

# U.S. Structured Finance Newsletter

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## HOME AFFORDABLE MODIFICATION PROGRAM

As the details of the Home Affordable Modification program were released, many in the non-agency loan space have begun to prepare for the “modification mania” that is expected to follow. Under the program, modifications can be offered to delinquent borrowers or those that are current on their mortgage payments but at risk of imminent default. The program offers lucrative incentives to borrowers, lenders and servicers for loans that stay current under the program and is expected to offer assistance to millions of homeowners. Listed below are some of the highlights.

### Loan Eligibility and Verification Requirements:

- Owner occupied, primary residence properties only – originated on or before January 1, 2009.
- First-lien loans up to \$729,750. Higher limits allowed for properties with two-to-four units.
- All borrowers must provide full documentation including a signed IRS 4506-T, two most recent paystubs and the most recent tax return in addition to signing an affidavit of financial hardship.
- The borrower can be *either delinquent or current* but facing imminent default.
- Loans can only be modified once under the program.

### Loan Modification Terms and Procedures:

- Participating loan servicers will be required to use a net present value (NPV) test on each loan that is at risk of imminent default or at least 60 days delinquent. The NPV test will compare the net present value of cash flows with and without the modification. If the test is positive, meaning that the net present value of expected cash flow is greater in the modification scenario, the servicer must modify absent fraud or a contract prohibition. If the NPV test result is negative, the servicer may still choose to modify the loan (unless prohibited under contract).
- Servicers will follow a specified sequence of steps in order to reduce the monthly payment to no more than 31% of gross monthly income (debt-to-income or DTI).
- The modification sequence requires first reducing the interest rate (subject to a rate floor of 2%), then if necessary extending the term or amortization of the loan up to a maximum of 40 years, and then if necessary forbearing principal. Principal forgiveness is also allowed.
- Once the loan has been modified, the monthly payments are fixed for five years.
- After five years, if the modified loan is still current, the interest rate will gradually increase by 1% per year until it reaches the Interest Rate Cap.<sup>1</sup>

### Payments to Servicers, Lenders, and Responsible Borrowers:

- The program will share with the lender/investor the cost of reductions in monthly payments from 38% DTI to 31% DTI.
- Servicers that modify loans according to the guidelines will receive an upfront fee of \$1,000 for each modification, plus “pay for success” fees on still-performing loans of \$1,000 per year.
- Homeowners who make their payments on time are eligible for up to \$1,000 of principal reduction payments each year for up to five years.
- The program will provide one-time bonus incentive payments of \$1,500 to lender/investors and \$500 to servicers for modifications made while a borrower is still current on mortgage payments.
- The program also includes incentives for extinguishing second liens on loans modified under this program.

For questions or comments please contact Kathleen Tillwitz at [ktillwitz@dbrs.com](mailto:ktillwitz@dbrs.com)

1. The Interest Rate Cap is the lesser of (i) original contractual rate or (ii) the Freddie Mac Primary Mortgage Market Survey rate for 30-year fixed rate conforming mortgage loans at the point of modification, rounded to the nearest 0.125%.