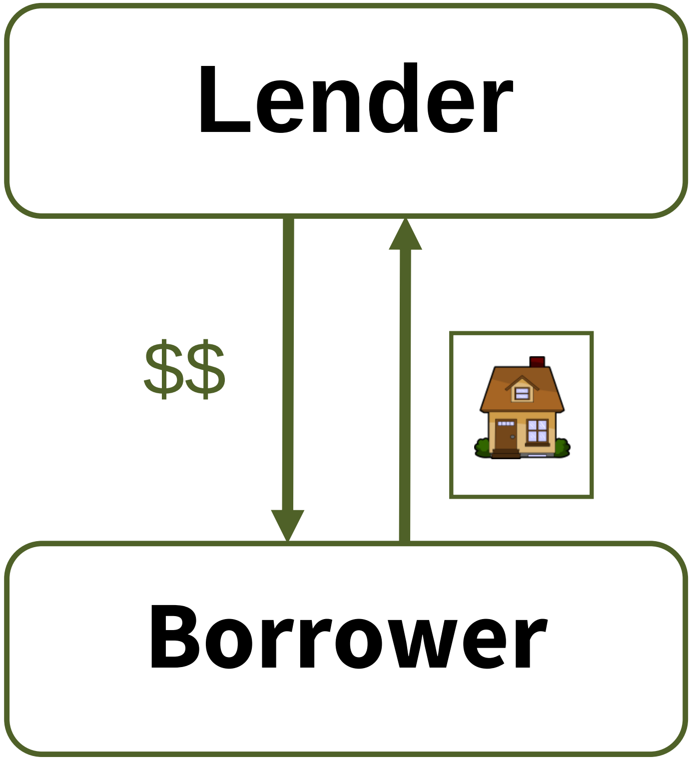
Fannie Mae and Freddie Mac Loss Mitigation Waterfall
June 17, 2021

Alys Cohen &
Andrea Bopp Stark
NCLC

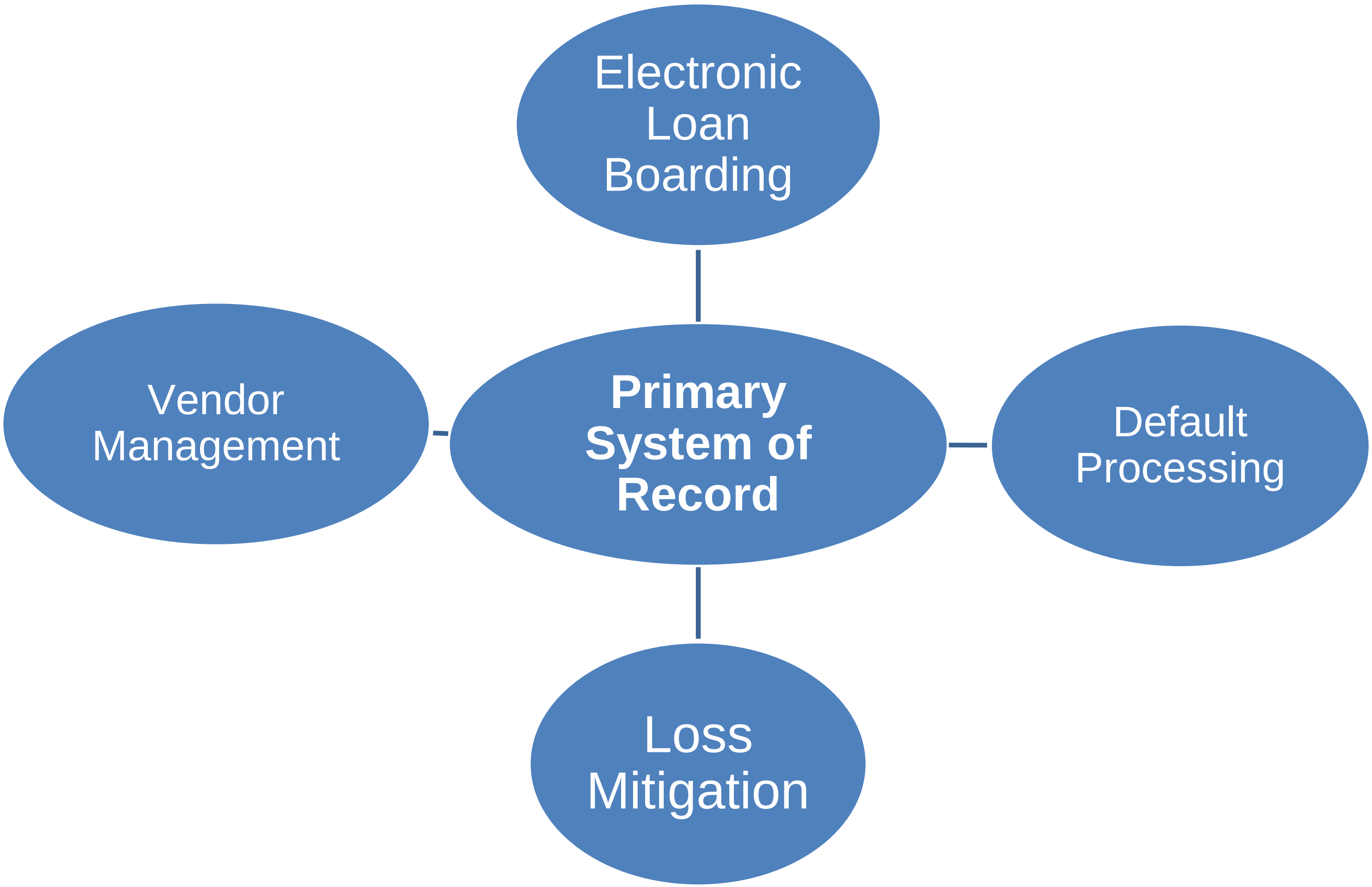
Introduction to Loss Mitigation

National Consumer Law Center
Fighting Together for Economic Justice



Lender
$$
Borrower

Servicing Modules



Who Are Servicers?

- Top Servicers: Wells Fargo, Chase, Mr. Cooper, NewRez, Bank of America
  - Top GSE servicers: Wells Fargo, Chase, NewRez, Quicken
- Servicers not the same as investors, holders, or lenders
- Servicers accept the payments and pass on to the trust
- Borrowers can’t hire or fire servicers

What is Loss Mitigation?

- Policy to minimize losses to investors from unnecessary foreclosures
- Consists of series of options/alternatives to foreclosure
- Goal is to keep loans performing, avoid liquidation losses

Common Servicer Violations

- Failure to process application in a timely way
- Failure to convert from trial to permanent plan
- Requiring resubmission of income information
- Asking for an upfront downpayment
- Telling homeowners they have to be in default
- Using incorrect income information in determining eligibility
- Improper denial of loss mit. options

Fannie and Freddie Loss Mit. Waterfall

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Government Sponsored Enterprises (the GSEs)

- Fannie Mae and Freddie Mac placed in government “conservatorship” in September 2008
- Federal Housing Finance Agency (FHFA) designated as federal agency to regulate the GSE’s
- Great influence over industry practices

The GSE's Loss Mit Hierarchy

- The Flex Mod fits into a "hierarchy" of GSE loss mitigation options:
  - Repayment or forbearance plans
    - Unemployment
    - Other temporary hardship
  - **Flex Modification**
    - Long-term or permanent hardship
  - Disposition options: short sale, deed in lieu

The GSE Flex Modification

- Loans owned/guaranteed by Fannie Mae or Freddie Mac
- How to find out who owns loan
  - freddiemac.com/mymortgage/
  - fanniemae.com/loanlookup/
  - RESPA 24 C.F.R. § 1024.36 (Request for Information & shortened response period)
  - TILA § 1641(f)(2) (request to identify owner of loan)

Total Replacement

- As of Oct. 1, 2017, Flex Modification replaced:
  - GSEs' version of HAMP
  - GSE Standard Modification
  - GSE Streamlined Modification

Fannie Mae Resources

- Fannie Mae Lender Letter LL-2016-06 (12/14/16)
- Fannie Mae Flex Mod FAQ (12/14/16)
- Flex Modification Online Course (with examples)
- Fannie Mae Single Family Servicing Guide (Part D2-3.2-09 (6/13/18) (eligibility) and Part F-1-30 (9/13/17) (waterfall))

Freddie Mac Resources

- Freddie Mac Bulletin 2016-22 (Dec. 14, 2016)
- Freddie Mac Flex Modification Reference Guide (Jan. 2018) (w/ examples)
- Freddie Mac Flex Modification FAQ (7/17)
- Freddie Mac Seller/Servicer Guide Topic 9206.5 (7/1/18)(eligibility); 9206.10 (7/1/18) (waterfall)

Start of Dialogue

Flex Mod: Basic Structure

- Uniform terms (program fixed interest rate; repayment term same for all Flex Mods)
- Minimal reliance on individual borrower information
- One basic waterfall (five steps)
- Just one variation in part of 5th step: for borrowers who submit an application before loan is 90 days delinquent

Overall Goal

Borrowers with mortgage loans less than 90 days delinquent:

- must submit a complete Borrower Response Package (BRP) and
- will be evaluated for a Fannie Mae Flex Modification which will target a 20% payment reduction and a 40% Housing Expense-to-Income (HTI) Ratio.

Borrowers with mortgage loans 90 or more days delinquent:

- not required to submit a BRP and
- will be evaluated for a Fannie Mae Flex Modification which will target a 20% payment reduction.

Getting a Flex Mod

- Two methods:
  - Borrower submits an application
    - Required if loan is *more than* 90 days delinquent
    - Permitted if loan is *less than* 90 days delinquent
  - Or servicer finds borrower eligible based on servicer's unilateral proactive review of loan file
    - Required for loans that are *less than* 90 days delinquent, or
    - If borrower had a prior step-rate modification and the interest rate increased w/in past 12 months, servicer must perform unilateral review if loan becomes *more than* 60 days delinquent

How to Apply

- Same application process for all GSE loss mit options
- Can be found online here: http://www.freddiemac.com/singlefamily/service/docs/form710.pdf
- Borrower must complete GSE Mortgage Assistance Application Form (Form 710)
- Submit Form with required documentation
  - Income
  - hardship certification
  - IRS tax transcript form (4506T)

- Whole packet called a “Borrower Review Package” or “BRP.”

When to *Apply*

- Must be at least 60 days delinquent or meet GSE "imminent default" standard
- No outer time limit to apply, but:
  - May run into dual tracking problem (start a foreclosure while seeking review for loss mit)
  - Dual tracking protections apply if submit borrower's first complete BRP 37+ days before foreclosure sale
  - If already had complete review, servicer must attempt to review for Flex Mod, but need not stop foreclosure.

Trial Period Plan

- If found eligible, servicer offers trial plan
- Duration 3-4 months
- No signed document until final (permanent) mod
- No documents due during trial period- just make payments & sign permanent mod
- Foreclosure stay while comply

Mod Offer Based on *Unilateral Review*

- Servicer may offer trial plan without application, without looking at any information submitted by borrower
- Servicer uses own loan file data on arrearage, UPB, property value, interest rate, and current payment amount
- Borrower income irrelevant
- Borrower makes 3 trial payments, then parties sign permanent Flex Mod.

Timing of Servicers' Unilateral Offers

- Servicer must review all borrowers at 90-to-105 days of delinquency
- Offer flex mod to all found eligible at this time
- *At servicer's discretion,* after 105 days *may* proactively evaluate and solicit borrowers who did not submit BRP
  - But if considering information provided by borrower, should be treated as application

General Eligibility Requirements

- Not eligible if:
  - Had more than 3 prior mods, any type
  - Past Flex Mod default (trial plan or permanent) within past 12 months
  - In compliance with other loss mit. option
- “Hardship” certification
  - None if based on servicer unilateral evaluation
  - Yes if based on BRP (it’s part of the form)

General Eligibility Requirements

- Can still apply and be found eligible for Flex Mod if:
  - Received a Flex Mod offer in the past and did not accept it.
  - Applied in the past and found not eligible
    - Now have changed circumstances, or
    - Past eligibility determination was erroneous

Basic Flex Modification Waterfall

- Same waterfall applies whether review based on application or unilateral servicer action,
  - But a variation in fifth and final waterfall step can apply if borrower submits complete BRP before 90 days delinquent

Basic Flex Mod Waterfall

- Five Steps (*See* Fannie Mae LL 2016-06 pp. 4-6)
  1. Capitalize arrears
  2. Set fixed interest rate -- See next slide
  3. Extend term to 480 months - always
  4. Principal forbearance stage 1
  5. Principal forbearance stage 2 (may have 2 parts depending on timing of application)

Step 2- interest rate

May or may not get a change in interest rate

If below 80% LTV:

if fixed rate- keep current interest rate

If adjustable rate- get loan mod. rate (GSE Mod Rate (3.125% as of 4/14/2021))

If above 80% LTV:

Fixed = Lower of current interest rate or loan mod rate

Adjustable = Loan Mod Rate

Step 3- Extend term

Extend remaining term to 480 months

- Every time, all loans

Payment Reduction Drivers

- Change in interest rate and term extension can determine percentage payment reduction (aiming for 20% reduction)
- Principal forbearance plays major role in payment reduction, but tied to property value and not income
- Cap on principal forbearance limits how far payment reduction can go
- Not eligible if waterfall produces mod that increases monthly payment

Principal Forbearance Stage 1

- This is <u>Step 4</u> in the waterfall
- First three steps were: (1) capitalize arrears, (2) reduce interest rate if eligible, and (3) fix term at 480 months
- Now, set interest-bearing principal at *lesser of*
  - Amount that brings interest-bearing principal to 100% of property's value (LTV), <u>or</u>
  - 30% of post-modification UPB (the "forbearance cap")

Principal Forbearance Stage 1

Example

- Post modification UPB is $250,000
- FMV is $200,000
- Compare amount of forbearance needed:
    - to set interest-bearing UPB at 100% FMV: $50,000 and
    - 30% of UPB: $75,000
- $50,000 is the lower amount, so is the forbearance limit *but only for this step.*

Crunching the numbers

- Must reduce the monthly payment by 20%
  - If prior principal and interest payment was $954.83, extending the term to 480 months and setting the interest rate at 3.5% only reduces the payment by 19%

Principal Forbearance Stage 2

- Step 5 in the waterfall:
- Only applies if did not yet reduce original P&I payment by 20%
- Tries to reach 20% P&I reduction by reducing interest-bearing principal to 80% of property’s market value
- 20% reduction not required for mod.- but payment cannot increase
- Only relevant if LTV is above 80%
- And subject to program cap on principal forbearance (30% post-capitalization UPB)
- It is the lower of 80% LTV or 30% UPB forbearance but stops when hits 20% reduction
- Can still get mod if don’t hit 20% as long as it doesn’t increase payment (one or the other)

Crunching the Numbers

- Can lower balance to 80% LTV
- 80% of $200,000 value = $40,000, which means can lower ppal to $160,000
- Total deferred: $250,000 - $160,000 - $90,000

But can only put 30% of capitalized UPB at end = $75,000 ($50,000 plus another $25,000)

Principal Forbearance Stage 2

- Notice: Three caps--Whether you put the full $25,000 at the end depends on when you hit the *lesser* of:
  - (a) amount needed to reduce interest-bearing principal to 80% of market value
  - (b) the forbearance cap (30% of modified UPB) or
  - (c) amount needed to achieve 20% P&I reduction

Principal Forbearance Stage 2: Crunching the Numbers

- Unpaid principal balance on a loan after capitalization of arrears is $250,000
- Current FMV is $200,000 so $50,000 is deferred to the end and a current PI payment of $954.83:
- If we only defer $3,000, that would still be under the 30% (of the capitalized UPB) cap of $75,000 and would get you to the 20% payment reduction and be less than the $40,000 to get you to 80% LTV.
- The principal balance would be $197,000.
- Interest rate of 3.5% + term of 480 months = $763.16 PI/ month
- 20% reduction would be $763.86

See NCLC Manual: Mortgage Servicing and Loan Modifications section 7.3.1.5

The Step 5 Variation for DTI

- There is a Step 5 variation only for borrowers who submit complete BRP before loan is 90 days delinquent
- Set modified payment with 20% P&I payment reduction *and* at PITI no more than 40% of borrower's gross income
- *If 40% but not a 20% reduction– or if 20% but not 40%- keep going 'til you get them both*
- Targets *both* a fixed payment reduction *and* a DTI calculation
- Payment reduction could be greater than 20%

The Step 5 Variation for DTI

- The calculation to reach 40% DTI is still subject to program forbearance cap: lesser of 80% LTV or 30% UPB
  - If already below 80%; no ppal forbearance or interest rate reduction
- Forbearance and payment reduction stop where hit cap
- Borrower could end up paying more than 40% DTI

The Step 5 Variation for DTI: Crunching the Numbers

Gross monthly income: $3,000
40% of $3,000 = $1,200

Taxes and Insurance payment: $300
Principal and Interest payment under prior analysis: $763.16
Total PITI: $1063.16

Better off not submitting an application; no additional benefit bc already below 40%. If borrower is above 40% DTI, the reduction is still subject to the up to 20% payment reduction cap.

Rules for All Servicer-Initiated Reviews AND Application Review if ≥ 90 Days Delinquent

Step 1	Capitalize Arrearage	Capitalize accrued interest, unpaid escrow, other advances
Step 2	Set Interest Rate	If fixed rate and LTV<80% = current interest rate If fixed rate and LTV≥80% = lesser of current rate and GSE Mod rate If adjustable = lesser of GSE mod rate, final interest rate for step-rate, and lifetime cap for ARM https://www.fanniemae.com/content/guide_exhibit/fannie-mae-standard-modification-interest-rate.pdf http://www.freddiemac.com/singlefamily/service/modrate.html
Step 3	New 40-Year Term	
Step 4	Forbearance (Part 1)	Interest-bearing principal balance is the lesser of: – Amount that brings interest-bearing principal to 100% of property's value (LTV), <u>or</u> – 30% of post-modification UPB
Did steps 1-4 reduce P&I payment by at least 20 percent?		YES □ STOP NO □ Step 5
Step 5	Forbearance (Part 2)	Goal: reduce P&I payment by 20% - Take interest-bearing principal as low as 80% of property's value (LTV), <u>but</u> - Forbearance still cannot exceed 30% post-mod UPB
Final Review (Eligible or Not)		If <31 days delinquent at evaluation, P&I must be reduced If 31+ days delinquent at evaluation, P&I must be equal to current payment or reduced

Rules for Application Review if < 90 Days Delinquent

Step 1	Capitalize Arrearage	Capitalize accrued interest, unpaid escrow, other advances
Step 2	Set Interest Rate	If fixed rate and LTV<80% = current interest rate If fixed rate and LTV≥80% = Lower of current rate and GSE Mod rate If adjustable = lesser of GSE mod rate, final interest rate for step-rate, and lifetime cap for ARM https://www.fanniemae.com/content/guide_exhibit/fannie-mae-standard-modification-interest-rate.pdf http://www.freddiemac.com/singlefamily/service/modrate.html
Step 3	New 40-Year Term	
Step 4	Forbearance (Part 1)	Interest-bearing principal balance is the lesser of: – Amount that brings interest-bearing principal to 100% of property's value (LTV), <u>or</u> – 30% of post-modification UPB
Did steps 1-4 reduce P&I payment by at least 20 percent AND DTI <= 40%?		YES □ STOP NO □ Step 5
Step 5	Forbearance (Part 2)	Goal: reduce P&I payment by 20% ***AND achieve a housing expense-to-income ratio of 40%*** - Take interest-bearing principal as low as 80% of property's value (LTV), <u>but</u> - Forbearance cannot exceed 30% post-mod UPB Income = gross income Housing Expense = PITIA; excludes MIP
Final Review (Eligible or Not)		If <31 days delinquent at evaluation, P&I must be reduced. If 31+ days delinquent at evaluation, P&I must be equal to

Online Calculators

- Mobilization for Justice (NY legal services program) provides online calculators for:
  - GSE Flex mod
  - FHA HAMP
  - Treasury HAMP (expired)
- http://mobilizationforjustice.org/publications-and-report/waterfall-worksheets/

Waiver of Waterfall Steps

- Servicer may request that a GSE make exceptions to Flex Mod eligibility requirements, including waterfall steps.
- Servicer makes request based on determination that “acceptable mitigating circumstances” exist.
- Not sure what will happen

The Big Picture

- Affordability is not the goal
- Underwater borrowers will benefit most
- Folks with substantial equity could be stuck with a high interest rate
- Property value is critical, but APS/AVM is not publicly available

- *Why would a borrower want to apply?*
- Especially wise to apply before 90 days behind if borrower is underwater and needs payment reduction
- If borrower does not apply, will not receive a denial letter with reasons
- RESPA dual tracking protections apply

- *Why would a borrower not want to apply?*
- Cannot document hardship or income
- If substantial equity, won't make any difference in modification offered

Rules on Multiple Mods

- Not eligible if:
  - Had 3+ prior mods
  - Defaulted on a flex mod trial plan in last 12 months (unless converted to unemployment forbearance)
  - Received permanent Flex Mod and defaulted (60+ days) within 12 months of effective date and didn’t bring it current

- Can be eligible even if:
  - Previously denied for a flex mod
  - Previously solicited for a flex mod, but didn’t accept it

Unilateral Review Problems

- Not clear what notice borrowers get that unilateral Flex Mod review occurred
- Notice of reasons for denial?
- Appeal opportunity?
- Property valuation plays major role in waterfall and wrong value can lead to improper denial, onerous terms

Unilateral Review Questions

- Did servicer perform the 90-to-105 day unilateral review at all?
- If so, did the servicer perform do it correctly?
- Did borrower get an offer and not accept it?
- If so, was the offer appropriate?
- If accepted, was offer appropriate?