

NORTH TEXAS BANKRUPTCY BENCH/BAR

May 20, 2016

Mortgage Modifications:

The New Principal Reduction Mortgage Loan Modifications

by:

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I. FHFA Principal Reduction Mortgage Modification Program

On April 14, 2016, The Federal Housing Finance Agency (FHFA) announced that Fannie Mae and Freddie Mac would offer principal reduction to certain seriously delinquent, underwater borrowers who are still struggling in the aftermath of the financial crisis to help them avoid foreclosure and stay in their homes.

The Principal Reduction Modification Purpose

Allows seriously delinquent, underwater homeowners to obtain a loan modification that permanently forgives a portion of mortgage debt.¹

Principal Reduction Modification Eligibility

- First lien mortgage that is owned or guaranteed by Fannie Mae or Freddie Mac.
- Must be at least 90 days delinquent as of March 1, 2016.
- Mortgage must have a pre-capitalization unpaid principal balance of \$250,000 or less as of March 1, 2016.
- Mark-to-market loan-to-value ratio of the mortgage must be more than 115% after capitalization of arrearages as of the date the borrower is evaluated for the modification.
- Owner-occupied; Investment properties are ineligible.
- Eligible loans must generally meet all other Streamlined Modification eligibility criteria.²

¹ This paper contains information available as of April 19, 2016. Updates will be provided at the conference.

² See Streamlined Modifications section, *infra*.

- Borrowers who are otherwise eligible for the Principal Reduction Modification and enter into a modification with a first trial payment due date between May 1, 2016 and December 1, 2016 will be eligible to have their principal forbearance converted to forgiveness.

Principal Reduction Loan Modification Program

- Servicers must solicit underwater eligible borrowers with modification terms no later than October 15, 2016.
- Servicers may continue to solicit through December 31, 2016.
- The modification terms include:
 - capitalization of outstanding arrearages;
 - interest rate reduction down to the current market rate;
 - extension of the loan term to 40 years; and
 - forbearance of principal and/or arrearages (e.g. balloon payments at end of loan term) up to a certain amount later converted to forgiveness.
- **Borrowers Must:**
 - Complete three timely payments; and
 - Accept the final modification.

Then:

- The principal forbearance amount calculated under the Streamlined Modification will instead be forgiven.
- Before program is fully implemented, borrowers who believe they may be eligible for a Principal Reduction Modification and want to pursue can accept an offered Streamlined Modification that will:
 - a. halt foreclosure proceedings, but
 - b. will not guarantee principal forgiveness.
 - c. If the borrower is later determined to be eligible for a Principal Reduction Modification, Streamlined Modification's principal *forbearance* converted to principal ***forgiveness***.

- If not eligible, borrowers continue to benefit from the payment relief granted under their Streamlined Modification, but will not receive principal reduction.
- **NOTE!!**
Borrowers ***should not default*** on their mortgage or on an existing modification in an attempt to become eligible for a Principal Reduction Modification.
- Borrowers struggling to pay their mortgage or who have additional questions about the program should contact their mortgage servicer.
- Consider using RESPA Request for Information and Notice of Error procedures.

Principal Reduction Modification Key Dates

- **March 1, 2016** – Eligibility cut-off date; borrowers must be 90 days delinquent as of this date. If they become 90 delinquent after this date, not eligible.
- **July 15, 2016** – Loan servicers must solicit, for a Streamlined Modification, all borrowers who are ***potentially*** eligible for Principal Reduction Modification on or before this date.
- **October 15, 2016** – Loan servicers must solicit all borrowers eligible for the Principal Reduction Modification starting no later than this date.
- **December 31, 2016** – Final date by which servicers may solicit borrowers eligible for the program or inform borrowers that they are eligible to have principal forgiven.

II. HAMP Streamlined Modifications

The HAMP Streamline Modification Program was designed to assist borrowers who meet basic HAMP eligibility criteria, and, among others, those who have not completed an application by the time their loan is 90 days delinquent. The Program just became effective on January 1, 2016.³ It was designed to assist borrowers who meet basic HAMP eligibility

³ See Supplemental Directive 15-06 – Making home Affordable Program – Streamlined Modification Process:

criteria, and, among others, those who have not completed an application by the time their loan is 90 days delinquent. The Program imposes additional mortgage servicer requirements and additional borrower eligibility requirements.⁴

Streamlined Modification Eligibility

- Must be a first lien mortgage loan.
- Must not be insured or guaranteed by a federal government agency (*e.g.*, FHA, VA, or Rural Housing).
- Must be at least 90 days delinquent, unless loan previously modified into a mortgage loan with a step-rate feature, and an interest rate adjustment occurred within the last 12 months, in which case the loan must have become 60 days delinquent after the interest rate adjustment.
- Must have been originated at least 12 months prior to the evaluation date for the modification.
- Must not have been previously modified in accordance with D2-3.2-05, Fannie Mae Standard Modification and become 60 or more days delinquent within 12 months of the modification effective date without being reinstated.
- Borrower must not have failed a Trial Period Plan under Fannie Mae standard modification within 12 months of being evaluated for eligibility for a Streamlined Modification.
- Must not be subject to:
 - a recourse or indemnification arrangement under which Fannie Mae purchased or securitized the mortgage loan or that was

https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1506.pdf

⁴ See D2-3.2-08: Fannie Mae Streamlined Modification Servicing Guide (04/13/2016).

<https://www.fanniemae.com/content/guide/servicing/d2/3.2/08.html>

- imposed by Fannie Mae after the mortgage loan was purchased or securitized;
 - a current offer for another mortgage loan modification or other workout option;
 - an active and performing Trial Period Plan;
 - an approved liquidation workout option; or
 - an active and performing forbearance plan or repayment plan, unless otherwise directed by Fannie Mae.
- The mortgage loan must not be on Fannie Mae’s most recent Non-Eligible List at the time the servicer evaluates eligibility for solicitation.

Borrowers in Bankruptcy

- Servicers may, but are not required to, offer Streamline HAMP to borrowers in active Chapter 7 or Chapter 13 bankruptcy cases.
- Borrowers in a Streamline HAMP trial period plan who subsequently file for bankruptcy **may not be denied** a permanent modification on the basis of the bankruptcy filing.
- Servicers should extend trial period plan as necessary to accommodate delays in obtaining court approvals or receipt of remittance of trial payments made to a trustee.
- A trial period plan is required for a Streamline HAMP permanent modification and cannot be waived. (Thus, must do the trial plan even if in bankruptcy.)

Eligibility for a Texas Section 50(a)(6) Mortgage Loan

A Texas Section 50(a)(6) mortgage loan is eligible for a Fannie Mae Streamlined Modification:

- If the requirements in “Determining Eligibility for a Fannie Mae Streamlined Modification” are satisfied, and
- If modified in accordance with applicable law.

However, Fannie Mae appears worried about litigation because:

- If servicer receives a notice from the borrower that a modification fails to comply with the Texas Section 50(a)(6) requirements, servicer must:

- Immediately inform Fannie Mae's Legal department by submitting a *Non-Routine Litigation Form (Form 20)* and including the borrower notice in its submission.
- Collaborate with Fannie Mae on the appropriate response, including any cure that may be necessary, within the 60-day time from provided by the requirements of Section 50(a)(6).

III. Modification Practice Tips

- Do not let your clients try to obtain a mortgage modification by themselves, because they will probably fail. Clients whose attorneys represent them in the process have a good success rate for those who are eligible.
- As a corollary, **do not** let the servicer talk to your clients regarding a mortgage modification. Depending on your client's situation, the loan modification offered might be great, or might be terrible. The client needs your help in evaluating.
- You probably already have a lot of information needed for the application in your bankruptcy database, but will have to update.
- Get paid for your work.
 - Make sure your contract provides for this type of extra work, or get an additional one.
 - Don't forget to disclose pursuant to Rule 2016(a).
 - Keep your time!
 - File a fee application.
- First Rule of mortgage modifications – Must know the owner of the loan being modified:
 - Fannie Mae/Freddie Mac websites (for Fannie and Freddie owned loans).
<https://www.knowyouroptions.com/loanlookup>
<https://ww3.freddie.mac.com/loanlookup/>
 - RESPA Qualified Written Request/ Request for Information - Ask for the name, address and contact information for the owner or assignee of the

loan. The servicer must respond within 10 business days. 12 U.S.C. § 2605(k)(1)(D); 12 C.F.R. § 1024.36(d)(2)(i)(A).

- Use companies and experts that can access this information and additional non-public information about all modifications that any trust has made with respect to the loans in that trust.
- Use other RESPA rules regarding the modification process to forestall a foreclosure if bankruptcy not available or not the best option.
- Sometimes a modification can be part of a litigation settlement - but probably will have to submit an application and all the paperwork, etc. (Not like in the old days.)
- If you do not feel qualified to assist your client with the mortgage modification process or do not have the time or resources, consider hiring special counsel. For some debtors, an appropriate modification may mean the difference between plan success and home retention or bankruptcy failure.
- Stay tuned. The HAMP Mortgage Modification are set to end December 31, 2016, but they could be extended or reinstated.