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Housing

Three Approaches for FHA Refinancing of Subprime Mortgages

The attached chart, prepared by attorney Raymond Natter, compares the House, Senate, and Bush administration's approaches to refinancing subprime home mortgages in conjunction with the Federal Housing Administration. In particular, the chart focuses on the House passed substitute bill for H.R. 3221; the Senate Banking Committee Print as of May 12; and the Bush administration's expansion for FHA Secure as described by the Department of Housing and Urban Development.

Despite wide agreement among members of Congress and the Bush Administration on the need for a broad response to the nation's mortgage market woes, the House, the Senate, and the White House are still hard at work on the specifics.

A House-passed measure, the FHA Housing Stabilization and Homeownership Retention Act of 2008, calls for a range of new measures that would allow homeowners to refinance subprime mortgages with help from the Federal Housing Administration.

The HOPE for Homeowners Act of 2008, a bill that had been poised for action by the full Senate prior to the Memorial Day recess, has much in common with the House effort, but also important differences. Meanwhile, the White House, which has voiced explicit opposition to the House bill, says its FHA Secure plan would allow federal authorities to ride to the rescue, but with lower costs and less red tape.

There is wide consensus that FHA modernization must be a critical piece of the rescue plan because the agency will be charged with a range and scope of responsibility it has never faced in its history. Both the House and Senate bills would enable the agency to assist borrowers refinance into lower-priced, FHA-backed loans. But the House and Senate have yet to agree on the maximum loan level that the FHA will be allowed to insure and the size of downpayments that will be required.

The Democratic leadership has been seeking to loosen FHA eligibility standards, bringing into FHA's orbit less creditworthy borrowers if lenders are willing to forgive a portion of their debts and make new government guaranteed loans with more manageable payments. Fees would be collected by FHA and if borrowers subsequently made profits on their homes, the government would get a share.

The Congressional Budget Office has conducted an analysis of the House bill and estimated that 500,000 homeowners would benefit at a potential cost of $1.7 billion. However, a key provision in the Senate bill would have Fannie Mae and Freddie Mac pick up the tab rather than have taxpayers directly shoulder the risk.

EDITOR'S INTRO BY BANKING REPORT STAFF

Raymond Natter, of Barnett, Sivon & Natter P.C., Washington, D.C., was formerly deputy chief counsel at the Office of the Comptroller of the Currency. He has also been counsel to the Senate Banking Committee and served as senior counsel at the Federal Reserve Board.

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Comparison of FHA Refinancing Proposals of Subprime Mortgages
May 21, 2008

Subject	House Passed Substitute for H.R. 3221	Senate Committee Print May 12, 2008	Administration's Proposal Expansion of FHA Secure [1]
Short Title	FHA Housing Stabilization And Homeownership Retention Act of 2008.	HOPE for Homeowners Act of 2008.	FHA Secure
New FHA Program	FHA shall insure mortgages on 1-4 family residences that are made to refinance "eligible" mortgages.	FHA is authorized to insure loans that refinance "eligible" mortgages.	FHA Secure is discretionary.
Oversight	"Oversight Board" (OB) composed of Secretaries of HUD and Treasury and Chair of the *Federal Reserve*. OB is to establish details of the program requirements and standards.	Board of the HOPE for Homeowners Program: Secretaries of HUD and Treasury and Chair of the *FDIC*.	Secretary of HUD.
Insurance Fund	The bill creates a Special Risk Insurance Fund.	The bill establishes the HOPE Fund.	No new insurance fund.
New Disclosures Required 3 Days Before Closing	Three days *before* closing on the refinancing loan, the lender must provide detailed disclosures to the borrower, e.g., total amount of loan, LTV, maturity date, amount of the exit premium, borrower's income.	No similar provision.	No new disclosures.
Reduction in Principal and Other Terms	The new loan must "substantially reduce" the amount of indebtedness owed on existing mortgages; and Must meaningfully reduce the amount of the debt service, through reduction of principal, APR, or changes in the term of the loan (or any combination). The new loan to value ratio (LTV) may not exceed 90% of the appraised value of the property. The 90% limit must also include: (i) the initial 3% FHA premium; and (ii) closing costs up to 2% of the amount of the loan.	The principal obligation cannot exceed the reasonable ability of the borrower to repay under standards developed by the Board; or If the Board establishes an action procedure, the amount established by that procedure. In no case may the refinanced loan have an LTV that exceeds 90% of the appraised value of the property (*after including the initial FHA premium as part of the debt but not closing costs*).	Write down of current loan to 97% of current appraised value for borrowers with no more than 2 delinquencies in the past year. Write down of current loan to 90% of appraised value for borrower with 3 delinquencies in the past year.

[1] As described by the Department of HUD.

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Subject	House Passed Substitute for H.R. 3221	Senate Committee Print May 12, 2008	Administration's Proposal Expansion of FHA Secure
Existing Loan	Adjustable or Fixed	Adjustable or Fixed	Adjustable Rate Loan Only
FHA premiums and other fees in connection with New Loan	All initial fees, appraisal fees, inspections, and closing costs up to 2% of loan, and an initial 3% FHA premium are paid through the proceeds of the refinanced loan. Annual FHA premium thereafter is 1.5% of remaining insured balance. HUD is to establish reasonable limitations on origination fees, and ensure that the APR will be commensurate with market rates.	The initial 3% FHA premium is paid from the proceeds of the loan. Annual FHA premium thereafter is 1.5% of remaining insured balance. The Board is to establish reasonable limitations on origination fees, and ensure that the APR will be commensurate with market rates.	Borrowers will have to pay upfront and annual premiums. FHA will be updating its pricing policies for these premiums. New premiums will be determined upon the individual borrower's credit risk profile
Loan Amount	The refinanced loan may be up to $729,000 for the life of the program.	The refinanced loan may be up to $550,440.	Loan limit is $729,000 until Dec. 31, 2008, unless further extended by law.
Documentation	The lender must document and verify income through income tax returns for prior two tax years and other methods as prescribed by the OB.	Same.	Documentation required under current FHA standards.
Fixed Rate, 30 Year Term	The new loan must have a fixed APR.	New loan must have a fixed APR and a maturity of at least 30 years from start of loan amortization.	Other options are available.
Underwriting Criteria	The OB to establish flexible underwriting criteria designed to ensure that the borrower would have a "reasonable expectation" of paying the loan. Criteria may not result in denying insurance to a borrower *solely* on the basis of: (i) current FICO scores; (ii) delinquency or default under the prior loan; or (iii) bankruptcy filing. Criteria must permit a total DTI ratio of 43%. The OB may permit a DTI of 50% if the borrower can make payments on existing mortgage in the amount that would be due under the new FHA insured loan, for a six month period. The existing mortgage holder is directed to exercise forbearance during this "trial" period. In addition, the OB may alter the DTI for a class of borrowers, as the Board considers appropriate.	The Board is authorized to establish underwriting standards.	Lenders will be required to use underwriting standards that ensure borrowers have the capacity to repay their mortgages. Borrowers must have a "reasonable credit history; employment history; and fully document and verify their incomes." Under this program, DTI ratio limit is 43%, but could be higher with compensating factors.

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	If borrower is in bankruptcy, DTI includes the amount of monthly payments due under a confirmed bankruptcy plan, but is not recurring debts that have been discharged.		
Lack of Capacity to Pay	As of March 1, 2008, the borrower must have had a total mortgage debt-to-income (DTI) ratio of more than 35%.	As of March 31, 2008, the borrower must have had a total mortgage debt-to-income ratio of more than 31%, or higher ratio as the Board may require.	Only borrowers who are delinquent on subprime ARM loans. Borrowers with more than 3 delinquencies may not participate.
Intentional Default	The borrower must certify that he or she did not intentionally default.	The borrower must certify that he or she did not intentionally default on the mortgage, or any other debt. Certification must also contain a statement that a false statement may result in a fine or imprisonment, or both.	No similar provision.
Owner-Occupied	The home must be owner-occupied and must be the principal residence of the borrower. Borrower may not have an ownership interest in another residence, unless OB creates an exception for a "partial ownership" interest.	The borrower must provide documentation to the FHA to prove that the loan is primary residence, occupied by the borrower, and the only residence in which the borrower has an ownership interest.	Owner-occupied principal residence.
Fraud Conviction	The borrower must not have had a conviction for mortgage fraud in the prior 7 years. Borrower must certify that he or she did not provide materially false information in obtaining the loan.	The borrower must not have a conviction for fraud under any Federal or State law. No time restricted.	No similar provision.
No Fraud in Obtaining Existing Loan	Borrower must certify that he or she did not knowingly, or willfully and with actual knowledge, furnish material information that was false in obtaining existing loan.	No similar provision	No similar provision

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Subject	House Passed Substitute for H.R. 3221	Senate Committee Print May 12, 2008	Administration's Proposal Expansion of FHA Secure
Fraud in Obtaining FHA Loan	Borrower must certify that he or she will repay the FHA loan for any benefit received if he or she made misrepresentations.	Same.	No similar provision.
Origination Date of Existing Loan	Existing mortgage originated prior to January 1, 2008	Existing mortgage originated before January 2, 2008.	December 31, 2008.
FHA Premiums	Initial premium of up to 3%. Annual premium of up to 1.5% of remaining insured balance.	Same.	Initial premium of 2.5%. Annual premium of .55%.
Prepayment Penalties	Mortgage creditors must agree to waive all prepayment penalties and default/delinquency fees.	Same.	No similar requirement.
Loan Proceeds as Payment in Full	Existing mortgage holders must agree to accept the proceeds of the new loan as payment in full.	Same.	Existing mortgage holders can recapture write down through subordinate loans.
Treatment of Second Lien Holders	OB is to facilitate agreement among lien holders. The OB is to establish either a formula for a fixed payment to second lien holders or a formula to provide second lien holders a portion of net equity realized when the house is sold or refinanced. In no case can the formula provide a second lien holder more than 1 percent of the current appraised value if the value of the property is less than the amount of the first mortgage. The program is voluntary.	The Secretary of HUD may take actions to facilitate agreement among mortgage holders, subject to standards established by the Board to allow junior lien holders to share in future appreciation. This is a voluntary program.	Existing mortgage holders can recapture write down through subordinate loans.
Source of Funds to Pay Second Lien Holder	Any amount paid to the second lien holder in connection with this program must come from the holder of the existing mortgage or from participation in the realization of net equity upon sale or refinancing of the insured loan.	No similar provision.	No similar provision.

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Imposition of an Exit Fee	Proceeds from the sale, refinancing or other disposition of the property remaining after satisfaction of the FHA insured loan ("net proceeds") are subject to an "exit premium." The premium will be at least 3% of the principal amount of the FHA insured loan, and could be higher, based on a formula that relates the share going to the FHA with the period in which the insured loan has been in existence. During the first year, 100%. During the second year, 80%. During the third year, 60%. After the third year and thereafter, 50%. The exit fees are to be reduced by the amount of insurance fees paid prior to the sale, refinancing or other disposition.	Any "equity" created from the sale, disposition or refinancing of the property is subject to sharing with the FHA. It is not clear how to compute "equity." This "equity" is divided between the FHA and the borrower pursuant to a schedule: During the first year, 100% to the FHA. During the second year, 90%. During the third year, 80%. During the fourth year, 70%. During the fifth year, 60%. After 5 years, 50%. In addition, upon the sale or disposition of the property, the FHA and borrower are each entitled to "50 percent of any appreciation in value of the appraised value of such property that has occurred since the date that such mortgage was insured." This may be a drafting error.	None.
Prohibition on New Second Loans	During the first five years after the refinancing, the OB shall prohibit second liens, except if necessary to ensure appropriate maintenance	During the first 5 years, the borrower may not obtain a new second mortgage. No exceptions authorized.	Second mortgages are permitted.
Appraiser Independence	Appraisers must meet the competency requirements of the Uniform Standards of Professional Appraisal Practice, and the appraisal must be conducted in accordance with the appraisal requirements for federally related mortgage transactions. No lender or other interested party may improperly influence the appraisal. Exception permits lender to ask appraiser to consider additional data, provide further details or explanations, and correct errors.	Same, except does not include provisions specifically allowing the lender to provide additional data, ask for better explanation, or correct errors. In addition, the appraiser must be licensed or certified under State law or nationally recognized professional appraisal organization, and have demonstrated verifiable education in the appraisal requirements established by the FHA.	No similar provision.

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Subject	House Passed Substitute for H.R. 3221	Senate Committee Print May 12, 2008	Administration's Proposal Expansion of FHA Secure
Standards to Protect Against Adverse Selection	The Oversight Board shall establish standards and policies to require the underwriter to provide reps and warranties on compliance with all underwriting and appraisal standards.	Same, and in addition, the FHA may not pay insurance benefits to a lender who violates reps and warranties, or in any case in which the borrower fails to make the first payment on the mortgage. The Board may establish other standards to protect against adverse selection, and may require "higher risk" borrowers to demonstrate payment performance for a reasonable time prior to being insured.	FHA may require similar reps and warranties.
Auction and Bulk Refi Mechanism	The Fed, in consultation with the OB, to study the need for, and efficiency of, an auction or bulk refinancing mechanism. Report is due 60 days after the enactment.	The Board shall, if feasible, establish a structure and procedures for an auction to refinance eligible mortgages on a wholesale or bulk basis.	No similar provision.
Aggregate Cap	Insurance for up to $300 billion of new refi loans.	Same.	Program assumes using existing $185 billion insurance authority.
Experts and Consultants	FHA may contract with private parties to develop underwriting criteria, pricing standards, quality review and other duties.	Same, and also provides that the Board may contract for services of experts and consultants as the Board considers appropriate.	Government agencies generally have authority to contract for experts and consultants.
Monitoring and Reports	HUD will monitor independent quality reviews to determine compliance with all requirements and status of insured loans, including rates of delinquencies. Various reports must be made to Congress.	Independent quality reviews not mandated, but the Board is required to make monthly reports on status of the program	FHA provides annual credit report to Congress. HUD I.G. conducts annual audit.
I.G.	The I.G. must conduct an annual audit and report.	No similar provision.	

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GNMA	The Secretary to ensure that GNMA will guarantee securities backed by insured refinanced mortgages.	Same.	
Sunset	This authority terminates 2 years after enactment, except Secretary may authorize up to 4 six-month extensions.	FHA may not insure mortgages under this program before Oct. 1, 2008 or after Sept. 30, 2011.	
Duty of Servicers	Absent contractual provisions to the contrary, a servicer owes a duty to maximize return to the securitization vehicle for the benefit of all investors and not to any individual party or group. A servicer shall be deemed to be acting in the best interests of the securitization vehicle and in the best interests of investors if the servicer modifies the loan, enters into a workout plan, or engages in other types of loss mitigation efforts, such as a short sale. Absent contractual provisions to the contrary, a servicer is not liable to any party for entering into a qualified loan workout plan.	Similar, but: (i) Adds this to the Truth-in-Lending Act; (ii) provides that the servicer owes a duty to investors, not to the securitization vehicle; (iii) does not override provisions of an "*investment*" contract; (iv) limits safe harbor to modifications involving owner occupied properties; (v) limits safe harbor to modifications in which the anticipated recovery under the modification exceeds, on a net present value basis, the anticipated recovery through foreclosure; and (vi) *does not provide any specific immunity from liability*.	
Authorizations	Appropriations authorized of $230 million for counseling services and $150 million for contracting and additional FHA personnel. Of the $230 million, at least $34.5 million is for counseling organizations providing loss mitigation information in low- and moderate-income neighborhoods; $35 million for the Neighborhood Reinvestment Corporation to make grants to counseling organizations; at least $21 million to hire lawyers to assist homeowners; and at least $20 million to assist veterans returning from active duty. At least $4.6 million must be used to identify and notify homeowners who are eligible to participate in the program.	Establishes HOPE Bonds and HOPE Trust Fund. The Treasury is to issue bonds (HOPE bonds) to provide necessary subsidy to the FHA for loans guaranteed under the program. The GSEs are to pay for the costs of borrowing by diverting contributions from the Affordable Housing Fund to a Housing Trust Fund, on a declining basis. Amounts collected in excess of the funds needed for the HOPE program will be used to reduce the national debt.	

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Grants Authorized	Authorizes $45 million per year for three years to provide grants to States and non-profit organizations providing homeownership and rental counseling.	No similar provision.	
FBI Authorization	Appropriations of $31.25 million are authorized per year for three years to hire additional FBI agents and prosecutors for mortgage fraud, and $.75 million for an interagency task force	No similar provision.	
Disabled Veterans	A governmental entity that operates a mortgage loan program or guarantee program may not deny benefits to a disabled veteran who has filed for bankruptcy protection, or who has not paid a debt that is dischargeable in bankruptcy.	No similar provision.	
Office of Housing Counseling, Public Outreach	An Office of Housing Counseling is established in the Department of HUD. The Office is to conduct research, grant administration, public outreach, and policy development related to housing counseling. An advisory committee is also established to assist the Department. The Office will establish materials, certify software, and conduct nationwide media campaigns. Appropriations are authorized of $3 million per year for three years.	No similar provision, but bill requires the Secretary of HUD to conduct a public outreach to ensure homeowners and lenders are aware of the FHA refi program.	
Fair Value Accounting	The SEC, in consultation with the Fed, to conduct a study of fair value accounting applicable to financial institutions. A report is required 90 days after enactment.	No similar provision.	

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Study of Root Causes of Defaults	The Secretary of HUD to study the root causes of default and foreclosure using as much empirical data as possible. The study will look at the role of escrow accounts to avoid foreclosures	No similar provision.	
GAO Study	The GAO to study The effects of a tightening credit market on first time homebuyers. The study is to include an analysis of financial literacy outreach efforts.	No similar provision.	
HUD Certified Counselors	An organization may not receive assistance for counseling unless it is HUD certified or uses HUD certified counselors.	No similar provision.	
Mortgage Booklet	The Secretary of HUD is to prepare a real estate settlement booklet at least once every 5 years. No similar provision.	No similar provision.	

Source: Barnett Sivon & Natter, P.C.

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