

A New Strategy for Housing:

A Simple Proposal to help Fix the Housing Markets



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THE PROBLEM

- ▶ Since 2006, the value of homes in the US has deteriorated dramatically.
- ▶ By some estimates, 27% of all mortgaged homes in the US are now worth less than their mortgages.
- ▶ Many homeowners are struggling to pay their mortgages. Nearly 4.2 million homeowners are in serious default or foreclosure.
- ▶ Another serious decline in housing values will push these numbers even higher.
- ▶ High rates of mortgage default and foreclosure have expanded the shadow inventory of homes poised to enter the housing market.
- ▶ As long as homebuyers perceive there is too much supply, home prices will not recover.

WHAT TO DO?

- ▶ We need to reduce the number of homeowners struggling to pay their mortgages
- ▶ We do not believe the answer is simply to ratchet up foreclosures.
 - ▶ By our estimates, it could take years to foreclose on the current backlog of distressed mortgages.
 - ▶ Housing values would suffer further during the process, making the problem larger.
- ▶ In the current crisis, housing is similar to an asset that has been over-financed with a cash flow that can no longer satisfy its debt.
- ▶ New equity needs to be attracted into housing investments in order to effect a real, long-term solution.
- ▶ We propose a restructuring of the assets, enabling new investment and providing a fair distribution of value among all participants: homeowner, lender and investor.
- ▶ Such an approach has distinct benefits
 - ▶ As a free market solution it is likely to be better than any mandated solution.
 - ▶ It creates a win-win opportunity.
 - ▶ It is *politically acceptable* as well as *economically sensible and efficient*.

HOW IT WORKS

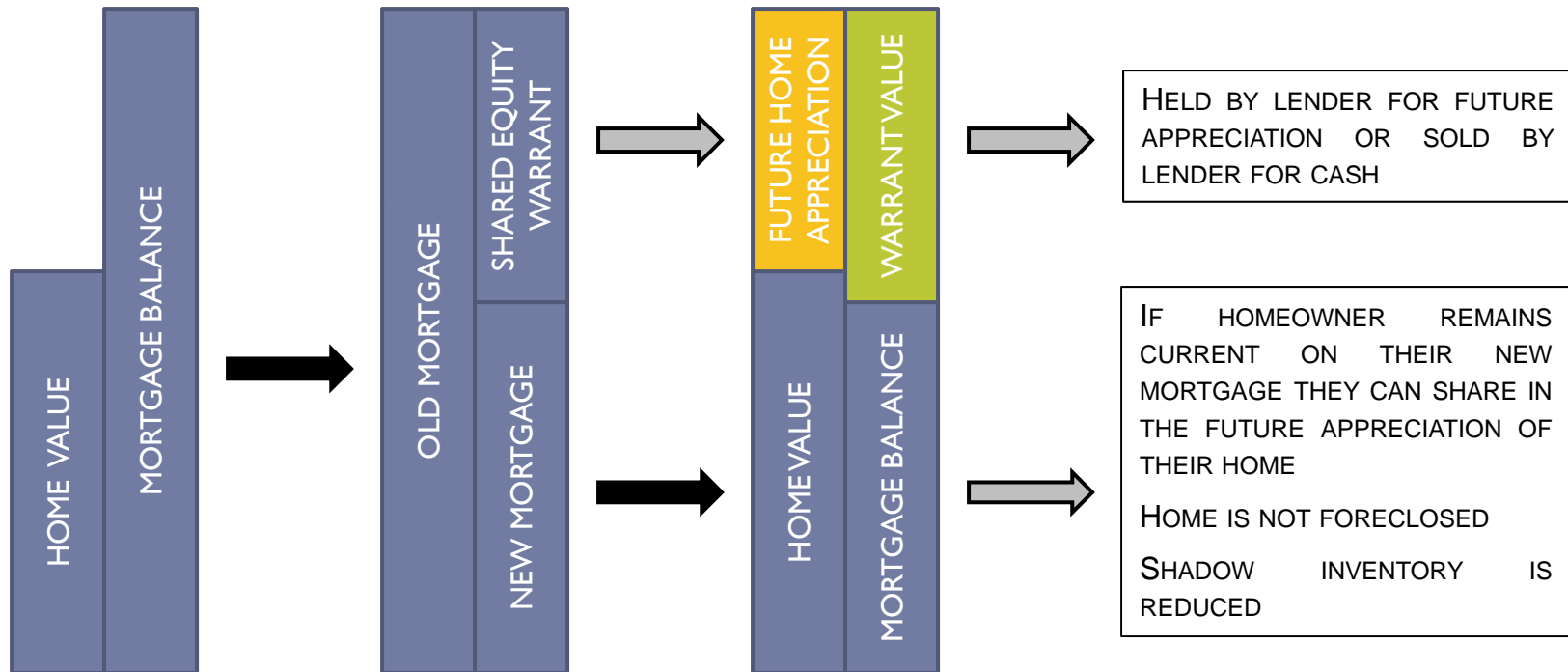
- ▶ The concept is to restructure the debt by replacing it with a bundle of securities that can be distributed to appropriate investors.
- ▶ We are proposing a structure that swaps existing debt for part debt and part equity.
 - ▶ The debt portion is structured to both qualify under FHA guidelines and provide real cash flow relief to the borrower.
 - ▶ The “equity” portion strips out a share of the future appreciation in home value and packages it for distribution to investors. Existing lenders have the right and option to retain these securities themselves.
 - ▶ Existing homeowners retain an ownership stake in the home, allowing them to share the benefit from house value appreciation and providing them an incentive to maintain the property.
 - ▶ Existing lenders have a chance to recover more of their loans than they might through foreclosure.
 - ▶ Overhang inventory is reduced substantially and the housing market has a real chance to recover.

HOW IT WORKS

Current Situation

Mortgage Restructuring

“Repaired” Situation Post-Restructuring



PROS & CONS FOR HOMEOWNERS

Pros:

- ▶ Avoid foreclosure
 - ▶ Avoid damage to credit history
 - ▶ Defer taxable event
- ▶ Stay in home
- ▶ Cash flow relief
- ▶ Retain equity interest in home appreciation

Cons:

- ▶ Give up a portion of upside potential in home value
- ▶ Long-term commitment

PROS & CONS FOR CURRENT LENDERS

Pros:

- ▶ Suffer smaller loss relative to foreclosure/ may recover substantially if hold the warrants
- ▶ Free up capital
- ▶ Improve earnings

Cons:

- ▶ Realize loss
- ▶ May produce lower return than capital market alternatives/ selling the mortgages to third parties

PROS & CONS FOR THE HOUSING MARKET

Pros:

- ▶ Vastly reduces shadow inventory from anticipated foreclosures
- ▶ Enables homeowners to sustain their homes, and thus, their neighborhoods
- ▶ Enables an economic recovery to have a positive effect on housing by “normalizing” supply and demand.

Cons:

- ▶ We can't think of any

MOVING FORWARD

- ▶ There is no doubt that this approach has many moving parts and requires much cooperation.
- ▶ That said, the problem is large enough that something constructive needs to be done.
- ▶ As this would be a negotiated settlement among interested parties, no new government participation (read bail-out) beyond the approval of the new FHA loan is needed.

CONCLUSION

- ▶ If a program like the one described can be employed on a broad basis, several key objectives can be addressed:
 - ▶ First, the potential flood of discounted housing inventory that threatens the recovery can be abated
 - ▶ Second, lenders can experience a better recovery on existing troubled loan assets
 - ▶ Third, taxpayers are not forced to “bail out” delinquent homeowners (GSE’s are still among the biggest holders of distressed loans)
 - ▶ Fourth, Americans who are struggling to stay in their homes may be able to do so