons he may have

at any time during the 5-year period before maturity. Furthermore, if he is only interested in obtaining future appreciation potential, he may pay a bit more in monthly payments to acquire that appreciation potential only with AG SwapRent contracts instead, so that he would not have to bear the downside risk if the property value goes lower in the future. It should be easily understandable that an AG SwapRent contract will be more expensive than a corresponding Generic SwapRent contract since it will only give the acquirer the right of future appreciation without the responsibility of the risk of downside losses.

It would be very interesting to note that in a non-recourse mortgage loan, as currently uniquely practiced in the US, the same financial profile could be simulated by conventional renting plus owning AG SwapRent contracts, i. e. appreciation only, by the home occupier. Whereas for the rest of the world, where recourse mortgage loans are usually practiced, the financial profile is equivalent to conventional renting plus Generic SwapRent contracts, i.e. the ownership units (either conventional legal or the new economic) always come automatically with the responsibility of downside depreciation risks for the owners.

In addition to economic owning and renting, the home occupier could of course also decide to buy into the underlying legal ownership in the trust in a lump sum fashion (money obtained from savings, work related bonus compensations, a sale of other financial assets or even winning a trophy prize from a game show competition, etc.) any time he wishes at the then future price level with the bank which has been his co-owner in the trust. If there is enough money at hand the home occupier could buy into the entire remaining legal ownership at the then current price in order to gain complete ownership at any time he/she wishes. However, since the legal ownership comes with very high transactional cost and many other legal and tax complications, it does not offer the same liquidity, flexibility and reversibility that making SwapRent transactions at REIDeX could easily provide.

For example, to sell back portions of the legal ownership would be quite difficult under the current Islamic mortgage practices. With the innovative economic owning/renting concepts, when the home occupier does not have enough monthly income to sustain these economic ownership (job loss, disability, etc.), he/she will simply lose part of the future appreciation potential that is represented by these economic ownership units that he/she owns. There will no longer be a reason for foreclosing and eviction, unless he/she can not even pay for the normal real rental payments. The social safety net of providing rental payment assistance to unemployed people is a totally separate issue and it is usually provided in each developed country. Most likely those safety net would kick in at that time for the home occupiers to continue to stay in their homes to look for another job and obtain income again. This is exactly how the newly created flexible economic ownership concept as facilitated by the SwapRent methodology could help avoid defaults and foreclosures and enhance social stability in a new housing finance system.

The provider banks of this new type of SwapRent based Islamic mortgages could similarly use the very same SwapRent contracts traded at REIDeX.com with other investors around the world to hedge off their own financial and property risks from being

a temporary co-owner in the co-ownership trusts with the local homeowners. The provider bank could then act solely as a middleman without having to hold any market risks of these real estate properties. As illustrated on slide #11 in the attached SwapRent presentation slides, the middleman banks, local governments or housing agencies could charge a fee or a spread for the services provided either as a for-profit business or as a self funded not-for-profit entity.

None of these new transactions or mortgage products described above involve the Riba concept, or the charging interests on the use money, that Sharia, the Islamic laws forbid.

If the Western societies could also learn the lesson and adopt this new innovative housing finance system made possible by the new “economic owning or renting” concepts as facilitated by SwapRent contracts, then homeowners will benefit from the flexibility and affordability, provider banks and mortgage lenders will benefit from the better risk management and governments will also enjoy higher tax revenue from enhanced property value and stronger economy. The entire society will subsequently enjoy a peaceful growth and prosperity. All these could be accomplished without the use of the concept of borrowing or lending, hence the potential abuse of it for housing people. When that nirvana time comes, words such as “mortgage foreclosures”, “securitizations”, “credit default swaps”, ... etc. may finally get to be obliterated from our dictionaries.

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