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To Our Clients & Friends:

As part of our effort to keep you informed about changes in the law concerning home ownership, we have prepared the following summary of the HOPE for Homeowners Act of 2008, one of the federal laws recently enacted by Congress and signed into law by the President. The Act gives qualified homeowners threatened by rising mortgage payments the opportunity to refinance their current mortgage loans and obtain new, fixed-rate loans insured by the Federal Housing Administration (FHA). While we do not have any information specific to your current mortgage payments or rates, here are some points for homeowners to consider in deciding whether this Act could help them:

A Summary of the “HOPE for Homeowners Act of 2008”

1. **Effective Date.** The Act takes effect on October 1, 2008, and runs through September 30, 2011. The FHA is responsible for administering the Act. There is currently some doubt as to: (a) whether the FHA will be ready to supply the necessary guidelines for the Act by October 1st; and (b) whether mortgage lenders will have established FHA mortgage loan programs to take advantage of the Act by that date.

2. **Potential Benefits.** The Act is designed to allow qualifying homeowners to cancel any mortgage debt on their homes that was incurred on or before January 1, 2008, and to replace it with an FHA-insured, 30-year fixed-rate mortgage loan equal to 90% of the home's current value.

a. This cancellation will forgive: (i) all of the homeowners' debt above 90% of the current value of their homes; and (ii) any prepayment penalties on current mortgage loans.

*Example:** Original home purchase price: \$400,000.00. Original interest-only first mortgage: \$320,000.00. Original interest-only equity line second mortgage: \$40,000.00. House appreciates during the housing boom to \$500,000.00. The equity line is increased to \$130,000.00 and fully borrowed upon by the owner. After the housing bust, the current home value is \$200,000.00. The new FHA mortgage loan would be for 90% of \$200,000.00 or \$180,000.00. Since the original mortgage loans were interest only, \$450,000.00 in principal on both mortgage loans would still be owed prior to the new FHA mortgage loan, but all except \$180,000.00 of that debt would be cancelled; i.e., \$270,000.00 would be forgiven.

b. The homeowners' new fixed interest rate would be based upon current market rates and could therefore be lower than the rates of their previous variable-rate first and second mortgages.

c. The homeowners have a new fixed interest rate, which will not go up like the rates of their old variable-rate mortgage loans.

3. **Requirements & Obligations.** The borrowing homeowners must meet the following requirements and agree to the following obligations:

a. The FHA-insured mortgage loan cannot exceed \$550,400.00.

b. The home must be the homeowners' primary residence, not a second home or rental or investment home. Further, the homeowners are not eligible for an FHA mortgage loan if the homeowners own a second home.

c. The homeowners must not have intentionally defaulted on their current mortgage loans.

d. The homeowners must currently have a monthly mortgage-payment-to-income ratio *greater than 31%* as of March 1, 2008; i.e., their total monthly mortgage payments must exceed 31% of their monthly income. Before homeowners can use an FHA mortgage loan, the homeowners' lender must document and verify the homeowners' income *with the IRS*.

e. In exchange for this FHA-insured mortgage loan, the homeowners must pay to the FHA a substantial share of any cash they receive from the future sale or refinancing of their home. The cash the homeowners receive comes from: (i) any *appreciation* or increase in the value of the home that occurs over time; and (ii) the initial 10% *equity* they receive when they obtain the FHA mortgage loan, plus the increase in that equity that occurs as they pay down the mortgage loan. When the homeowners sell or refinance their home, the cash derived from *appreciation* is divided and paid 50% to the homeowners and 50% to the FHA. The cash derived from *equity* is shared between the homeowners and the FHA based upon when the sale or refinance closing occurs in relation to the closing on the FHA loan, as follows:

	<u>FHA Share</u>	<u>Homeowners' Share</u>
Within 1 year:	100%	0%
Within 2 years:	90%	10%
Within 3 years:	80%	20%
Within 4 years:	70%	30%
Within 5 years:	60%	40%
5 years or more:	50%	50%

There is no phase-out over the years of the FHA's entitlement to its share of the cash from the sale or refinance closing, whether that cash is derived from *appreciation* or *equity*.

*Example:** Using figures from the previous example, the devalued home of \$200,000.00 begins to appreciate again, ending at a value of \$300,000.00, when it is sold at that price 3½ years

from now. The \$180,000.00 mortgage loan has been paid down from \$180,000.00 to \$160,000.00. The homeowners' and the FHA's shares are calculated as follows:

Appreciation = \$300,000.00 price — \$200,000.00 value at the time of the FHA mortgage loan = \$100,000.00.

Equity = \$200,000.00 value at the time of the FHA mortgage loan — \$160,000.00 current FHA mortgage loan balance = \$40,000.00.

	<u>FHA</u>	<u>Homeowners</u>
Homeowners' Share of Appreciation = 50% x \$100,000.00 =		\$50,000.00
FHA's Share of Appreciation = 50% x \$100,000.00 =	\$50,000.00	
Homeowners' Share of Equity = 30% x \$40,000.00 =		<u>\$12,000.00</u>
FHA's Share of Equity = 70% x \$40,000.00 =	<u>\$28,000.00</u>	
TOTAL	<u>\$78,000.00</u>	<u>\$62,000.00</u>

Important Note: The Act is silent as to how closing costs will be handled. It is therefore unclear whether these costs would be subtracted from the homeowners' share before or after division of the appreciation and equity with the FHA. How closing costs are ultimately treated under the Act will significantly impact the amount of money homeowners receive from subsequent closings.

4. **Limitations & Uncertainties.** Even if a homeowner qualifies and meets all of the Act's requirements, these new FHA-insured mortgage loans may be difficult to obtain due to the following limitations of the Act:

a. The Program is voluntary for lenders, so the Act does not *require* that either first or subordinate mortgage lenders agree to a replacement and cancellation of their mortgage loans in exchange for an FHA mortgage loan.

b. The home's "current value" for FHA purposes is the amount for which it could be sold. The current mortgage lender, however, will lose another 10% of that value because its current mortgage loans must be written down to 90% of that value, whereas, if the lender completed a foreclosure of the home, it would recover 100% of that value. This is a disincentive for the mortgage lender to agree to an FHA mortgage loan unless the cost to the lender of foreclosure and of selling the home after foreclosure (e.g., broker's commission, repair costs, payment of delinquent taxes and association dues, maintenance costs over time, etc.) exceed that 10% of the value.

c. In exchange for issuing its insurance, the FHA requires: (i) an initial premium payment equal to 3% of the loan amount; and (ii) an ongoing premium of 1½% of the loan balance annually. These premium payments will be built into the cost of the new loan and create an additional disincentive.

d. The homeowners' mortgage lender must believe, and make representations and warranties to the FHA, that the homeowners' current income and expenses will allow them to

repay the FHA mortgage loan, as determined by the FHA's current affordability requirements. This creates legal liability to the FHA on the part of the lender.

e. If the homeowners cannot afford to make the payments on an FHA mortgage loan equal to 90% of the home's current value, the FHA mortgage loan amount must be decreased until the homeowners *can* afford the payments necessary to repay the decreased loan amount. This, in turn, increases the amount that the first mortgage lender and subordinate lien holders must write off.

f. The mortgage lender involved in originating the FHA mortgage loan is typically the homeowners' first mortgage lender, and it is required to obtain the agreement of subordinate mortgage, judgment, and tax lien holders to extinguish their loans and release their liens before the FHA will approve the new mortgage loan. This may require the first mortgage lender to pay the subordinate lien holders for a release of their liens, which is another financial disincentive for the first mortgage lender to agree to an FHA mortgage loan.

g. While the program is authorized to insure \$300 billion in mortgage loans, that amount is expected to serve only approximately 400,000 homeowners in the entire United States.

h. If homeowners are barely making their mortgage loan payments, are ignoring other debt obligations to make their mortgage payments, or are soon going to be unable to make their mortgage payments, their mortgage lenders may not agree to an FHA mortgage loan until the homeowners stop making those payments. On the other hand, if the homeowners choose to stop making payments before their ability to do so ends, the homeowners have intentionally defaulted and would be ineligible for the new FHA mortgage loans. Therefore, homeowners could find themselves in a "Catch-22."

5. **Effect on Credit.** The Act is silent regarding the effect on homeowners' credit if they obtain an FHA-insured mortgage loan under the Act. Since the Act is silent, and the mortgage lender and subordinate lien holders are actually writing off all or portions of the debts owed to them by the homeowners, use of these FHA mortgage loans may adversely affect the homeowners' credit ratings, although it is not yet clear by how much.

*If you would like more information about this Act
or how it may apply to your specific case, please contact us at 741-8224.
(Please see the enclosed flyer for a description of
our attorneys' experience and areas of practice.)*

Sincerely,

Garret T. Barnes

Adron H. Walker

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* *The information contained in this letter and any examples is summary in nature and is given for educational purposes only. It is not intended as specific or detailed advice, as we do not*

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