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FHA HOPE for Homeowners Program
Updated Summary—January 15, 2009

Basics. The FHA HOPE for Homeowners Program (Program) is established by the HOPE for Homeowners Act of 2008 (the "HOPE Act"), which is Title IV of the Housing and Economic Recovery Act of 2008. Up to a total of $300 billion in FHA insured loans may be made under the Program. The Government National Mortgage Association (Ginnie Mae) is granted corresponding commitment authority to guarantee securities backed by pools of Program loans. Loans may be insured under the Program from October 1, 2008 through September 30, 2011. The HOPE Act creates a board (the "Board") that is responsible for establishing the details of the Program. The Emergency Economic Stabilization Act of 2008 (EESA) amended the HOPE Act to revise certain aspects of the Program.

Potential for Future Changes. As explained in this summary, the EESA and the Board made changes to the initial Program requirements to help expand the availability of the Program. Recently, legislation was introduced in the United States House of Representatives to amend the Troubled Asset Relief Program provisions of the EESA, and also amend the HOPE Act. The intent of the proposed HOPE Act amendments is to further liberalize the Program in order to expand the pool of borrowers who may receive Program loans.

Board. The Board created by the HOPE Act is comprised of the HUD Secretary, Treasury Secretary, Federal Reserve Board Chair, and FDIC Board of Directors Chair, or their respective designees.

Guidance. The Board issued a final rule for the Program (the "Rule") that was published in the *Federal Register* on October 6, 2008, and became effective on that date. In the preamble to the rule, the Board states that because the Program is temporary and designed to address the immediate needs of homeowners faced with the threat of foreclosure, regulations adopted by the Board are limited to the basic requirements of the Program. The Board's intent is to "leave FHA with sufficient flexibility to issue such guidance or processing requirements to make this a Program that is able effectively to assist distressed homeowners avoid foreclosure." Because the Rule was issued before the EESA became law, the Rule does not reflect the EESA amendments.

The Board issued an interim final rule for the Program (the "Interim Rule") that was published in the *Federal Register* on January 7, 2009, and became effective on that date. Comments on the Interim Rule are due by March 9, 2009. The Interim Rule amends the Rule to reflect the EESA amendments and additional revisions made by the Board. The Interim Rule, along with the new Mortgagee Letter discussed below, implement changes to the Program that were announced in November 2008.

HUD issued Mortgagee Letter 2008-29 dated October 1, 2008 that provides origination guidance and Mortgagee Letter 2008-30 dated October 1, 2008 that provides servicing guidance. Because the Mortgagee Letters were issued before the EESA became law, the Mortgagee Letters do not reflect the EESA amendments. HUD issued Mortgagee Letter 2009-03 dated January 6, 2009, which supplements the prior Mortgagee Letters to reflect the EESA amendments and additional revisions made by the Board. The prior Mortgagee Letters continue to apply except as modified.

Voluntary. A holder of an existing mortgage is not required by the HOPE Act to participate in the Program generally or with respect to any particular loan.

Loans Eligible for Refinancing. A loan is eligible for refinancing if (a) the loan was made on or before January 1, 2008, (b) the borrower (i) occupies the property securing the loan as his or her primary residence, and (ii) cannot afford the payments of the loan, subject to the minimum mortgage debt-to-income requirement and such other standards established by the Board, and (c) the borrower has made at least six full payments during the life of the loan. Mortgagee Letter 2008-29 defines "full payment" as the payment that was acceptable to the lender for meeting the monthly payment obligation under the terms and conditions of the loan.

Mortgagee Letter 2008-29 also provides that any type of loan is eligible for refinancing under the Program, including conventional (prime, Alt-A or subprime) or government-backed (FHA, VA or Rural Development) loans, and fixed-rate or adjustable-rate loans. Additionally, the loans that are eligible for refinancing can have a variety of characteristics, including interest only, payment option, negative amortization and/or "any other exotic" features.

Initially, the minimum mortgage debt-to-income requirement had to be satisfied as of March 1, 2008. Based on the EESA, the Interim Rule and Mortgagee Letter 2009-03 expand the eligibility standard for borrowers with an adjustable rate loan with a post March 1, 2008 reset. As a result, the minimum mortgage debt-to-income requirement varies based on whether the borrower has (a) a fixed rate loan or adjustable rate loan with no reset after March 1, 2008 or (b) an adjustable rate loan with a reset after March 1, 2008.

For a borrower who has a fixed rate loan or adjustable rate loan with no reset after March 1, 2008, as of March 1, 2008 the borrower must have a minimum mortgage debt-to-income ratio of more than 31%, considering all existing mortgage loans of the borrower as of such date.

For a borrower who has a first or subordinate lien mortgage loan as of March 1, 2008 that has or may reset after such date, the borrower must have a minimum mortgage debt-to-income ratio of more than 31% based on (a) the borrower's income and total monthly mortgage payment(s) as of March 1, 2008 or (b) the borrower's income and total monthly mortgage payment(s) as of the date the borrower first applied for the Program loan. While the ratio may be determined as of the date the borrower first applied for the Program loan, only debt from mortgage loans existing as of March 1, 2008 may be considered. However, the total debt outstanding under a mortgage line of credit as of the date the borrower applied for the Program loan may be used for the calculation, as long as the line of credit existed on March 1, 2008. The calculation should be made using the fully indexed and fully amortizing payment for the mortgage loan as of March 1, 2008 or the date that the borrower first applied for the Program loan, as applicable. The indexed rate should be based on the index prevailing on the applicable date, plus the margin applicable after the expiration of any introductory rate. The fully amortizing payment is based on the actual loan term.

When calculating the debt-to-income ratio as of the date the borrower applied for the Program loan, the lender should: (a) analyze the employment and income documentation that it will use to qualify the borrower for the Program loan, (b) obtain from the servicer(s) the total monthly mortgage payment due at the time of loan application for each mortgage loan existing as of March 1, 2008, and (c) verify that only debt resulting from mortgages outstanding as of March 1, 2008 is being used to make the calculation. When the existing mortgage loan does not provide for escrow payments, the lender should obtain tax and insurance information from the borrower. If the borrower does not provide insurance information, the servicer of the mortgage loan should estimate the monthly cost of hazard and, if applicable, flood insurance based on the property's location and the rate in effect at the time of application for the Program loan. If the borrower does not provide real estate tax information, the lender should obtain the information from public records. (See *Debt to Income Details* below.)

The Rule and Mortgagee Letter 2008-29 also provide that the borrower must have made a minimum of six full payments during the life of the existing senior mortgage loan. The Mortgagee Letter defines "full payment" as the payment that was acceptable to the lender for meeting the monthly payment obligation under the terms and conditions of the mortgage loan.

Borrower Eligibility Exclusions. The HOPE Act provides that the borrower may not have been convicted under federal or state law for fraud during the ten-year period ending upon the insurance of the Program loan. The Rule and Mortgagee Letter 2008-29 simply provide for the borrower not being convicted of fraud in the past ten years.

The borrower may not have an ownership interest in any other residential property.

The HOPE Act requires that the borrower provide a certification that he or she did not intentionally default on the existing mortgage loan or any other debt, and did not knowingly, willfully and with actual knowledge, furnish material information known to be false for the purpose of obtaining the existing mortgage loan. The Rule defines "intentionally defaulted" to mean that (a) the borrower knowingly failed to make payment on the mortgage or debt, (b) had available funds at the time payment on the mortgage or debt was due that could pay the mortgage or debt without undue hardship, and (c) the debt was not subject to a bona fide dispute.

Mortgagee Letter 2008-29 contains an initial form of a *HOPE for Homeowners Certification* for borrowers. Mortgagee Letter 2009-03 includes a revised *HOPE for Homeowners Certification*. It appears that only technical changes were made (i.e., addition of a form number and an OMB legend). The form includes the certifications that the borrower did not intentionally default or provide false information in connection with the existing loan, and a certification that the borrower was not convicted of fraud in the past ten years.

Eligible Properties. The Rule provides that the following property types are eligible for a Program loan: (a) detached and single family dwellings, (b) individual condominium units, (c) individual cooperative units, and (d) manufactured homes that are permanently affixed to realty and treated as realty under applicable state law, except state taxation law. Although initially, pursuant to the Rule and Mortgagee Letter 2008-29, only one-unit properties were eligible, the Interim Rule and Mortgagee Letter 2009-03 provide that one- to four-unit properties are now eligible. With a two- to four-unit property, the borrower must occupy one of the units as the borrower's primary residence, and may not have an ownership interest in any residential property other than the two- to four-unit property. The nationwide maximum mortgage limits are as follows: two-unit property, $704,682; three-unit property, $851,796; and four-unit property, $1,058,574. HUD notes in Mortgagee Letter 2009-03 that FHA has a separate policy requiring three- and four-unit properties to be self-sufficient.

Debt to Income Details. The Rule defines "total monthly mortgage payment" for purposes of the debt-to-income threshold as (a) the principal and interest, as determined on a fully indexed and fully amortized basis, and (b) (i) for escrowed loans, the monthly required amount collected for real estate taxes, premiums for required hazard and mortgage insurance, homeowner's association dues, ground rent, special assessments, water and sewer charges and other similar charges required by the note or security instrument or (ii) for non-escrowed loans, one-twelfth of the total estimated annual cost for such items.

Mortgagee Letter 2008-29 provides that reconstructing a borrower's prior debt-to-income ratio based on the total monthly mortgage payment may be difficult, especially as the Program nears its sunset date. The Mortgagee Letter sets forth the following requirements to comply with the eligibility requirement:

a. The lender must obtain from the borrower evidence that the prior mortgage debt-to-income ratio was more than 31% on March 1, 2008, such as pay stubs for March 2008 or a signed and dated copy of the individual Federal income tax return, when available, to determine gross monthly income for that month (earnings divided by 12), or W-2s, financial records, or verification of employment from the borrower's employer.

Lenders may rely on the borrower's signed and dated 2007 Federal tax return if the lender has no reason to believe that the borrower's income in March 2008 was materially different than the income reported on the 2007 Federal tax return.

For self-employed borrowers, lenders must obtain a copy of the quarterly tax return that contains income stream information for March 2008, or a signed and dated Profit and Loss Statement and balance sheet that contains income stream information for March 2008, or a signed and dated copy of the individual 2008 Federal tax return when available (earnings divided by 12).

b. The lender must obtain from the servicer of the existing mortgage loan the borrower's total monthly payment due for March 2008, including any amounts due on subordinate liens. For non-escrowed loans, the lender should obtain tax and insurance information from the borrower. If the borrower does not provide insurance information, then the servicer of the mortgage loan should estimate the monthly cost of hazard insurance (and flood insurance, if applicable) based on the property's location and rates in effect for 2008. If the borrower does not provide real estate tax information, the lender should obtain it from public records.

As noted above, Mortgagee Letter 2009-03 addresses how a lender should analyze the borrower's mortgage debt-to-income ratio in cases in which the ratio may be assessed as of the date the borrower first applied for the Program loan.

No Fraud Conviction and No Other Property Details. As noted above, to be eligible for a Program loan, the borrower may not have been convicted under federal or state law for fraud during the prior ten years, and may not have an ownership in other residential property. In Mortgagee Letter 2008-29, FHA advises that, similar to its validation tool for social security numbers, FHA will use an automated tool at the time of case number assignment that will check the borrower's name against several databases for convictions of fraud and an ownership interest in other residential property. If a lender receives a warning at case number assignment and believes the warning to be in error, the lender must provide evidence appropriate to the Homeownership Center documenting that the borrower has not been convicted of fraud or does not have an ownership interest in other residential property. After evaluating the documentation, the Homeownership Center will determine whether to lift the warning.

Disclosure and Certification. Borrowers must be provided with a *HOPE for Homeowners Consumer Disclosure and Certification Form* at the time of initial loan application for the Program. The *Form* must be signed and dated by the borrower at least one day before execution of the initial Uniform Residential Loan Application. Borrowers also must sign the *Form* at the time of closing. An initial version of a *HOPE for Homeowners Consumer Disclosure and Certification Form* is attached to Mortgagee Letter 2008-29. A revised version of the *Homeowners Consumer Disclosure and Certification Form* is attached to Mortgagee Letter 2009-03.

Counseling. Counseling is not required, but Mortgagee Letter 2008-29 provides that "borrowers should be strongly encouraged to contact and work with a housing counseling agency."

Underwriting Requirements.

TOTAL. Mortgagee Letter 2008-29 provides that approved lenders must use FHA's TOTAL Mortgage Scorecard (TOTAL), but that regardless of the risk classification obtained from TOTAL for each mortgage originated under the Program the lender must satisfy the underwriting requirements noted below regarding the total monthly payment amount on the Program loan, debt to income, and income verification.

Other Obligations. The Mortgagee Letter also provides that for those borrowers current on their existing mortgage, underwriters should not automatically reject them for making the mortgage payment their first priority at the expense of meeting other recurring obligations in a timely manner. If the borrower

was offered partial forbearance, the underwriter must determine that he or she has made payments under the forbearance agreement in a timely manner.

Debt to Income. The Rule defines the "total monthly mortgage payment" as (a) the principal and interest, as determined on a fully indexed and fully amortized basis, and (b) the monthly required amount collected for real estate taxes, premiums for required hazard and mortgage insurance, homeowner's association dues, ground rent, special assessments, water and sewer charges and other similar charges required by the note or security instrument. Initially, the Rule limited the total monthly mortgage payment for a Program loan to 31% of the borrower's gross income, and limited the sum of the total monthly mortgage payment and all monthly recurring expenses of the borrower to 43% of the borrower's gross income.

The Interim Rule and Mortgagee Letter 2009-03 provide for higher debt ratios based on the loan-to-value ratio. The standard 90% loan-to-value ratio limit may be exceeded, up to a maximum ratio of 96.5%, if the debt-to-income ratios do not exceed 31% for mortgage payments and 43% for total debt payments. At the standard 90% loan-to-value ratio limit, the borrower may have debt ratios that do not exceed 38% and 50%. While initially a borrower had to be qualified through the use of a three-month trial modification to have debt ratios above 31% and 43%, the trial modification requirement no longer applies. Note that the loan-to-value limits include the financed upfront mortgage insurance premium

Payment on Program Loan. The Rule and Mortgagee Letter 2008-29 provide that the borrower's total monthly payment on the Program loan must not be greater than the borrower's aggregate total monthly payment under the borrower's existing senior mortgage loan and all existing subordinate mortgage loans.

Payments on Existing Loan. The Rule and Mortgagee Letter 2008-29 also provide that the borrower must have made a minimum of six full payments during the life of the existing senior mortgage loan. The Mortgagee Letter defines "full payment" as what was acceptable to the lender for meeting the monthly payment obligation under the terms and conditions of the mortgage loan.

Non-Occupant Co-Borrowers. The Rule provides that if one of the borrowers will not reside in the property, the non-occupant borrower must relinquish all interests in the property before the application for insurance under the Program is submitted to FHA. However, Mortgagee Letter 2008-29 provides that if there are non-occupant co-borrowers, they will need to quit claim their interest in the property prior to the occupying co-borrowers applying for a Program loan.

Income Verification. The HOPE Act provides that in complying with FHA underwriting requirements for loans insured under the Program the lender must document and verify the income of the borrower (or the non-filing status of the borrower) by procuring (a) an income tax return transcript of the income tax returns of the borrower, or (b) a copy of the income tax returns from the IRS, for the two most recent years for which the filing deadline for such years has passed, and by any other method in accordance with procedures and standards that the Board must establish.

The Rule and Mortgagee Letter 2008-29 provide that the lender must use FHA's procedures to verify the borrower's income and must comply with the following additional requirements:

a. The lender must document and verify the income of the borrower by obtaining a transcript of the borrower's Federal income tax returns or a copy of the borrower's Federal income tax returns obtained directly from the IRS for the most recent two years; and

b. The lender must document and verify the borrower's income in any case in which the borrower had not filed a Federal income tax return.

Appraisal. The HOPE Act provides that any appraisal of the property must:

a. Be based on the current value of the property.

b. Be conducted in accordance with Title IX of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

c. Be completed by an appraiser who meets the competency requirements of the Uniform Standards of Professional Appraisal Practice (the "USPAP").

d. Be wholly consistent with the appraisal standards under the National Housing Act for FHA insured loans.

e. Comply with the appraisal independence requirements under the HOPE Act (see below for a discussion of the requirements).

The Rule provides that the appraisal must be performed by an appraiser on the FHA Appraiser Roster, and that the appraisal must be conducted in accordance with the USPAP and dated no more than 90 days from the date on which the Program loan transaction is closed, except as otherwise provided by the Board. The lender must inform the appraiser that copies of the appraisal may be shared with holders and servicers of existing subordinate mortgages.

Mortgagee Letter 2008-29 provides that the appraisal must have been specifically ordered for the Program loan transaction. Although generally the appraisal should be no more than three months old at the time of loan closing, if the appraisal is older than three months because of transactional delays it still may be acceptable with an explanation that addresses how the appraisal meets existing FHA standards and the requirement for "current" appraised value. The lender may require a new appraisal if the existing appraisal and explanation are not sufficient.

The Mortgagee Letter provides that if both the current lender or servicer and the new lender that will make the Program loan order an appraisal, the value provided in the appraisal ordered by the new lender will prevail.

Declining Markets. HUD advises in Mortgagee Letter 2008-29 it expects many of the properties financed under the Program will be located in declining market areas. HUD states that no standard definition of a declining market exists, other than a market in which home prices are falling, and that a declining market could be as small as a neighborhood or as large as an entire state. The Mortgagee Letter sets forth appraiser responsibilities and lender responsibilities regarding declining markets.

Appraiser Responsibilities. Mortgagee Letter 2008-29 provides that it is the appraiser's responsibility to determine whether a property is located in a declining market. When the appraiser selects the box in the appraisal form to indicate that property values are increasing, stable or declining, the appraiser is certifying that he or she has performed an objective analysis of quantifiable data supporting the observations made.

The appraiser must provide (a) an explanation in the "Market Conditions" section of the appraisal report that includes relevant information in support of the conclusions about appraised value relating to trends in property values, demand/supply and marketing time, and (b) a description of the prevalence and impact of sales and financing concessions and/or down payment assistance in the subject's market area. The Mortgagee Letter also notes that other areas of discussion may include days on the market, list-to-sale price ratios, and/or financing availability.

Lender Responsibilities. Mortgagee Letter 2008-29 provides that the lender's responsibility is to properly review the appraisal and determine that the appraised value used to support the Program loan amount is accurate and adequately supported. Lenders may determine that the appraised value is supportable through services such as the S&P/Case-Schiller Index, Office of Federal

Housing Enterprise Oversight House Price Index (or any index developed by its successor, the Federal Housing Finance Agency) or National Association of Realtors statistics.

Lenders are reminded that if the appraiser they select provides a poor or fraudulent appraisal that leads FHA to insure a mortgage at an inflated amount, the lender is held equally responsible with the appraiser for the violation if the lender knew or should have known of the defects or fraud in the appraisal. FHA will pursue appropriate enforcement actions against the appraiser, the lender or both. Lenders accept responsibility, equally with appraisers for the integrity, accuracy and thoroughness of the appraisal submitted to FHA for mortgage insurance purposes.

Lenders should inform appraisers that the purpose of the appraisal is for the Program, and advise appraisers that a copy of the appraisal will be shared with subordinate lien holders and also will be provided to the borrower.

Appraisal Independence. The HOPE Act provides that no mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, nor any other person with an interest in a real estate transaction involving an appraisal in connection with a Program loan shall improperly influence, or attempt to improperly influence, through coercion, extortion, collusion, compensation, instruction, inducement, intimidation, nonpayment for services rendered, or bribery, the development, reporting, result, or review of a real estate appraisal sought in connection with the loan. HUD may impose civil money penalties for any knowing and material violation of this prohibition, under the same terms and conditions as are authorized in Section 536(a) of the National Housing Act (12 USC Section 1735f-14(a)). The Rule also includes the prohibition and authority for HUD to seek civil money penalties, and provides that such authority does not preclude HUD from bringing any other action that it may be authorized to bring for a violation of the prohibition.

Requirements to Protect FHA.

Provisions Regarding Borrower.

Borrower Certification. As noted above, the HOPE Act requires the borrower to certify that he or she has not intentionally defaulted on the existing mortgage or any other debt, and has not knowingly, or willfully with actual knowledge, furnished material information known to be false for the purpose of obtaining any existing mortgage that is eligible for refinancing under the Program. The certification must contain an acknowledgment that any willful false statement made in the certification is punishable, under Section 1001 of United States Code Title 18, by fine or imprisonment of not more than five years, or both. Additionally, the borrower must agree in writing that he or she shall be liable to repay to FHA any direct financial benefit achieved from the reduction of indebtedness on the existing mortgage loan or mortgage loans on the residence refinanced under the Program derived from misrepresentations made in the certification and documentation provided pursuant to the certification requirement, subject to the discretion of HUD.

The Rule requires the borrower to provide any additional certifications that FHA may require. The Rule also defines “direct financial benefit” to mean the greater of the following two factors:

a. The amount of initial equity the borrower has in the property at the closing for the Program loan, as determined pursuant to the equity sharing provisions of the Rule; and

b. The total amount that the existing senior mortgage loan and all existing subordinate mortgage loans on the property have been written down.

Notice to Borrower of False Information. The Rule provides that if FHA finds that the borrower made a false certification or provided false information via any means, including but not limited

to false documentation, FHA shall inform the borrower, in writing or any other acceptable format, of such fact.

The notice must be sent to the borrower's last known address by both certified and ordinary mail. The notice must state with specificity the misrepresentation or false statement made by the borrower, and include a request for repayment of the direct financial benefit that the borrower is deemed to have received, as determined by FHA, by the refinancing of the existing eligible senior mortgage loan and subordinate mortgage loans. Neither HUD nor the United States are precluded by the request for repayment from bringing any other action that they may be authorized to bring.

The borrower may request a hearing before a Hearing Officer within 45 days from the date of the false information notice. The hearing will be conducted in accordance with the provisions of 24 CFR Part 26, subpart A, except as modified by the Rule.

Provisions Regarding Mortgagee and Program Loan.

Adverse Selection/No First Payment Default. The HOPE Act requires that the Board establish standards and policies to require that an underwriter of a Program loan provide such representations and warranties as the Board considers necessary or appropriate to enforce compliance with the underwriting and appraisal standards of the Program. The Board must prohibit HUD from paying insurance benefits to any lender who violates the representations and warranties, or when the borrower fails to make the first payment on a Program loan. The Board may establish such other standards or policies as necessary to protect against adverse selection, including requiring loans that HUD identifies as being higher risk to demonstrate payment performance for a reasonable period of time before the loans may be insured under the Program.

Underwriter and Mortgagee Certification. The Rule requires that the underwriter and mortgagee provide certifications, in a format approved by FHA, that the Program loan is in compliance with the underwriting and appraisal standards of the Rule, and that the loan meets all requirements applicable to the Program. FHA may require additional certifications by the mortgagee to ensure compliance with such additional standards as FHA deems necessary given the specific mortgage transaction presented.

Submission For FHA Insurance. The Rule initially required that a mortgagee must submit a complete case binder for a Program loan to FHA within 120 days from the date of closing, or such other time as the Board may prescribe. The Interim Rule eliminates the 120-day submission requirement, and provides that a Program loan is eligible for insurance if the mortgagee submits a complete case binder within such time period as the Board prescribes. Mortgagee Letter 2009-03 provides that existing FHA standards apply to the endorsement of Program loans. As a result, case binders for Program loans must be submitted in accordance within the timeframe applicable to standard FHA loans. When submitting a case binder for insurance endorsement under the Program, lenders must:

a. Include evidence in the case binder that the borrower made the first payment from their own funds within 120 days of the closing on the Program loan. (Lenders are not eligible for a claim payment if the first mortgage payment is not received within 120 days of closing.)

b. Certify that the loan is current at the time of submission.

c. Certify that the lender did not bring the loan current to make it eligible for endorsement.

A form of *FHA HOPE for Homeowners Attachment to the FHA Loan Underwriting and Transmittal Summary* is included with Mortgagee Letter 2009-03.

Violation of Program Requirements. The Rule provides that if FHA finds that the mortgagee who originated and/or underwrote a Program loan violated the Program requirements, (a) if the mortgagee still holds the loan, FHA is prohibited from paying FHA insurance benefits to that mortgagee, and (b) if the mortgagee no longer holds the loan, FHA will pay the insurance claim to the mortgagee currently holding the loan (if all other requirements of the contract for mortgage insurance are met and the current holder did not participate in the violation of Program requirements) and FHA must seek indemnification from the non-holding mortgagee.

First Payment Default. The Rule prohibited FHA from paying a mortgage insurance claim to any mortgagee if the first total monthly mortgage payment was not made within the time frame to submit a Program loan for FHA insurance. The Rule required the submission of Program loans for insurance within 120 days, however, as noted above, the Interim Rule eliminated this requirement. Nevertheless, the Interim Rule continues the prohibition. Under the Interim Rule, FHA may not pay an insurance claim on a Program loan if the first total monthly mortgage payment is not made within 120 days of closing. The mortgagee may not, directly or indirectly, make all or a part of the first total monthly mortgage payment on behalf of the borrower. Additionally, the mortgagee is prohibited from escrowing funds at closing for all or part of the first total monthly mortgage payment. (See *Submission For FHA Insurance* above.)

Monitoring. The Rule provides that FHA is authorized by the Board to engage in monitoring activities to ensure mortgagee compliance with Program requirements. The Mortgagee Review Board is authorized by the Board to impose sanctions and civil money penalties against mortgagees that violate Program requirements. The authority of the Mortgagee Review Board to impose sanctions and civil money penalties does not preclude HUD from bringing any other action that HUD may be authorized to bring.

If FHA does not have to pay an insurance claim under the Rule because of a violation of Program requirements by the mortgagee, this does not preclude the Mortgagee Review Board or HUD from bringing any action against the mortgagee that the Mortgagee Review Board or HUD are authorized to bring.

Mortgagee Letter 2008-29 provides that current monitoring practices (such as Post Endorsement Technical Reviews, Appraiser Watch, and Lender Monitoring Reviews), will be used to monitor lenders and appraisers participating in the Program, as well as loan performance. If a serious violation of Program requirements, or general FHA program requirements, is discovered, FHA's standard indemnification procedures and claim payment procedures apply (i.e., holders of FHA insurance benefits who were not a party to the violation will be paid a claim and the deficiency or loss to FHA will be pursued under the indemnification agreement with the lender responsible for the violation).

Program loans will not be included in HUD's performance analysis of a lender's compare ratio with respect to the Credit Watch Termination Initiative. Rather, FHA will develop a separate module in Neighborhood Watch to display a lender's performance compare ratio for Program loans.

The Mortgagee Letter also provides that as part of its Lender Monitoring Reviews, FHA will perform an independent background check to determine whether the borrower has been convicted of fraud in the last ten years. The lender's liability is limited to what it "knew or should have known." With respect to the "knew or should have known" standard, the Mortgagee Letter refers to information indicating a fraud conviction that was available to the lender during processing, or the receipt by the lender of a fraud conviction warning at the time of case number assignment.

Terms of Program Loans.

Primary and Sole Residence. The borrower must document to the satisfaction of HUD that the property that will secure a Program loan is occupied by the borrower as his or her primary residence, and that such property is the only residence in which the borrower has any present ownership interest.

Maximum Loan Amount. The maximum loan amount may not exceed 132% of the 2007 loan limitation under Section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act (12 USC Section 1454(a)(2)) for a property of applicable size, which is $550,440 (i.e., 132% of $417,000) for a one-family residence. The nationwide maximum mortgage limits for two- to four-unit residences are as follows: two-unit property, $704,682; three-unit property, $851,796; and four-unit property, $1,058,574.

The maximum loan amount may not exceed 96.5% of the appraised value of the property. The initial loan-to-value limit was 90% under the HOPE Act; however, the EESA amended the HOPE Act to allow the Board to authorize a higher loan-to-value ratio in its discretion. Under this authority, the 96.5% limit is set forth in the Interim Rule and Mortgagee Letter 2009-03. However, as discussed above, the expanded debt-to-income limits are not available for loans with a loan-to-value ratio in excess of 90%.

Additionally, it must be determined pursuant to FHA underwriting standards, or any other standards as may be established by the Board, that there is a reasonable ability of the borrower to make his or her mortgage payments.

The existing lender, and any subordinate lien holders, must accept the new loan amount as payment in full for the eligible mortgage loan. Thus, to the extent the outstanding principal balance of the eligible mortgage loan exceeds the applicable percentage of the appraised value of the property, the lender must forgive the excess, plus the amount necessary to pay the upfront mortgage insurance premium discussed below. For example, if the outstanding principal balance of the eligible mortgage is $110,000 and the property value is $100,000, assuming that the borrower will receive a loan with a 90% loan-to-value ratio, the existing lender would have to accept as payment in full of the eligible mortgage loan $87,300 (i.e., the maximum $90,000 Program loan, less $2,700 for the upfront mortgage insurance premium).

The EESA amended the HOPE Act to provide for an upfront payment to a holder of an existing subordinate mortgage loan as payment in full of all indebtedness and in lieu of any future appreciation payment under the shared appreciation provisions discussed below.

Insurance Premiums. At the time a Program loan is made, an upfront mortgage insurance premium of 3% of the loan amount must be paid from the proceeds of the loan. The Rule provides that the upfront premium must be paid with proceeds from the Program loan through a reduction of the amount of indebtedness that existed on the existing eligible mortgage loan prior to its being refinanced.

Additionally, there is an annual premium of 1.5% of the amount of the remaining insured principal balance of the Program loan.

Term to Maturity. The HOPE Act provides that a Program loan must have a term to maturity of not less than 30 years from the date of the beginning of amortization. The Interim Rule and Mortgagee Letter 2009-03 impose a maximum term limit of 40 years (increasing the 30-year maximum initially provided for in Mortgagee Letter 2008-29). The preamble to the Interim Rule and Mortgagee Letter 2009-03 note that if a Program loan will be included in pool of loans that will back securities insured by Ginnie Mae, then the loan term should be 30 or 40 years to maintain consistency with the other loans in the pool, as applicable.

Interest Rate and Fees. The HOPE Act provides that a Program loan must have a single rate of interest that is fixed for the entire term. The Board must establish procedures to ensure that interest rates

on Program loans are commensurate with market rates on the applicable types of loans. The Board also must establish a reasonable limitation on origination fees for Program loans.

The Rule provides that mortgagees may charge and collect from borrowers allowable closing costs. The allowable closing costs may be paid from the following sources:

a. The borrower's assets;

b. The mortgagee holding or servicing the existing senior and subordinate mortgage loan or the mortgagee originating the Program loan;

c. Premium pricing by the mortgagee providing the Program loan (premium pricing is defined as the price for the sale of a mortgage loan with an above market rate of interest);

d. Financed as part of the Program loan, provided that the mortgage amount is adjusted accordingly, and the loan-to-value ratio does not exceed 90% (including the upfront mortgage insurance premium);

e. A Federal, state, county, parish, or municipal program; or

f. Such other sources as the Board may permit.

Mortgagee Letter 2008-29 provides that only fixed-rate mortgages are allowed under the Program, and that while the interest rate is to be negotiated between the borrower and the lender, lenders should offer rates that are commensurate with interest rates on similar types of loans, if any (not considering the annual premium in that comparison).

The Mortgagee Letter also provides that standard FHA policy regarding closing costs (outlined in Mortgagee Letter 2006-04) applies, including the one percent cap on origination fees. The Mortgagee Letter also states the sources for payment of fees as provided for in the Rule. (In connection with revising Regulation X under the Real Estate Settlement Procedures Act, HUD removed the one percent cap on origination fees for FHA loans. The removal of the cap currently is scheduled to be effective on January 1, 2010; however, there is a potential for HUD to accelerate the implementation date.)

Waiver of Prepayment Penalty and Default Fees. The HOPE Act provides that all penalties for prepayment or refinancing of the eligible mortgage, and all fees and penalties related to default or delinquency on the eligible mortgage, must be waived or forgiven. The Rule provides that this requirement applies to both the existing mortgage loan and also all subordinate mortgage loans. With regard to the requirement that all fees and penalties related to default or delinquency be waived, Mortgagee Letter 2008-29 simply provides for the waiver of late fees.

Equity Sharing. Upon the sale or disposition of the property or the refinancing of the Program loan, the borrower must share with HUD any equity in the property that is created as a direct result of the sale or refinancing. The portion of such equity that must be shared with HUD is determined based on the following formula:

If the sale or refinancing occurs during the period that:

a. Begins on the date that the Program loan is insured and ends one year after the date of insurance, HUD is entitled to 100% of the equity.

b. Begins one year after the date of insurance and ends two years after the date of insurance, HUD is entitled to 90% of the equity.

c. Begins two years after the date of insurance and ends three years after the date of insurance, HUD is entitled to 80% of the equity.

d. Begins three years after the date of insurance and ends four years after the date of insurance, HUD is entitled to 70% of the equity.

e. Begins four years after the date of insurance and ends five years after the date of insurance, HUD is entitled to 60% of the equity.

f. Begins five years after the date of insurance and ends when the property is sold or the loan is refinanced, HUD is entitled to 50% of the equity.

The Rule defines “disposition” as any transaction that results in whole or partial transfer of title of a property, other than (a) a sale of the property, or (b) any transaction specified in 12 USC Section 1701j-3(d)(1) through (8). Section 1701j-3 sets forth the federal preemption of due on sale clause prohibitions, and subsection (d) lists transactions that are excluded from the preemption. The transactions identified in clauses (1) through (8) of the Section, which are not considered dispositions of property for purposes of the equity sharing requirement, include:

a. The creation of a lien or other encumbrance subordinate to the lender’s security instrument that does not relate to a transfer of rights of occupancy in the property.

b. The creation of a purchase money security interest for household appliances.

c. A transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety.

d. The granting of a leasehold interest of three years or less not containing an option to purchase.

e. A transfer to a relative resulting from the death of the borrower.

f. A transfer where the spouse or children of the borrower become an owner of the property.

g. A transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property.

h. A transfer into an inter vivos trust (i) in which the borrower is and remains a beneficiary and (ii) that does not relate to a transfer of rights of occupancy in the property.

The Rule provides that the initial equity created as a direct result of the origination of a Program loan on a property, as calculated by the mortgagee, shall equal:

a. The appraised value of the property that was used at the time of origination of the Program loan to underwrite the loan and to determine compliance with the maximum loan-to-value ratio at origination under the Program; less

b. The original principal amount of the Program loan on the property.

The Interim Rule modifies this formula. Pursuant to the Interim Rule, to determine the initial equity created as a result of the Program loan, the original principal balance of the Program loan must be subtracted from the lesser of:

a. The appraised value of the property at the time of origination; or

b. The outstanding amount due under all existing senior mortgages, existing subordinate mortgages and non-mortgage liens on the property.

The intent of this change is to avoid requiring that a borrower share with HUD any equity in the property that existed before the Program loan is made. Mortgagee Letter 2009-03 reflects the modified formula. The instructions in the revised form of Shared Equity Note for the determination of the initial equity in the property do not reflect this change.

The Rule also provides that upon the sale or disposition of a property or the refinancing of a Program loan, FHA shall calculate and be entitled to receive the portion of the initial equity pursuant to the equity sharing provisions of the HOPE Act (summarized above), subject to such standards and policies as the Board may establish.

Mortgagee Letter 2008-29 provides that the originating lender will prepare a Shared Equity Note and related mortgage (a "Shared Equity Mortgage" or "SEM"). Mortgagee Letter 2008-29 includes a form of Shared Equity Note and Mortgagee Letter 2009-03 includes a revised form of Shared Equity Note. Mortgagee Letter 2009-03 expressly provides that the revised version of the Shared Equity Note is to be used as of January 6, 2009. A dollar amount equal to the initial equity will be inserted in the loan documents. The Shared Equity Note and SEM will be executed by the borrower, and the SEM will be recorded with all other documents, and be in a second lien position. The originating lender is responsible for ensuring that a Shared Equity Note and SEM comply with state law.

Mortgagee Letter 2008-29 also provides that the lender will complete actions necessary to determine and document a borrower's commitment to share equity and future appreciation (see below) with HUD as required by the HOPE Act. The lender also will complete actions necessary to determine and document the commitment of existing lien holders to waive all rights to collect existing debts and to release their liens. The specific actions are as follows.

The lender will:

a. Identify all existing lien holders through review of the borrower's loan application and by obtaining a preliminary title report.

b. Request that all existing lien holders provide a payoff statement itemizing unpaid principal, unpaid accrued interest, daily interest calculation, and allowable closing costs advanced on behalf of the borrower (e.g., taxes, insurance, legal fees, etc.).

c. Refer the borrower to the HOPE for Homeowners Consumer Disclosure and Certifications he or she signed at the time of initial loan application.

d. Provide the borrower copies of all payoff statements for review, requesting that the borrower notify the lender within five business days of receipt of any discrepancies noted on the payoff statements.

Absent any challenge from the borrower regarding a payoff amount, the lender will:

a. Determine the dollar amount of the borrower's initial equity.

b. Using the *Appreciation Worksheet,* calculate the maximum dollar amount that each subordinate mortgage lien holder could receive from HUD's share of future appreciation, if any, using the formula and charts contained in the *Appreciation Worksheet*. Mortgagee Letter 2008-29 included an initial form of *Appreciation Worksheet*, and a revised *Appreciation Worksheet* was issued along with Mortgagee Letter 2009-03.

c. Provide each subordinate lien holder with the *Appreciation Worksheet* describing appreciation sharing and stating the maximum amount that the lien holder may be entitled to receive.

d. Obtain the lien holder's signature on the *Appreciation Worksheet*, by which the lien holder must acknowledge it has read and accepts the terms of the *Appreciation Worksheet* and is prepared to execute a full release of its lien in exchange for an upfront payment or a future appreciation share, as indicated in the *Appreciation Worksheet*.

e. Prepare and cause the borrower to execute the Shared Equity Note and SEM and a Shared Appreciation Note and related mortgage (a "Shared Appreciation Mortgage" or "SAM") for the Program loan. (The Shared Appreciation Note and SAM are described below under *Equity Appreciation Sharing*.)

f. Prepare and cause the borrower to execute the Shared Equity Note, SEM, Shared Appreciation Note and SAM for the Program loan.

g. Record the SEM and SAM with other loan documents.

h. Deliver the original Shared Equity Note and Shared Appreciation Note and the recorded SEM and SAM to HUD's servicing contractor (see below) and retain copies in the servicing file.

Although Mortgagee Letter 2008-29 provides for registration of the SEM and SAM with the Mortgage Electronic Registration System (MERS) as MERS Original Mortgages, Mortgagee Letter 2009-03 revises this requirement. The first mortgage must be registered with MERS. The lender may elect to register the SEM and SAM with MERS, but registration is not required. If the lender elects to register the SEM or SAM with MERS, the lender must pay the registration fee (and not pass the fee on to the borrower), and HUD should be listed as both the investor and servicer. HUD's MERS OrgID for the Program is 1007870.

Lenders must deliver the original Shared Equity Note and Shared Appreciation Note and original recorded SEM and SAM to HUD at the following address, no later than 15 business days from the date of endorsement: U.S. Department of HUD, c/o C&L Service Corporation/Morris-Griffin Corporation, 2488 East 81st Street, Suite 700, Tulsa, Oklahoma 74137. HUD accepts certified copies of the recorded mortgages when the original recorded documents are not available. Additionally, time extensions may be granted by the National Servicing Center in the event document delivery is delayed by events beyond the control of the lender. The lender also must provide a copy of the HUD-1 Settlement Statement and a copy of the appraisal that was completed in order to establish the amount of the Program loan.

The Shared Equity Note and Shared Appreciation Note will be serviced by HUD through its special servicing contractor.

The revised form of Shared Equity Note that is attached to Mortgagee Letter 2009-03 provides that:

a. In cases in which the Program loan is refinanced or there is a sale or any other disposition, excluding a sale of the property described in paragraph b., or an event of default, the equity to be shared is the difference between the appraised value of the property at origination and the amount of the Program loan.

b. In cases in which the there is a sale of the property to a party not related to the borrower and the gross proceeds from the sale are less than the appraised value at the time of

origination of the Program loan, the equity to be shared is the amount from paragraph a., less allowable settlement costs. The allowable settlement costs consist of the following:

i. Real estate sales commissions consistent with the prevailing rate, but not to exceed six percent of the contract sales price;

ii. Local and state transfer tax stamps and other closing costs customarily paid by the seller; and

iii. Other actual, customary closing costs customarily paid by the seller, not to exceed two percent of the contract sales price.

Note that the instructions do not reflect the revised approach for the calculation of the initial equity provided for in the Interim Rule and Mortgagee Letter 2009-3.

Equity Appreciation Sharing. The HOPE Act provides that upon the sale or disposition of the property, the borrower must share with HUD 50% of any appreciation in the appraised value of the property that occurred since the date that the Program loan was insured.

Calculation of Appreciation. The Rule provides that the amount of the appreciation in value of a property securing a Program loan that occurs between the date that the loan was insured under the Program and the date of any subsequent sale or disposition of the property shall be equal to the following, as such amounts may be established to the satisfaction of FHA:

a. The gross proceeds from the sale or disposition of the property (calculated at the pre-default rate of interest); less

b. The amount of closing costs, as adopted by the Board, incurred by the borrower in connection with such sale or disposition, if any; less

c. 75%, as may be modified by the Board, of the actual expenditures for capital improvements made by the borrower after the date of origination of the Program loan; and less

d. The appraised value of the property that was used at the time of origination of the Program loan to underwrite that loan and determine compliance with the maximum loan-to-value ratio at origination.

“Capital improvements” is defined by the Rule to mean a repair, renovation, or addition to a property that significantly enhances the value of the property, but does not include expenses for interior décor, landscape maintenance or normal maintenance or replacement expenses.

Mortgagee Letter 2008-29 provides that the originating lender will prepare a Shared Appreciation Note and related mortgage (a “Shared Appreciation Mortgage” or “SAM”). Mortgagee Letter 2008-29 includes a form of Shared Appreciation Note, and Mortgagee Letter 2009-03 includes a revised form of Shared Appreciation Note. Mortgagee Letter 2009-03 expressly provides that the revised version of the Shared Appreciation Note is to be used as of January 6, 2009. The SAM will be executed by the borrower and be recorded in a third lien position. The originating lender is responsible for ensuring that the Shared Appreciation Note and SAM comply with state law.

As noted above, the Mortgagee Letter 2008-29 also sets forth obligations of the lender to document the borrower’s commitment to sharing future appreciation with HUD, and the commitment of existing lien holders to waive all rights to collect existing debt and release their lien, and regarding the delivery of documents to HUD. See *Elimination of Existing Liens and Subordinate Holders Equity Appreciation Share or Upfront Payments* below for a discussion regarding the ability of subordinate lien

holders to share in HUD's portion of the equity appreciation, or receive an upfront payment in lieu of sharing in the equity appreciation.

Mortgagee Letter 2008-30 provides further guidance regarding the exclusion of an amount based on capital improvements from the appreciation in equity that must be shared. Upon the receipt of a request from the borrower, the calculation of accrued appreciation in the property may be reduced by an amount equal to 75% of the actual expenditure for capital improvements completed at the borrower's expense after origination of the Program loan, subject to the following conditions:

a. The combined total cost of the capital improvements must be $2,500 or greater;

b. The borrower must submit original or legible copies of paid invoices itemizing the work completed;

c. The work must be of a nature that significantly changed and enhanced the value of the property, including but not limited to a room addition; full roof replacement; complete exterior painting, siding or stucco; full kitchen renovation; major landscape renovation; a patio or deck addition; or an in-ground swimming pool;

d. Expenses, including but not limited to interior décor (paint, flooring, window and wall coverages); landscape maintenance (mowing, tree trimming or removal, reseeding, planting, fertilization) or normal maintenance or replacement of appliances, systems, and fixtures may not be included; and

e. There will be no allowance for "sweat equity".

Subordinate Lien Prohibition. The HOPE Act provides that subordinate liens are prohibited for the first five years of the loan. The Board may create exceptions determined to be necessary to ensure the maintenance of property standards. Any subordinate lien loan permitted under an exception (a) may not reduce HUD's equity share under the equity appreciation requirements, and (b) may not result in a combined loan-to-value ratio of greater than 95% at the time of the new subordinate lien loan.

The Rule provides that, subject to the exception stated below, during the first five years of the term of a Program loan a borrower shall not incur any debt, take any action, or fail to take any action that would have the direct result of causing a lien to be placed on the property securing the loan if such lien would be subordinate to the Program loan. This restriction does not prevent the borrower from incurring new mortgage debt secured by a lien on the property securing the Program loan that is subordinate to the Program loan, if the following requirements are satisfied:

a. The proceeds of the new mortgage debt are necessary to ensure the maintenance of property standards, including health and safety standards;

b. Repair or remediation of the condition would preserve or increase the property's value;

c. The cost of the proposed repair or modification is reasonable for the geographic market area;

d. The results of the repair or remediation are not primarily cosmetic;

e. The new mortgage debt is closed-end credit (as defined under Regulation Z);

f. The sum of the unpaid principal balance and accrued and unpaid interest on the Program loan and the original principal balance of the new mortgage debt:

i. Does not exceed 95% of the estimated appraised value of the property securing the Program loan after completion of the proposed repair or remediation; and

ii. Is less than:

A. The estimated appraised value of the property securing the Program loan after completion of the proposed repair or remediation; less

B. FHA's proportionate share of the initial equity created upon origination of the Program mortgage as determined pursuant to the equity sharing schedule under the HOPE Act (which is summarized above) as if a sale of the property had occurred on the date of origination of the new mortgage debt.

Mortgagee Letter 2008-29 also addresses the prohibition on subordinate lien financing, and describes the maintenance of property standards requirement as follows: The condition to be repaired represents a health and safety hazard and/or the failure to make the repair will cause the property condition to deteriorate. The Mortgagee Letter also provides that HUD will not subordinate equity or appreciation sharing notes to any subordinate financing, within or after the five-year period following the origination of the Program loan, except under the exception described above or for FHA loss mitigation actions (i.e., mortgage modifications and partial claims).

Further guidance is provided in Mortgagee Letter 2008-30. If a borrower needs to obtain a loan for property repairs, the borrower should contact HUD through the HUD contractor at the following address, and provide information documenting the need for repairs, repair cost estimates and a current appraisal prepared by an FHA roster appraiser: U.S. Department of HUD, c/o C&L Service Corporation/Morris-Griffin Corporation, 2488 East 81st Street, Suite 700, Tulsa, Oklahoma 74137.

Documentation Requirements. Mortgagee Letter 2008-29 provides that in addition to the standard documentation requirements set forth in HUD Handbook 4155.1 REV-5, Chapter 3, for a Program loan mortgagees must provide the additional documentation specified in the Mortgagee Letter in the case binder on the right hand side. The Mortgagee Letter notes that the additional documentation will become part of the pre-endorsement review conducted by FHA staff (Direct Endorsement Program) or the lender (Lender Insurance Program). An initial suggested form of pre-endorsement review checklist for FHA staff and lenders to use is attached to Mortgagee Letter 2008-29. A revised checklist is attached to Mortgagee Letter 2009-03. For lenders that submit electronic case binders, the additional required information must be a new index labeled "H4H".

The additional documentation is as follows:

a. Evidence that the existing mortgage loan(s) being refinanced was originated on or before January 1, 2008. Examples of evidence are the HUD-1 Settlement Statement or the mortgage payment history from the servicer.

b. If the existing senior mortgage loan is delinquent at the time of refinance, evidence that the borrower made six full payments during the life of the loan. An example of evidence is the mortgage payment history from the servicer. Note, both the Rule and a separate provision of the Mortgagee Letter describe the six payment requirement as applying in all cases, and not simply when the current loan is delinquent. Thus, it appears to be advisable to have evidence of such payments in all cases.

c. Evidence that the prior aggregate mortgage debt-to-income ratio was more that 31% on March 1, 2008, or at the time of the application for the Program loan, as applicable. See *Debt to Income Details* above regarding evidence of income and debts for this purpose.

d. Evidence that the property is the borrower's primary residence. Examples of such evidence are a Federal or state tax return, driver's license and/or voter registration card.

e. The initial and final HOPE for Homeowners Consumer Disclosure and Certifications signed and dated by the borrower(s), along with the initial and final Uniform Residential Loan Application and Addendum to the application.

f. In cases in which a warning is received from FHA that the borrower was convicted of fraud and the lender believes the warning to be in error, the lender must document that the borrower has not been convicted of fraud under Federal or state law in the last ten years.

g. Copies of the previous two years' Federal tax returns or transcripts of the borrower's income tax returns obtained directly from the IRS. (The income verification requirement is separate from the March 2008 debt-to-income verification requirement.)

h. Evidence that the first payment on the Program loan was made by the borrower and not (i) by any interested party to the transaction, (ii) from the loan proceeds or (iii) escrowed at closing. (Note, HUD should provide guidance on appropriate evidence.)

i. The HOPE for Homeowners Lender and Underwriter General Certifications, signed by an officer of the lender and the Direct Endorsement Underwriter.

j. Initially, if a trial modification period was used to exceed the 31% and 43% debt-to-income ratios, the lender was required to document that the borrower, using his or her existing gross income, made timely mortgage payments on the existing senior mortgage loan pursuant to the terms of the trial modification for the three consecutive months preceding the application for the Program loan, and that the amount of the mortgage payment is at least 90% of the estimated total monthly mortgage payment on the new Program loan. However, as discussed above, the trial modification requirement was eliminated.

Elimination of Existing Liens and Subordinate Holders Equity Appreciation Share or Upfront Payments.

Elimination of Existing Liens. The HOPE Act provides that holders of all outstanding mortgage liens on the property securing an eligible mortgage must agree to accept the proceeds of a Program loan as payment in full of all indebtedness and remove their liens. Mortgagee Letter 2008-29 provides that the indebtedness under the mortgages includes advances by existing lenders and services for taxes, hazard insurance and/or mortgage insurance, and out of pocket third party legal expenses of the existing lenders and serivcers associated with foreclosures and preservation and protection (see Mortgagee Letters 2007-03 and 2005-30).

As discussed below, the HOPE Act provides for the sharing of HUD's equity appreciation interest with subordinate lien holders. Subject to standards established by the Board regarding such sharing, HUD may take actions as may be necessary and appropriate to facilitate coordination and agreement between first and subordinate lien holders. To enhance the potential for a subordinate lien holder to agree to release its lien in order to provide for a Program loan, the EESA amended the HOPE Act to provide for an upfront payments by HUD to any holder of an existing subordinate mortgage as payment in full of all indebtedness and in lieu of any future appreciation payments.

Subordinate Mortgage Holders Sharing in Appreciation or Upfront Payments. The HOPE Act requires that the Board establish standards and policies that will allow for the payment to the holder of an existing subordinate eligible mortgage a portion of any future appreciation in the value of the property that the borrower must pay to FHA under the equity appreciation requirement discussed above. The EESA

amended the HOPE Act to provide for a payment by HUD to any holder of an existing subordinate mortgage loan as payment in full of all indebtedness and in lieu of any future appreciation payments under the shared appreciation provisions.

Equity Appreciation Sharing. The factors that the Board must consider in establishing the standards and policies are (a) the status of any subordinate mortgage, (b) the outstanding principal balance of and accrued interest on the existing first lien mortgage and any outstanding subordinate mortgages, (c) the extent to which the current appraised value of the property securing a subordinate mortgage is less than the outstanding principal balance and accrued interest on all other mortgage loans that are senior to the particular subordinate mortgage, and (d) such other factors as the Board deems to be appropriate.

The Rule provides parties that hold, on the date of origination of a Program loan, an existing subordinate mortgage loan on the property are eligible to receive a portion of FHA's interest in the appreciation value of the property, as determined in accordance with the Rule and such additional standards and policies that the Board may establish, if:

a. The existing subordinate mortgage loan was originated before January 1, 2008;

b. The amount of the unpaid principal and interest on the existing subordinate mortgage loan on the date of origination of the Program loan was at least $2,500;

c. Each person holding the existing subordinate mortgage loan agrees, in connection with the origination of the Program loan, to fully release:

   i. The borrower from any indebtedness under the existing subordinate mortgage loan; and

   ii. The holder's mortgage lien on the property.

Thus, the potential for equity appreciation sharing is available only to subordinate lien holders with an unpaid debt that exceeds $2,500. Mortgagee Letter 2008-29 confirms that subordinate lien holders whose write off is less than $2,500 will not receive the opportunity to share in future appreciation.

The eligible holder of an existing subordinate mortgage loan on the property may receive an interest in FHA's interest in the appreciation in the value of the property up to the following amount:

Subordinate Lien Holder's CLTV	Percent of Unpaid Principal and Interest that Lien Holder is Eligible to Receive
Cumulative CLTV >135%	9%
Cumulative CLTV ≤135%	12%

The payment to a subordinate lien holder will depend on the actual appreciation of the property. Also, if there is more than one subordinate mortgage holder, the interests of each eligible existing subordinate mortgage loan shall have priority among each other in the same order of priority that existed among the existing subordinate mortgage loans on the date of origination of the Program loan. The payment will be based on the unpaid principal and interest under the subordinate lien loan as of the first day of the month in which the borrower applied for the Program loan, calculated at the pre-default rate of interest.

Mortgagee Letter 2009-03 provides that a subordinate lien holder will indicate the election to receive an appreciation share or an upfront payment in an *Appreciation Worksheet*, a revised form of

which is attached to the Mortgagee Letter. Not less than ten business days before the scheduled date of closing, the originating lender must send an *Appreciation Worksheet* for each eligible subordinate mortgage lien, executed by the subordinate lien holder and the originating lender, to HUD's National Servicing Center at a specified address. Not less than five business days before closing, the National Servicing Center will notify the originating lender of discrepancies noted on the *Appreciation Worksheet*, if any, and request corrections before closing.

If a subordinate lien holder elects to receive an appreciation share, before closing of the Program loan HUD will provide the originating lender with an *Appreciation Share Certificate* for each applicable subordinate lien holder. The originating lender must deliver each *Appreciation Share Certificate* to the closing agent along with instructions directing the agent to provide each *Certificate* to the applicable subordinate lien holder. While Mortgagee Letter 2009-03 provides that the lender shall instruct the closing agent to use any delivery method with receipt confirmation, the Mortgagee Letter also provides that the closing agent will deliver the *Certificate* to the subordinate lien holder either at closing or by certified mail.

Appreciation Share Certificates are numbered and registered by holder name and address in HUD's system of records. If a holder elects to sell, trade or otherwise transfer its *Certificate*, it must notify the National Servicing Center of the transfer in writing, at a specified address, by providing the *Certificate* number and the name, address and telephone contact information for the authorized representative of the transferee. The notification must be on the letterhead of the holder and signed by an authorized representative of the holder. This tracking method appears to replace the original plan to use MERS to track subordinate lien holders with an interest in future appreciation of a property. If the Program loan is not endorsed for FHA insurance, any related *Appreciation Share Certificate* becomes void.

Upon the sale or disposition of a property securing a Program loan, other than sale or disposition related to a default, any proceeds due to FHA as a result of the appreciation in value of the property (as calculated pursuant to the Rule) shall be distributed:

a. First, to the holders of *Appreciation Share Certificates*, if any, in accordance with the shared appreciation provisions of the Rule summarized above; and

b. The remaining amounts, if any, will be retained by FHA.

When the property is sold in a transaction that does not involve a "related party" of the borrower, the amount of appreciation since the time of origination of the Program loan is based on the gross proceeds from the sale. For non-sales dispositions or sales to a "related party" of the borrower, the amount of appreciation will be calculated based on the appraised value of the property at the time of disposition or sale. The Interim Rule defines the "related party" of a particular person to include any of the following, or another person acting on behalf of the particular person or any of the following:

a. The person's father, mother, stepfather, stepmother, brother, sister, stepbrother, stepsister, son, daughter, stepson, stepdaughter, grandparent, grandson, granddaughter, father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law, the spouse of any of the foregoing, and the person's spouse;

b. Any entity of which 25% or more of any class of voting securities is owned, controlled or held in the aggregate by the person or the persons referred to in paragraph a.; and

c. Any entity of which the person or any person referred to in paragraph a. serves as a trustee, general partner, limited partner, managing member, or director.

Upfront Payment. The Interim Rule and Mortgagee Letter 2009-03 provide that an eligible subordinate lien holder may elect to receive an upfront payment in lieu of an equity appreciation share. If a subordinate lien holder is not eligible to receive an equity appreciation share, the holder may not receive an upfront payment.

The upfront payment would be a cash payment at the closing of the Program loan. The payment would equal the following percentage of the unpaid principal and interest on the subordinate mortgage loan:

Subordinate Lien Holder's CLTV	Percent of Unpaid Principal and Interest that Lien Holder is Eligible to Receive
Cumulative CLTV >135%	3%
Cumulative CLTV ≤135%	4%

The payment will be based on the unpaid principal and interest under the subordinate lien loan as of the first day of the month in which the borrower applied for the Program loan, calculated at the pre-default rate of interest.

A subordinate lien holder will indicate the election to receive an upfront payment or appreciation share in an *Appreciation Worksheet*, a revised form of which is attached to Mortgagee Letter 2009-03. Not less than ten business days before the scheduled date of closing, the originating lender must send an *Appreciation Worksheet* for each eligible subordinate mortgage lien, executed by the subordinate lien holder and the originating lender, to HUD's National Servicing Center at a specified address. Not less than five business days before closing, the National Servicing Center will notify the originating lender of discrepancies noted on the *Appreciation Worksheet*, if any, and request corrections before closing.

When a subordinate lien holder elects to receive an upfront payment, the originating lender will provide instructions to the closing agent to pay the applicable amount reflected on the *Appreciation Worksheet* previously provided to HUD. The originating lender must advance the funds to make any upfront payment to a subordinate lien holder. Within fifteen days after the endorsement of the Program loan, HUD will automatically reimburse the originating lender the amount of each upfront payment. (See *Non-endorsement of Program Loan for FHA Insurance* regarding how the originating lender may recoup upfront payments made to subordinate lien holders if the Program loan is not endorsed for insurance.)

Non-endorsement of Program Loan for FHA Insurance

If a Program loan is not endorsed for FHA insurance, HUD will not reimburse the originating lender for any upfront payment advanced to a subordinate lien holder. Additionally, HUD will not be liable for any payment to subordinate lien holders who elected the share in future equity appreciation, and will record releases of the SEM and SAM. HUD will notify each applicable subordinate lien holder that the *Appreciation Share Certificate* is void, and will request return of the *Certificate*.

The originating lender will receive a refund from HUD of the upfront mortgage insurance premium and any periodic mortgage insurance premium payments received by HUD. The originating lender may apply refunded mortgage insurance premiums first to reimburse itself for any upfront payments made to subordinate lien holders, and then in accordance with normal servicing guidance.

Tax Effect of Indebtedness Discharge. Although the Program will run through September 30, 2011, initially the exclusion from income of the discharge of qualified principal residence indebtedness, which was due to expire on December 31, 2009, was not extended. However, the EESA amended the IRS

Code to extend the exclusion through December 31, 2012 for debt discharged on or after January 1, 2010.

Application of Other FHA Eligibility Requirements.

The Rule provides that all of the provisions of 24 CFR Part 203, subpart A concerning eligibility requirements for mortgages on one-family dwellings under National Housing Act Section 203 apply to Program loans (i.e., mortgages insured under National Housing Act Section 257), except the following provisions:

a. Section 203.7, Commitment process.
b. Section 203.10, Informed consumer choice for prospective FHA mortgagors.
c. Section 203.12, Mortgage insurance on proposed or new construction.
d. Section 203.14, Builder's warranty.
e. Section 203.16, Certificate and contract regarding use of dwelling for transient or hotel purposes.
f. Section 203.18, Maximum mortgage amounts.
g. Section 203.18a, Solar energy system.
h. Section 203.18b, Increased mortgage amount.
i. Section 203.18c, One-time or upfront MIP excluded from limitation on maximum mortgage amounts.
j. Section 203.18d, Minimum principal loan amount.
k. Section 203.19, Mortgagor's investment in the property.
l. Section 203.20, Agreed interest rate.
m. Section 203.29, Eligible mortgage in Alaska, Guam, Hawaii or the Virgin Islands.
n. Section 203.32, Mortgage lien.
o. Section 203.37a, Sale of property.
p. Section 203.42, Rental properties.
q. Section 203.43, Eligibility of miscellaneous type mortgages.
r. Section 203.43a, Eligibility of mortgages covering housing in certain neighborhoods.
s. Section 203.43d, Eligibility of mortgages in certain communities.
t. Section 203.43e, Eligibility of mortgages covering houses in federally impacted areas.
u. Section 203.43g, Eligibility of mortgages in certain communities.
v. Section 203.43h, Eligibility of mortgages on Indian land insured pursuant to section 248 of the National Housing Act.
w. Section 203.43i, Eligibility of mortgages on Hawaiian Home Lands insured pursuant to section 247 of the National Housing Act.
x. Section 203.43j, Eligibility of mortgages on Allegany Reservation of Seneca Nation Indians.
y. Section 203.44, Eligibility of advances.
z. Section 203.45, Eligibility of graduated payment mortgages.
aa. Section 203.47, Eligibility of growing equity mortgages.
bb. Section 203.49, Eligibility of adjustable rate mortgages.
cc. Section 203.50, Eligibility of rehabilitation homes.
dd. Section 203.51, Applicability.
ee. Sections 203.200 to .209, Insured Ten-Year Protection Plans (Plan).

The Rule also provides that, for purposes eligibility requirements, all references in 24 CFR Part 203, subpart A to (a) Section 203 of the National Housing Act shall be construed to refer to Section 257 of the Act, (b) the "Mutual Mortgage Insurance Fund" shall be deemed to be to the Home Ownership Preservation Entity Fund, and (c) the "Commissioner" shall be deemed to be to the Board or the Commissioner, as the context may require.

Servicing of Program Loans.

Application of Other FHA Servicing Requirements. The Rule provides that all of the provisions of 24 CFR Part 203, subpart C concerning servicing requirements for loans insured National Housing Act Section 203 apply to Program loans (i.e., mortgages insured under National Housing Act Section 257), except the following provisions:

a. Section 203.664, Processing defaulted mortgages on property located on Indian land;
b. Section 203.665, Processing defaulted mortgages on property located on Hawaiian Homelands;
c. Section 203.665, Processing defaulted mortgages on property in Allegany Reservations of Seneca Nation of Indians; and
d. Sections .670 to .681, Occupied conveyance.

The Rule also provides that, for purposes of servicing requirements, all references in 24 CFR Part 203, subpart C to (a) Section 203 of the National Housing Act shall be construed to refer to Section 257 of the Act, (b) the "Mutual Mortgage Insurance Fund" shall be deemed to be to the Home Ownership Preservation Entity Fund, and (c) the "Commissioner" shall be deemed to be to the Board or the Commissioner, as the context may require.

Mortgagee Letter 2008-30 provides that Program loans are to be serviced in accordance with the servicing policy for other FHA-insured forward mortgages as described in HUD Handbook 4330.1 REV-5, and any Mortgagee Letters that update the Handbook, except as otherwise provided in Mortgagee Letter 2008-30.

Refinance of Program Loans.

General. Upon the refinance of a Program loan, the borrower must pay to HUD the full equity interest of HUD as provided for in the Shared Equity Note. Program loans may not be refinanced under the FHA streamline process. Program loans may be refinanced into another conventional loan product, subject to the conditions set forth below.

Refinance to Access Equity. Commencing 12 months from the date the Program loan was closed, HUD will subordinate its SAM to a refinance to access the initial equity if:

a. The refinance results in a 30-year amortizing fixed-rate loan with a principal and interest payment that is lower than the principal and interest payment on the Program loan (note, this requirement was not revised even though the maximum term of a Program loan was increased from 30 to 40 years);

b. The proceeds from the refinance are sufficient to pay off the percent of initial equity due to HUD; and

c. The cash received by or on behalf of the borrower is limited to the borrower's initial equity as stated in the Shared Equity Note and any earned equity the borrower has accrued by paying down the principal balance of the loan.

Refinance to Access Appreciation. No earlier than five years from the date of closing on the Program loan, HUD will allow a refinance to access the appreciation if:

a. The cash received by or on behalf of the borrower from the refinance is limited to the initial and earned equity and no more than 25% of the appreciation accrued since the origination of the Program loan; and

b. The borrower consents to a modification of the Shared Appreciation Note that specifies that HUD is entitled, upon the sale or other disposition of the property, to a fixed dollar amount equal to 50% of the appreciation (as adjusted for capital improvements) that accrued between origination of the Program loan and the date of the refinance, as well as 50% of any future appreciation that may accrue between the date of the refinance and sale of the property.

HUD will, based on a new appraisal performed by an FHA roster appraiser and provided by the refinance lender, calculate the total appreciation (as adjusted for capital improvements) accrued since origination and multiply that amount by 25% to determine the maximum amount of appreciation the borrower may obtain from the refinance transaction.

Additional Provisions. If the Program loan is being refinanced into a new FHA loan, the borrower must (a) meet all standard eligibility and qualifying guidelines for FHA mortgage insurance, (b) have made all of his or her mortgage payments during the previous 12 months, within the month due, and (c) be current for the month due.

Upon receipt of any request to subordinate the SAM to a refinance, HUD will determine its equity interest based on the number of years since origination of the Program loan, and will provide to the refinance lender the amount require to pay off the Shared Equity Note.

Default and Loss Mitigation. Mortgagees must follow the same documentation and reporting guidelines applicable to FHA-insured loans when providing loss mitigation to borrowers with Program loans. HUD's Loss Mitigation Program allows for the following special considerations when evaluating a Program loan borrower for loss mitigation:

a. *Special Forbearance*. The mortgagee should follow existing Program guidance.

b. *Loan Modification*. HUD will subordinate the SEM and SAM to any modification of a Program loan completed in accordance with HUD's Loss Mitigation Program.

c. *Partial Claim*. A partial claim note does not require subordination of the SEM and SAM.

d. *Pre-Foreclosure Sale*. The lender must include the total dollar amount of the Shared Equity Note in the total debt calculation for the negative equity ratio calculations in addition to any existing Partial Claim. Net proceeds must fit into the 82% requirement and up to $2,000 can be used to pay off any junior property preservation lien. If a junior property preservation lien does not exist, the borrower is not eligible for the $2,000.

e. *Deed in Lieu*. HUD will accept a deed in lieu of foreclosure subject to the SEM and SAM liens and will allow up to $2,000 to be used to satisfy a junior property preservation lien.

Loans With First Payment Default.

No Insurance Payment, But Still Insured. The HOPE Act prohibits HUD from paying an insurance claim on a Program loan if the borrower did not make at least one full payment within 120 days of closing. However, Mortgagee Letter 2008-30 provides that such a loan remains insured and must be serviced in accordance with HUD's servicing and loss mitigation guidance. The Mortgagee Letter also provides that lenders must remit the portion of the annual mortgage insurance premium due each month. (As noted above, Mortgagee Letter 2009-03 provides that when a Program loan is not endorsed for FHA insurance, the originating lender will receive a refund from HUD of the upfront mortgage insurance premium and any periodic mortgage insurance premium payments received by HUD. The Mortgagee Letter does not reconcile this statement with the statement in Mortgagee Letter 2008-30 that the lender must continue to remit periodic mortgage insurance payments.)

Verify No First Payment Default Before Filing Claim. Before filing any claim for insurance benefits, the lender must verify that the borrower made at least one full payment on the Program loan within 120 days of closing.

Loss Mitigation. Borrowers on Program loans without one full payment within 120 days of closing must be considered for and offered all appropriate loss mitigation options. However, the lender may not file a claim for loss mitigation incentives, reimbursement of loss mitigation expenses, partial claim advances or forgiveness of principal and interest associated with pre-foreclosure sales, a deed in lieu, a claim without conveyance or any conveyance claims. The following restrictions apply to loans with such a first payment default:

a. *Partial Claim*. The lender is encouraged but not required to offer a loss mitigation option similar to a partial claim. HUD may subordinate the SEM and SAM to a partial claim advance note in favor of a lender if the advance generally complies with FHA Loss Mitigation Program guidance. However, HUD is not able to reimburse the lender for the advance.

b. *Pre-Foreclosure Sale*. The lender is required to offer eligible borrowers the opportunity to participate in a Pre-foreclosure Sale Program with terms similar to that specified by FHA. However, the lender is not required to pay the borrower any consideration or to advance funds for satisfaction of junior liens as provided in the FHA Loss Mitigation Program. When a pre-foreclosure sale generally complies with HUD guidance, HUD may release its SEM and SAM liens to accommodate the loss mitigation action.

c. *Deed in Lieu*. Lenders are required to utilize the deed in lieu option when appropriate. When a deed in lieu generally complies with HUD guidance, HUD may release its SEM and SAM liens to accommodate the loss mitigation action.

Voluntary Termination of Insurance. Under Section 229 of the National Housing Act (12 USC Section 1715t), HUD must terminate any insurance contract upon request by the borrower and the mortgagee. In the event the borrower and mortgagee mutually request termination of insurance on a Program loan and the request is granted, annual mortgage insurance premiums will no longer be due and payable to HUD. However, the borrower will not be entitled to a refund of any upfront mortgage insurance premium received by HUD and will remain obligated for the shared equity and shared appreciation mortgages.

Sale and Payoff.

Upon the sale or other disposition (i.e., a transfer of title without a sale) of the property, the borrower must satisfy both the Shared Equity Note, if it has not been satisfied previously because of a refinance, and the Shared Appreciation Note. Mortgagee Letter 2009-03 provides that upon receipt of a payoff request, HUD will provide the closing agent with the required payoff amounts from the borrower for the Shared Equity Note and Shared Appreciation Note. The Mortgagee Letter also provides that within five business days of receipt of the Shared Appreciation Note proceeds, HUD will notify holders of *Appreciation Share Certificates* of the disposition of the property and provide instructions for redemption of the *Certificates*.

Shared Equity Note and HUD's Initial Equity Share. If the net proceeds are less than HUD's share of the initial equity because of a deduction for allowable closing costs, then the net proceeds will be shared as follows:

a. First, HUD will receive from the net proceeds its proportionate share of any closing costs deducted from the initial equity.

b. Second, the remaining net proceeds, if any, will be distributed between HUD and the borrower according to the schedule stated in the Shared Equity Note. (See the example below.)

HUD will accept net proceeds that are less than its share of the initial equity as payment in full of the Shared Equity Note, subject to the following conditions:

a. The sale is an arms length transaction with no identity of interest between the parties;

b. The sales price was based on a current appraisal performed in accordance with the Uniform Standards of Professional Appraisal Practice and acceptable to HUD; and

c. The net proceeds from the sale are equal to or greater than 88% of the appraised value or such other value as may be approved by HUD based on circumstances beyond the control of the borrower. (See the example below.)

Example.

Program loan details:

$100,000 property value.
$90,000 original principal .
$10,000 Shared Equity Note.

Sale details (sale occurs six years after Program loan is closed):

$103,000 price.
$7,000 closing costs.
$88,000 unpaid principal of Program loan.
$8,000 net proceeds.

Result:

$4,500 HUD share
$3,500 borrower share

Explanation:

Deducting the $7,000 in closing costs from the $103,000 sales price results in $8,000 of equity, which is $2,000 below the initial equity. HUD receives 50% of the $2,000 shortfall amount ($1,000) out of the net proceeds. The remaining net proceeds of $7,000 are shared 50/50, so $3,500 goes to HUD and $3,500 goes to the borrower (with HUD's total share being $4,500).

Shared Appreciation Note and SAM.

To the extent that there is appreciation available from HUD's equity share for distribution, HUD will provide instructions to the closing agent to distribute the funds at closing to each *Appreciation Share Certificate* holder in order of their former priority. The *Appreciation Share Certificate* holder with the highest former priority will receive up to the full dollar amount of its interest, but not in excess of the available appreciation that may be shared. If additional appreciation is available, the *Appreciation Share Certificate* holder with the next highest former priority will receive up to the full dollar amount of its interest, but not in excess of the remaining available appreciation that may be shared. This process

continues until all *Appreciation Share Certificate* holders are satisfied or the available appreciation that may be shared is exhausted. If there is any available appreciation that may be shared after all *Appreciation Share Certificate* holders are satisfied, HUD receives the remaining amount.

Release.

Upon receipt of all equity and appreciation proceeds due HUD, the HUD contractor will issue and record satisfaction and release of the SEM and SAM.

Fiduciary Duty of Servicers of Existing Loans. The HOPE Act amends the Truth in Lending Act to set forth a fiduciary duty of servicers, and then addresses how that duty is met, including by refinancing a loan with a Program loan.