EquiDebt Solutions, LLC

Writing a new American Dream

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Diversifying Mortgage Risk Through Equity Sharing

An Incentive for Implementing Principal Reduction Loss Mitigation Strategies

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The HEFI Solution:

The HEFI (Home Equity Fractional Interest) is a consumer finance innovation to augment debt-only home financing. This patented security instrument allows homeowners to offer fractional equity stakes in their homes while retaining all of the benefits of home ownership. It could be used in several different situations, such as:

- *A workout tool for a loan modification that allows for principal reduction*
- *Facilitating down payment support for builders, REO holders and municipalities*
- *A cash-out mechanism for homeowners with adequate equity*

Finding a solution to today's ever evolving balance sheet dilemma while preventing foreclosures, mitigating risk and preserving the value of collateral requires a more innovative approach than just lowering mortgage interest rates and extending mortgage maturities. The two key objectives here should be:

1) *Avoiding preventable foreclosures*
2) *Maintaining the integrity of the assets that support an entity's balance sheet*

So, how is this done?

Both of these issues can be addressed by allowing home financing to include a *minority, passive equity* partner.

With such a partner, the homeowner can "right-size" their financial obligation by owning less than 100% of the equity in their home, while maintaining all the benefits of homeownership; essentially "Downsizing-in-Place."

With a properly standardized "Home Equity Fractional Interest" security, institutional investors could and would be that partner. Collateral integrity is maintained because <u>the HEFI is a tangible asset</u> that can help offset the costs associated with reducing the principle balance.

Preventing foreclosures:

The majority of *preventable* foreclosures consist of situations where the homeowner wishes to retain the home, but (i) only has the financial capacity to maintain a mortgage that is less than the current balance and (ii) owes more than the home is worth.

A foreclosure could be prevented if the lender reduced the principal of the mortgage to some X% of the home's *current* market value and swapped the principal reduction for a HEFI security.

The** ***HEFI is an equity instrument; it is NOT A DEBT INSTRUMENT (e.g. a note or a mortgage)!

The HEFI conveys to its owner an "in-the-money call option" with two components:

- A *fixed*, intrinsic value portion (the "HEFI Consideration") equal to the difference between the new mortgage amount and the Fair Market Value
- A *contingent*, variable value portion (the "HEFI Percentage") equal to a specific percentage* of future appreciation until the home is sold or the HEFI is redeemed

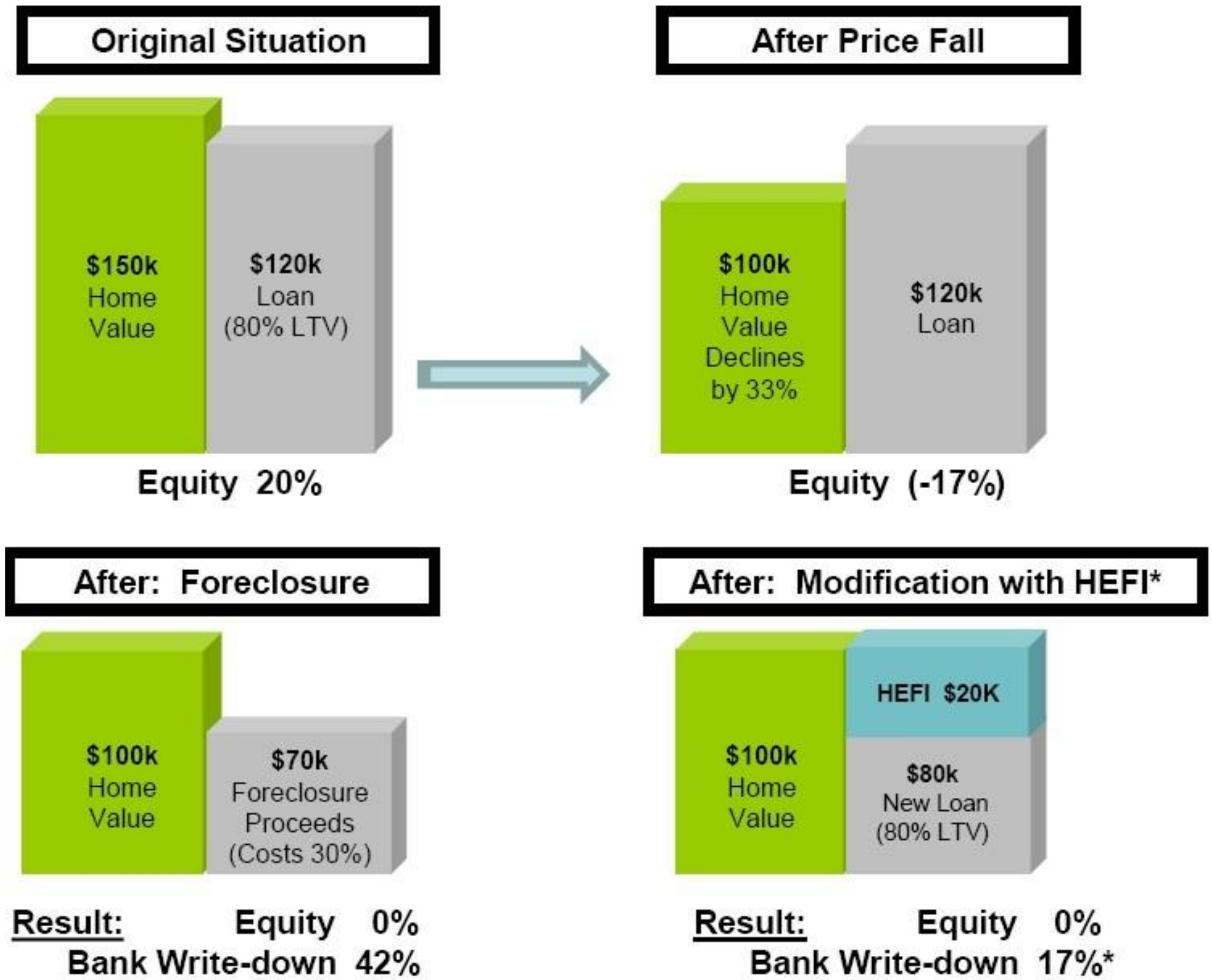
Because the homeowner is no longer *underwater* and has a new sustainable mortgage expense, subsequent foreclosure is unlikely and the homeowner now has the incentive to maintain and improve the property.

Why the HEFI Program Works:

1) Achieves a sustainable monthly mortgage expense for the homeowner
2) Gives the homeowner the opportunity to earn equity which will incentivize him/her to maintain and improve the home
3) Together 1 and 2 mitigate the likelihood of a re-default by decreasing recidivism rates
4) To create a new saleable mortgage that will allow the mortgage lender (note holder) to sell the mortgage to FNMA, FHLMC, GNMA, MBS, etc.
5) The HEFI provides for a *fair* solution in that it requires a "give-up" by the homeowner, making it a useful part of any modification program. There is **no** *Moral Hazard*!
6) This program doesn't "kick the can down the road" – it is a permanent solution that is implementable today
7) Protect your investment by having a built-in loss mitigation tool:
   a) The HEFI will convert into tenant-in-common ownership in an event of default
   b) HEFI owner can sell the home in a non-distressed environment to protect their investment
   c) Avoid the costs and elongated timeframes associated with foreclosure

The HEFI provides the lender with the economic offset necessary, while suppressing any potential moral hazards, to engage in principle reduction activities

* Percentage (or HEFI Percentage) can be a fixed number or customized as a waterfall over time. This percentage is the amount that would be converted into tenant-in-common (TIC) ownership in the event of a default.



**This is only an estimate and is contingent on the book value given to the HEFI Consideration during accounting determination. The upside of the appreciation share is not shown and the percentage of HEFI appreciation sharing is flexible and specific to each HEFI owner.*

Equity sharing concepts:

Businesses have embraced the concept of debt and equity for hundreds of years. It is not only seen as practical but as an intelligent way to diversify risk.

<u>The Business Solution</u>: Firms that have distressed revenues, but remain viable with lower debt, undergo *financial restructuring:*

- Lenders *reduce debt* in exchange for a fraction of *equity*
- The resulting deleveraged firm can continue in business
- Costly liquidation is avoided
- Equity retained by managers provides proper incentives

The HEFI Solution: The business solution has a direct equivalent in the residential housing market:

- Homeowners can avoid foreclosure by granting a fraction of homeowner equity in exchange for a reduction in their mortgage balance
- Homeowners continue to remain in homes and retain benefits and obligations of ownership
- Foreclosure costs to bank and community are avoided
- Homeowners' residual equity provides proper incentives for continued mortgage service and maintaining the property
- Value of equity fraction received mitigates lender's write-down

Why is the HEFI unique?

- The HEFI represents a passive investor interest
    - Similar to corporate equity
    - Not tied to the mortgage
    - Homeowner retains full ownership rights and obligations
- HEFIs can be sold into capital markets
- The HEFI is the *only* fair solution available
    - Eliminates moral hazards and is fair to taxpayers and non-participants
    - Subsidies are not required
- The HEFI is the only practical way to diversify residential equity exposure
- The HEFI provides a much needed alternative to down payment assistance programs that can be utilized by builders and homeowners
- In an event of default, a costly and lengthy foreclosure process is avoided
- The HEFI introduces equity financing to the residential real estate market, a concept that has been accepted and utilized by the commercial real estate market for over 100 years.

Capital markets interest in the HEFI:

The HEFI security represents a passive investor interest in a home; just as a share of stock represents a passive investment in a company. The HEFI security is analogous to a call option.

Institutional investors such as pension and endowment funds would be interested in HEFIs to achieve diversification beyond stocks and bonds. The residential equity asset class is as large as the entire US stock market. To be properly diversified, institutional investors might want to hold about as much in the residential equity asset class as they do in stocks.

Right now, though, there is no practical way for them to invest in residential equity; HEFIs and a HEFI trading market would create an attractive and practical way for them to invest in this asset class.

Q&A:

Q: **Is HEFI the first equity sharing idea to come to market?**

A: *No, equity sharing concepts have been utilized by affordable housing initiatives for over 30 years and on over 800,000 different homes: http://www.nhi.org/pdf/SharedEquityHome.pdf*
The HEFI is a standardized delivery system for shared equity that makes it viable outside of the affordable/subsidized housing market.

Q: **Why is the HEFI a better option than Fannie Mae's Deed for Lease (D4L) program?**

A: *The HEFI program allows the homeowner to remain the owner on title (keeping tax write-offs), equity is building immediately to the homeowner (incentivizing them to keep up the property), there is less exposure/risk to the lender (they are not a landlord) yet the lender maintains loss mitigation options similar to that in a D4L scenario.*

Q: **How is the HEFI recorded on title since it is not a debt?**

A: *The HEFI is recorded as a lien against the property, much the same as a mechanics lien, a tax lien or a legal judgment lien is recorded.*

Q: **Why is the HEFI structured as an option instead of the HEFI owner taking title today?**

A: *Being structured as an option is important in that it allows the homeowner to remain vested on title as 100% owner. It also allows the HEFI owner to remain silent and passive; unless an event of default occurs.*

Q: **When would a HEFI owner exercise their option to take a tenant-in-common interest?**

A: *The HEFI owner may only exercise their option if an event of default occurs. Some of the events of default are: failure to keep payments current (mortgage, insurance, taxes, etc.), a non-permitted ownership transfer occurs, failure to maintain the property in good working condition, false or misleading representations and warranties, etc.*

Q: **Why would a HEFI owner exercise their option to become a tenant-in-common owner in the case of a default?**

A: *Because, as a tenant-in-common owner the HEFI owner can step into the homeowner's shoes and effect a sale of the property to protect their collateral, as opposed to how a second mortgage lien would be left to wait for the first mortgage to perform a foreclosure.*

Q: **How would a HEFI owner know when an event of default occurs?**

A: *HEFIs will be managed and serviced through a platform called HEX, Home Equity Xchange. HEX will monitor and track all HEFIs and their underlying collateral on a monthly, quarterly and yearly basis.*

Q: ***When can a homeowner redeem/buy-back the HEFI?***

A: *The homeowner may redeem/buy-back the HEFI at any time* he/she wishes. A procedure is built into the system to assure the HEFI Owner that the buyback price is fair at the time the buyback is requested.*

Q: ***What effect does the HEFI have on other programs?***

A: *The HEFI would not preclude borrowers or lenders from availing themselves of other government programs, such as HAMP, homebuyer tax credits or interest reductions. Those programs add to the attractiveness of HEFIs.*

**** In most cases the redemption/buy-back is restricted to after the first 12 months***

Home Equity Xchange (HEX):

- HEX functions as the singular portal where Homeowners and HEFI owners can be interfaced with the highest concern for security and information management.
- HEX combines the services of a legal document preparation system, a security instrument tracking system (similar to MERS), a servicing platform and a singular repository of relevant data for proper analytics to be applied for secondary trading of HEFI's.
- From origination to securitization, HEX will be the singular repository where all equity transactions can be processed and coordinate.

EquiDebt Solutions:

EquiDebt has positioned itself as a structuring and advisory agent for entities in the residential real estate arena.

- EquiDebt Currently holds the *only* unrestricted license to represent the HEFI
- EquiDebt controls HEX, LLC (Home Equity Xchange), the platform that issues, services, tracks and manages the HEFI instruments
- The HEFI is licensed to EquiDebt by Home Equity Securities, the inventor and author of the patents solidifying the proprietary nature of the HEFI security

Focus and opportunity:

EquiDebt's primary focus today is on the implementation of the HEFI (Home Equity Fractional Interest) in loss mitigation efforts and as an alternative to down payment assistance for builders and REO sellers. Ultimately these efforts will open the door for the HEFI to be used as a retail product, presenting a financing alternative to today's 2nd liens and HELOCs.

Additional opportunities are:

- Banks
- Portfolio Lenders
- Hedge Funds
- Mortgage Trusts
- REITs
- Builders
- Municipalities