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## The Housing and Economic Recovery Act of 2008

The Housing and Economic Recovery Act of 2008 (the "Act") was signed into law today. In the words of the Chairman of the Mortgage Bankers Association, the Act represents "the most important piece of housing-related legislation that we have seen in more than a generation."<sup>1</sup> The Act is a comprehensive and expansive effort to calm the secondary residential mortgage loan market and assist troubled homeowners and buyers. Below is a brief discussion of some of the provisions of the Act affecting the residential mortgage loan industry.

### **FHA Mortgage Refinance and Insurance Program**

The Act establishes the HOPE for Homeowners Program under the FHA and a Board to administer standards and requirements for that program. The Act authorizes the FHA to insure payment of up to \$300 billion of mortgage loans originated from October 1, 2008 through September 30, 2011. The program would be voluntary for eligible borrowers, and their lenders would have to agree to release the existing mortgages at a discounted payoff amount from the proceeds of a new FHA-insured loan. To participate in the program, borrowers and their mortgage loans must meet the following eligibility criteria:

- Eligibility of the borrower:
  - The borrower must be unable to pay the existing mortgage loan and must certify that he or she has not intentionally defaulted on that loan. The mortgage debt-to-income ratio on the existing loan, using only verified and documented income in the computation, must be greater than 31 percent as of March 1, 2008;
  - The borrower must occupy the mortgaged property as his or her principal residence; and
  - The borrower must have no fraud conviction in the previous 10 years;
- Eligibility of the existing loan to be refinanced:
  - The loan was originated on or before January 1, 2008;
  - The existing lender(s) must waive any prepay penalties or other outstanding fees related to default or delinquency; and
  - The existing lender(s) must accept the proceeds of the insured loan as payment in full of all existing mortgage debt and extinguish all liens; and

<sup>1</sup> Press Release issued by the Mortgage Bankers Association on July 28, 2008.

→ Eligibility of the new FHA-insured loan:

- The principal shall not exceed 90 percent of the appraised value of the mortgaged property;
- The principal shall not exceed 132 percent of loan limit applicable to Freddie Mac in 2007;
- The term shall not be less than 30 years and the interest rate shall be fixed;
- Generally, no second liens shall be allowed for five years after origination;
- The Board shall establish guidelines to ensure that interest rates are “market” and to set limitations on origination fees that can be charged;
- The appraisal and appraiser shall meet several requirements (for example, the appraiser must be independent of all persons with an interest in the related real estate transaction);
- Upon disposition of the mortgaged property, HUD is entitled to 50 percent of the appreciation in the appraised value of the mortgaged property (to be shared with subordinate lien holders under the prior loan pursuant to standards to be established by the Board) and the borrower is entitled to the remaining 50 percent; and
- Upon disposition of the mortgaged property, HUD is entitled to 100 percent of the equity created in the first year after origination, which percentage

steps down annually to 50 percent after the fifth anniversary of origination, and the borrower is entitled to the remaining percentage in each case.

The Board or HUD may establish additional underwriting guidelines or borrower requirements. At the time of origination of the insured loan, a premium of 3.0 percent of the new principal balance shall be due to HUD from the proceeds of the loan (through the reduction of the amount of indebtedness on the loan being repaid). Additionally, a premium of 1.5 percent of the remaining principal balance shall be due to HUD annually. No mortgage insurance will be paid by HUD under this program in the event there is a breach of any underwriting guidelines, representations or warranties by the lender or there is a first payment default under the loan.

#### **Government-Sponsored Enterprise (“GSE”) Regulatory Changes**

The Act abolishes the Office of Federal Housing Enterprise Oversight of the Department of Housing and Urban Development (the “OFHEO”) and the Federal Housing Finance Board and creates a new independent agency, the Federal Housing Finance Agency (the “FHFA”), to regulate Fannie Mae, Freddie Mac and the Federal Home Loan Bank System, to be fully funded through assessments on those GSEs. A Director of the FHFA will be appointed to a five-year term by the President with the advice and consent of the Senate. The initial Director will be the current head of the OFHEO. In addition to general oversight of the GSEs, the Director’s authority includes (in consultation with the Federal Reserve during an interim period) issuing regulations,

orders or guidance on GSE operations, management, executive compensation, capital requirements, and loan portfolio and market risk standards. The Director can, and in certain circumstances must, appoint the FHFA as a conservator or receiver of a GSE or take other remedial actions if certain conditions exist, including undercapitalization and other unsafe or unsound conditions or practices. The Act preserves the rights of certain counterparties pursuant to “qualified financial contracts” to terminate or accelerate such contracts if the FHFA becomes a receiver or a conservator of a GSE.

The Act also grants emergency authority to the Treasury Department through December 31, 2009, to purchase securities, including equity, issued by the GSEs and temporarily increases the existing line of credit available to Fannie Mae and Freddie Mac.

The Act permanently increases the limit on the principal balance of a mortgage loan that Fannie Mae and Freddie Mac can purchase, or the conforming loan limit, to the greater of \$417,000 or 115 percent of an area’s median home price, not to exceed \$625,500, and authorizes the FHA to adjust the limit according to the annual housing price index.

#### **New Mortgage Disclosure Truth in Lending Act (“TILA”) Requirements**

The Act generally requires delivery of TILA disclosures seven days prior to loan origination. Disclosures are to include examples of how payments would change based on rate adjustments. These examples must include the maximum possible payment under the loan terms. The Act also mandates that the borrowers receive these disclosures before paying anything more than

a bona fide, reasonable credit report fee. Various portions of the TILA changes take effect between 12 and 30 months from today.

### **Licensing of Individuals in Loan Origination**

The Act facilitates the establishment of a National Mortgage Licensing System and Registry that will serve as a clearing house for state and federally licensed individuals in the loan origination business. This Registry seems likely to build upon the existing state-organized National Mortgage Licensing System to which several states currently are transitioning. If a State does not implement the substantive regulatory measures called for under the Act and participate in the Registry, HUD has the authority to license individuals in that State. States will be required to report various information regularly to the Registry.

Generally, the Act requires that all individuals, except for purely clerical or administrative staff, involved in originating residential loans be subject to licensing and registration through a state or federal regulator consistent with the requirements of the Act. Employees of federal banks and thrifts and their subsidiaries must be registered.

The Registry allows for improved background checks for lending officers and supports the application of new minimum licensing standards established by the Act, including:

- No record of a revoked originator license;
- No felony conviction in the previous seven years (or ever if fraud was involved);

- Demonstrated record of financial responsibility, character and general fitness;
- Education requirements (20 hours pre-license and eight hours annually);
- Minimum net worth or surety bond requirements to be set; and
- Passing grade on written test on subjects that will include ethics, federal and state origination law, consumer protection and fair lending rules.

HUD will have enforcement duties in certain instances and may, among other remedies, seek cease and desist orders and fines up to \$25,000 for each violation.

### **FHA Insurance Reforms**

Effective January 1, 2009, the Act raises FHA loan limits to the lesser of 115 percent of the local area median home price or \$625,500 (up from \$362,790) with a minimum of \$271,000. To be eligible, borrowers must pay 3.5 percent (up from 3 percent) of the purchase price up front with no down payment assistance from the seller (including assistance through any third party). The Act also raises the limit on the size of reverse mortgages that the FHA can insure to \$417,000 (up from \$275,000) and establishes new requirements for originating reverse mortgages including prohibiting the marketing of additional financial products as a condition of eligibility for a reverse mortgage and limiting origination fees to 2.0 percent of the maximum claim amount of a mortgage (up to a \$200,000 cap that is subject to certain adjustments).

### **Affordable Housing**

The Act establishes the Housing Trust Fund and the Capital Magnet Fund, which are intended to attract private capital for, and increase investment in, development, preservation or purchase of affordable housing for extremely low income families and economic development activities or community service facilities to stabilize or revitalize low income or underserved rural areas. These funds will be distributed through grants to States pursuant to a formula that will be established by the Secretary of Treasury within the next 12 months.

### **Other Important Mortgage Industry Provisions**

- With respect to pooled mortgage loans, the Act codifies a servicer's fiduciary duty to maximize the net present value of the pooled loans to all investors and "parties having a direct or indirect interest in" such investment except as provided in the terms of the related offering, and a servicer shall be deemed to have acted in the best interest of such investors and parties if it implements a modification or work out plan pursuant to the HOPE program, provided:
  - A default has occurred or is reasonably foreseeable,
  - The mortgaged property is occupied by the mortgagor; and
  - The anticipated recovery exceeds the net present value of the anticipated recovery through foreclosure;
- HUD to ensure that securities backed by or based on insured residential mortgages are eligible for Ginnie Mae

- guarantees up to \$300 billion in the aggregate;
- Approximately \$3.9 billion in community grants for the purchase of abandoned and foreclosed homes;
- Additional \$11 billion in state tax-exempt housing bonds authorized for financing new mortgages and low-income housing and refinancing certain subprime loans;
- Foreclosure protections and other assistance for servicemembers that include extending foreclosure protection from 90 days to nine months (expires January 31, 2010) and limits interest rates to 6 percent during military service and for one year thereafter (expires January 1, 2011);
- Creation of credit and housing counseling programs;
- Revised Standards for FHA Appraisers to add requirements that such appraiser be certified by the State in which the mortgaged property is located or by a nationally recognized professional appraisal organization and have verifiable education with respect to the appraisal requirements established by the FHA;
- Creation of first time homebuyer tax credit and increase of the Standard Deduction for property taxes; and
- Revisions to the REIT income and asset tests.

Additional details regarding REIT-related tax provisions included in the Act can be found in [this Client Alert](#) from the Hunton & Williams tax group.

A copy of the Act is available at [http://www.house.gov/apps/list/press/financial-svcs\\_dem/hr3221\\_bill\\_text.pdf](http://www.house.gov/apps/list/press/financial-svcs_dem/hr3221_bill_text.pdf).

For more information or if you have any questions regarding the Act or its implications, please contact any of the attorneys or offices listed in this Client Alert.

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