

October 8, 2008

Debt-for-Equity Swaps at the Residential Housing Level

We were pleased to see that the ESSA of 2008 contained many of the ideas that you advocated and fought hard for, including the notion of transparency, auction pricing, and the use of debt-for-equity swaps in order to relieve commercial and investment banks of their troubled loan portfolios. Ultimately, the goal must be to restore liquidity and confidence in the financial system, but to do it in a way that provides the opportunity for the taxpayers to benefit as the recovery progresses. Without transparency and participation in the recovery process, the public will continue to lose trust in the government's efforts to repair the damage. We feel strongly that the use of an impartial and unbiased open auction system that will lead to competitive market pricing of asset repurchases is key to the restoration of that confidence, and critical to combating any perceived conflicts of interest that may surround the process. If there is a shortfall on the balance sheets of participating institutions we support the use of a debt-for-equity swap as compensation.

In much the same fashion, we feel that troubled homeowners can be provided a sensible recovery package that addresses their immediate needs and enshrines the shared appreciation feature that we discuss above. At the heart of our current crisis are the homeowners themselves, and their current distress, along with the widespread decline in residential housing prices have led us to the precipice and led to calls for unprecedented governmental intervention. Unfortunately, the 20 trillion dollar residential housing market represents too large a number for any proposed recovery plan. Perhaps an innovative approach to a new ownership structure of those assets may be effective in easing the burden of foreclosure and the continuing cycle of property devaluation that accompanies those loan defaults. Interestingly, the notion of shared appreciation can provide the stability and relief that the market seeks.

Currently, the entire housing market and indeed the concept of residential home ownership is based entirely and accessed exclusively through debt. Mortgages, and the various derivative products that surround and multiply the mortgage industry are based exclusively on debt financing, and no working market exists that allows institutional equity investors—a key source of liquidity in the functioning capital markets—to participate in the ownership of this enormous market. It is our contention that an alternative to debt financing based upon shared equity ownership can provide relief to the current troubled homeowners, as well as lead to stabilization of housing prices in general.

(The creation of a capital market for equity securities in owner-occupied residential real estate was proposed recently by Professor John O'Brien from the UC Berkeley and is the cornerstone of the company that he and a number of other Berkeley professors have founded, Home Equity Securities, LLC. While Professor O'Brien and his company have taken a broader approach to the creation of this marketplace, the current crisis facing us provides a unique starting point for the initiation of this market. Home Equity Securities, LLC can be found here:

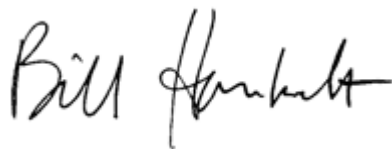
<http://www.homeequitysales.com/index.html>)

At the heart of our proposal is the creation of a process through which lenders and homeowners benefit from a creative resolution of a distressed situation. To use an example, imagine a homeowner who can no longer meet the obligations of a \$500,000 mortgage on a property that has fallen in value to \$400,000. Presently, the bank begins foreclosure, and eventually the loss on the loan is taken as a write-off on the books of the institution. As an alternative, we would propose that the bank approach the homeowner with the option of a more manageable mortgage of \$360,000, and in exchange for the lower mortgage payments the bank would receive equity ownership in the property representing the dollar value of loan forgiveness, in this case \$140,000 of the \$400,000 loan, or 35% equity. The lender could either hold on to that equity, or pool it and sell it as a closed-end investment trust, into a transparent and working equity marketplace. The equity ownership represents that 35% of the ultimate sale value of the property, a clearly valued fractional interest in the single family owner occupied real estate market. The benefit to the homeowner is clear, as he receives fractional ownership and the benefits of continued homeownership, while at the same time the institution receives equity ownership in exchange for foreclosure abatement.

Certainly not all homeowners will be able to easily “downsize in place” as described in the example above. The government should be ready to subsidize mortgage holders who agree to the debt-for-equity swap and avail themselves of the shared ownership structure if necessary. A \$250 per month subsidy, for a period of five years, recently suggested by Thomas Peterffy, CEO of Interactive Brokers, would provide a strong incentive for homeowners to participate, and would help make the new mortgage a viable loan. Such a subsidy would also disproportionately help the smaller homeowner, who needs the help most acutely.

The crisis that we face at this moment calls for a number of different approaches. Clearly, we are moving towards a solution that may begin to relieve the pressures on the large illiquid portfolios that plague the banking system. At the same time, an innovative approach to the critical issue of the residential real estate market, the stabilization of housing prices, and the abatement of foreclosures must also be considered. An alternative to debt financed home ownership underpinned by the principles of shared appreciation in equity is another approach that should be examined.

Sincerely,

A handwritten signature in black ink that reads "Bill Hambrecht". The signature is written in a cursive, flowing style.

William R. Hambrecht
Chairman and CEO