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Implementation Guidelines for the Homeowner Affordability and Stability Plan

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The U.S. Department of the Treasury released implementation guidelines for the Homeowner Affordability and Stability Plan on March 4, 2009. As you may recall, the Homeowner Affordability and Stability Plan was announced by President Obama on February 18, 2009 and included the following programs:

1. A loan modification program for homeowners who are at risk of default and foreclosure, which has now been dubbed the Home Affordable Modification program.
2. A refinancing program for homeowners who are current with mortgage payments but owe more than their homes are currently worth, which will now be known as the Home Affordable Refinance program.

Treasury refers to both programs together as the Making Home Affordable program. This update will focus on the Home Affordable Modification program. The Home Affordable Modification program became effective March 4, 2009, but significant questions remain as to the proper implementation of the program. The program is intended to modify mortgages of borrowers facing financial hardship to allow such borrowers to avoid foreclosure and to save costs for lenders. Some of the key aspects of this program are detailed in a question-and-answer format below.

Which Mortgages Are Eligible for This Program?

To qualify for the Home Affordable Modification program, mortgages must meet the following requirements:

- The mortgage must be a first mortgage encumbering a 1-4 unit residential property that serves as the borrower's current primary residence.
- The borrower must have had a change in circumstances that causes financial hardship, or be facing a recent or imminent increase in the amount of the borrower's monthly payment that is likely to create a financial hardship.
- The unpaid principal balance of the mortgage must be no more than $729,750 (this amount increases proportionately for multiple unit properties.)
- The mortgage can not have been previously modified under the Home Affordable Modification Program.

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- The mortgage must have been originated on or before January 1, 2009 (mortgages are eligible to be modified until December 31, 2012).

What Underwriting Steps Must Be Taken Before a Loan Can Be Modified?

1. **Net Present Value Test**. After determining that the mortgage is eligible based on the requirements set forth above, a net present value test must be performed on the mortgage. This test determines whether the estimated net present value of the mortgage, as modified, is greater than the estimated net present value of the mortgage absent modification. Relevant parameters for the net present value test include the estimated value of the property upon foreclosure, cure and redefault rates, the amount of any incentive payments made under the Home Affordable Modification program and other information affecting the potential future value of the mortgage. If the net present value test determines that the modified loan is more valuable, as modified, participating servicers are required to offer the borrower a modification. However, servicers have the option of offering borrowers a loan modification even if the modified loan is estimated to be less valuable. The Treasury will release further parameters for the net present value calculation at a later date.
2. **Income Verification**. Servicers must verify borrowers' incomes by obtaining the borrowers' most recent tax returns, along with each borrower's two most recent pay stubs, or other reasonably reliable evidence of income. In addition, each borrower must certify that they do not have sufficient liquid assets to make the monthly mortgage payment.
3. **Credit Information**. Servicers must also obtain a recent credit report for each borrower. If the borrower will have a total debt-to-income ratio of more than 55% after the loan is modified, servicers will need to obtain a signed statement from the borrower indicating that the borrower will obtain credit counseling.

How Are Loans Modified Pursuant to the Home Affordable Modification Program?

1. **Interest Rate Reduction**. First, a servicer must attempt to reduce the interest rate for the mortgage in increments of 0.125% (subject to a floor of 2%) until a mortgage debt-to-income ratio (Front-End DTI Ratio) of 31% is

reached. For purposes of calculating Front-End DTI Ratio, mortgage debt includes principal, interest, taxes, insurance, homeowners association and/or condominium fees and certain arrearages. Mortgage insurance premiums and debt service on subordinate liens are not included. If the interest rate required to reach a Front- End DTI Ratio of 31% is above an interest rate cap (set at the lesser of: (a) the original contractual rate, or, (b) the current Freddie Mac Primary Mortgage Market Survey rate) the modified rate will become the interest rate for the remainder of the term of the mortgage. If the modified interest rate is below the cap set forth above, the modified rate will remain in effect for the first five years and then increase by 1% per year until it reaches the level of the cap, at which time it will be fixed.

2. **Extension of Term or Amortization**. If a Front-End DTI Ratio of 31% cannot be reached by lowering the interest rate to 2%, servicers may extend the term of the mortgage to up to 40 years. If loan terms prohibit extending the term, the amortization period can be increased to up to 40 years, which will result in a balloon payment that will be due upon the maturity or other termination of the loan.
3. **Forbearance of Principal**. If the above steps still do not result in a Front-End DTI Ratio of less than 31%, servicers may forbear principal, which would then become due upon the maturity or other termination of the loan. The guidelines mandate that interest cannot accrue on the forbearance amount.
4. **Trial Period**. After the modified interest rate is determined, the borrower engages in a trial period lasting 90 days, or 3 payment periods, during which the borrower must make payments at the modified terms. If the borrower is current at the end of the trial period, the modification is then effective.

What Incentives Are Available in Connection with the Home Affordable Modification program?

The incentives available under the Home Affordable Modification Program vary by the status of the individual, as described in more detail below.

1. **Lenders**. Lenders, or the party that owns the mortgage, are eligible for the following incentive payments:
    - A payment in the amount of one-half of the difference between the borrower's monthly payment, as modified, and the lesser of: (a) the

monthly payment of the loan at a 38% Front-End DTI Ratio, or, (b) the borrower's current monthly payment. This compensation will be paid for up to five years.
    - A bonus incentive of $1,500 for any loan modified while the borrower is still current (including less than 30 days delinquent), subject to de minimis restraints.
    - Compensation to partially offset probable losses from home price declines for loans that have already been modified.
2. **Servicers**. Servicers, including lenders that service their own loans, are eligible for the following incentive payments:
    - An initial payment of $1,000 for each successful modification.
    - Annual payments of up to $1,000 for the first three years following successful modification, provided the borrower stays in the program.
    - A bonus incentive of $500 for any loan modified while the borrower is still current (including less than 30 days delinquent), subject to de minimis restraints.
    - Incentives for referring eligible borrowers to the Federal Housing Administration's Hope for Homeowners program.
    - Incentives to negotiate short sales or deeds-in-lieu of foreclosure with borrowers that do not qualify for the Home Affordable Modification program.
    - Incentives to extinguish junior liens affecting the properties that serve as collateral for the modified mortgages.
3. **Borrowers**. In addition to lowered mortgage payments, borrowers are eligible for the following incentive payments:
    - Annual principal reductions of up to $1,000 for each of the first five years after a loan modification if mortgage payments are made on time.
    - Incentives to negotiate short sales or deeds-in-lieu of foreclosure if the borrower does not qualify for the Home Affordable Modification program.

What Are Examples of Potential Pitfalls for Servicers and Lenders Under the Home Affordable Modification Program?

- **No Charges to Borrowers**. The 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.

- **Service Contracts**. Servicers participating in the Home Affordable Modification Program are required to enter into service contracts with Treasury's financial agent prior to December 31, 2009. These service contracts are likely to require servicers to offer loan modifications to all eligible mortgages in a servicer's loan portfolio. Treasury expects to circulate examples of these contracts in April 2009.
- **Mandatory Participation**. Any lender receiving assistance under the Administration's Financial Stability Plan is required to maintain a loan modification program meeting the Home Affordable Modification guidelines.
- **Servicing Agreements**. The Treasury guidelines state that servicers must comply with the terms contained in servicing agreements (including pooling and servicing agreements) for eligible mortgages, or make reasonable efforts to remove any prohibitions or obtain waivers from any necessary party.
- **Trial Period Failures**. If a borrower is unable to make the modified payments due during the trial period, the loan is ineligible for the Home Affordable Modification program, and servicers and lenders will not receive any incentive payments.
- **Tax and Insurance Escrow**. Servicers participating in the Home Affordable Modification program must escrow for modified borrowers' real estate taxes and mortgage-related insurance payments.
- **Recordkeeping**. Servicers performing loan modifications will be subject to detailed data gathering and recordkeeping requirements. Treasury will issue details on these requirements at a later date.

Reinhart Boerner Van Deuren s.c. is prepared to guide lenders and servicers through the process of becoming part of the Home Affordable Modification program. We have formed a team that is ready to act as a cost-effective, flat-fee loan modification service on behalf of lenders and loan servicers. In addition to our loan modification services, we would also welcome the opportunity to assist you in designing and implementing internal loan modification procedures. If you are interested in speaking with a member of our loan modification team, please contact Karla Wyse (262-951-4543).

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