

# U.S. Structured Finance Newsletter

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## HOPE FOR HOMEOWNERS IN THE NEW HOUSING LAW

In our previous newsletter, we discussed the topic of cramdowns (a process facilitated by a bankruptcy court in which the unpaid principal balance of a first lien mortgage may be written down for a bankrupt borrower) and how they related to the new *Housing and Economic Recovery Act of 2008*. Unfortunately, that aspect of the bill had been debated, and on April 4, 2008, a Senate amendment containing such provisions was excluded from the final legislation. It was strongly opposed by the lending industry, which maintained that it would undermine investor confidence in secondary markets and potentially result in higher interest rates and larger down-payment requirements for borrowers.

Another section of the new law, however, does address individuals who are having difficulty paying their mortgages and who cannot refinance because of house price depreciation: the *HOPE for Homeowners Act of 2008*. If the lender decides to forgive all debt above 90% of the home's current value, the borrower can seek a new fixed-rate loan guaranteed by the Federal Housing Administration (FHA), the proceeds of which would be used to retire the existing loan.

This law will enable the FHA to refinance the mortgages of at-risk borrowers living in their only home if (1) mortgage holders write down the principal of the mortgage; (2) borrowers agree to share future equity with the federal government; and (3) the borrower can afford to repay the new loan. To be eligible for the FHA refinancing, the mortgagor needs to certify that he or she has not intentionally defaulted on the mortgage and will be liable for repayment. In addition, the mortgagor must meet the debt-to-income ratio requirements, where, taking into consideration all existing mortgages of that mortgagor as of March 1, 2008, the mortgagor must have a ratio of mortgage debt-to-income greater than 31%.

As an example of how the law works, let's take a look at Borrower A, who purchased a \$400,000 home in 2005 on an 80/20 plan, borrowing \$320,000 on an adjustable-rate first mortgage and \$80,000 on a second mortgage. Now Borrower A is having difficulty making his monthly payments because the adjustable-rate mortgage coupon has increased and he can't refinance because the home's value has dropped to \$300,000. If the lender agrees to forgive all debt above \$270,000, he would qualify for relief under the new law and be able to refinance into a new FHA loan. In this example, the original lender would thus settle for \$270,000, or a loss of \$50,000, while the lender on the second mortgage would suffer a total loss of \$80,000.

If the home is sold at a profit at some future date, the FHA will be entitled to a share of any home price appreciation. If the home is sold in the first year, the FHA is entitled to 100% of the appreciation. In each of the next five years, the percentage of the appreciation owed the FHA declines by 10% until it reaches the minimum 50%.

DBRS agrees that this refinance program is necessary to stabilize the housing market and reduce the impact of turmoil in that market on the economy of the United States as well as reduce foreclosures. Further, even though investors will see losses come through more quickly, the actual severity could potentially be lower than if the loans were to go through the typical lengthy foreclosure and real estate owned (REO) process. DBRS will continue to monitor the impact of the new housing law on RMBS transactions.

For questions or comments, contact the author Jan Buckler at [jbuckler@dbrs.com](mailto:jbuckler@dbrs.com).

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