

HOPE for Homeowners Act of 2008

Recent developments in the credit markets and Washington have obscured the earlier efforts of Congress and the Bush Administration to assist distressed mortgage borrowers. The Housing and Economic Recovery Act of 2008, the omnibus deferral housing bill that was enacted at the beginning of August, 2008, contains the HOPE for Homeowners Program (“H4H”) to help at least some such distressed borrowers. The H4H program was effective on October 1, 2008, but was almost immediately amended by the Economic Stabilization Act (“EESA”) that was passed and signed on October 3, 2008.

H4H creates a new, temporary, voluntary program within FHA to provide FHA-insured mortgages to distressed borrowers. The new mortgages offered by FHA-approved lenders will refinance distressed loans at a significant discount for owner-occupants at risk of losing their homes to foreclosure. The program requires the parties to a mortgage to voluntarily agree to a trade-off to avoid foreclosure. In exchange for relief from foreclosure, homeowners will share any future equity appreciation with FHA and pay for FHA loan insurance. At the same time, the mortgage investor and/or lender will have to take a significant loss in order to benefit from the proceeds of the loans refinanced with government insurance. If these losses are less than the losses associated with foreclosure, the investor and/or lender would have an incentive to participate.

Borrower Eligibility. H4H maintains FHA’s long standing requirement that new loans be based on a family’s long-term ability to repay the mortgage. FHA allows only owner-occupants to be eligible for FHA-insured mortgages. Borrowers must also meet the following eligibility criteria:

- Their mortgage must have originated on or before January 1, 2008;
- They cannot afford their current loan;
- They did not intentionally miss mortgage payments; and
- They do not own second homes

H4H originally required eligible borrowers to have a mortgage debt-to-income ratio or at least 31% on their current loans as of March 1, 2008. EESA revised this requirement to allow borrowers to qualify for H4H if the mortgage to debt ratio exceeds 31% after March 1, 2008 due to a reset in the terms of their mortgage loans.

Eligible borrowers will be able to finance their loans with FHA-insured loans that have the following features:

- 30-year, fixed rate mortgage;
- No prepayment penalties;
- \$550,440 maximum mortgage amount; and
- New home appraisals from FHA-approved appraisers

H4H originally set a maximum loan-to-value ratio of 90%, but EESA permits LTVs greater than 90% for participating borrowers as the H4H supervisory board may determine in its discretion. H4H also originally required the extinguishment of any subordinate liens in exchange for a share of FHA's interest in any equity appreciation. EESA revises H4H to allow for the FHA to make payments to subordinate lienholders in lieu of a share of any future appreciation.

Before the passage of EESA, HUD had issued rules permitting borrowers to qualify with a mortgage payment-to-income ratio of 58% and debt-to-income ratio of 50%, but only if the borrower successfully completed a 3-month trial period. FHA insurance would be available for such high ratio borrowers only after the trial period. It is unclear if this rule survives the passage of EESA.

HUD rules also require potentially eligible borrowers to provide lenders with 2 years of tax returns, to have a loan that was originated before January 1, 2008, to have made at least 6 payments on their old loan, and to be unable to make any more payments. Again, it is unclear whether these underwriting criteria will continue to apply to H4H in light of EESA.

EESA may have increased the pool of borrowers able to participate in H4H. First, under the Treasury's troubled asset relief program ("TARP"), the Treasury is required to create and implement a plan to minimize foreclosures on properties securing the mortgage-related assets it acquires. Specifically, Treasury is required to encourage the servicers of the underlying mortgages to participate in H4H. Treasury is also authorized to use loan guarantees and credit enhancements to facilitate loan modifications. Such modifications may include rate reductions, principal reductions or other modifications.

Second, EESA requires federal entities other than Treasury that own or control assets secured by residential real estate not acquired as part of TARP to draft and implement a plan to avoid foreclosures and to assist renters. These entities include the Federal Housing Finance Agency, the FDIC and the Federal Reserve Board. These entities, acting as owners of mortgage-related assets or as conservators or receivers for financial institutions, are also required to encourage the servicers of the underlying mortgages to participate in H4H.

The federal entities must implement these actions within 60 days of EESA's enactment and report to Congress every 30 days thereafter on the number and type of loan modifications made, and the actual foreclosures occurring during each reporting period. The agencies are also required to consult with one another in developing their assistance plans to utilize consistent approaches, and to encourage similar assistance efforts by servicers of loans which the entities do not control, but in which they have an interest.

Equity & Appreciation Sharing. In order to avoid a windfall to the borrower created by the new 90% loan-to-value FHA-insured mortgage, the borrower must share the newly-created equity and any future appreciation equally with FHA upon sale of the property.

The homeowner's access to the newly created equity is phased-in over 5 years, but the FHA's share of the equity will never drop below 50% for sales occurring at any time thereafter.

Qualified Safe Harbor. The legislation provides servicers with an incentive to participate in the program by offering a safe harbor against legal liability.

Program Size and Funding. H4H is authorized to insure up to \$300 billion in mortgages and is expected to serve approximately 400,000 homeowners. Borrowers will pay an upfront premium of 3 percent of the original mortgage amount and an annual premium of 1.5 percent of the outstanding mortgage amount. Any additional costs incurred by FHA will be reimbursed by Fannie Mae and Freddie Mac.

Program Oversight. H4H will be overseen by a board made up of the Secretary of HUD, the Secretary of the treasury, the Federal Reserve Chairman and the FDIC Chairman. In addition to the eligibility requirements summarized above, H4H authorizes the oversight board to establish underwriting standards and policies to protect against the adverse selection of unqualified program participants. At a minimum, the oversight board is prohibited from paying a loan insurance claim where the lender violates its required representations and warranties, or where the borrower misses the first payment on a program loan.

Given the relatively narrow eligibility requirements as well as the voluntary nature of participation in the program, H4H may have a limited effect on minimizing foreclosures. The success of the program depends on the collective judgment of the lenders as to whether the costs of participating in the program are less than the costs of taking a loan through foreclosure.