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White House Looks to Mortgage Modifications to Stabilize Housing Market

Hoping to prevent up to nine million foreclosures, on Wednesday, February 18, the White House announced the framework for its "Homeowner Affordability and Stability Plan" (the "Plan"). Details of the Plan will follow on March 4, 2009.

The Plan is both aggressive and comprehensive. It dedicates more than \$75 billion to modify existing mortgage loans and expands Fannie Mae's and Freddie Mac's portfolios by \$50 billion to \$900 billion, in the hope of restoring stability and confidence to the mortgage market.

Mortgage Modifications

The crown jewel in the Plan is the Administration's proposal to aggressively incentivize every player in the mortgage market – from borrowers to lenders, holders and servicers to modify existing mortgage loans.

Who is Eligible for the Plan?

The Plan is available for a borrower who has a high debt-to-income ratio. The Administration has not announced the minimum DTI ratio sufficient to qualify a borrower for relief under the plan; however, the ratio must be in excess of 31 percent (the threshold to which the Plan would lower payments). Nevertheless, if the borrower's back-end ratio (which includes all debt, not just mortgage debt) is equal to 55 percent or more, the borrower must enter a counseling program as a condition of the modification.

The borrower must occupy the residence securing the loan as his or her primary dwelling; and unlike previously proposed relief programs, a borrower does not need to be in default on his or her mortgage to qualify.

What Loans Qualify for the Plan?

Only first-lien loans in amounts equal to or less than Freddie Mac/Fannie Mae conforming limits are eligible for modification under the Plan. The existence of a subordinate-lien will not preclude the first-lien from the Plan.

How Does the Plan Work?

The Treasury will partner with lenders and servicers to lower borrowers' monthly mortgage payments. Although this result can be achieved via a principal

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reduction, the Plan sets forth three steps to accomplish the goal via interest rate reductions. The first step is for lenders to reduce interest rates so that the monthly mortgage payment is not greater than 38 percent of the borrower's monthly gross income. Second, Treasury will match further reductions to the interest rate – dollar for dollar – down to a 31 percent DTI ratio. Third, lenders must keep interest rates at this lowered threshold for five years, which can then gradually be stepped up to the conforming loan rate as of the time of the modification.

What Incentives Exist to Participate in the Plan?

Lenders, servicers and borrowers are all eligible for incentive payments to enter into mortgage modifications and for staying current on payments, as follows:

- **Servicers.** Servicers will receive an up-front fee of \$1,000 per modification undertaken pursuant to the Plan, and a \$500 payment if the modification is done prior to the borrower becoming delinquent on the loan even though default is imminent. Servicers also are eligible for payments of up to \$1,000 per year if the borrower remains current on the loan. It is unclear whether services will have to share these fees with investors.
- **Holders.** Mortgage holders will receive a fee of \$1,500 for modifications made pursuant to the Plan for a borrower who is current in his payments, but at risk of imminent default. Holders may also be eligible for a payment from a \$10 billion fund that will guarantee losses for declines in housing values.
- **Borrowers.** Provided the borrower remains current in his or her payments, he or she can receive payment subsidies directly to principal of up to \$1,000 per year for five years.

Is the Plan Mandatory?

Although the Plan described as voluntary, all of the federal banking agencies – the Department of the Treasury, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration and the Federal Housing Finance Agency – are in the process of developing modification guidelines. Any entity that receives Financial Stability Plan assistance (see Venable's Alert: <http://www.venable.com/docs/pubs/2089.pdf>) is required to adopt and follow the modification requirements.

Mortgage Refinancing

A borrower may be eligible to refinance a first-lien loan held in portfolio or placed into securities by Fannie Mae or Freddie Mac into a 30 or 15-year fixed rate loan. At present, only those borrowers who are current on their payments and who are unable to refinance because their homes have lost equity are eligible to participate; however, more detailed eligibility requirements will be announced later. The refinanced first lien loan cannot have a loan to value ratio (including costs of refinancing) that exceeds 105 percent of the home's current value, and it may not contain a balloon payment or prepayment fees. As with the modification proposal, the existence of a subordinate-lien does not preclude a first-lien refinancing; however the subordinate-lien holder must consent to remaining in second position.

Judicial Modifications

The Administration will seek amendments to the Bankruptcy Code to give bankruptcy judges the authority to modify conforming mortgage loans in a Chapter 13 bankruptcy proceeding (see Venable's Alert: <http://www.venable.com/docs/pubs/2085.pdf>). This authority would permit a judge to bifurcate the loan into a secured portion up to the value of the property and unsecured portion for any difference between the amount remaining on the loan and the secured amount. In addition to the amendment to the Bankruptcy Code to provide this authority, the Administration supports legislation to provide the Departments of Housing and Urban Development and Veterans Affairs with the authority to pay partial claims on FHA and VA loans upon such a bifurcation.

Secondary Market Enhancements

The portfolios of Fannie Mae and Freddie Mac will be allowed to grow under the Plan by \$50 billion to \$900 billion. The Administration hopes that this increased funding will ensure that interest rates remain low and that confidence will return to the mortgage markets.

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