

U.S. Structured Finance Newsletter

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GOVERNMENT INCENTIVES FOR SHORT SALES AND DEEDS IN LIEU

On May 14, 2009, the Obama Administration announced a Foreclosure Alternative Program (FAP) that provides incentives for servicers and borrowers to pursue short sales and deeds-in-lieu (DIL) of foreclosure in cases where a borrower meets the eligibility requirements for a Home Affordable Modification but does not qualify or is unable to keep up payments under a modification plan. The program is intended to allow families and servicers to avoid the costly foreclosure process and to minimize the negative impact of foreclosures on borrowers, financial institutions and communities. Listed below are some of the highlights of the program:

Foreclosure Alternative Program:

Borrowers will be eligible for the FAP if they meet the minimum eligibility criteria for a Home Affordable Modification but do not qualify for a modification or were unable to sustain payments under a trial period plan or a modification. Prior to proceeding with a foreclosure, participating servicers must evaluate each borrower to determine if a short sale is appropriate. In a short sale, a servicer allows the borrower to sell the property at its current value, even if the sale nets less than the total amount owed on the mortgage. Approval of a short sale requires the borrower to list and actively market the home at its fair value. The sale must be an arms length market transaction with all proceeds (after selling costs) applied to the discounted mortgage payoff. If the borrower actively markets the property but is unable to sell it within the agreed upon time period, a servicer may consider a DIL. With a DIL, the borrower voluntarily transfers ownership of the property to the servicer, provided the title to the property is free and clear.

Minimum and Maximum Duration:

Under the program, servicers will allow borrowers at least 90 days to market and sell the property, with possibly more time based on local market conditions. The property must be listed with a licensed realtor experienced in selling properties in the neighborhood. Marketing of the property may run concurrently with the foreclosure process; however no foreclosure sale can take place during the marketing period as long as the borrower is acting in good faith to sell the property. There will be a maximum marketing period of one year for the property.

Incentive Payments:

- Servicers receive incentive compensation of up to \$1,000 for the completion of a short sale or DIL.
- Borrowers receive incentive compensation of up to \$1,500 to assist with relocation expenses.
- The U.S. Treasury will share the cost of paying junior lien holders to release their claims, matching \$1 for every \$2 paid by the investors, up to a total contribution of \$1,000 by Treasury.

DBRS believes that offering incentives to avoid foreclosure through short sales and DILs can ultimately save borrowers', servicers' and investors' time and money. However, the lengthy marketing period and the cap on the matching arrangement that is being offered to second lien holders may not provide enough enticement for them to release their claim. Currently, second lien holders have been reluctant to approve short sales because most properties already have a current loan-to-value in excess of 100% so they have nothing to lose by waiting for the property to go through the foreclosure process and be sold as Real Estate Owned (REO) property. Additionally, the FAP allows the borrower "up to one year" to market and sell a property. This extensive time period may give second lien holders pause in removing their lien if they believe market conditions may improve during the sale period, which could result in a higher return than the U.S. Treasury program. As a result, DBRS will continue to monitor the industry's participation in the FAP and its impact on loss severities affecting Residential Mortgage Backed Securities (RMBS).

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