

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

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## **HAMP — Home Affordability Modification Program by Andrew W. Saag**

Due to our country's worsening economic condition, particularly within the housing market, President Obama created a plan dubbed the Home Affordability Modification Program (HAMP), which is one aspect of Obama's more comprehensive Homeowner Affordability and Stability Plan. The intent of the plan is to help reduce the rising number of foreclosures and stabilize the real estate market by assisting qualified homeowners refinance to obtain lower mortgage rates.

The Obama administration believes this program could assist up to 9 million homeowners who are making a good faith effort to make their mortgage payment. The program is designed to not only help stabilize the real estate market, but also lessen the destructive impact the economic crisis has on families and communities. The administration has developed strict eligibility requirements with the intent that only working homeowners who have made every possible effort to stay current on their mortgage payments will qualify for assistance. HAMP offers incentives to homeowners, lenders and servicers to take part in this new program.

### **What are the eligibility requirements?**

To qualify for the program, mortgages must meet a number of requirements. First, the mortgage must be a first mortgage that serves as the borrower's current primary residence. The home must be a single family 1-4 unit residential property including condominiums, cooperatives and manufactured homes affixed to a foundation and treated as real property under state law. The borrower must be facing a financial hardship or be facing an imminent threat that would lead to a financial hardship. The unpaid principal balance of the mortgage must be equal to or less than \$729,750 for a one unit property. This amount increases for multiple unit properties. The mortgage to be modified must have been originated on or before Jan. 1, 2009. Finally, the mortgage must not have been previously modified under HAMP.

### **Which eligible mortgages must be modified?**

If a mortgage is eligible to be modified, a net present value (NPV) test must be performed to determine whether the estimated NPV of a modified mortgage is greater than the estimated NPV of an unmodified mortgage. According to Home Affordable Modification Program Guidelines, some of the factors to determine the NPV of a loan include home price forecasts, valuation of the house price depreciation reserve, foreclosure timelines, and foreclosure costs and REO stigma. The results of the NPV test will determine if the mortgage is required to be modified. If the NPV of the modified mortgage is more valuable than an unmodified mortgage (a "positive test"), servicers must modify the loan; however, a positive test is not required to be eligible to receive a modified loan. Mortgage servicers may still offer loan modifications to borrowers without a positive test.

### **How are eligible loans modified?**

There are three ways in which an eligible loan may be modified: reducing interest rates, extending the term or amortization of the loan and forbearance of the principal of the loan. First, a servicer must reduce the interest rate of the loan in increments of 0.125 percent (the interest rate must not be below 2 percent) until a front-end DTI ratio is as close as possible to 31 percent without going below 31 percent. When calculating the front-end debt-to-income (DTI) ratio, mortgage debt is defined as principal, interest, taxes, homeowners insurance, hazard/flood insurance, and homeowners association and/or condominium fees. Mortgage insurance premiums are not included in the calculation. The modified interest rate will become the new interest rate for the life of the loan, so long as it is below the interest rate cap.<sup>[1]</sup> If the modified interest rate exceeds the interest rate cap, the modified rate will remain in effect for five years followed by an annual increase of 1 percent until the rate reaches the interest rate cap, at which time it will be fixed for the life of the loan.

If the front end DTI ratio of 31 percent is not reached, servicers may extend the term of the loan up to 40 years. If extending the loan is prohibited, servicers may extend the amortization period up to 40 years. Servicers need only extend to a term that is necessary to reach the front end DTI ratio. The servicer is not required to extend a loan to a full 40 years.

Finally, if the steps above do not result in a front end DTI ratio of less than 31 percent, servicers may forbear principle. If this occurs, the forbearance amount must be paid on the maturity date, upon sale of the property or upon payoff of the interest bearing balance. No interest will accrue on the forbearance amount.

The guidelines mandate that a 90-day trial period take place after the modified interest rate is established to determine whether the borrower can stay current under the new payment plan. If the borrower makes the required payments during the 90-day trial period, the modification is then effective.

### **What incentives does the program offer to servicers?**

HAMP offers a number of incentives to servicers. Servicers will receive \$1000 for each eligible modification that adheres to the program's guidelines. Servicers will also receive \$1000 each year for the first three years after the conclusion of the trial period, so long as the borrower stays current on his/her modified loan. Finally, servicers will receive a one-time payment of \$500 for any loan modified while the borrower is still current following successful completion of the trial period.

Additionally, the government incentivizes the borrowers themselves by offering a \$1000 deduction off the principle on their loan if they make their mortgage payments on time for the first five years of the loan. These incentives are designed encourage all parties to modify loans such that borrowers will be able to successfully pay off the loan over time. Whether or not these incentives work remains to be seen.

### **Is there a Safe Harbor for Servicers who modify existing loans under this program?**

Yes. On May 20, 2009, President Obama signed the Helping Families Save Their Home Act of 2009 which, in part, provides a legal safe harbor from liability for servicers whenever a servicer of residential mortgages agrees to enter into a qualified loss mitigation plan with respect to one or more residential mortgages originated before the date of enactment of the Helping Families Save Their Homes Act of 2009. A servicer will not be liable for monetary damages or be subject to any equitable relief if the servicer implements a qualified loss mitigation plan that meets the following criteria:

1. Default on the mortgage has occurred or is "reasonably foreseeable";
2. The borrower occupies the home;
3. The lender "reasonably and in good faith" believes that more money would be recovered through a loan modification or workout plan than foreclosure.

### **What potential litigation could come from the program?**

There are a number of issues that could become subjected to litigation because of this program. One group of people that might file litigation is investors in mortgage securities. Because most of the mortgages are owned by investors who have already sustained enormous losses in their investments, these investors will likely be opposed to loan modifications. It is possible that investors may come together as a group to try and prevent modification mortgage modification.

Litigation may also spin off from lenders and servicers who are unhappy with certain aspects of HAMP. One problem could stem from the fact that: "[t]he guidelines prohibit servicers from passing along most charges in connection with loan modifications. For instance, while notary fees, property valuation and other required fees may be reimbursable from a lender or investor, servicers cannot pass these costs to borrowers. In addition, servicers cannot require a borrower to contribute cash to the closing of a loan modification and must waive any unpaid late fees."<sup>[2]</sup> While there are currently no pending cases in connection with the program, these issues could result in servicers filing litigation to collect these unpaid fees.

<sup>1</sup> Defined as the lesser of (i) the fully indexed, fully amortized original rate or (ii) the Freddie Mac Primary Mortgage Market Survey rate at the date the modification document is prepared.

<sup>2</sup> Guidelines for Obama Loan Modification Program, [http://mortgagemeltdown.typepad.com/my\\_weblog/2009/03/guidelines-for-obama-loan-modification-program.html](http://mortgagemeltdown.typepad.com/my_weblog/2009/03/guidelines-for-obama-loan-modification-program.html).