

DEVELOPER & LENDER SOLUTIONS

From the Desk of:
R. Kymn Harp
 (312) 456-0378
 rkharp@rsplaw.com



SOLVE THEIR PROBLEM – MAKE A SALE

A Private Sector New Home Solution for the Vast Majority

*Could Buyers Equity Fund™ Have It Right?**

Lest we forget, “solving” a problem is the shortest path to making a sale. If the prospective customer is hungry, sell him food. If thirsty, sell her drink. If hot – sell her air conditioning. If cold – sell him warm clothes, or a cozy place in the sun. If you can solve the customer’s problem, you will make the sale.

The real challenge is not the sale; it is knowing the problem and how to fix it.

Demand for new homes is not the problem. People still want homes to live in. The Vast Majority still have jobs. The Vast Majority can pay their bills on time and have good credit. Contrary to popular belief, a huge percentage can qualify for a mortgage to buy a new home.

The Vast Majority have concerns, which are problems standing in the way of their purchasing a new home, but the problems described above are not the problems they face. They are aware that others face these problems, and are concerned about the fallout these problems may have for them, but being aware that others have these problems is not the same as having these problems themselves.

If home developers, real estate brokers, residential mortgage brokers, and holders of mass quantities of REO want creditworthy buyers who comprise the Vast Majority of potential homebuyers to purchase new homes, they need to focus on solving the problems of the Vast Majority, not the problems of someone else.

What are the genuine concerns and actual problems faced by the Vast Majority of potential new home buyers? If we can answer that question, and solve those problems, new home sales will follow.

First, what is true?

RealtyTrac® www.realtytrac.com, a leading online marketplace for foreclosure properties, estimates that in hard hit states like Nevada, Arizona, California, Michigan and Florida, the home foreclosure rate is near five percent (5%) of all homes. That is one in twenty.

According to first quarter 2010 statistics released by the Mortgage Bankers Association (MBA) www.mbaa.org, the national association representing the real estate finance industry, throughout the United States 9.94% of all mortgages loans on one-to-four-unit residential properties are delinquent at least 90 days or in the process of foreclosure. Using a broader delinquency definition that includes all homes at least one payment past due plus homes in foreclosure, the rate is roughly 14.69%.

Those statistics are staggering, but any way you look at it, the Vast Majority of all residential mortgage loans in the United States remain current and are in good standing.

According to the U.S. Bureau of Labor Statistics, unemployment throughout the United States stands near 10%. Some claim the underlying unemployment rate is really closer to between 17%

(Continued on page 2)

RSP CHICAGO
 25 East Washington St.
 Suite 1000
 Chicago, IL 60602
 T. (312) 782-9000
 F.(312) 782-6690

RSP GLENVIEW
 2222 Chestnut Ave.
 Suite 101
 Glenview IL 60026
 T. (847) 729-7300
 F. (847) 729-7390

© 2010, R. Kymn Harp

and 20% when taking into consideration underemployment and those who have become discouraged and stopped looking for work. Using even the higher number as the genuine unemployment rate, the Vast Majority have jobs and are leading economically productive lives.

It is true that the housing market is depressed and home sale velocity is slow. It is also true that babies are being born, families are growing, young adults yearn to leave home and find a place of their own, couples are getting married and getting divorced and need new living accommodations, and people are moving to be closer to new jobs, aging parents, better schools, urban amenities, and simply to enjoy a scenic neighborhood in the suburbs.

The need for new housing is great. The question to ask is, why are so few people – relatively speaking – buying new homes?

For the Vast Majority who have secure jobs and good credit the answer may not be that they are worried about losing their jobs or that lenders won't lend. Once again, these are real problems for some but – contrary to popular myth – that is not what's holding back most people from buying a new home.

So what is the problem preventing the Vast Majority from buying a home? Let's think about it in terms of our own lives.

The overall economy continues to struggle. Signs exist that we may be at the beginning of an economic recovery, but news reports abound every day about the foreclosure crisis and the effect it is having on home values. Most reports indicate we are a long way from being out of the woods and that hundreds of thousands of homes are in default or in various stages of the foreclosure process. Add to that, ominous news reports about the economic crisis in Greece, and in Europe generally. Financial reporters are warning that problems with the Euro may drag down the European economy and the U.S. economy alike. According to these reports, we may be in for a double dip recession, with a second economic decline a very real possibility.

Beyond these economic concerns, for all of 2009, extending into 2010, the American public was hammered on a daily basis about the rising cost of healthcare and the economic risk of uninsured ailments. That's on top of mega-sized deficits from bank bailouts, auto industry bailouts, the AIG bailout, and just about every other bailout one can dream of. The Vast Majority are wondering how we going to pay for all of these government bailout programs, and how can we protect ourselves and our families from financial ruin?

Recently, concerns have been raised about the stock market. Most are relieved the market has recovered substantially from its low water mark in March of 2009, but warnings are being sounded that stocks may now be overpriced relative to the price earnings ratio of the companies they represent, and that the market may be due for a massive correction in the not too distant future. What will that do to our 401k's and other retirement accounts and equity investments?

With this background, the Vast Majority must ask themselves: "Is this the right time to buy a new home?" "What if I use up my nest egg as a down payment, and then the economy turns sour?" "What if I borrow against my 401k to pay the down payment, and the stock market crashes again? How will that affect my retirement?" "If I buy a new house, how will I pay for the upgrades, appliances and decorating I envision to make it the home I dream of?" "What if I buy a new home, the economic recovery stalls, and the value of my home declines?" "What if I use my savings as a down payment, the economy stalls, and I become saddled with unexpected health care expenses for myself or my family? Where will the money come from to pay these bills?" "What if I use my rainy day fund as a down payment, and then the rain begins to fall?"

The list goes on, but *these* are the real and legitimate concerns of the Vast Majority. *These* are the questions that keep the responsible masses who have good jobs, good credit and a savings account up at night. Sure – they want to buy a new home. Some even need to buy a new home. But they have concerns about the unknown. They legitimately fear that if they use their economic safety net today to buy a new home, they may find themselves in the same mess as the overstretched homeowners in foreclosure we have been reading so much about.

(Continued on page 3)

If we can find a solution to these problems, developers and holders of mass REO might actually make a sale.

So, how might we solve the legitimate concerns of the Vast Majority so that they will act on their need or desire to purchase a new home?

Simply lowering the sale price of a home will not get it done. Even assuming the Vast Majority purchaser is planning to make a down payment of 20% to purchase the home, a price reduction of ten percent (10%) saves them the cash equivalent of only two (2%). A price reduction of 15% will save them an equivalent 3% in available cash. A price reduction of 5% will save them only 1%.

If the prospective purchaser is planning to put down only 10% as a down payment, the out of pocket cash value of these price reductions is halved. If only 5%, the cash value is halved again.

For example: If we lower the price of a new home 10%, from \$400,000 to \$360,000, the developer/seller is taking a hit for \$40,000. The prospective homebuyer planning a down payment of a full 20%, however, frees up cash of only \$8,000. [A 20% down payment on a \$400,000 home is \$80,000. A 20% down payment on a \$360,000 new home is \$72,000.] The price is less, but the out of pocket reduction of the buyer's available cash down payment is reduced only a small fraction.

What if a buyer puts down 15% of the purchase price to buy a new home. A \$40,000 price reduction would reduce the necessary down payment by only \$6,000. For a 10% down payment, the savings is only \$4,000.

Consider another concern. What if, after purchasing even a reduced price home, the economy sinks again, resulting in an additional 15% reduction in the value of the home? The down payment would be gone; with the homeowner's equity wiped out. At that point, the homeowner would have, in effect, a 100% mortgage and no cash in reserve.

Suppose the home value does not decline. A buyer commits its available cash and puts down 10% to buy a \$400,000 home. Sometime after closing, the homeowner is faced with an unexpected major expense or business opportunity. Absent more borrowing from credit cards or a home equity loan, if available, and another layer of debt requiring new and additional monthly payments, where will the cash come from? The buyer's available cash is tied up in the down payment.

In still another example: What if a homeowner wishes to take advantage of the depressed real estate market and buy a "foreclosure" property from a bank? It is not uncommon that the "foreclosure" home needs work. It may need appliances. It may be an unfinished renovation project. It may have damage from neglect, a consequence of sitting vacant over a long period of time. The bank may be willing to "deal" and the price may be right, but once the home is purchased, will the buyer have sufficient funds available to purchase the appliances, complete the renovation, or make the needed repairs? As mentioned above, merely reducing the price does not necessarily free up much cash in the hands of the buyer.

These are all common scenarios. There are many more and many variations of the same theme. *These* are the problem scenarios the Vast Majority are thinking about. *These* scenarios are "the problem". Is it prudent? Is it safe to tie up my available cash in an uncertain economy?

So, once again, what is the solution? How can the "problem" these purchasers face be solved? How can the concerns of the Vast Majority be managed in a way that will relieve their legitimate concerns and fears, thus removing the major obstacle to their purchase or investment decision?

Buyer's Equity Fund, LLC, a Delaware company based in Chicago, Illinois, thinks it has a solution. Buyers Equity Fund may be right.

Buyers Equity Fund™ has devised what it calls an "equity share" program. More precisely, it is an "appreciation share" program, since it relies solely on future appreciation as its source of return on investment and return of investment. It is unlike other equity share programs beginning to pop up in the market due to its unique funding

(Continued on page 4)

design and remarkable composition that may genuinely benefit all participants rather than merely, or even primarily, the company itself. You be the judge.

To fully appreciate the “win-win-win” design of the Buyers Equity Fund program, consider its component constituents.

Here’s how it works:

For Homebuyers:

A prospective homebuyer purchasing a Buyers Equity Fund approved property can elect to enter into what is referred to as an “Equity Share Option” with Buyers Equity Fund. Under the core program, the homebuyer has up to three choices if the owner chooses to participate in the program. The homebuyer can choose a five percent (5%) option, a ten percent (10%) option, or a fifteen percent (15%) option. What does that mean? It means that the homebuyer can choose to receive an unrestricted cash option payment from Buyers Equity Fund in an amount equal to 5%, 10% or 15% of the purchase price of the qualified home the homebuyer has just purchased.

The payment is not a loan, it is a genuine “option payment” granting Buyers Equity Fund an option to, in effect, share in the future appreciation of the home. It does not bear interest. It does not require periodic repayment. It is without personal recourse to the homeowner.

If the value of the home goes up, Buyers Equity Fund shares in the appreciation by first recovering an amount equal to its option payment, and then sharing in a percentage of the appreciation. If the value of the home goes down, stays the same, or does not appreciate sufficiently to enable recovery of even the option payment, Buyers Equity Fund takes the loss, not the homeowner.

Recovery is genuinely limited to only the home’s incremental increase in value, if any. There are certain protections built into the Equity Share Option to protect Buyers Equity Fund in case the homeowner breaches its obligations to hold and maintain the property, or tries to scam Buyers Equity Fund by selling to a straw buyer for a reduced price, but under ordinary circumstances, the homeowner enjoys immediate unrestricted use of significant interest free cash that it will never have to repay if the value of the home does not increase.

Using our earlier example, if the homebuyer purchases a qualified home for \$400,000, the homebuyer can choose to receive either \$20,000, \$40,000 or \$60,000 in unrestricted cash from Buyers Equity Fund in return for agreeing to share a portion of any future appreciation in the home. There is no requirement that the newly purchased home even have any equity. Because the Equity Share Option relies solely on future appreciation of the home as its source of value, the equity down payment made by the buyer, if any, is protected and is not included as part of the equity in determining the future value of the Equity Share Option.

The homeowner entering into an Equity Share Option is obligated to hold the property for a minimum holding period to give the home adequate time to sufficiently appreciate, but the holding periods seem pretty reasonable. In the case where the homeowner receives a five percent option payment, the holding period is five years and the percentage of appreciation allocated to Buyers Equity Fund is twenty percent. In the case where the homeowner receives a ten percent option payment, the holding period is six years and the percentage of appreciation allocated to Buyers Equity Fund is thirty percent. In the case where the homeowner receives a fifteen percent option payment, the holding period is seven years and the percentage of appreciation allocated to Buyers Equity Fund is forty percent.

The homeowner is not required to sell the home at the end of the holding period. The homeowner is simply required to own the home for at least the minimum holding period to allow sufficient time for the home to appreciate in value sufficiently for Buyers Equity Fund to realize a return on investment. Under the Equity Share Option, the homeowner may continue to own the home for up to forty years before being required to sell or refinance the home at its then current fair market value so that the Equity Share Option can be extinguished.

(Continued on page 5)

It takes only a little imagination to recognize that the Equity Share Option solution devised by Buyers Equity Fund can solve virtually all of the major financial concerns standing as obstacles to the Vast Majority of prospective homebuyers. As the title to this article suggests: Solve their problem – make a sale.

For the Homebuilder/Construction Lender and Holder of Mass REO:

To fully understand how the Buyers Equity Fund program can benefit homebuilders, their construction lenders and other lenders holding large quantities of REO, the description of how the Buyers Equity Fund program helps the prospective homebuyer tells only part of the story.

By overcoming the legitimate concerns of the Vast Majority of potential homebuyers, it is reasonable to expect that sales velocity will increase. Just as the shortest path to making a sale is to overcome the concerns and obstacles of the prospective homebuyer, the most effective way to help homebuilders and condo converters, their lenders, and owners of mass quantities of REO, is to stimulate sales without slashing to fire-sale prices.

The challenge for these stakeholders is to sell properties at prices that don't build in unrecoverable losses. Slashing prices to generate sales has at least two downsides. The obvious first problem is that once the sale is closed, the loss is unrecoverable. The property is gone. The \$400,000 home that is sold for \$380,000, or \$360,000, or \$340,000, or less, is off the books, but the loss is irreversible. The \$20,000, \$40,000, \$60,000, or greater, haircut the developer and its lender took actually did little to solve the real underlying concerns of the Vast Majority of homebuyers, but it did guaranty a huge write-down for loss.

Besides the immediate negative impact the write-down has on the bottom line, it also impacts the value of every other unit in the same development, and perhaps beyond. If experience teaches anything, it teaches that it is much easier to reduce prices than it is to raise them. Once the price is slashed, the value of every other similar unit in the neighborhood, whether in the developer's inventory of unsold homes, the REO portfolio, or owned by others, likewise suffers.

To the extent the Buyers Equity Fund program solves the homebuyers purchase concerns without a drastic reduction in the purchase price, the homebuilder and its lenders and other stakeholders will benefit. This is the "general market benefit". It is valuable, but not what makes the Buyers Equity Fund program unique.

The really unique aspect of the Buyers Equity Fund is its funding mechanism. To have the greatest impact the Buyers Equity Fund program relies on participation of a wide range of developers, lenders and owners of REO. The core program is funded through the issuance of zero coupon debenture bonds having a nominal rate of return of just over 7%. Participation in the bond purchase program is limited to developers and institutions qualifying as "accredited investors" under applicable securities laws.

The majority of funds raised through bond issuance are deposited into a blind pool for use in making option payments to homebuyers acquiring qualified properties. Redemption of the bonds will commence once the equity share options start coming to fruition in 5, 6 or 7 years, as the minimum holding periods for homeowners start to expire.

If we assume that over the next 5, 6 or 7 years the housing market will recover from today's depressed prices, the equity share options should generate a sizable return to enable bond redemptions to commence. Through the bond redemptions, homebuilders and their lenders and other bondholders have the opportunity to recapture the full cost of the bonds plus an expected compounded return of just over 7%.

There is no guaranty that properties will appreciate sufficiently over the life of the Equity Share Options to generate a return, but it is a reasonable expectation that they may. Even accepting that the bonds may be the equivalent of "hope bonds", [where you "hope" they will have future value, even with no absolute guaranty], generating an immediate sale of homes in inventory while reserving the possibility of recovering the entire bond purchase price plus a 7% return on investment has to be better than just writing-down the price of homes with no chance of recovery.

(Continued on page 6)

To make the bond purchase scenario even more palatable, Buyers Equity Fund has arranged for non-recourse bond purchase financing for 90% of the bond purchase price that is payable only as and if the developer's lots and homes qualifying for participation in the Buyers Equity Fund program are sold. The credit score of the bond purchaser is not a factor. The source of repayment is limited to partial payment upon the sale and closing of qualified homes. Interest on the bond purchase financing is 7%, which is essentially the same as the rate of return on the bonds, so it is a wash. Additionally, neither principal nor interest is payable except upon closing of sale of a participating lot, so it creates no new periodic debt service burden.

* * *

The structure of the Buyers Equity Fund program makes it a win for the homebuyer, a win for the developer, and a win for its lender, if you believe the housing industry is going to recover in the next few years. If you don't believe this, you might want to seriously consider finding another line of work. Why would you participate in home development and financing if you believe we are forever doomed to the economic morass the housing industry has found itself in during this current recessionary cycle.

The key word in the last paragraph is the last one, "cycle". It is important to remember that the economy is and always has been cyclical. This has been a tough recession, and it may not be over yet, but it will be. The housing market will recover. Housing prices will go up. If not sooner, then later. They always have, and likely always will. Perhaps not at the fast pace of the bubble boom years, but probably somewhere near the historical average. That would make the Buyers Equity Fund resoundingly successful for all.

And that does not even take into account the prospect of hyper-inflation that a growing chorus predicts lies in our foreseeable future because of the massive infusion of trillions of dollars in bailout funds since the fall of 2009. How fast and how far might that make housing prices rise? Remember the mid to late '70's and early '80's?

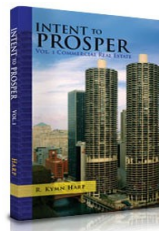
But that's a topic for another article all its own . . .

Thanks for listening.

**This article is presented for general information purposes only. Nothing in the foregoing article is intended as legal advice or investment advice. The foregoing article shall not be interpreted as being a part of any offering of debenture bonds or other securities whatsoever.*

About the Author:

R. Kymn Harp is a Chicago attorney focused on real estate development and finance, distressed transactions, and business management for over 31 years. Mr. Harp is a frequent speaker and author on topics concerning the real estate industry, and author of a recent book entitled INTENT TO PROSPER, Vol. 1 – Commercial Real Estate. Mr. Harp served as outside program design counsel to Buyer's Equity Fund, LLC and Buyer's Equity Fund Management, LLC, and participated in drafting most of the core Buyers Equity Fund program legal documents.



www.IntentToProsper.com