SUMMARY OF THE OBAMA ADMINISTRATION'S HOMEOWNER AFFORDABILITY AND STABILITY PLAN

On February 18, 2009, the Obama Administration unveiled its comprehensive Homeowner Affordability and Stability Plan (Plan). This Plan is intended to limit the number of foreclosures and stabilize home values, thus aiding the US housing market.

The Plan has three components.

First, the Plan provides authority for Fannie Mae and Freddie Mac (the Government-Sponsored Enterprises or GSEs) to increase mortgage refinancing options for borrowers with loans held by one of these two GSEs.

Second, the Plan will create a US$75 billion Homeowners Stability Initiative (the Initiative) that will provide incentives for lenders and servicers to modify loans, and incentives for borrowers to stay current on their loan payments. The US Department of the Treasury (Treasury) will require all recipients of government funds under the Financial Stability Plan announced on February 10, 2009 to participate in the Initiative going forward. The Financial Stability Plan is described in the Arnold & Porter LLP client advisory available at http://www.arnoldporter.com/resources/documents/CA_TreasuryAnnouncesFinancialStabilityPlan_021309.pdf. For borrowers in bankruptcy court, the Administration, as part of the Initiative, will support legislation that will allow judges to modify mortgages as unsecured loans. Also, the Initiative will increase financial support for community-based programs aimed at preventing foreclosure and homelessness.

Third, the Plan provides an increased Government funding commitment for mortgage securitization, and an increase in the size of the GSEs' mortgage portfolio to US$900 billion.

Much of the details of the Plan have yet to be released. For example, guidance about borrower eligibility for the refinancing part of the Plan, as well as further guidance on the loan modification initiative, is expected to be released on March 4, 2009.

1. REFINANCING OPTION FOR RESPONSIBLE HOMEOWNERS SUFFERING FROM FALLING HOME PRICES

The first component of the Plan will provide a mechanism for homeowners that meet certain requirements to refinance a loan owned or guaranteed by Fannie Mae and Freddie Mac. The refinanced loans will be for 15- or 30-year set terms, at a fixed interest rate. Only first mortgages with a loan-to-value ratio equal to or below 105% will be eligible under this program. This represents an expansion of

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the GSEs' capacities to refinance loans in which borrower equity is less than 20%. However, there will not be a cash-out component to the refinance, except for closing costs and minor allowances for association fees, property tax bills, insurance costs, and rounding adjustments. The GSEs will attempt to maintain the same level of mortgage insurance on the refinanced loans, but they will be working with the mortgage insurance industry to secure this aim.

The Administration is expected to release more detailed borrower eligibility information on March 4, 2009, which is expected to include (1) income qualifications; (2) a requirement of an acceptable mortgage payment history; and (3) agreement from any existing second mortgage lenders to remain in a subordinate position. Once launched, this refinancing option is expected to be in effect through June 10, 2010.

2. US$75 BILLION HOMEOWNER STABILITY INITIATIVE

The second component of the Plan involves a Homeowner Stability Initiative, which aims to encourage loan modifications occurring on troubled loans at the pre-default stage, the bankruptcy stage, and through community-based programs.

A. Lender and Servicer Loan Modifications

The Initiative first will target borrowers who have either a high proportion of mortgage debt relative to their income, or a mortgage balance that exceeds the current market value of the home. Borrowers who show other indications of being at risk of imminent default also may be eligible despite being current on their mortgage payments. Other borrower requirements include:

- HUD-certified credit counseling for a borrower whose total "back end" debts (which includes not only housing, but other debts such as car loans and credit cards loans) are equal to or exceed 55% of his or her income.
- Eligibility only for mortgages on owner-occupied, primary residences, where the mortgage does not exceed the Fannie Mae and Freddie Mac conforming limits.
- Exclusion of speculators and owners seeking to modify investment properties.

Loan modifications made under the Initiative will involve a partnership between lenders and the Treasury that seems inspired in part by the Federal Deposit Insurance Corporation's (FDIC's) loan modification program (Mod in a Box) and loss sharing proposal. The FDIC's Mod in a Box and loss sharing proposal are described in the Arnold & Porter client advisory available at: http://www.arnoldporter.com/resources/documents/CA_FDICsLoan-ModificationProgramAndLossSharingProposal_120808.pdf.

If a loan is eligible, the first step of the modification will be conducted by the lender, who will reduce the loan's interest rate so that the borrower's mortgage debt-to-income ratio is not greater than 38%. Treasury will then match any further reductions in the interest payments dollar-for-dollar until the ratio is reduced to 31%. Alternatively, lenders can bring down monthly payments by reducing the mortgage principal, and Treasury will partially share the costs of any principal reduction, up to the amount the lender would have received for an interest rate reduction. Either of these loan modifications will remain intact for five years, at which point the interest rate could be stepped up to the conforming loan rate that was in place at the time of the modification.

Loans will be ineligible for modification if the total cost of a loan modification, including government subsidies, is greater than the cost of foreclosure—a concept which the FDIC has referred to as the "net present value" test. Also, Treasury will not provide payments for loan modifications that reduce an interest rate to below 2%.

To increase the number of voluntary participants in the Initiative, Treasury will provide financial incentives to lenders and servicers for modifying loans, and to borrowers for subsequently sustaining payments.

Lenders will receive:

- US$1,500 for each modification made to a borrower who is not in default.
- Yet unspecified incentives for pursuing mitigating alternatives such as short sales and deeds in lieu of foreclosure.

Servicers will receive:

- US$1,000 for each loan modification.
- US$500 for each loan made to a borrower before default.
- "Pay-for-success" fees of up to US$1,000 each year for three years, awarded monthly.

Borrowers with modified loans will receive:

- Payment reductions of up to US$1,000 each year for five years, if they remain current on payments.

In addition to incentive payments, the Administration and the FDIC will create a US$10 billion insurance fund to protect lenders against declines in home prices. Lenders will receive an insurance payment on each modified loan that is connected to declines in the home price index. The money for this fund will be appropriated through the Troubled Asset Relief Program, otherwise known as TARP.

Each servicer participating in the Plan will be required to report standardized loan-level data on modifications, borrower and property characteristics, and outcomes.

B. Judicial Loan Modifications

The second prong of the Initiative involves allowing modifications of loans subject to bankruptcy proceedings. The avenue to achieve this goal requires a legislative revision of the bankruptcy laws to grant judges the power to modify mortgages, or so-called "cram-down" legislation. Such legislation would deem loans that exceed the value of a debtor's property as unsecured. Bankruptcy judges would then be able to modify loans to make the payments feasible for the debtors. In order to receive this reduction, however, debtors would first request a loan modification from the lender. This legislation also would give the Federal Housing Authority (FHA) and the Veterans Administration (VA) the authority to provide partial claims in the event of bankruptcy or voluntary modification so that these loans would also be subject to judicial modification. It is not clear that the current "cram-down" legislative proposals in Congress mirror the legislation that is contemplated as part of the Plan.

C. Community-Based Programs

The Initiative will also focus on increasing loan modifications and assistance through community-based programs. For example, programmatic restrictions and high costs have contributed to low participation rates in the FHA's HOPE for Homeowners program (H4H). To ensure more homeowner participation in H4H, the Plan calls for the FHA to reduce borrower fees, increase flexibility for lenders to modify troubled loans, permit borrowers with higher debt loads to qualify, and allow payments to servicers of the existing loans. The US Department of Housing and Urban Development (HUD) will also award US$2 billion in Neighborhood Stabilization program grants for innovative programs that reduce foreclosure. Another US$1.5 billion will go towards assistance for renters to reduce homelessness.

3. SUPPORTING LOW MORTGAGE RATES BY STRENGTHENING CONFIDENCE IN FANNIE MAE AND FREDDIE MAC

The third component of the Plan calls for increasing the Government's funding commitment to Fannie Mae and Freddie Mac by using authorized funds from the Housing and Economic Recovery Act of 2008. This part of the Plan has four components.

First, Treasury will increase the amount of preferred stock purchased in Fannie Mae and Freddie Mac from US$100 billion to US$200 billion each.

Second, Treasury will continue to purchase mortgage-backed securities from the GSEs.

Third, Treasury is going to increase the size of the GSEs' retained mortgage portfolios allowed under the agreements by US$50 billion to US$900 billion.

Finally, the Obama Administration is expected to work with Fannie Mae and Freddie Mac to support state housing finance agencies in serving homebuyers.

The Plan, as introduced by the Administration, will likely go through a series of revisions and alterations. The Mortgage Bankers Association, the Mortgage Insurance Companies of America, and Republican members of Congress have already presented inquiries and suggested changes to the Administration. As the parameters of the Plan are finalized, and future guidance is released, please contact us with questions about how this Plan may affect your business practices.

We hope that you have found this client advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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