

Legal analysis to guide the mortgage industry and protect its interests.

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## What You Need to Know About HOPE for Homeowners by Meaghan E. Ryan

This week, the U.S. Senate is set to vote on the extensive Housing and Economic Recovery Act of 2008, H.R. 3221, co-sponsored by Senators Christopher Dodd (D., CT) and Richard Shelby (R., AL). The bill, which has received widespread bipartisan support, is expected to pass the Senate by July 11, 2008. Similar legislation was approved by the U.S. House of Representatives earlier this year. The act establishes the HOPE for Homeowners Program, an Affordable Housing Trust Fund and a nationwide licensing system for loan originators, and it also proposes a new regulator for Freddie Mac, Fannie Mae and the Federal Home Loan Banks.

The HOPE for Homeowner's Program is a voluntary program that will allow certain borrowers who are at risk of defaulting on their mortgages to refinance their mortgages through a private lender with a Federal Housing Administration (FHA) loan guarantee. The program authorizes the FHA to insure up to \$300 billion in refinanced mortgages of homeowners facing foreclosure from 2009 to 2011. The mortgage assistance is limited to homeowners facing foreclosure on their principal residence and does not extend to investment property. Aspects of the program include:

**Eligible borrowers** — Borrowers eligible for the program must lack the capacity to make their current mortgage payments. A mortgagor must have a mortgage-debt-to-income ratio of at least 31 percent in order to qualify for the program, taking into account all existing mortgage debt. The mortgagor must also certify that he has not intentionally defaulted on the subject mortgage, or on any other debt. Moreover, a mortgagor may not grant a second lien on the property for at least the first five years following the refinance.

**New principal balance** — The new principal balance will be determined by the mortgagor's reasonable ability to make mortgage payments. Additionally, the current mortgage holder must agree to a new principal balance that does not exceed a 90 percent loan to value based on a re-appraisal of the property. The new loan must have a fixed interest rate and a term of at least 30 years.

**Equity/Appreciation sharing** — The homeowner must share any new equity and appreciation equally with the FHA. The homeowner's access to any newly created equity will be phased in over the first five years following the refinance, with the homeowner and the FHA sharing the new equity equally in years five and after. For example, if the homeowner sells the home within one year after the refinance, the FHA is entitled to 100 percent of any new equity. If the homeowner sells the home from one to two years after the refinance, the homeowner is entitled to 10 percent of the new equity, and the FHA is entitled to the remaining 90 percent.

**Standards to protect against adverse selection** — The board is authorized to establish standards and policies to protect against adverse selection of loans, including requiring demonstrated payment performance for a reasonable period of time for loans identified as high risk.

Additionally, prepayment/refinance penalties and fees, and penalties related to default/delinquency must be waived. Holders of subordinate liens must agree to accept the proceeds of the new loan as satisfaction or be otherwise extinguished. The program also contains a provision that will amend the Truth and Lending Act (TILA), imposing a fiduciary duty on servicers of pooled mortgages to maximize the net present value of the pooled mortgages for all investors. Generally, servicers that take advantage of modification or refinancing pursuant to the HOPE program will be deemed to have acted in the investors' best interests.

The HOPE for Homeowners Program will be funded in part by a portion of funds from the newly established Affordable Housing Trust Fund, to be funded by Freddie Mac and Fannie Mae. Importantly, both entities are prohibited from passing through the costs of the program through increased charges or fees, decreased premiums, or any other manner to the originators of mortgages purchased or securitized by either Freddie Mac or Fannie Mae. Funds from the Housing Trust Fund are allocated to the HOPE for Homeowners Program as follows: 100 percent in 2009, 50 percent in 2010 and 25 percent in 2011, for an estimated total of \$960 million over the three year period.

The Affordable Housing Trust Fund is a block grant program that is intended to increase and preserve the supply of low cost rental housing and to increase home ownership for low income families. Starting in 2010, the funds will be allocated to states to facilitate loan modification/refinance options for borrowers facing foreclosure. The states may use the proceeds for low-income housing, whether by rental or home ownership. Seventy-five percent of the funds must be allocated to extremely low-income families.

Other provisions of the bill include:

**FHA modernization** — The bill implements extensive FHA reform intended to modernize, streamline and expand the reach of the FHA program. Under this bill, the FHA loan limit is increased from 95 percent to 110 percent of area median home price with a cap at 150 percent of the Government Sponsored Enterprise (GSE) limit for high cost areas (currently \$625,000). Down payments of 3.5 percent will be required for any FHA loan, and counseling requirements are increased, which is intended to help provide more stable homeownership.

**Enhanced mortgage disclosures** — The bill expands the types of home loans subject to early disclosures under TILA to include any extensions of credit secured by the dwelling of a consumer, including refinancings. The disclosures must be provided at least seven days prior to closing. The bill requires a new disclosure concerning variable rate mortgages, informing borrowers of the maximum monthly payment possible under the loan. Also, the statutory damages for TILA violations are increased to a range from \$400 to \$4000.

**SAFE Mortgage Licensing Act** — The bill establishes a licensing system for all mortgage originators to help standardize requirements to ensure that originators meet minimum educational and performance standards. Lenders are prohibited from issuing loans if they have not registered with the national system as a registered loan originator or obtained a license and registration as a state-licensed loan originator.

**Assistance to soldiers facing foreclosure** — The bill lengthens the time a lender must wait to initiate foreclosure from three months to nine months following a soldier's return from service. The bill further provides returning soldiers with one year relief from increases in mortgage interest rates. Additionally, the bill increases the VA loan guarantee amount.

**First-time homebuyer's credit** — The bill establishes a refundable tax credit for first-time homebuyers equal to the lesser of 10 percent of the purchase price or \$8000, which will function like an interest-free loan. The federal government will recapture the credit over 15 years.

The bill's effectiveness, particularly the HOPE for Homeowners Program, faces several challenges. It is estimated that only 400,000 of the approximately 1.1 million eligible loans will be refinanced under the HOPE for Homeowners Program. Current mortgage holders must evaluate eligible loans and determine if participation in the program will provide a better return than modifying the loans on their own, despite the risk of default. They must also evaluate whether the proceeds from a foreclosure sale will exceed the proceeds of the new loans. Borrowers must also decide whether participation in the program is a good option, specifically, whether they will forego potential profits on their home in the future in order to avoid foreclosure today.

The FHA must also develop effective screening procedures to ensure that the borrowers who participate in the program are those who are most likely to repay the new loans. This will be tricky: To qualify for the program, borrowers must be unable to afford their current mortgage payments, but they must be financially strong enough to make payments on the new loans. This effectively eliminates those borrowers who are facing unemployment.

Additionally, subordinate lien-holders must be persuaded to cooperate. Given the popularity of second mortgages and home equity loans in recent years, many lenders will have to be willing to take significant losses.

It appears there is a high likelihood that this bill, or a bill in similar form, will be presented to the President. Such a bill, and any accompanying regulations that are implemented, may have a significant impact on the mortgage industry.

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