

SwapRentSM as a third economic policy management tool for governments

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In light of the recent Conference on the Future of Housing Finance on the 17th of August held by the Treasury Department, I would like to have an opportunity to discuss again on how a third economic policy management tool could be made available to central bankers. This new third alternative economic policy management tool, in addition to the conventional monetary and fiscal policies, will finally make it possible for policy makers to help our country de-leverage and stimulate at the same time.

This could be a very timely subject since the current market's focus is on what the Fed may be building up many other asset bubbles such as the bond market by keeping an extremely low interest rate level. This could have been the alternative soft landing policy to de-leverage that the Fed needed before they decided to precariously pop the real estate bubble by raising rates between mid 2004 to mid 2005 without a plan for the aftermath that had caused the financial crisis of 2008.

Now that they had reverted back to the bubble building policy again by keeping a near-zero interest rate level, it certainly makes people wonder why they had even bothered to pop the bubble in 2004 to begin with. What would have happened if they did not rush to pop the bubble without being prepared for its drastic consequences? Would they have learned the lessons by now and be more willing and open about learning other policy alternatives?

These SwapRentSM related proposals have been made available to most of those relevant policy makers and key decision makers since July 2007. Many of them and their relevant staff members are still studying them. It would be interesting to observe if and when those policy makers would be willing to take a public stand of these innovative proposals and/or open them to public debate.

The detailed quantitative and technical explanations are available in an article entitled "The SwapRentSM Transactions for Homeowners, HELM and FARM – A New Alternative Housing Finance System" that I have published in the Journal of Housing Finance International (HFI) by The International Union of Housing Finance (IUHF) in December 2009.

(http://www.swaprent.com/files/IUHF_SwapRent_Mr_Liu.pdf)

Here below are a few summarized points.

A generic SwapRentSM transaction was created as a new "temporary own-rent switching" contract that facilitates the realization of the separation of the "Shelter Value" from the "Investment Value" of owning a real estate property. The shelter value is the right to occupy and use the property similar to those rights of a conventional renter. The investment value of a property is best demonstrated by the actual difference between the cost to own and the cost to rent.

To put in layman's terms, a SwapRentSM contract allows either a property owner or an investor to choose between receiving a stream of monthly cash flows vs. receiving a portion of the property's future appreciation or depreciation potential and vice versa.

Since this new alternative housing finance system is not based on a lending concept but rather a tradable co-ownership equity financing concept to help our nation de-leverage, it does not have to rely on a low interest rate environment to be effective to create jobs and to stimulate our nation's economic growth. Therefore, once a SwapRentSM market has been established, the Fed or central banks in many other countries could raise rates at any time as they see fit in order to prevent growing further asset bubbles, to fight potential inflation or to save the value of the national currencies without having to worry about its potential impact on hurting the chances of an economic recovery. This is due to the fact that SwapRentSM could pick up the role to stimulate the national economies independently of the interest rate levels.

Among the most relevant job creation SwapRentSM applications to our economy now is that entrepreneurs could create new monthly income by willingly giving up a portion of the future appreciation potential of their own homes, which may or may not be realized by the horizon date (e.g. 2, 3, 5, 8 or 10 years) given the current economic situation. The entrepreneurs could then use these pooled new monthly cash flows to start a new business, hire people or to make new investments at the grassroots level.

As for defaulting homeowners, all the government needs to do is to encourage, and/or to facilitate as a middleman, the current risk holders of those distressed mortgage assets to be very generous in the design of the initial monthly subsidy income scheme so that local home owners, commercial property owners and other normal small business owners feel it is too good a deal to pass.

Based on pure free market principles, the more people there are in a neighborhood to sign on to this new program the more likely the local property markets and the local economic prosperity will indeed recover and the more likely free market based investors will rush to inject more fresh new fund into the local communities directly through this new free market mechanism. As a result, the government's role will be limited to being a middleman to channel this fresh new capital from private sectors to the local communities without having to fiddle with taxpayer's money.

As a result the more the SwapRentSM contracts will appreciate in value due to the property market recovery that will reward the initial monthly subsidy providers. This new economic concept of a farming approach to wealth creation is indeed a self-fulfilling prophecy in the true spirit of capitalism. The more you sow, the more you'll reap. None of this will be based on lending and hence no more fear of building up further bubbles.

Homeowners who see the signs of an imminent swift recovery will think twice about their earlier plans to walk away. The only way for homeowners to feel that they should not purposely make a strategic default and walk away seems to be to somehow make them feel that they might be missing out on a swift recovery if they do walk away.

If the government itself is the credit risk stake holder of these distressed assets (through Fannie/Freddie etc.), it would be an excellent opportunity to use these GSE entities or HFA for the purpose of providing the initial monthly subsidy through the SwapRentSM transactions. The initial offerers of these monthly cashflows to homeowners through these SwapRentSM contracts, whoever they may be, could later sell these appreciated SwapRentSM contracts to other free market investors to get their money back, perhaps even with a nice profit if property value has indeed recovered.

Pension funds and insurance companies could be the ideal long-term investors as the economic landlord investors to provide the monthly subsidy cash flows to either credit worthy homeowners or property owning small business owners in this farming approach to wealth creation since they normally would have more longer term liabilities to match.

As the property owners who do not even need any additional monthly income from swapping a part of future appreciation of their own properties also get motivated due to their own profit driven motives since they do not expect the property market would appreciate by the horizon dates anyway (e.g. 2, ,3, 5 or 8 years, etc.) given the current economic conditions and the lack of a prudent government policy, these additional monthly income would become their discretionary disposable income that would make them the ideal consumers with a new found consumption power to purchase the goods and services from the small business owners in the local communities, hence enhance the results of the goal of economic stimulus.

From the homeowners or commercial property owners' perspective, a 100% ownership of future zero appreciation by horizon date is still zero, a partial shared 50% ownership of future 20% or 30% appreciation of their own properties driven by the new fresh capital injection into local communities induced by the SwapRentSM program will translate into a 10% or 15% gain for them. It seems a much better deal, especially when they realized that they would have been paid a generous stream of monthly cash flows along the way to achieve this partial appreciation gains.

Meanwhile with the new swapped current monthly income streams they could enjoy the additional flat screen TVs purchased at local malls, lease another new electric hybrid car from local car dealers or eating out more at local restaurants. Wouldn't that be the American way as usual without piling up any more debts?

In a sense, the more participation by local property owners to the SwapRentSM program the more additional fresh new capital would be injected into the local community through the new economic landlord investors from both here and abroad. That is exactly the reason why this SwapRentSM program has to be open to all property owners to participate, not just for the distressed homeowners. Let the free market forces reign and the economic prosperity will happen. If you build it, they will come.

This proposed SwapRentSM program could be implemented on top of many other government plans already in place or currently in the pipeline in order to prevent political conflicts. It could also be made to be complementary, not competing with any other homeowners rescue or economic stimulus plans proposed by many other economists.

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