INTRODUCTION

In January 2007, the Senate Banking, Finance & Insurance Committee began holding informational hearings on a problem whose nature, depth, and breadth have changed enormously in the past two years. What started out as a nontraditional and subprime mortgage problem – a blip in an otherwise healthy economy – has evolved into a global liquidity crisis and an economic downturn that some economists are labeling the Great Recession, because of its severity.

Several major financial institutions have failed; many others have merged or been acquired in a last-ditch effort to save themselves. The stock market is in free fall. California's unemployment rate is above 10%, and rising. Home equity is a vanishing commodity, eroding even more quickly than the retirement savings accounts of aging baby boomers. Consumer confidence is at all-time lows. Notices of default and foreclosures are at all-time highs.

Last year in California, nearly a quarter million Californians (249,940) lost their homes to foreclosure. Over 96% of those properties reverted to the lender. On average, 29 borrowers lose their homes to foreclosure every hour; one home is lost to foreclosure every two minutes.

When it first began, the problem seemed limited to subprime borrowers with poorly underwritten and inadequately disclosed mortgage loans. Yet, as the problem has grown and the economy has weakened, the effects of what was initially labeled "the subprime mortgage crisis" have spread to borrowers among all walks of life and income levels, and to all types of loans. For some, the problem is mortgage affordability. Either mortgage payments have grown to levels that are no longer sustainable by borrowers, or borrowers' financial situations have declined to levels that can no longer accommodate an unchanged mortgage payment.

Affordability, however, is no longer the only symptom of the growing problem. What was once solely an affordability problem is increasingly becoming a negative equity problem. More borrowers are leaving mortgages they can afford, because their home values have fallen below their mortgage values, and the borrowers would rather walk away from a bad investment than spend years trying to rebuild their home equity. Some cry foul at these actions, harkening back to a time when one took responsibility for one's investment decisions, and observed one's contractual obligations, despite the financial consequences of doing so. Others ask simply, "Why prolong a bad investment? Why not cut my losses and start to rebuild?"

Neither the federal government nor the state stood still while mortgage problems grew and the economy faltered, yet still, the problems grew worse. Recently, after a year of disorganized attempts to prop up the financial sector and enact programs touted as "the solution we have been waiting for," the federal government announced its latest solution – the Making Home Affordable program.

On March 18, 2009, this Committee will review the details of the latest federal program and examine California's own recently-enacted law, intended to provide relief to the same borrowers targeted for help with the new federal plan. Will these federal and state efforts truly work? Will they reduce foreclosure rates? Stop the free-fall of housing values? Rekindle a market for home

mortgage refinance? Help restore confidence among beleaguered Californians? Or are they simply the latest installments in an ever-growing assemblage of well-meaning, ineffective plans, notable only for their growing size and complexity? Invited witnesses will address these questions, and others.

MAKING HOME AFFORDABLE PLAN

On February 18, 2009, the U.S. Department of the Treasury (Treasury) released preliminary information about a program it initially titled the Home Affordability and Stability Program. Treasury released further details about the Home Affordability and Stability Program on March 4, 2009, and renamed the program Making Home Affordable. The Making Home Affordable Plan will be referred to interchangeably in the remainder of this paper as MHA and the Treasury Plan. Because details of the plan are still emerging, the summary provided below should be considered a snapshot reflecting information available as of March 11, the date this background paper was prepared. Those requiring updates on the details of the plan, as new information becomes available, are encouraged to consult www.financialstability.gov. Supporting information summarizing the MHA Plan, which was obtained from the www.financialstability.gov web site, is included in Appendix A of this background paper.

The MHA Plan has three major components, as follows:

1) A refinancing component, called the Home Affordable Refinance program.

   The refinance program will be available to borrowers with loans whose unpaid principal balance is $729,750 or less, and which are owned or guaranteed by Fannie Mae or Freddie Mac. Both companies have established toll-free phone numbers and Internet portals for use by borrowers who wish to determine whether their loan is owned or guaranteed by either government-sponsored enterprise (GSE). Fannie Mae's contact information for borrowers wishing this information is 1-800-7FANNIE, and www.fanniemae.com/homeaffordable. Freddie Mac's contact information is 1-800-FREDDIE, and www.freddiemac.com/avoidforeclosure. Individuals who visit these web sites are prompted to provide their name, address of the property in which they are interested, and contact information.

   Borrowers with good payment histories, whose first liens (i.e., primary mortgages) are greater than 80% of their home's value, but no greater than 105% of their home's value, will be eligible to refinance with Fannie Mae and Freddie Mac, at competitive rates, using this program. These borrowers are currently unable to refinance, because their loan-to-value ratios are too high.

   Borrowers with second mortgages are not automatically eliminated from consideration, but the holders of those second mortgages must agree to subordinate to the first mortgage before the borrower can be considered for a first mortgage refinancing through the Home Affordable Refinance program.

   Borrowers with first mortgages greater than 105% of their home's value, and borrowers that

are currently delinquent on their mortgages are not eligible. Further details on this component of the MHA Plan are still pending. The program is currently scheduled to begin on or around April 1, 2009 and to end in June, 2010.

How Many Californians Will the Home Affordable Refinance Program Help?

Together, Fannie Mae and Freddie Mac own or guarantee 56% of all outstanding mortgage loans nationwide, according to the Federal Housing Finance Agency (FHFA; the GSEs' conservator). Treasury estimates that between 4 and 5 million homeowners nationwide will be eligible to refinance using this program. However, there is currently no estimate of the number of Californians who might be included within Treasury's total. Given the dramatic drops in housing values across nearly the entire state, a significant number of Californians are more than 105% underwater.

According to First American Core Logic, 30% of mortgages in California – corresponding to 1.9 million borrowers -- were underwater as of December 31, 2008 (see Appendix B). An additional 4% of mortgages are within 5% of being in a negative equity situation. An average of 43,000 California borrowers enter a negative equity position every month. Fully 723,000 California borrowers have loan-to-value ratios of 125% or more.

California's negative equity situation is far worse than that of any other state. California is home to 17 of the 50 areas nationwide, with the highest percentages of underwater mortgages. The following areas are among the most affected in California. Values in parentheses represent the percentage of mortgages in each area on which borrowers owe more than their homes are worth. These areas include: Merced (55%), Stockton (55%), Modesto (51%), Riverside-San Bernardino-Ontario (45%), Bakersfield (43%), Vallejo-Fairfield (43%), Yuba City (43%), Madera (41%), Fresno (40%), Sacramento-Arden Arcade-Roseville (38%), Visalia-Porterville (36%), Salinas (36%), San Diego-Carlsbad-San Marcos (31%), Santa Barbara-Santa Maria (28%), Oakland-Fremont-Hayward (27%), Redding (25%), and Santa Rosa-Petaluma (25%).

2) A loan modification component, titled the Home Affordable Modification program, discussed in more detail below, and funded with $75 billion in federal funds.

3) A mortgage interest rate stabilization component, which is so far unnamed. This component has four parts, all of which are designed to support low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac. First, Treasury will double its purchases of Fannie Mae and Freddie Mac preferred stock, to $200 billion each.

   Treasury will also continue purchasing Fannie Mae and Freddie Mac mortgage-backed securities. Initial purchases were credited with driving down mortgage interest rates to the 5% range and spurring a new wave of refinancing applications.

   Third, Fannie Mae and Freddie Mac will be allowed to increase the sizes of their portfolios by $50 billion each, to a total of $900 billion.

> Finally, the Obama Administration will work with Fannie Mae and Freddie Mac to support state housing finance agencies in serving homebuyers (though details of this partnership have not yet been announced).

HOME AFFORDABLE MODIFICATION PROGRAM

Treasury's loan modification program is targeted at borrowers who are having trouble affording their mortgages, or who will soon encounter such trouble. (As noted above, the Home Affordable Refinance program is targeted at borrowers who are not having trouble affording their loans, but whose homes have declined in value since they were purchased).

Eligibility for the Home Affordable Modification program is limited to borrowers with first mortgages that were originated on or before January 1, 2009, with unpaid principal balances equal to or less than $729,650. Borrowers must live in the property that secures the loan they wish to have modified and use it as their principal residence in order to qualify. Modifications are not available on loans secured by vacant, investor-owned, or condemned properties. There is no minimum or maximum loan-to-value ratio for eligibility. Loans may be modified only once under the program.

The Home Affordable Modification program began on March 4, 2009. Borrowers may be accepted into the program through December 31, 2012. Participation in the program by servicers is generally voluntary, although participation will be mandatory for any institution that accepts future funding from Treasury's Financial Stability Program. In information released on March 4th, Treasury described the voluntary nature of the program, as follows (emphasis shown below is taken from the Treasury document):

> Investor and servicer participation in the program is voluntary. However, the government is offering substantial incentives to servicers, investors, and borrowers, and it is expected that most major servicers will participate. Participating servicers will sign a contract with Treasury's financial agent, through which they will agree to review every potentially eligible borrower who calls or writes asking to be considered for the program. All loans that meet eligibility requirements and test "positive" for modifications in the NPV model **must** be modified, unless there is fraud or the modification is prohibited by the pooling and servicing agreement that govern [sic] the servicing of the loan. As contracts are signed, a list of participating servicers will be available on the internet at www.FinancialStability.gov.

Treasury has not yet identified its financial agent. However, servicers who choose to participate will be required to enter into written program agreements with this financial agent before December 31, 2009.

Screening Borrowers and Modifying Loans

Although participation in the program is voluntary, once a servicer agrees to participate, that servicer may not be selective in the loans to which it applies the program rules. A participating servicer must screen every potentially eligible borrower who calls or writes in requesting a

modification, to determine whether that borrower is experiencing or is about to experience a financial hardship. Using financial documentation provided by the borrower, servicers must ascertain whether the borrower has had a change in circumstances that is causing the borrower a financial hardship and making it difficult to afford their mortgage, or is facing an imminent increase in their mortgage payment that is likely to create a financial hardship.

To date, the details released by Treasury are somewhat unclear on what happens next. If a borrower is at least 60 days delinquent, or the servicer determines that a non-defaulted borrower facing a financial hardship is in imminent default, that servicer must perform a net present value (NPV) calculation which compares the cash flows expected from a loan modification to the cash flows expected in the absence of a modification. However, to date, the guidelines are silent on how borrowers who are not yet 60 days delinquent, or are not facing imminent default, must be treated. A positive NPV test automatically triggers a modification. A negative NPV result does not automatically disqualify a loan for modification; instead, servicers may choose whether or not to offer one. Servicers also have the option (and are encouraged) to modify loans that are not in imminent default, but it is not clear that an NPV test is required in these cases.

The guidelines are also somewhat ambiguous on exactly what the NPV calculations must consider. Treasury did release information regarding acceptable discount rates, property valuation methodologies, home price appreciation assumptions, foreclosure costs and timelines, and borrower cure and redefault rate assumptions, but the actual model, and complete details on each of the components of the model, will be released separately, at some time in the future.

This additional information will be critical to a fuller understanding of the NPV calculation, because, as the guidelines are currently drafted, the NPV test appears designed to yield a positive value. This is so, because the NPV test must only be performed on loans at least 60 days delinquent or deemed to be at risk of imminent default, and because the test must compare cash flows expected from a loan modification to cash flows expected in the absence of a modification. By looking only at a loan that is in default or headed for default, it appears impossible for the NPV test to yield anything but a positive number. Cash flows on a delinquent loan are zero, while cash flows on a modified loan will yield some amount, albeit an amount less than that originally provided for in the mortgage loan contract. As noted above, the additional information scheduled to be released by Treasury about the NPV calculations will likely help clarify this point.

Once a loan has been selected for modification (either because an NPV test run on that modification is positive, or because the servicer elects to modify the loan irrespective of an NPV test result, or without performing an NPV test), the servicer is required to target a "front-end debt-to-income ratio" (front-end DTI) of 31% for the borrower, using verified financial information provided by the borrower. The front-end portion of the ratio generally includes all first mortgage and housing-related payments (principal, interest, taxes, homeowners insurance, hazard and flood insurance, homeowners association fees, and/or condominium fees). Mortgage insurance premiums on first mortgages, and principal and interest payments in connection with second and subsequent mortgages, are not included in the front-end portion of the ratio. Gross income, for purposes of the ratio, includes verified wages, salary, overtime, fees, commissions,

tips, social security payments, pensions, annuities, insurance policies, retirement funds, disability or death benefits, unemployment benefits, rental income, and all other verifiable income.

The Waterfall

In order to get to a front-end DTI of 31%, servicers are first directed to capitalize any arrearages owed by the borrower or advanced by the servicer on behalf of the borrower (i.e., add them on to the total amount owed over the life of the loan). Late fees may not be capitalized, but most other unpaid amounts may be, such as unpaid interest, past-due real estate taxes and insurance premiums, delinquency charges paid to third parties, and similar types of payments.

Next, the servicer is directed to lower the borrower's interest rate to as low as 2%, targeting a front-end DTI of 31%. If an interest rate reduction alone does not reduce the borrower's front-end DTI to 31%, servicers are next directed to extend the loan's amortization period, to as long as 40 years. If both of those changes fail to reach a front-end 31% DTI, the servicer is directed to forbear principal (i.e., tack it on to the back end of the loan, at which point it is due as a balloon payment when the loan is paid off). This process of first trying interest rate reductions, then moving on to a longer amortization period, and then to principal forbearance, is called "the waterfall."

Lenders may, but are not required, to forgive principal in order to target 31% (not forbear it, but forgive it). However, if they do, they are still required to follow the waterfall process described above. Thus, for example, if principal forgiveness lowered a front-end DTI to 34%, the servicer would still be required to use interest rate reduction, an increase in the amortization period, and possibly principal forbearance to reduce the front-end DTI to 31%.

Servicers must fully cover the costs of reducing a borrower's front-end DTI to 38%. Treasury will match the cost to the servicer of reducing the front-end DTI from 38% to 31%, but not below 31%. Any servicer who wishes to reduce a borrower's front-end DTI ratio below 31% is fully responsible for the costs of that reduction, once it falls below 31%. If a borrower's initial (pre-modification) front-end DTI ratio is below 38%, and the borrower's loan is modified, Treasury will match the cost to the servicer to reduce the borrower's initial front-end DTI to 31%, but not below.

Servicers are also required to calculate a borrower's back-end DTI. Back-end DTI includes all monthly debt payments, including not only those included in the front-end calculation, but also everything else (monthly payments on second mortgages and other junior liens, alimony, car payments, credit card debt, cell phone bills, etc.). There is no ratio of back-end DTI that disqualifies a borrower from a loan modification. However, borrowers whose back-end DTIs will be above 55% once their loans are modified are required to receive counseling from a HUD-certified counselor. Despite this requirement, these borrowers are under no obligation to accept the advice of that counselor or work with that counselor to reduce their debts.

Interest Rate Caps

Once a loan has been modified by lowering its interest rate, the modified (lowered) rate must remain in place for five years, after which the servicer may increase the rate in one percentage point intervals annually, until it reaches the interest rate cap. The interest rate cap is the lesser of the fully-indexed, fully-amortized, original contractual mortgage rate or the Freddie Mac Primary Mortgage Market Survey rate for 30-year fixed rate conforming mortgage loans, as of the date the modification document is prepared. This Freddie Mac rate is released weekly, and is available at http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp. For reference, the most recently-released Freddie Mac rate for a 30-year fixed rate conforming mortgage loan was 5.15% (as of March 5, 2009).

Cost to Participate

No modification fees or other charges may be imposed on a borrower who participates in the Home Affordable Modification program. Unpaid late fees owed by the borrower must be waived. Modification fees and charges incurred by servicers (such as notary fees, property valuation fees, and other required fees) must be reimbursed by investors. However, servicers must cover the cost of credit reports pulled in connection with Home Affordable loan modifications.

Trial Period

Every borrower who receives a loan modification made through the Home Affordable Modification program must first successfully complete a 90-day trial period (or a longer period, if necessary to comply with the contractual obligations a servicer may have to its investors). Borrowers must be current at the *end* of the trial period in order to qualify for a long-term modification and to receive incentive payments (described below). There does not appear to be any prohibition against missing one or two payments during the trial period, as long as the borrower is fully paid up at the end of his or her trial. The loan modification is deemed to be effective the first calendar month following a borrower's successful completion of the trial period.

Financial Sweeteners

Servicers, investors, and borrowers are eligible for a variety of different payments under the Home Affordable Modification program, each of which appears to be additive (i.e., it does not appear that accepting one of the five payments excludes an individual or entity from accepting any of the other five payments, if they are otherwise eligible). These five payments include:

1. Cost-sharing payments paid to servicers in connection with reducing a borrower's front-end DTI from 38% to 31%.

2. $1,000, to servicers, for each modification they make that meets the Home Affordable Modification guidelines, once a borrower successfully completes their trial period.

3. Monthly “pay for success” payments to servicers, up to $1,000 per year for three years, which are paid as long as the borrower stays current on his or her modified loan, and as long as the modification reduces the borrower’s monthly front-end payment by at least 6% relative to its prior level (not by six percentage points, but by 6%).

4. $1,500 to note holders (i.e., to lenders or investors) and $500 for servicers for modifying the loan of a borrower who is still current, but is at risk of imminent default, as long as the modification reduces the borrower’s monthly front-end payment by at least 6%.

5. Monthly “pay for performance” payments of up to $1,000 per year for five years, accrued to borrowers who stay current on their modified loans, as long as their modification reduces their monthly front-end payments by at least 6%. These principal reduction payments will be paid to servicers, but must be applied by servicers to reduce the principal balance on each eligible borrower’s loan.

The Federal Deposit Insurance Corporation (FDIC) will also create an insurance fund of up to $10 billion, designed to discourage lenders from foreclosing on mortgages that are currently viable, out of fear that home prices will continue to fall. Although details of this insurance plan are not yet available, the insurance fund will provide lenders and investors who hold loans modified under the program an additional payment on each modified loan, linked to declines in the home price index.

Only One Bite of the Apple

Any borrower who receives a Home Affordable Modification, and who subsequently becomes 90-days or more delinquent on the modified loan, is deemed to have defaulted on their modification. Redefaulting loans are removed from the program, and further “pay for success” and “pay for performance” payments are terminated. A borrower may not receive more than one loan modification under the Home Affordable Modification program. However, according to the guidelines, “Redefaulting loans should be considered for other loss mitigation programs prior to being referred to foreclosure.”

Transparency and Accountability

Borrowers will be required to provide declarations under penalty of perjury, attesting to the truth of the information they provide to servicers regarding their eligibility for the program. Servicers who participate in the program will be required to maintain records documenting their modifications. Detailed guidance regarding data requirements, and regarding measures to prevent and detect fraud, will be released at some time in the future.

Other Key Components That Have Not Yet Been Fleshed Out

Compensation will be provided to servicers and borrowers in order to facilitate short sales or deeds-in-lieu of foreclosure, in cases where borrowers either fail the NPV test, fail to qualify for a modification, or default under a modification.

Additional incentives will be provided to extinguish junior liens on homes with first-liens modified under the program.

The Hope for Homeowners program guidelines will be modified to encourage participation in that program, as an alternative to the Home Affordable Modification program.

FHA, VA, and rural housing loans (none of which are eligible for Home Affordable Modifications) will be addressed through standalone modification programs.

Will the Home Affordable Modification Program Help Californians?

The degree to which the Home Affordable Modification program will help Californians will only be known after the program has been given a chance to work. However, the sheer number of Californians currently in mortgages that are larger than their homes are worth, or about to enter that position, is likely to reduce the effectiveness of the program in California. As noted elsewhere in this report, increasing numbers of Californians who can afford their mortgages are choosing to walk away from their homes, trying to leave a bad investment behind them and start fresh. Convincing these Californians to remain in their homes and stay current on their mortgages, while the housing market recovers and their home equity returns, may be a challenge far greater than convincing servicers to modify loans under the provisions of the Home Affordable Modification plan. Those who collect data to measure the effectiveness of the program would be wise to include a category which tracks the number of individuals whose modifications failed because they chose to walk away.

CALIFORNIA'S NEW FORECLOSURE DELAY LAW

In mid-February, 2009, the Legislature enacted two identical measures, both of which were subsequently signed by Governor Schwarzenegger (SB 7 x2, Chapter 4, Statutes of 2009, and AB 7 x2, Chapter 5, Statutes of 2009). These bills require mortgage loan servicers to wait an additional 90 days (over and above the three months required under existing law) between recording a notice of default (NOD) and a notice of sale on which a servicer intends to foreclose. The new foreclosure delay law is operative beginning May 21, 2009 (the ninety-first day following adjournment of the special session during which it was enacted). The law sunsets on January 1, 2011.

Under the provisions of the new law, the 90-day foreclosure delay applies to non-judicial foreclosure actions on delinquent first-liens made between January 1, 2003 and January 1, 2008, when the property secured by the lien is owner-occupied, residential real property and is the principal residence of the borrower. The delay provided for in the bill does not apply to non-judicial foreclosure actions commenced on second liens, non owner-occupied residential real property, or commercial property, nor does it apply to judicial foreclosures on any type of property, nor to any loan made, purchased, or serviced by a state or local public agency or authority.

If a servicer wishes to be exempt from the 90-day foreclosure delay, it must demonstrate, through an application submitted to the state, that it has implemented a comprehensive loan

modification program. Applicants whose loan modification programs are approved by the state receive an exemption and may follow the more traditional non-judicial foreclosure process (which requires three months between recording an NOD and a notice of sale).

For purposes of the new law, a comprehensive loan modification program is one that includes, at a minimum, all of the following features:

> It is intended to achieve modifications whose net present values exceed the amount that would be recovered through foreclosure.
>
> It targets a ratio of the borrower's housing-related debt to the borrower's gross income of 38 percent or less, on an aggregate basis in the program.
>
> It includes some or all of the following features: reduces the interest rate for at least five years, provides for a 40-year amortization period, defers the principal amount of any unpaid balance until loan maturity, reduces principal, complies with a federally-mandated loan modification program, or includes "other factors" the Commissioners of Financial Institutions, Corporations, and Real Estate deem appropriate.
>
> It is intended to achieve long-term sustainability for the borrower.

A state-regulated servicer desiring an exemption from the foreclosure delay must apply for one from its primary regulator (e.g., Department of Financial Institutions, Department of Corporations, or Department of Real Estate). When the law was being drafted, many believed that federally-regulated servicers would be directed to apply to the Commissioner of Corporations for their exemptions. However, since enactment of the law, some have suggested that the law's wording directs federally-regulated depository institutions to apply for their exemptions from the Department of Financial Institutions, rather than the Department of Corporations. Clarification on this point will be forthcoming in the regulations the commissioners are required to adopt (see immediately below).

Within 10 days of the operative date of the bill (May 31, 2009), the commissioners are required to adopt emergency and final regulations to clarify how the bill will work, and to issue the application form that must be used by financial institutions to apply for an exemption from the 90-day delay. However, because May 31, 2009 is a Sunday, the commissioners have until Monday, June 1, 2009 to issue their regulations.

Once the application form is issued by the commissioners, financial institutions have up to 14 days in which to submit their applications, a period of time during which the 90-delay does not apply. If a financial institution chooses not to apply for an exemption, or if the financial institution needs more than 14 days in which to complete its application, that institution will be subject to the 90-day delay, beginning 14 days after the commissioners issue the application form.

Once a financial institution submits an application to be exempted from the 90-day delay, state regulators have up to 30 days to render a decision on that application. The 90-day foreclosure

delay does not apply during the pendency of an application (i.e., servicers may follow existing non-judicial foreclosure law while their applications are being reviewed). The delay also does not apply for 30 days, after a servicer has its application denied.

The Secretary of Business, Transportation & Housing is required to maintain an Internet-based list of which institutions receive orders granting exemptions, the date of each order, and a link to web sites describing approved loan modification programs.

A commissioner may revoke a servicer's exemption upon finding that the servicer's application was materially false and misleading or that the servicer's loan modification program was materially altered from the program on which the exemption was based. Revocations may not be retroactive.

The law explicitly states that nothing among its provisions shall require a servicer to violate contractual agreements for investor-owned loans or to provide a modification to a borrower who is not willing or able to pay under the modification. The law also explicitly exempts servicers from its provisions in all of the following instances: 1) the borrower has surrendered his or her keys to the property, 2) the borrower has contracted with an organization that advises people who have decided to leaves their homes on how to extend the foreclosure process and avoid their contractual obligations under their mortgages, and 3) the borrower has filed for bankruptcy, but the proceedings have not been finalized.

The Secretary of Business, Transportation & Housing must submit bi-annual reports to the Legislature regarding actions taken to implement the bill, beginning three months after the first exemption is issued by any of the commissioners. Additionally, to the extent feasible within existing resources, the commissioners must collect loan modification data from some or all servicers and post those loan modification data on an Internet web site at least quarterly.

EVALUATING CALIFORNIA'S 90-DAY FORECLOSURE DELAY IN THE CONTEXT OF THE FEDERAL HOME AFFORDABLE MODIFICATION PROGRAM

Questions have been raised about the degree to which servicers who participate in the federal Home Affordable Modification program will be eligible for an exemption from California's new 90-delay foreclosure law. Others have asked about the degree to which servicers who choose not to participate in the Home Affordable Modification program may still qualify for an exemption from California's new 90-day foreclosure law. Answers to these questions will only be known, once the commissioners release their emergency regulations, which, as noted above, are required to be finalized by May 30, 2009. The chart below is intended to facilitate a comparison between some of the key components of the two foreclosure-prevention efforts.

Component	90-Day Foreclosure Delay Law	Home Affordable Modification Program
Eligible Loans	First liens of any value, originated from January 1, 2003 to January 1, 2008, on owner-occupied, principal residences.	First liens equal to or less than $729,650, originated prior to January 1, 2009, on owner-occupied, principal residences.

Component	90-Day Foreclosure Delay Law	Home Affordable Modification Program
Net Present Value Calculation	Anticipated recovery under the loan modification or workout plan must exceed the anticipated recovery through foreclosure.	Must be applied only to borrowers 60 days or more delinquent or in imminent default. Cash flow resulting from the modification must be greater than the cash flow resulting from a failure to modify.
Targeted Front-End Debt to Income Ratio	38% or less, in the aggregate across the program	31% on each loan
Items included in the Front-End Debt to Income Ratio	Housing payments (principal, interest, taxes, and insurance, plus assorted fees) related to the property and to the first lien. Mortgage insurance is included.	Housing payments (principal, interest, taxes, and insurance, plus assorted fees) related to the property and to the first lien. Mortgage insurance is excluded.
Loans That Must Be Included in the Program	Not specified, but servicers are not required to modify a loan if doing so would violate contractual agreements for investor-owned loans or if a borrower is unwilling or unable to pay under a modification.	All loans serviced by the financial institution, held by eligible borrowers, unless the modification is explicitly prohibited by contract. Servicers are required to use reasonable efforts to obtain waivers of limits on their participation in the program.
Length of Program	June 2009 through December 2010	April 2009 through December 2012
Required Components of the Loan Modification	One or more of the following: interest rate reduction for at least five years, lengthened amortization period of up to 40 years, deferral of the principal amount of any unpaid balance until loan maturity, principal reduction, compliance with a federally-mandated loan modification program, or "other factors" the commissioners deem appropriate.	One or more of the following, applied in the following order: interest rate reduction for at least five years, lengthened amortization period of up to 40 years, deferral of the principal amount of any unpaid balance until loan maturity. Principal may be reduced in addition to or in lieu of the other options.
Data Reporting Requirements By Servicers	Required. Details not yet available.	Required. Details not yet available.