

BBVA Research Flash

U.S.

Obama Administration Expands Mortgage Modifications

- **Increases eligibility for debt-constrained and underwater borrowers**
- **Will triple the payment to banks per dollar of principal forgiven**
- **Investors with rental properties will also be eligible**
- **Fannie Mae and Freddie Mac's participation is up to federal regulators**

Following Tuesday's State of the Union address, today the Obama Administration announced an expansion of the Home Affordable Modification Program (HAMP) to help debt-laden and underwater borrowers. This announcement is the Administration's first move in 2012 to support the housing market, prevent foreclosures and help homeowners repair their balance sheets. The initial HAMP program has been proceeding slowly. It was expected to reach 4 million homeowners, but it has seen only about 900,000 successful modifications, and thus this new plan is an attempt to reach more borrowers and entice lenders to participate. Beyond extending the filing deadline by an additional year to the end of 2013, the new rules will greatly expand eligibility for the program and triple the payment to banks (and Fannie Mae and Freddie Mac) for reducing principal (from \$0.21 per dollar forgiven to \$0.63). Certainly, the higher payment provides an incentive for lenders to modify the mortgages of underwater borrowers and those with high debt service ratios.

Previously, HAMP attempted to peg the ratio of borrower's debt payment to income at or below 31% if this ratio was exceeded when the mortgage was initiated. With HAMP 2, in addition to mortgage debt, the new program will consider other types such as medical and credit card debt to determine eligibility. Notably, the Administration is proposing to expand HAMP's eligibility to owners of rental properties – previously only owner-occupants could apply. The program's expansion to investors adds roughly 700,000 properties to the potential total, according to Treasury Assistant Secretary Tim Massad.

To achieve a large impact, Fannie Mae and Freddie Mac will have to participate in this expanded program. Whether those entities participate, is up to their chief overseer – the Federal Housing and Finance Administration (FHFA). The FHFA has already publicly stated its opposition to a principal forgiveness program over the principal forbearance option that is already in place. Last week, in response to a congressional inquiry, the FHFA stated that it does not favor allowing Fannie Mae and Freddie Mac to engage in principal forgiveness, because such a program would require nearly \$100 billion to pay down existing mortgages to their current values. They conclude that the long-term costs to taxpayers and added risk to Fannie and Freddie's portfolio outweigh the potential benefits. Furthermore, the Federal Reserve's January 4 whitepaper on housing questioned the potential benefits and efficacy of principal reduction on delinquency and foreclosure rates in light of substantial costs.

Bottom Line: Today the Obama Administration announced an expansion of the Home Affordable Mortgage Program (HAMP) that will extend the filing deadline by an additional year, and broaden eligibility to include underwater borrowers, homeowners with high debt payment to income ratios and investors who own rental properties. Furthermore, the program will triple its payment to banks (and to Fannie Mae and Freddie Mac) for every dollar of principal forgiven. Whether Fannie Mae and Freddie Mac participate remains in question, as housing regulators must make the final decision. Given the Administration's recent comments and renewed attention to the housing market, we expect an additional announcement in the coming weeks to expand the reach of the separate Home Affordable Refinance Program (HARP).

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