A Home Appraisers Private-Public Win-Win Housing Fix

By Indianapolis Appraisal Associates, Inc

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Disclaimer: This is a rough outline- not a detailed plan. Government Sponsored Enterprises and especially Mortgage Backed Securities are very complex. The outline will require significant details be worked out but the philosophy of the program will balance housing supply demand, increase housing money liquidity, and bridge private/governmental investments.

Objective:

- Balance Supply/Demand immediately;
- Increase the velocity/availability of GSE housing "money";
- restore liquidity to underwater consumers with the purpose of re-flating previous asset/GDP consumption levels

Basic concepts:

1) Refinance a significant/meaningful number of Homeowners to stop new defaults
2) Immediately balance supply/demand by removing existing and forthcoming GSE REO's from GSE "balance sheet inventory"
3) Recapitalize GSE's so they may continue to productively function (maintain historical levels of housing demand)

(MBS's & GSE's i.e. Fannie Mae/Freddie Mac, USDA…Ginnie Mae… HUD/FHA must be kept intact or there will substantial further price declines- there is effectively NO housing market at current prices without these entities)(Remember, these entities/mortgage insurers failures is more the result of catching an unprecedented "once in a lifetime falling economic knife" and lack of oversight than "trailing" egregious executive pay.

Simply "privatizing" the GSE's means passing the risk costs solely onto private lenders which will now seem excruciatingly expensive to borrowers after record low mortgage rates. It is reasonable to think that typical mortgage rates would be priced similarly to what jumbo rates (not GSE insured) are currently, and then climb with rates overall. This would crush near term and future demand at a time when the market needs more demand to remove the existing oversupply.

I.e. falling real incomes in the last decade and job losses on the order of 800,000 per month at the end of 2008 rendered the ability of many "conventionally good borrowers" to simply not be able to pay. The GSE capital reserves/insurance was simply insufficient to backstop this unprecedented quantity of mortgages defaulting at once. But remember this: In my opinion, these entities are responsible for creating the macro conditions that facilitated the "wealth effect", or the significant "appreciation" in home values that many borrowers seem to think was the result of them solely making good decisions.

These entities created the demand that is responsible for home prices as we came to know them.

<u>The Parties:</u> <u>Private capital/Governmentally facilitated plan</u>

<u>Part One:</u>
Refinance those with stable incomes at today's lower rates.

LTV Cost basis for this program:

<u>L:</u> Payment, affordable to borrower at today's income using a conventional mortgage income factor
<u>TV:</u> Today's appraised value.

-Payment amount is the most critical factor in any refinance programs chance of success and therefore these limited edition mortgages <u>are to be based more on a borrowers income, than the value of their home:</u>

Nuts and Bolts:
1st mortgage written to thirty years fixed based upon the aforementioned conventional mortgage income factor for the LTV.
2nd mortgage written to however many additional years required to repay their "mortgage balance owed over current appraised value" (amount "under water") <u>instead of lender's having to write down principal/future anticipated income payments</u>.

-Additionally, the 2nd mortgage will act much like a revolving line of credit. I.e. if borrower's income falls, their payment remains the same until resetting at their periodic index adjustment hearing; however the loss of payment revenue to lenders will be added back to this non-severable second mortgage...

This second note "upside down principal" would also be adjustable and indexed to borrower's future income (periodic reviews). I.e. if borrower

becomes able to re-pay more than when originally qualifying, this second mortgage payment will increase (1st mortgage payment stays the same).
2nd mortgage adjustable interest rate maximum is to be priced at no more than twice the rate of the 1st (fixed) mortgage.

Example:
Borrower currently owes $90,000 on a home that appraises for $100,000.
Borrower, after falling incomes and home values, now (conventionally) only qualifies (based upon appropriate mortgage income factors) for an $80,000 mortgage.
1st mortgage is written for $70,000. fixed @4%. (1st mortgage is not written at $80,000. in this example because the 1st mortgage must factor in the second mortgages expense in the qualifying mortgage income factor.

2nd mortgage is written for $20,000. adjustable @market rate not exceeding twice that of 1st mortgage.

<u>KEY</u> TO THE CONCEPT:

In lieu of lenders writing down principal, lenders will receive “loss of principal/interest income” tax credits (useable for as long as thirty years out) for every year the (2nd mortgage) mortgage exceeds thirty. Credits will be issued per year based upon that years prevailing rate, with a small index kicker for those that do not need to employ them now, even though the lender has 30 years to actually use them.

<u>For capitol ratio/balance sheet accounting</u>, these tax credits should carry the same credibility of a US Treasury and be counted towards lender capital ratio/balance sheet requirements as “cash or cash equivalents”.

** (see footnote) In lieu of applying tax credits to lenders incomes to lower lenders tax burdens, <u>lenders could optionally</u> trade their tax credits at a special Federal Reserve **Discount Window or equivalent facility <u>at a discount</u> to the true prevailing rate if their cash flows needs exceeded their tax credit benefits (those that fail stress tests or that are priced out of the commercial paper market due to their credit ratings for example).**

This concept will serve to <u>“keep money flowing”.</u> Lenders should not be allowed to “sell” these tax credits because the goal of my plan is to keep money flowing and stimulate housing demand- not generate extractible net profits for lenders and their investors.

This is similar to a STRIP concept where the investor will receive “income tax credits” and the homeowner will retain possession and any future benefit at re-sale.

Note: *Tax credits are a cost to the Government but a much lesser one than current insurance costs. Tax credits can only be claimed for producing results unlike tax rate reductions which are not based upon productivity. The GDP benefit of my program would outweigh the cost of the credits.*

Program Benefits:
Lenders: Do not have to foreclose forcing insurers to insolvency and do not have to write down principal for nothing in exchange. And, with the use of tax credits lenders do not "lose" the anticipated income from the mortgage that would have been written down to create a payment affordable to the underwater borrower.

The tax credits will help lenders/insurers retain their book values and capital ratios so that they are no longer effectively "insolvent" and unable to make new loans.

Borrowers: Get to stay in their homes at payments they can afford, and many good borrowers who no longer conventionally qualify for their original mortgage terms get the benefit of today's unprecedented rates.

*Borrowers obviously cannot sell their homes without paying off both mortgages.

Part Two:
Recapitalize the GSE's.

1) Removes non performing GSE inventory in effect partially recapitalizing the GSE's- the program above will serve to dramatically slow new REO's from being booked
2) Provides quality low-to-moderate income housing with emphasis given to foreclosed homeowners at their actual ability to pay currently
3) Provides stability throughout the entire real estate industry
    a. Productive inventory once renovated
    b. Qualified Tenant occupation
    c. Private Investor Involvement and private profit opportunity

Investors and Tenants both must be qualified and selected from pools matched to their qualifications. This part is also designed for lenders forced to buy back soured GSE insured loans.

If any party at either time defaults on their obligations, a pre-determined successor acquires the property rights and the original investor's equity in the case of an investor's default, less repairs required for minimum HUD/Section 8 standards. Section 8 scales to be modeled and perhaps inspector personnel could also be re-employed.

Not a bailout. A Government backed capitalistic, equitable approach.
Winning big or losing big is directly in the hands of the private investor- good "landlords" will profit.

SIMPLE MATH OF HOW IT WORKS

1) Investor buys a $100,000 (after repairs) home from the GSE REO pool for $50,000

2) Investor Borrows (from special Treasury account) interest free repair money. $20,000 for example.

3) Example: Investor rents the home for $583. per month/ $7,000.00 per year (example-actual rent to be based upon existing Section 8 tables/indexes)

"Rent income" is directly collected and paid into a new "special Treasury escrow account (not to individual investor) (which then funds the bond issuance portion of the "MBS/institutional type investor pool" that is to be used to recapitalize the GSE programs without a new Treasury loan"). As the fund becomes profitable, from investing the rents collected, and after the initial (private investor acquisition/rehab loans) Treasury loan is re-paid, the dividend portion will also be paid from this account to new "MBS re-insurance" investors (serving to recapitalize the GSE's). This account is a "float" account to be invested by only the most capable in control of it (Buffett/PIMCO quality management).

When does the investor earn any money?

How the Program Works

Eligible Single Family homes located in revitalization pools will be listed exclusively for sale through the program.

What Homes will be Available for this program?

REO's and "buybacks" are removed from GSE's/HUD/Ginnie/USDA "inventory" and placed into these new pools and made available to private investors.

1) Investor buys the home leveraging up to 50% from a special Federal Reserve fund
2) Investor renovates the home to minimum HUD/Section 8 standards
    a. Renovation money is also 50% investors personal, 50% from the special Federal Reserve fund at 1% deferred interest.
3) Investor rents home to qualified tenant(s) for a minimum three year period (stability)…The 1% renovation interest does not have to be paid during the three year period by the private investor but must be paid upon re-sale, unless the private investor is able to work with and convert the tenant into

the buyer. In that case, they will “earn” back this 1% interest rate for their effort of converting a renter to a homeowner.

4) After the three year period, <u>with acceptable investor performance</u>, investor may then re-sell the home and keep a net entrepreneurial profit of up to 25% **<u>tax free</u>** (profit over cost base and repairs). **<u>This program is to carry a special one-time capital gain free profit for the investor: 25% TAX FREE IN THREE YEARS IS CURRENTLY A VERY DESIRABLE RETURN</u>. All additional remaining money is paid back into the special Federal Reserve Fund. Additionally, all profits earned from investing the rents collected (“float”) also go back into the special Federal Reserve Fund.**

Participating in the Plan

Investors will check the listings in their state. Follow the instructions to submit their interest in purchasing a specific home/homes. If more than one person/entity submits on a single home, a selection will be made by yield/random lottery. Private investor’s must meet the income and credit requirements and comply with Gov’s regulations for the program.

Program requires that investors sign a **second mortgage and note** for the (interest free repair money) discount amount. No interest or payments are required on this "silent second" provided that the investor fulfills the <u>three-year</u> tenant occupancy requirement.

Note: When investors close on their home/s, they sign a note and a mortgage. The mortgage is filed right after the first (primary) mortgage, making it a second mortgage. When participants pay off their first mortgage (usually done by refinancing), this programs mortgage moves into first position. If a participant is attempting to refinance their first mortgage, the lender will want its new loan to be in first position. In order to accomplish this, this Program must be willing to subordinate its position to the new first mortgage.

Bottom Line- this is not for the get rich quick investor: Investors will not receive periodic payments over the three year holding period (<u>periodic payments will be used to recapitalize the GSE’s via investment income</u>), but rather have the opportunity to receive up to a 25% **tax free** profit for successfully managing each property. <u>If their properties are in appreciating markets, a 25% tax free profit with a 50% “free” leverage repair escrow kicker could be more than an incredible investment.</u>

-----------------------------------**POOLS**---

The Revitalization Money Pools can initially be funded by the Federal Reserve. MBS/Institutional investors will be used as they have been traditionally to recapitalize the pools after the program is rolling.

1) Special one time only tax free half common stock/bonds will be issued to fund these MBS renovation pools. **This is a stock/bond hybrid (paid from the rents collected above)**. The half common stock part of the share will pay half of the yield with dividends based upon the funds cash flow, the other half of the investors yield will come from a bond that pays reliably as fixed income.

****Part Three for LENDERS: for consideration:**

Lenders can optionally opt to write down principal and then trade "principal write down credits" for the opportunity to borrow from the special Discount Window or equivalent facility, at a discount to the true, and/or future, prevailing rate.

Trading these credits could provide an investment return hedge against future rate inflation by employing this leverage.

Foot Notes:

Stock/Bond hybrid otherwise known as IDS: Income Deposit Security:

From Carla Pasternak of Street Authority: An income deposit security (IDS), also known as an enhanced income security (EIS), is an exchange-traded security composed of both an issuer's common shares and its subordinated notes.

An IDS is a hybrid security that consists of both common stock and a bond rolled into one instrument. The IDS itself is listed on an exchange, but the underlying securities may or may not be. IDS holders generally may, after a specified period, detach the underlying shares or debt instruments and trade these components separately.

IDS holders receive periodic distributions from the issuer. A portion of each distribution represents dividends on the underlying common shares. Meanwhile, another portion represents interest on the underlying debt securities. IDS issuers are often required to adhere to strict written distribution policies, many of which require the issuer to distribute a stated percentage of its free cash flow.

It is important to note that although the issuer may have an obligation to pay out a stable percentage of its free cash flow, this free cash flow amount can vary from month to month or quarter to quarter. As a result, the dividends paid by an IDS may rise and fall depending on the company's operating performance, acquisition activity, or other factors that affect cash flow.

For certain investors, such as long-term income investors, *income deposit securities* offer the best of both worlds. They provide current income, and because they are part stock, they protect against inflation by allowing the investor to participate in share price gains.

In general, income deposit securities are a feasible financing option only for companies with reliable cash flows and limited capital expenditure needs.

Mr. Martin completed the Metropolitan Indianapolis Board of Realtors® (REAL) Real Estate Academy of Leadership in 2007-2008.

Mr. Martin is President of Indianapolis Appraisal Associates, Inc; provider of **Indianapolis area real estate appraisals** for: Estate/Probate, Divorce, Bankruptcy, Tax Appeal, Home Buyer and Seller consulting, Mortgage, and Insurance Loss.

Testimonials regarding Mr. Martin's **home appraisals** are available at http://www.appraisers.in

For additional information or a Free, No Obligation **home appraisal** consultation, Contact:

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