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The "Plan to Help Responsible Homeowners and Heal the Housing Market"

A look at what it means for mortgage servicers

Consumer Finance Point of View

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Overview of plan

On February 1, 2012, President Obama unveiled his **Plan to Help Responsible Homeowners and Heal the Housing Market**. This plan expands on the *Blueprint for an America Built to Last,* which was unveiled during his 2012 State of the Union address. The President’s plan consists of eight main components:

1. **Broad Based Refinancing to Help Responsible Borrowers Save an Average of $3,000 per Year:** The plan provides borrowers with an opportunity to refinance and take advantage of historically low interest rates, and therefore reduce their monthly payments, provided they are current on their mortgage. Specifically, the plan seeks to:

    - Provide access to refinancing for all borrowers, not just those whose loans are owned or guaranteed by Fannie Mae or Freddie Mac, who are current on their payments and meet a set of simple criteria.

    - Streamline the refinancing process for all Government Sponsored Enterprise (“GSE”) borrowers who are current on their loans.

    - Give borrowers the chance to rebuild equity through refinancing.

2. **Homeowner Bill of Rights:** The plan features a single set of standards to make sure borrowers and lenders play by the same rules, including:

    - Increasing transparency in mortgage lending by providing borrowers with access to a simple mortgage disclosure form that contains full detailing of fees.

    - Providing a new set of guidelines to prevent conflicts of interest that potentially harm homeowners.

    - Establishing forms of support to keep responsible borrowers out of foreclosure, including early intervention, continuity of contact, and time and options to avoid foreclosure, such as modifications.

    - Protecting families against inappropriate foreclosure, including right of appeal.

3. **First Pilot Sale to Transition Foreclosed Property into Rental Housing to Help Stabilize Neighbourhoods and Improve Home Prices:** The Federal Housing Finance Agency (FHFA), in conjunction with the US Department of the Treasury (Treasury) and the US Department of Housing and Urban Development (HUD), has announced a pilot sale of bulk packages of foreclosed properties (REO). The bulk sales will seek to promote investment from developers who intend to transition the properties into rental housing.

4. **Moving the Market to Provide a Full Year of Forbearance for Borrowers Looking for Work:** The plan encourages servicers to provide relief for unemployed borrowers by allowing up to 12 months of forbearance of payments.

5. **Pursuing a Joint Investigation into Mortgage Origination and Servicing Abuses:** Under the leadership of federal and state co-chairs, investigations regarding the misconduct that contributed to the financial crisis will continue.

6. **Putting People Back to Work Rehabilitating Homes, Businesses and Communities Through Project Rebuild:** The plan proposes an investment of $15 billion in a national effort to rehabilitate and refurbish foreclosed homes and businesses using the nation’s construction workers.

7. **Expanding the Home Affordable Modification Program (HAMP) Eligibility to Reduce Additional Foreclosures and Help Stabilize Neighbourhoods:** The Administration will extend the existing HAMP program by one year while expanding the eligibility for the program. Newly eligible borrowers include:

- Borrowers who struggle with secondary debt including second liens, medical bills, and consumer loans. A second level HAMP evaluation protocol ("HAMP Tier 2") will have more flexible debt-to-income criteria that will allow a HAMP modification for borrowers whose front-end debt-to-income ratio is already below the 31% threshold.

- Owners of properties that are currently occupied by a tenant or that are intended to be rentals.

8. **Increasing Incentives for Modifications that Help Borrowers Rebuild Equity:** In a further effort to encourage investors to consider or expand principal reduction modifications, the Administration will:

- Increase the incentive to reduce principal from 6-21 cents per dollar to 18-63 cents per dollar depending on the degree of principal reduction.

- Encourage the GSEs to offer principal reduction to their underwater borrowers by paying principal reduction incentives to Fannie Mae or Freddie Mac if they will allow for principal forgiveness in conjunction with HAMP modifications.

Assessment of impact and likelihood of potential implementation

The **Plan to Help Responsible Homeowners and Heal the Housing Market** was announced as a comprehensive plan to reform the housing market. While the plan was unveiled on February 1, 2012, many of the individual components of the plan date back much further to prior government initiatives. Several of the components included within the plan are already underway or in the process of implementation through a combination of efforts from the Administration and other industry participants.

Other components of the plan can be executed at the sole discretion of the Administration, while some will require participation from other entities, including Congress. Considering these interdependencies, the fact that some initiatives are already underway, and the differing level of implementation effort associated with each component, the components of the plan have varying degrees of uncertainty regarding their likelihood of implementation. When assessing the likelihood of implementation of these plans, this analysis considers the degree to which the Administration is expected to be able to take significant action that will be in effect within the next year.

Furthermore, the different components vary in terms of their impact on mortgage servicers should they be implemented. When assessing the impact of these plans, this analysis considers the potential incremental impact to mortgage servicers above and beyond previously announced initiatives

This assessment takes into account the settlement with the 49 state Attorneys General, and ongoing servicer responses to Consent Orders and other regulatory directives. Servicers should continue to monitor these other developments as they consider the impact of the President’s plan.

The table below presents our overall assessment of the likelihood and potential impact to mortgage servicers of implementation of the various components based on information that is currently available.

Component of Plan	Likelihood	Impact
1. Broad Based Refinancing	Low	High
2. Homeowner Bill of Rights	In Progress	Low
3. REO Sale and Rental	In Progress (Pilot)	Moderate
4. Full Year Forbearance	In Progress	Low
5. Joint Investigation	In Progress	Moderate
6. Project Rebuild	Moderate	Low
7. Expanding HAMP Eligibility	In Progress	High
8. Increasing Mod Incentives	High	High

Basis for further analysis

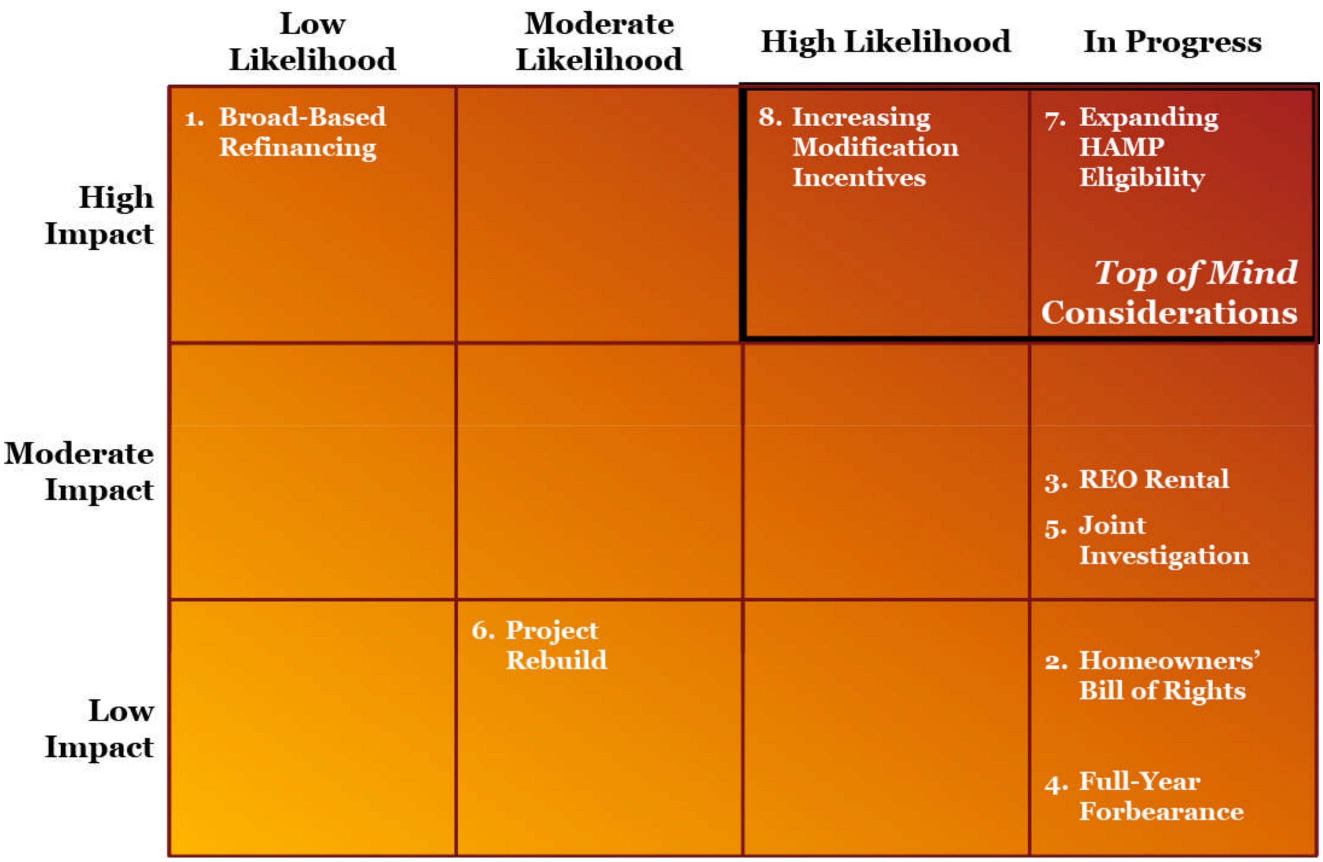
This assessment illustrates that the various components of this plan do not all posess the same level of urgency for mortgage servicers. For analysis purposes, we have organized the components into three categories based on their potential impact and the likelihood of their implementation:

1) **High Likelihood or In Progress and High Impact:** These components are likely to have a major impact on mortgage banking industry operations in the near future, and as such, servicers may consider these to be ***top of mind*** areas of focus.

2) **In Progress but Low to Moderate Impact:** While these components are currently ongoing and will continue to be implemented, they are not anticipated to significantly impact mortgage banking industry participants, or the ***impact has already been felt***.
3) **Low to Moderate Likelihood of Implementation:** These components have a higher level of uncertainty and therefore may be unlikely candidates for implementation, and even if implemented are likely to be on a longer time horizon. As such, even if impactful, these are ***not immediate concerns*** for mortgage banking industry participants.

Where to focus attention

The chart below depicts the relative level of urgency among the various components of the plan within the dimensions of impact and likelihood of their respective implementation.



The primary focus of this paper is the expansion of HAMP eligibility and increased modification incentives, which should be top of mind considerations for mortgage servicers based on their high levels of potential impact and high likelihood of implementation. Expansion of eligibility is already in progress, with the March 9, 2012 release of MHA Supplemental Directive 12-02. The analysis of the changes to HAMP includes an in-depth look at the provisions of the plan, an assessment of how they might affect industry participants with a focus on mortgage servicers, and steps servicers can take to prepare for implementation.

This will be followed by a brief look into the current state of implementation on the Joint Investigation on MBS, Homeowners' Bill of Rights, Full-Year Forbearance, and REO Rental, as well as an assessment of how potential future changes to these components could impact servicers.

The final section will review why there is a lower likelihood that Broad-Based Refinancing and Project Rebuild will be implemented in their proposed form, and what servicers should watch for in terms of future developments.

Top of mind considerations

The proposed modifications to HAMP would extend the duration of the program, increase the population of eligible borrowers, and increase the incentives offered for providing relief.

The last two components of the plan address HAMP in two areas: expanding the scope of the program by extending the duration of the program and increasing the population of eligible borrowers, and increasing the incentives offered under the program. These initiatives were previously announced on January 27, 2012, and have since been met with a combination of enthusiasm from potentially impacted borrowers and market scepticism regarding the number of incremental borrowers who will benefit from the new guidelines. Implementation of the increases to duration and the population of borrowers began with the release of Supplementary Directive 12-02, but the full extent of these changes remains to be seen. Regardless of the final impact to borrowers and the number of additional modifications that occur, these changes to HAMP will require significant incremental implementation efforts on the part of mortgage servicers.

Introduction

The plan calls for two main areas of reform to HAMP: **expansion of eligibility** and **increases to incentives**:

Expansion of Eligibility

- Extension through December 31, 2013
- Alternative evaluation opportunity with more flexible Debt-to-Income criteria
- Inclusion of non-owner occupied properties

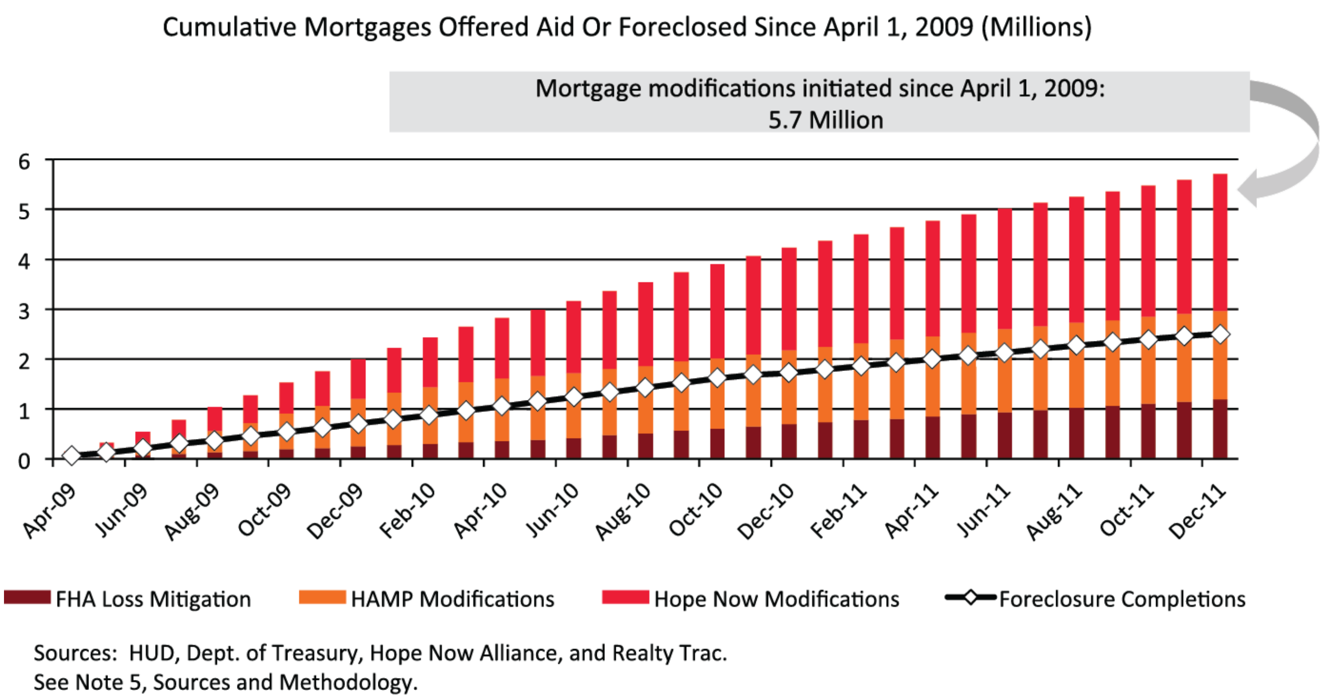
Increases to Incentives

- Triple the incentives paid to loan owners for write-downs of principal (now 18 to 63 cents/dollar, depending on LTV)
- Addition of Treasury Incentives for write downs on GSE loans

Current state of HAMP

According to the US Department of Housing and Urban Development's February 2012 National Scorecard, 1.8 million HAMP trial modifications were started between April 2009 and the end of January 2012, leading to over 950,000 homeowners receiving a HAMP permanent modification. This has resulted in estimated borrower savings of$11 billion in monthly mortgage payments. Including FHA loss mitigation efforts and Hope Now modifications, over 5.7 million borrowers have initiated mortgage modifications during this period.[1]

Figure 1: Mortgage aid extended more than 5.5 million times, outpacing foreclosures



Source: February 2012 HUD Scorecard

While these are significant numbers, the totals have fallen short of original expectations. Initial projections estimated 3 to 4 million permanent modifications would be completed through the HAMP program.[2]

Program reform overview

The plan's is designed to increase participation in HAMP by reaching a broader pool of eligible borrowers. The reforms are intended to provide relief to underwater homeowners, protect tenants at risk of foreclosure-related displacement, and increase the number of borrowers aided through the program. Servicers will have to expand their consideration of HAMP modifications to include the newly eligible borrowers and refine their decisioning processes based on changes to incentive compensation structures.

The Treasury Department's Supplementary Directive 12-02 outlines changes to the scope of the HAMP program which will take effect on June 1, 2012, including the extension through December 31, 2013, and implementation of the new "HAMP Tier 2" alternative. The SD also clarifies servicer responsibilities related to establishing right party contact and issue of borrower notices, and expands the population of eligible borrowers for the Home Affordable Unemployment Program (UP), the Home Affordable Foreclosure Alternatives (HAFA) Program, and the Second Lien Modification Program (2LMP).

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[1] *February 2012 National Scorecard*. US Department of Housing and Urban Development. http://portal.hud.gov/hudportal/documents/huddoc?id=FebNat2012_Scorecard.pdf.

[2] *Servicer Performance Report*. Making Home Affordable Program. http://www.makinghomeaffordable.gov/news/latest/Documents/Feb%20Report%20031210.pdf. February 2010.

The existing HAMP modification is now referred to as "HAMP Tier 1" and will continue to be used for loans secured by properties which are the borrower's primary residence. The new "HAMP Tier 2" includes mortgages secured by tenant-occupied or vacant rental properties for borrowers who have 2 or more unpaid payments, own 5 or fewer single family properties, and will make reasonable efforts to rent or use the property as a primary occupancy and keep it occupied for 5 years following the permanent modification.

Restrictions are in place regarding multiple modifications, including a limitation that each loan may only be modified once in Tier 1 or Tier 2, and a loan which has failed or lost good standing in Tier 1 is not eligible for reconsideration under Tier 1 but may be considered for Tier 2. A borrower who has failed or lost good standing in Tier 2 is not eligible for reconsideration in either tier. A borrower may have up to three properties modified under Tier 2.

Pre-screening requirements have been updated to include borrowers which may be potentially eligible due to the expanded Tier 2 eligibility criteria. Servicers must pre-screen all first lien mortgage loans with 2 or more unpaid payments due to determine if they meet the basic HAMP eligibility criteria. All successfully pre-screened borrowers **must be proactively solicited** if they meet the criteria, unless:

- Prior to June 1, 2012: were 2 or more payments delinquent and did not occupy the property as a primary residence;
- Were 2 or more payments delinquent and were previously solicited;
- Were evaluated and deemed ineligible for HAMP; or
- Defaulted on a trial period plan or lost good standing on a permanent HAMP modification.

While these borrowers do not require proactive screening, they may request consideration following June 1, 2012, and must also be re-screened in the event that they cure the initial delinquency but subsequently re-default.

Additional changes included within SD 12-02 include:

Definition of Owner Occupied: The definition has been expanded to include properties whose owners have been displaced but previously occupied the property, intend to do so again in the future, and do not have tenants occupying the building.

Unemployment Program (UP): Servicers may grant assistance to borrowers whose loan is secured by vacant or tenant-occupied properties, must consider borrowers regardless of monthly mortgage payment ratios, and must consider borrowers regardless of default on HAMP trial modifications or failed HAMP permanent modifications.

Home Affordable Foreclosure Alternatives (HAFA): There are no longer occupancy criteria for HAFA eligibility, full contractual payments above 31% of income are permitted upon borrower request, servicers are permitted to authorize increased lien and liability release fees, and borrower relocation incentives are limited to borrowers or tenants who will be forced to vacate.

Second Lien Program (2MP): HAMP Tier 2 loans will be included in LPS matching and 2MP participants which service corresponding second liens must offer to modify the borrower's second lien.

NPV: A new NPV Calculation (NPV 5.0) will be required for evaluation of all loans that meet the HAMP Eligibility Criteria following June 1, 2012. NPV 5.0 includes updated data fields to incorporate both Tier 1 and Tier 2 waterfalls.

Incentives: SD 12-02 does not adjust borrower, servicer, or investor incentives for HAMP Tier 1, but does include new incentives for HAMP Tier 2

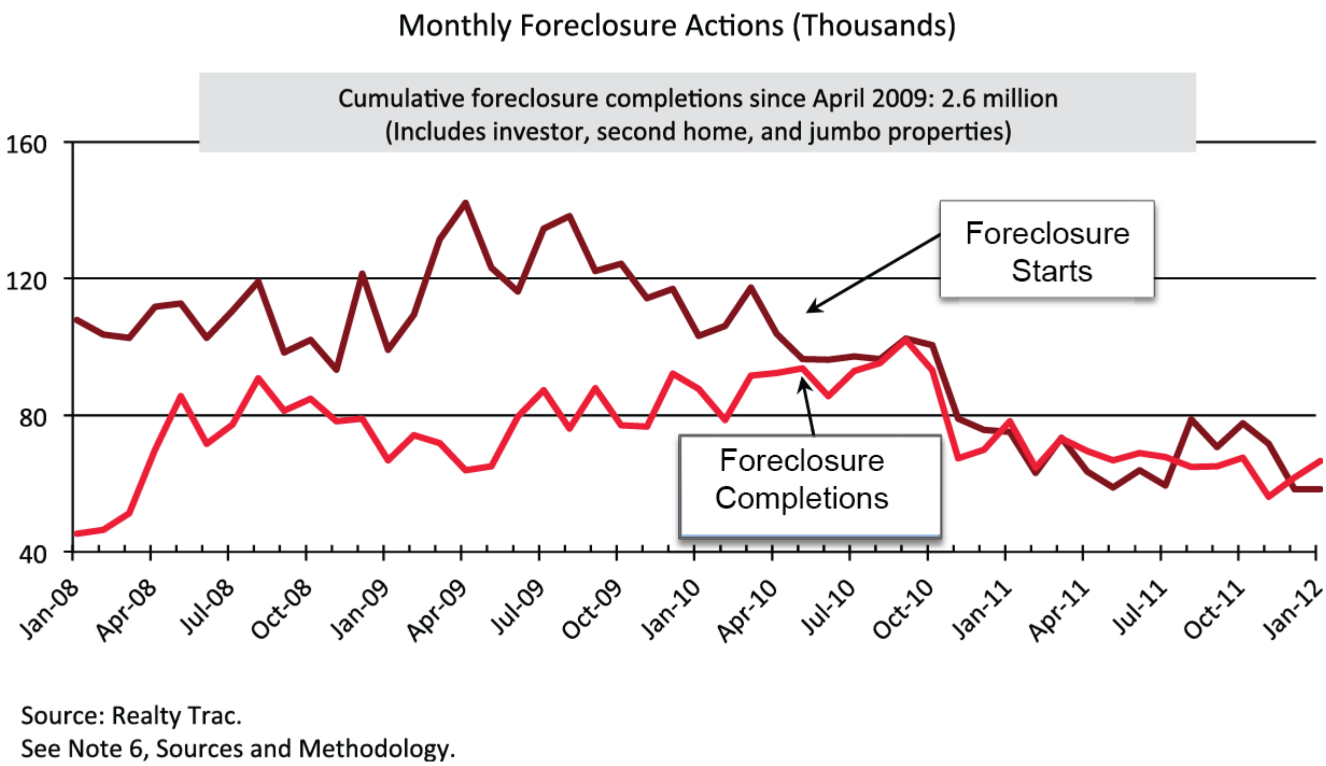
Reporting: HAMP reporting and payment processes are being updated to incorporate HAMP Tier 2; further details are not available at the time of the release of SD 12-02. Servicers should not report HAMP Tier 2 activity until the Program Administrator's updates are in place.

The list of changes above is not comprehensive and represents a high level overview of the content of SD 12-02. Servicers should refer to SD 12-02 and supplementary guidance for specific information regarding the requirements and program changes.

Industry reaction

Many industry participants question the extent to which these modifications will impact the housing market.[3] Trends on GSE-owned loans are already heading in a positive direction; 73% of high LTV loans are current, as opposed to only 60% a year ago[4], which may be an indication that the Administration's plan to include GSE loans in the eligible population for Treasury Incentives may not have a significant impact. The HUD and Treasury's Scorecard on the Administration's Comprehensive Housing Initiative for February 2012 notes that foreclosure starts across non-GSE and GSE owned loans are continuing to trend downward, as seen below. However, some industry participants believe that the downward trend in the foreclosure start rate may be related to continued foreclosure delays and recycling of customers in loss mitigation (i.e. "churn").

Figure 2: Mortgage aid helps foreclosures trend downward although foreclosure completions turn up again



Source: February 2012 HUD Scorecard

A recent Federal Reserve white paper indicates that 8.6 million borrowers are underwater with negative equity totalling $425 billion, a figure which other industry participants believe may be even higher. LPS data indicates that nearly 4 million loans are severely delinquent or in foreclosure, and the average loan in foreclosure hasn't

[3] *Fixing Housing: What Obama wants, what Republicans want, and why experts say both are wrong*. Associated Press. Factiva. 25 January 2012.

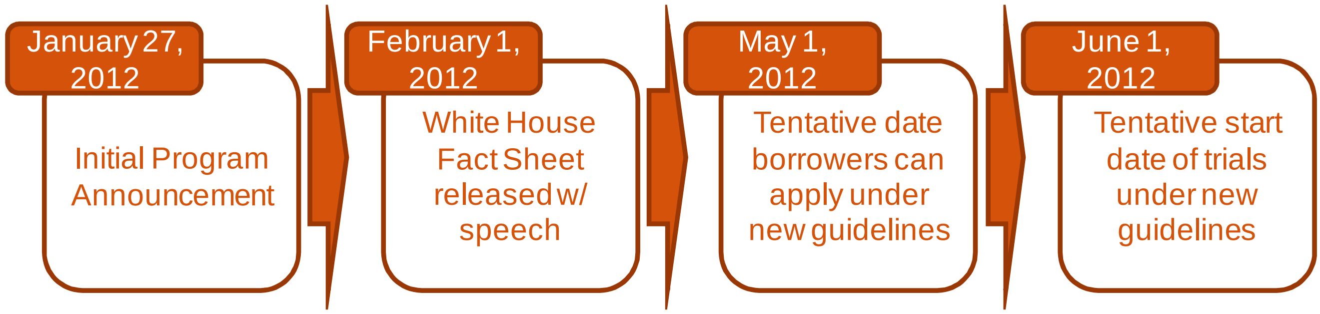
[4] DeMarco, Edward. Letter to Elijah E. Cummings, Ranking Member of the Committee on Oversight and Government Reform. Federal Housing Finance Agency. http://www.fhfa.gov/webfiles/23056/PrincipalForgivenessltr12312.pdf. 20 January 2012.

made a payment in over 630 days.[5] Many industry participants believe that the housing downturn has passed the point where principal forgiveness can lead to a meaningful reduction in the long-term foreclosure rate.

Amid estimates that the program will cost upwards of $100 billion[6], the FHFA is calling for a program focusing on forbearance instead of forgiveness, noting that this is less costly to the taxpayer but equally effective at lowering monthly payments. The FHFA is obligated to consider the NPV of any action undertaken to prevent foreclosures, per the Emergency Economic Stabilization Act (EESA) of 2008. Their analyses, based on the HAMP NPV calculation, indicate that forbearance is economically favourable over forgiveness.[7] While forgiveness lowers re-default rates, forbearance offers greater cash flows to the investor in the event of a successful modification. The FHFA further notes that instituting a forgiveness program would require significant costs to upgrade technology, update processes, and provide training.[8] The FHFA acknowledges that forgiveness may be relatively more effective for non-GSE loans, due to the fact that 80% of underwater GSE borrowers are current on their loans, a figure that is substantially higher than that of underwater non-GSE borrowers. However, the FHFA remains sceptical that forgiveness would be preferable even for non-GSE borrowers.[9]

Industry participants also note that prior Administration initiatives including HAMP and HARP have not reached the volumes of borrowers originally estimated. The HAMP program was initially estimated to reach 3-4 million borrowers, but only 950,000 borrowers have received permanent modifications as of the February 2012 Scorecard.[10] Even if the total volume of modification activity does not reach the levels anticipated by the Administration, it is likely that in the near term, servicers will see a substantial increase in modification activity. As such, servicers must begin to prepare for these increased volumes, especially given the condensed timeframe for implementing the new guidelines.

Implementation timeline



SD 12-02 confirmed the June 1, 2012 effective date for implementation of HAMP Tier 2. The Program Administrator's ability to update reporting capabilities and implement procedural changes including NPV 5.0 will determine whether this aggressive timeline is met. Servicers must be ready to implement changes prior to this date.

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[5] Berliner, Bill. *Implications of a program that cuts principal*. National Mortgage News. Factiva. 6 February 2012.

[6] DeMarco, Edward. Letter to Elijah E. Cummings, Ranking Member of the Committee on Oversight and Government Reform. Federal Housing Finance Agency. http://www.fhfa.gov/webfiles/23056/PrincipalForgivenessltr12312.pdf. 20 January 2012.

[7] Ibid.

[8] Ibid.

[9] Ibid.

[10] *February 2012 National Scorecard*. US Department of Housing and Urban Development. http://portal.hud.gov/hudportal/documents/huddoc?id=FebNat2012_Scorecard.pdf.

Impact on servicers

Servicers will need to consider impact in four key areas: **Compliance**, **Solicitation**, **Decisioning**, and **Operational Support**. These changes should take into account the requirements outlined in SD 12-02, as well as forthcoming information from the Program Administrator.

Compliance

It is an opportune time for servicers to consider whether they have adequate change control processes in place associated with program changes and implementation. Internal processes including quality assurance and quality control and reporting will require updates to conform to new program guidelines. It continues to be important for executive management to have a top-of-the-house view of the state of compliance and quality throughout its execution of the MHA programs. This top-of-the-house view should include an assessment to ensure that appropriate change management is in place to properly implement program changes. Additional investments in governance, oversight, and quality assurance programs, including risk assessment and management reporting, may be required due to the extension of the program through December 31, 2013, as well as changes to program guidelines.

While servicers must focus on enhancements and updates based on the extended program, they must not lose sight of existing compliance requirements. Servicers must continue to address and remediate compliance issues arising from MHA-C examinations, if applicable.

Solicitation

Expanded eligibility parameters will increase the population of covered borrowers. Therefore, servicers will need to update solicitation queries and protocols to include populations of loans and borrowers which were previously excluded, including those who had previously been denied but would now qualify under the new guidelines. The solicitation protocols as outlined in SD 12-02 will require an expanded pool of borrowers for consideration given the more inclusive guidelines for HAMP Tier 2. Management will have to make determinations about optional solicitation efforts, including those borrowers meeting the exclusions for activity prior to the June 1, 2012 effective date, and must be aware of re-screening requirements. Additionally, management will need to update call scripts to provide program offerings to callers who were previously ineligible for MHA programs. Finally, staff will need to be trained in the program changes.

Decisioning

Servicers will need to reach out to investors to determine whether they want to allow principal reductions and continue to monitor whether the GSEs will allow principal reductions. Modification waterfalls and decisioning processes will need to be updated to provide for principal reductions to the extent to which investors (or guarantors) are willing to permit them, and Single-Point-of-Contact staff will need to be trained to offer principal reductions during their analyses of options available to borrowers. The decisioning process will need to incorporate the updates made to NPV 5.0, which includes consideration of different waterfall requirements for Tier 1 and Tier 2, as outlined in SD 12-02.

Operational support

Once the HAMP reforms are implemented, servicers will likely experience an increase in applications for modifications resulting from newly eligible borrowers. Staff will need to be trained to support the changes to the processes outlined above, and incremental staffing requirements may arise as modification volumes increase. Up to 10 million loans could qualify under the new guidelines,[11] which could drive significant increases in the volume of transactions. This may prove especially problematic considering that modification volumes have trended downwards in recent months,[12] potentially causing servicers to reduce staffing levels accordingly.

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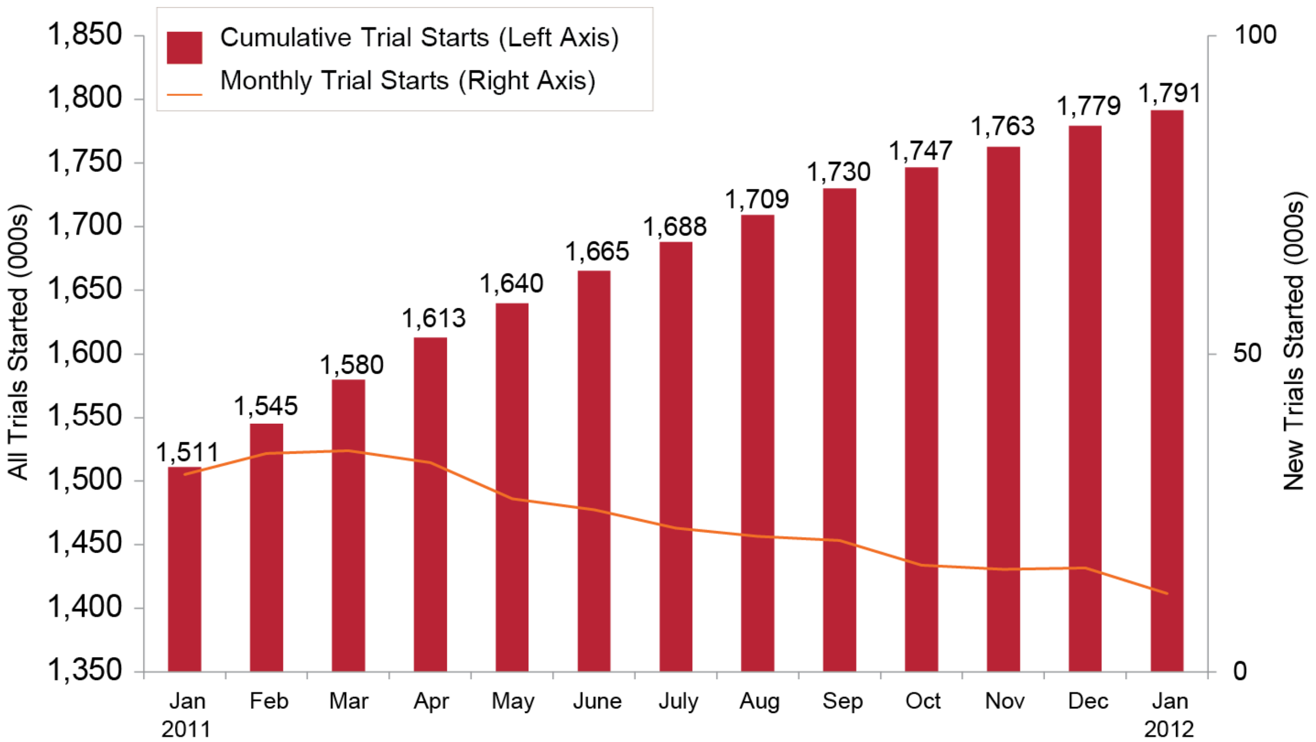
[11] "Experts react to Obama's new housing plan" http://www.washingtonpost.com/blogs/ezra-klein/post/experts-react-to-obamas-new-housing-plan/2012/02/02/gIQAR3OmkQ_blog.html.

[12] *January 2012 Making Home Affordable Report*. Department of the Treasury. http://www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/Jan%202012%20MHA%20Report_WITH_SERVICER_ASSESSMENTS_FINAL.PDF. 2 March, 2012.

Thus, servicers may need to ramp up staffing to accommodate increased HAMP volumes due to the extension and expansion of the program.

Figure 3: HAMP trials started



Source: HAMP system of record. Servicers may enter new trial modifications into the HAMP system of record at any time. For example, 16,759 trials have entered the HAMP system of record since the prior report; 12,335 were trials with a first payment recorded in January 2012.

Source: January 2012 MHA Summary Results

In addition to staffing levels, significant training and process adaptation will be required to operationalize the changes. This could include enhancements to loan modification workflow systems, underwriting systems, and loan accounting systems to allow for principal forgiveness.

Summary

While there are questions within the industry about the cost of the program and the total volume of modifications which can be expected, it is clear that there will be an increase in modification application activity. Servicers face a short implementation timeline to adapt to these new guidelines and should begin to think about how to operationalize the changes to their policies and procedures and key aspects such as compliance, decisioning, and solicitation.

Impact of many components has already been felt

While the President presented the plan as a go-forward method to address the housing market, many of the initiatives he outlined are already in progress and have reached the point where the primary impact to servicers has already been felt and is well understood. As such, most servicers have already implemented plans to address these components and minimal future action is required. Servicers should already be aware of, and have taken steps to address, the following components of the plan:

- Extending Forbearance Terms to Full Year Period
- Homeowners' Bill of Rights
- Joint Investigation into Mortgage Origination and Servicing Abuses
- Transition of REO to Rental Properties

Full-year forbearance

Some market participants have already moved to full-year forbearance. Both the FHA and HAMP implemented minimum forbearance periods of one year for unemployed borrowers in October, 2011. The GSEs have moved to allow their servicers to provide up to one year of forbearance, and similar changes have been implemented at large servicers.[13]

In addition, many other major market players have already made the move to this timeline, but have done so for market reasons in advance of any regulatory requirements. At this time, there does not appear to be any further regulatory move towards requiring that all servicers adopt this extended timeframe.

While servicers may continue to extend forbearance timelines, their decision will be based on market trends rather than the impacts of the plan.

[13] *Fact Sheet: President Obama's Plan to Help Responsible Homeowners and Heal the Housing Market*. The White House. http://www.whitehouse.gov/the-press-office/2012/02/01/fact-sheet-president-obama-s-plan-help-responsible-homeowners-and-heal-h. 01 February 2012.

Homeowner Bill of Rights

The Administration is not the only government body interested in moving forward with a Homeowners' Bill of Rights. Numerous incarnations of proposals have surfaced in recent months, including initiatives spearheaded by Consumer Finance Protection Board (CFPB) Director Richard Cordray. The CFPB issued a statement following the announcement highlighting their "Know Before You Owe" program and joint efforts with other federal agencies to develop national servicing standards. The plan included components such as simplified mortgage fee schedules, a draft of which is already available on the CFPB website, and which closely mirrors a similar proposal regarding checking account fees proposed by Sen. Richard Durbin. Many servicers have already made efforts to simplify fee schedules following the passage of the Dodd-Frank Act, and it is unlikely that the new Homeowners' Bill of Rights will dramatically alter the timing or extent of these developments.

Many of the provisions outlined as "Assistance for At-Risk Homeowners" and "Safeguards Against Inappropriate Foreclosure" are already included within servicing guidelines for government agencies and GSEs, or have been addressed by recent initiatives including Consent Orders, the settlement with the 49 state Attorneys General, and proposals by the CFPB. Changes which are already underway include the CFPB disclosure forms, the foreclosure complaint system operated by the Treasury, single point of contact requirements, elimination of dual-track foreclosure proceedings, and the review process for borrowers denied eligibility for government loan modification programs.

Significant increases to servicing requirements could bring a major impact; however, many of the details within the plan are still forthcoming, which may appear to indicate that this component will likely be a general statement of principles that is unlikely to dramatically restructure servicing requirements above and beyond efforts which are already in place. Agencies may trend towards standardized guidelines over time, in line with CFPB goals, but this Bill of Rights does not have the power to institute additional requirements. Servicers should, however, be prepared for additional requirements that drive increased transparency of servicing operations as well as additional clarity around supporting borrower documentation.

> *The Homeowners' Bill of Rights represents a laundry list of goals in line with existing CFPB initiatives, not new details or additional requirements.*

Joint investigation into mortgage originations and servicing abuses

As originally announced in the State of the Union address, the Department of Justice, the Department of Housing and Urban Development, the Securities and Exchange Commission and state Attorneys General have formed a Residential Mortgage-Backed Securities Working Group under the Financial Fraud Enforcement Task Force that will be responsible for investigating misconduct contributing to the financial crisis through the pooling and sale of residential mortgage-backed securities.

As this endeavour unfolds, it will be noteworthy to observe whether this new investigation will be a departure from the approach taken by the Financial Fraud Enforcement Task Force ("FFETF"), created in 2009.[14] This new working group will share a similar mandate to existing investigations by the FFETF, the SEC, the CFPB, and a wide variety of other government entities. Although it is unclear to what extent the new investigation's scope will differ from existing programs, servicers should monitor developments of additional information they

[14] Jaeger, Jaclyn. *Yet Another Mortgage Crisis Enforcement Task Force*. Compliance Week. Factiva. 7 February 2012.

may be required to track and report in preparation for audits and onsite examinations from the multitude of current investigations.

The joint investigation is just one of many government entities investigating similar topics without a clear overarching strategy or cohesive approach.

Transition of REO to rental properties

In conjunction with the President's plan, the FHFA announced the launch of the pre-qualification phase of a pilot program to sell REO properties in bulk to investors interested in converting the properties for rental. This program is intended to reduce foreclosure inventory and stabilize hard-hit urban housing markets.

While this idea has been supported by a variety of institutions including the Federal Reserve, the recently launched FHFA pilot program represents the very beginning of a long-term strategy, and is unlikely to significantly impact servicers in the near term. A separate pilot program has been initiated by one servicer which is considering an alternative approach to REO rentals. It appears that the industry has not reached consensus on the best approach to take when implementing this strategy.

Overview of pilot programs

First announced as part of the government's REO Initiative in August 2011, the REO Rental program is a joint effort between the FHFA, HUD, and Department of Treasury which is intended to be the first step towards developing a national REO rental program. Details around the program are extremely limited at this point. The FHFA requested submissions for pre-qualification for investors on February 1, 2012, and announced the first pilot sale on February 27, 2012.

The program will sell pools of assets in the nation's hardest-hit areas. The initial transaction included 2,490 properties in the following hard-hit metropolitan areas: Phoenix, Chicago, Atlanta, Las Vegas, Los Angeles, and parts of Florida. Investors will now be able to submit specific plans for the purchase and rental of these properties, with the provision that the properties must be rented for a specified number of years.[15]

A separate pilot program has been implemented by one of the large servicers to offer certain customers who are facing foreclosure the option to remain in their homes and rent the property instead. In this pilot program, which is initially targeting 1,000 borrowers in Nevada, Arizona, and New York, the homeowners give up title to their property in exchange for forgiveness of their mortgage debt, and are then allowed to rent the property for up to three years with a rent payment lower than their prior mortgage payment. In this Mortgage-to-Lease program, the bank would initially retain ownership of the properties but would have the option to sell to investors at a later date.[16]

[15] *FHFA Announces Pilot REO Property Sales in Hardest-Hit Areas*. Federal Housing Finance Agency. http://www.fhfa.gov/webfiles/23403/REOPR22712F.pdf. 27 February 2012.

[16] Schwartz, Nelson D. *Bank of America Tests Rental Program as Alternative to Foreclosure*. New York Times DealBook. http://dealbook.nytimes.com/2012/03/22/bank-of-america-tests-rental-program-as-alternative-to-foreclosure/?ref=business. 22 March 2012.

Potential impact if enacted

As of the end of the third quarter of 2011, Fannie Mae had 122,616 single-family REO properties[17] on its books and Freddie Mac held 59,596.[18] Of these properties, a Federal Reserve White Paper estimates that 2/5 of Fannie and 1/2 of FHA REO properties would have cap rates sufficiently high to justify renting[19]. However, since the GSEs are under conservatorship, it remains to be seen how their conservator (FHFA) will respond to the possibility of allowing the GSEs to take haircuts on REOs, which may limit the pool of properties available to sell in this manner. Furthermore, geographical dispersion within pools of REO will introduce complexity in managing the properties. This complexity could deter investors who are unwilling to take on the challenge and cost of managing these properties.

Since the proposed FHFA program would involve the sale of REO for rental purposes, as opposed to the management of REO as rental properties, the impact on servicing operations may be limited. For servicers, the primary likely impact of this program would be on REO marketing and sales decisioning, given that bulk sales would need to be considered and marketing operations would need to be tailored to target rental property investors.

Servicers considering implementing a program similar to that currently being piloted by the one large servicer would be impacted more significantly if they retained ownership of the properties. Managing rental operations would be a significant operational consideration for most servicers. A similar program which instead involved the selling of the properties to investors could be implemented with less significant operational changes focused more towards REO marketing and sales decisioning, similar to the considerations for the FHFA program.

Limitations of the strategy

Although the Federal Reserve White Paper indicates that selling REO properties for rental is a strategy which merits further research and has significant potential, there are a number of factors which may challenge the potential of this plan. First and foremost is the need for geographic concentrations of REO properties. While the GSEs have geographic concentrations of REO properties in many major markets, smaller and mid-size individual banks may not have the geographic concentrations in their own REO portfolios that would allow them to profitably pursue this strategy without an integrated national program.

Additionally, the pool of investors interested in these rental properties may be limited. Foreclosed properties are often not ideal for rental purposes, and the neighbourhoods with high volumes of foreclosed properties typically feature depressed rental prices, which may cause investors to struggle to obtain financing, especially since mortgage products for pools of SFR properties are not currently readily available. The properties included within the initial FHFA pilot program are predominantly properties which are already used for rental purposes. In fact, the FHFA fact sheet on the properties indicates that 85% of units within these properties are already leased, and only 15% are vacant. These properties are among the most attractive and well-suited for the purposes of REO rentals, and as such even a successful pilot implementation may not be indicative of a viable potential for large-scale implementation.

The large servicer's pilot plan is intended to determine if there is customer interest in converting from "homeowner" to "renter" of their own home to avoid the inconvenience of moving. However, it will be noteworthy to observe the level of customer response to this pilot. One final observation regarding the large servicer's pilot is that it only targets bank-owned loans, not those which have been sold to other investors.[20]

While the government can look for auxiliary benefits as hard-hit communities are helped, servicers would need to justify the lower bulk investor prices through lower holding costs or some form of government incentive, which would be unlikely to gain Congressional support. Without the development of a coordinated national

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[17] Fannie Mae 10-Q, page 15, Nov. 3 2011.

[18] Ibid.

[19] *The US Housing Market: Current Conditions and Policy Considerations*, p.11, Board of Governors of the Federal Reserve System.

[20] Schwartz, Nelson D. *Bank of America Tests Rental Program as Alternative to Foreclosure*.

strategy that includes some degree of government subsidization, it is unlikely that this pilot program will evolve into a large-scale implementation.

The Federal Reserve further notes that this program is likely to undergo significant trial and error before the development of an economically viable model.[21] In all likelihood, any further evolution of REO Rental programs is years off on the horizon. The varied approaches currently being taken in the trial programs highlight the complicated nature of determining the best approach to REO Rentals. The success of these and other potential future projects will likely determine the structure of any further developments in this area.

What servicers should watch for

The FHFA pilot programs should be monitored to see how successful they are in attracting investors at reasonable prices and finding suitable groups of rental properties, as investor response is likely to drive the evolution of this program. Should the program prove successful and bulk property sales for rental purposes appear to be economically viable, servicers will have to determine whether there is a place for non-GSE REOs in the rental market. The one large servicer's pilot program should also be monitored to determine customer response, and see if eventual sale of the properties to investors becomes a viable strategy. Other pilot programs may be introduced by other servicers, which should be monitored for alternative approaches. It is likely that only mega servicers with large concentrations of REO properties in metropolitan areas would be able to undertake similar programs on their own, but development of cooperative programs should be tracked for potential future opportunities for smaller servicers as well as for mega servicers' properties outside of major metropolitan areas. This might require servicers to update their REO marketing and sales operations to allow for the consideration of bulk investor sales for rental purposes.

Servicers should monitor the FHFA and other servicers' programs to determine if similar solutions may be worth considering as a coordinated national program is developed.

[21] *The US Housing Market: Current Conditions and Policy Considerations*. Federal Reserve. http://federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf. 4 January 2012.

Remaining components are not immediate concerns

The remaining components of the plan face a number of challenges that may impact the likelihood that they will be implemented in the near future, at least in their current form. Each faces a variety of obstacles to successful implementation, which appear likely to derail the efforts or at the very least significantly delay meaningful progress. While these should be monitored over the long-term, they are unlikely to impact servicers in the short-run:

- Broad-based refinancing reform
- Project rebuild

Broad-based refinancing reform

Although the broad-based reform as proposed in the plan would have a large impact on servicers if implemented, there is significant uncertainty regarding whether a split Congress could pass legislation supporting this in the current environment, particularly in an election year.

Overview of proposed reform

The plan calls for two main areas of broad reform: Streamlined GSE refinance and a new FHA program for Non-GSE refinance. These reforms would mirror changes which have already been implemented by the US Department of Agriculture and FHA, but would be far more extensive in scope and therefore have a very significant impact on mortgage servicers, who would be required to revamp their refinancing process to include new guidelines. This would likely take place in a fashion similar to the extensive changes required by the changes to HAMP outlined above, for a population expected to be significantly larger than that impacted by the existing HAMP and HARP programs. The Administration proposes that this program be funded through a Financial Crisis Responsibility Fee, which would be charged to the largest financial institutions based on size and risk factors.

The plan requests Congress take steps to mandate that the GSEs eliminate appraisal fees for all borrowers through the use of Mark-to-Market and alternative valuation techniques when AVM results are not available, allowing for a more streamlined and unified underwriting process. Additionally, it urges the FHA create a program to allow refinancing for non-GSE single-family owner-occupied standard loans for which the borrower is current on payments and has a FICO score of 580 or higher. This process would be streamlined to require only proof of employment, not appraisals or tax returns. The reduced underwriting requirements will allow for underwater borrowers to potentially refinance based on other compensating factors.

Potential impact if enacted

Should these proposals become effective, it would significantly change the playing field for refinancing, and represent a major impact to servicers. Mortgage servicers would face requirements to make changes similar to those outlined above related to the HAMP expansion, but on a significantly larger scale. The administration estimates that 3.5 million borrowers have non-GSE mortgages with rates high enough to provide a sufficient incentive to refinance under the new plan.[22] This is in addition to approximately 11 million borrowers who could be eligible for Fannie or Freddie refinances under the plan.[23] While these numbers are significant, it is worth noting again that prior estimates for HAMP and HARP modifications were also very optimistic, estimating 4 to 5 times the impact seen to date. Regardless of the exact number of incremental refinancings, these refinance reforms would cause servicers to significantly rethink their policies and operations around refinancing,

[22] *Obama seeks to broaden reach of housing assistance*. CBS News. http://www.cbsnews.com/8301-505245_162-57369394/obama-seeks-to-broaden-reach-of-housing-assistance/. 1 February 2012.

[23] Ibid.

particularly due to the provisions for increased competition. Implementation of this plan could have an impact far greater than even the current HAMP reforms. However, the likelihood that this plan will come to fruition is clouded by political uncertainty.

On March 6, 2012 President Obama announced an FHA Refinancing plan which does not encompass the broad-based reform included within his February 1 proposal. In order to be implemented, the proposed broad-based refinancing reform would require Congressional support rather than a unilateral Administration initiative. Thus, the announced FHA refinancing plan is a limited component of the initiatives related to FHA loans. The announcement covers a reduction of FHA refinancing fees from 1.15% to 0.55% and reduces the up-front fee from 1% to 0.1% for any FHA loan issued prior to June 1, 2009. Additionally, loans restructured with these new fees will be excluded from banks' compare ratios, which are used by the HUD to track banks' default and claim rates relative to comparable firms and may lead to disciplinary action such as termination of underwriting authority and possible loss of FHA approval when exceeding 200%. This comparison ratio exclusion will make refinancing more attractive for servicers who had previously been concerned about refinancing loans from periods with high default rates.[24] While the announcement represents a significant fee reduction which may be an attractive option for an estimated 2-3 million borrowers, it does not represent a major change to refinancing policies and procedures, only to the fee structure. It appears unlikely that the more significant changes included in the February 1, 2012 proposal will be enacted.

Congressional roadblocks

The President noted that the GSE reform initiatives are within the existing authority of the FHFA but that the GSEs have not acted to date. The FHFA does not support these initiatives,[25] meaning that the only way they can be implemented is through an act of Congress.

It appears that this broad-based reform package is unlikely to receive Congressional support. The Financial Crisis Responsibility Fee which is critical to the funding of the program has been proposed twice before in similar form, and soundly rejected by Congress on both occasions.

What servicers should watch for

Although it is unlikely the current proposal will make it through Congress, it is possible that some more limited refinancing reform package could be implemented, similar to the March 6th FHA announcement. The FHFA has already taken steps to reduce refinancing costs and allow more underwater borrowers to refinance.

It is likely that there will continue to be tweaks to refinancing requirements in the coming months. Servicers should take a proactive approach in evaluating their portfolios to identify the population of loans that will potentially be eligible for the program. This will allow servicers to better understand the potential resource requirements of this initiative

While broad-based reform is unlikely, servicers should keep up to date on minor refinancing requirement updates and ensure compliance. Servicers should also anticipate an uptick in FHA refinancings.

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[24] Christie, Les. *Obama reduces refinance costs for FHA mortgages*. CNN. http://money.cnn.com/2012/03/06/real_estate/obama_mortgages/?hpt=hp_t3. 6 March 2012.

[25] DeMarco, Edward. Letter to Elijah E. Cummings, Ranking Member of the Committee on Oversight and Government Reform. Federal Housing Finance Agency. http://www.fhfa.gov/webfiles/23056/PrincipalForgivenessltr12312.pdf. 20 January 2012.

Project rebuild

The President's 2012 budget proposal included $15 billion to implement Project Rebuild, as outlined in the American Jobs Act. This program is intended to build upon the prior Neighborhood Stabilization Program and bring in private sector expertise and capital to focus on commercial and residential property improvements, thereby creating construction jobs.

Overview of proposal and potential impact

The program as proposed is a $15 billion program, with 2/3 of the funding to be allocated to states and municipalities through a formula determined by HUD and 1/3 of the funding competitively bid upon by the states and municipalities. The structure of the program would be very similar to that of the Neighborhood Stabilization Plan. Up to 30 percent of funds would be eligible for commercial projects, while the majority will be targeted towards areas determined by the HUD to have foreclosures, homes in default, or other poor economic indicators. All funds would be spent within three years, and would target an estimated 150,000 properties, creating an estimated 191,000 jobs.[26]

Obstacles to implementation

While the Neighborhood Stabilization Program made it through Congress, the $15 billion required to fund Project Rebuild is unlikely to gain approval in the near term. On this issue and many others, Democrats and Republicans continue to have philosophical differences of opinion about whether and to what extent the government should be involved.

Additionally, the new proposal includes a level of complexity above and beyond the Neighbourhood Stabilization Plan. By introducing commercial properties, the measure no longer focuses solely on the housing market, making it a more complex system to organize and allocate funding, creating significant amounts of uncertainty around how projects would be chosen.

What servicers should watch for

Servicers may see some level of funding for construction jobs come through in the budget, but it is unlikely to be in the form of the currently proposed Project Rebuild. What is implemented is likely to be smaller in scope, and potentially limited to residential properties similar to the prior Neighbourhood Stabilization Plan (NSP). Servicers are likely to see a new plan which serves as a continuation of prior NSP initiatives, and are unlikely to need to adapt to significant incremental changes. Servicers with large concentrations of low value properties where additional investments in repair may increase the market value of the home, should segment and establish target areas within their REO portfolios that may benefit from the program

Servicers should track legislation to see if any incremental provisions are included which differ from prior Neighbourhood Stabilization Program initiatives.

[26] http://www.stablecommunities.org/sites/all/files/library/1994/projectrebuildfactsheet9-13-11final.pdf.

Conclusion

While the President's plan included a significant and overarching plan for potential reform, the impact to mortgage servicers is likely to be concentrated around a few key components of the plan.

The top-of-mind considerations for mortgage servicers focus around the two expansions of the HAMP program: expanded scope through extended duration and broadening of the pool of eligible borrowers, and increased Treasury incentives. Specifically, servicers should ensure that their policies, procedures, operations, management reporting, and quality assurance and control are updated for the new guidelines and enhanced eligibility. This should include a compliance risk assessment and integrated change management to ensure the implementation successfully addresses all aspects of the new guidelines. Servicers must be ready by the June 1, 2012 effective date for those changes outlined in SD 12-02.

At the same time, servicers should track progress of programs which are already in progress, and ensure that they remain aware of any updates which could lead to significant impacts. These programs include extending forbearance terms to a full year period, the Homeowners' Bill of Rights, the Joint Investigation, and REO Rentals. Servicers should already be aware of these initiatives, and in many instances may already have felt the impacts from these changes. To the extent that additional impacts may be felt going forward, servicers should remain flexible and ensure that they are prepared to adapt internal operations as necessary.

Servicers should also keep an eye out for potential future impacts from programs which do not reach top-of-mind status in the short term. These programs include broad-based refinancing reform and Project Rebuild. Servicers should remain aware of any further developments in these areas to ensure future impacts are considered when appropriate. While major impacts may not be felt in the near term, there is a significant chance of partial or related changes such as the March 6th FHA announcement.

Servicers should prioritize their efforts to focus on the top-of-mind concerns and immediate needs for enhancements to operations, policies, procedures, and risk and quality programs; by making these enhancements without losing sight of potential future impacts, servicers can ensure that they are successfully positioned to respond to the plan and its ramifications for the mortgage banking industry.

For more information

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