

Litepaper

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THE OVERVIEW

Within the housing market of the United States lies a lesser-known aspect: a substantial subset of residential mortgages referred to as "scratch and dent" mortgages. These non-conforming mortgages deviate from the standard criteria set by prime mortgage buyers such as Fannie Mae and Freddie Mac. Often labeled as "scratched and dented" due to various reasons like underwriting errors, miscalculated qualifying income, incomplete paperwork, or properties with unique challenges, these mortgages face limited secondary market activity and liquidity options.

For mortgage lenders, these loans present a significant predicament. Typically, they are compelled to retain these loans on their balance sheets, thereby tying up capital that could otherwise be utilized for more productive lending endeavors. When these loans are sold, they often incur substantial discounts ranging from 100.000 to 60.000 below conforming loan pricing. Moreover, the lack of transparency and fragmented nature of scratch and dent mortgage data further exacerbate the financial strain. Large-scale buyers encounter significant obstacles in obtaining efficient insights into aggregated information on regional loan performance, severely hampering pricing discovery and market fluidity.

This litepaper delves into the intricacies and potential of tokenization as an innovative solution to address these pervasive challenges. Tokenization holds the promise of revolutionizing the handling of these mortgages, potentially unlocking substantial revenue and reducing risks for lenders. By introducing transparency and standardization to this high-yield asset class, tokenization could also tap into significant untapped potential for investors, transforming a traditionally opaque and complex market segment into a more accessible and profitable venture.

THE PROBLEM

In the specialized field of scratch and dent mortgages, various unique challenges arise, differing significantly from those encountered in standard mortgage markets. First and foremost, valuation complexities take center stage. The inherent irregularities in these loans make their assessment for valuation a complex and highly subjective task. This challenge is further compounded by the absence of uniform pricing models, resulting in inconsistent valuations that pose significant hurdles for both sellers and buyers.

The market for these mortgages is considerably limited, primarily appealing to specialized niche investors. This narrow market results in reduced liquidity, posing challenges for holders of scratch and dent mortgages to quickly sell them without incurring significant financial losses. Dealing with scratch and dent mortgages presents considerable challenges. Each mortgage requires meticulous analysis due to its distinctive characteristics, resulting in heightened complexity and costs. The necessity for thorough due diligence and specialized handling leads to higher operational expenses compared to standard mortgage portfolios. Consequently, managing scratch and dent mortgages becomes an intricate and demanding endeavor.

TOKENIZATION

Tokenization offers an innovative solution to the intricate world of scratch and dent mortgages, effectively addressing the enduring challenges in this sector. By converting these non-conforming mortgage assets into digital tokens, tokenization enables seamless trading on blockchain networks. This forward-thinking approach has the potential to revolutionize the market for scratch and dent mortgages, ushering in an era marked by transparency, liquidity, and security.

Tokenization provides a gateway to a more standardized and accessible market, particularly considering the limited trading activity in scratch and dent mortgages. This evolution in trading not only expands the market but also ensures 24/7 accessibility, offering a significant advantage. Moreover, tokenization reduces the barriers to entry for investors. Traditionally, institutional buyers, banks, and funds have dominated the scratch and dent mortgage market. However, tokenization democratizes access, allowing a broader range of investors to participate in this domain.

At the core of this transformative shift lies blockchain technology, which introduces a decentralized and immutable ledger. By enhancing transaction transparency and security, this ledger effectively mitigates risks and strengthens investor trust. The integration of tokenization and blockchain technology in the scratch and dent mortgage sector not only advances trading practices but also fundamentally reshapes the perception and handling of these unique mortgage assets within the financial realm.

THE SOLUTION

Allonge is at the forefront of revolutionizing the secondary mortgage market through the pioneering of a DeFi protocol specifically designed to tokenize scratch and dent mortgages. Our mission is to radically transform this niche market segment, ensuring efficiency and transparency through a streamlined, legally compliant process. By embracing the power of tokenization, Allonge aims to establish a market that is not only more accessible and cost-effective for investors but also significantly alleviates the financial burdens traditionally faced by originators of scratch and dent mortgages. Our vision extends beyond market improvement; we aspire to set a new standard in mortgage trading, fostering a more equitable and seamless experience for all parties involved.

Our strategy revolves around forging strong partnerships with key industry players, including lenders, aggregators, investors, and scratch and dent funds, on the supply side. On the demand side, we look to expand access to accredited investors ranging from institutions like hedge funds and family offices to high-net-worth individuals. By aligning incentives between mortgage originators seeking liquidity and this global capital base looking to tap into previously inaccessible US residential income-generating assets, Allonge unlocks embedded value for both sides.

Our approach involves crafting customized mortgage pools that effectively meet the specific needs of both investors and lenders when offloading loans from their balance sheets. By eliminating intermediaries, we aim to substantially reduce investment costs. This strategic move is intended to enhance liquidity and streamline cash flow distribution, thereby reshaping the financial landscape of the mortgage industry for improved efficiency and investor benefit.

We recognize the importance of navigating the regulatory landscape and adhering to applicable securities laws and regulations. We will closely collaborate with legal and regulatory experts to ensure compliance while exploring innovative ways to launch the protocol with a strong emphasis on transparency and risk management.

Furthermore, our objective is to establish a marketplace for tokenized trading, empowering investors with convenient access and effective management of their investments. By fostering a strong community of dedicated sellers and investors, committed to the success of the Allonge DeFi Protocol, we aim to create a new market paradigm that benefits both investors and the wider financial ecosystem. Simultaneously, we enhance accessibility and compliance for our lender partners. As a result, Allonge intends to generate revenue through protocol and platform usage fees, in exchange for providing automated services throughout the tokenization process and facilitating increased liquidity.

MARKET

In the United States, the estimated annual volume of residential scratch and dent loans amounts to approximately \$25 billion. Over the past decade, this market has witnessed consistent growth and development, characterized by a significant increase in the volume of scratch and dent mortgages. This upward trend is projected to persist, as the pricing and sale of these loans are influenced by a range of factors, including market volatility, economic conditions, and buyer demand.

TOKENIZATION PROCESS

Allonge offers a comprehensive end-to-end platform for tokenizing scratch and dent mortgages. Our solution seamlessly connects lenders to global sources of liquidity by issuing and managing compliant security tokens that represent fractional mortgage interests.

We conduct a thorough vetting process for each mortgage, ensuring proper documentation, resolution of technical defaults, eligible loan-to-value ratios, and debt-to-income ratios prior to approval. This robust diligence process guarantees asset quality. Our automated eligibility checks and machine learning-enhanced review eliminate the labor-intensive manual work typically required for banks to approve capital market sales.

Vetted loans approved for issuance undergo a digitization process that converts paper-based notes into programmatically structured security tokens built on ERC-1404. Our end-to-end tokenization engine handles e-note warehousing, required legal transfers/assignments, and immutable on-chain record keeping before minting mortgage tokens available for sale. The entire issuance pipeline, from diligence to investor delivery, takes less than two weeks, bridging secondary market liquidity gaps for lenders accustomed to 45+ day wait times.

We market new Security Token Offering (STO) to our expanding global network of accredited investors. Approved buyers can gain exposure with no lock-up periods. We also provide liquidity ourselves, committing to make firm bids to purchase 5% of lender inventory.

As borrowers make payments, Allonge tracks monthly mortgage servicing data and cash flows on-chain, creating real-time transparency into payment histories, prepayment rates, and default dynamics. Tokenholders receive automatic yield distributions to their wallet, representing interest income. There is no need for slow paper checks or wire transfers, and no information gaps or guesswork about underlying mortgage performance.

A dashboard provides 24/7 insights into mortgage analytics, such as weighted-average LTV ratios or yield distribution over time across tokenized inventory. Investors benefit from streamlined, integrated portfolio tracking with data export functionality. Our ERC-1404 tokens restrict resale only for 1 year post-issuance. Afterward, accredited holders worldwide can seamlessly trade interest in Allonge-issued mortgage securities via our Alternative Trading System (ATS), ensuring compliant liquidity. An Alternative Trading System (ATS) represents an SEC-regulated private secondary market for trading financial assets, including securities. In Allonge's case, after the initial 1-year lockup period expires for our mortgage security tokens, we would operate an ATS venue allowing verified accredited holders to trade their interests with other eligible counterparties in a compliant, private market setting under lighter regulatory oversight. An ATS provides cost-effective secondary liquidity, eliminating the need to register as a national securities exchange.

TOKENOMICS

The tokenomics of Allonge encompasses a combination of regulated security tokens and USD-stablecoins, strategically positioned to foster growth at the intersection of decentralized finance and institutional asset securitization. The platform primarily settles transactions in USDC, a USD-backed stablecoin. This decision aligns with the latest regulatory guidance that classifies fiat-collateralized stablecoins as e-money, simplifying compliance and avoiding the need for securities classification. Key platform interactions, such as payment of asset tokenization and re-issuance fees, provision of token liquidity incentives, and settlement of mortgage token trades on our Alternative Trading System (ATS), are all carried out using USDC.

In the realm of mortgage asset securitization, Allonge leverages the ERC-1404 token standard for each tokenized mortgage. This standard is specifically designed for compliant offerings, embedding regulatory metadata directly into the tokens. The ERC-1404 standard plays a crucial role in automating key verification steps, including embedding accreditation status for tokenholders, restricting transfers to eligible investors, and triggering Anti-Money Laundering (AML) checks prior to re-trades. The benefits of ERC-1404 extend to facilitating interoperability with existing Security Token Offering (STO) ecosystems, future-proofing tokens as regulations evolve, and decentralizing ongoing access controls.

With regards to secondary trading and inventory management, Allonge implements a 1-year lockup period after which mortgage securities become tradable on our ATS among verified accredited investors. Moreover, the protocol acquires up to 5% of lender inventory to provide initial liquidity.

The innovative two-token structure of Allonge integrates the traditional finance world of mortgage lending with decentralized networks, offering a secure and compliant pathway. The human-readable compliance data in ERC-1404 smart contracts enhances investor confidence, providing a robust framework for asset digitization. This approach ensures streamlined compliance and connects with decentralized capital, representing a significant advancement in merging traditional financial instruments with the evolving landscape of decentralized finance.

CONCLUSION

As we conclude this exploration of Allonge's innovative venture into the tokenization of scratch and dent mortgages, it becomes evident that we are on the brink of a significant transformation in the secondary mortgage market. Allonge's pioneering DeFi protocol represents more than just a technological advancement; it signifies a paradigm shift in how non-conforming mortgage assets are valued, traded, and managed. By integrating the robustness of regulated security tokens with the stability of USD-backed stablecoins, Allonge is developing a solution that effectively addresses the inherent challenges of valuation complexity, market liquidity, and operational efficiency in this specialized market.

The implementation of the ERC-1404 token standard for compliant offerings serves as a testament to our unwavering commitment to transparency, security, and regulatory adherence. This standard not only streamlines the trading process but also instills confidence among investors and stakeholders in the mortgage market. With a strategic focus on partnerships, compliance, and community building, Allonge is well-positioned to democratize access to mortgage-backed securities, providing a new avenue for investment and participation in a market that has conventionally been opaque and exclusive.

We invite you to join us on this journey as we embark on redefining the landscape of mortgage trading. Whether you are an investor seeking fresh opportunities, a lender aiming to unlock the untapped value in non-conforming loans, or an enthusiast of financial innovation, Allonge offers a platform where your goals and aspirations can find alignment. Together, we aspire to create not only a new market paradigm but also a more inclusive and efficient financial ecosystem for the future. Embrace the opportunity to be part of this transformative movement. Join Allonge, and let us redefine mortgage, one token at a time.

**CONTACT US FOR
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