



CRS Report for Congress

H.R. 6076: Home Retention and Economic Stabilization Act of 2008

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Summary

The Home Retention and Economic Stabilization Act of 2008 (H.R. 6076) would defer foreclosure for eligible mortgage borrowers for up to 270 days. If passed, the bill would give extra time to some borrowers and lenders to consider alternatives to foreclosure, including traditional loss mitigation and participation in the new Federal Housing Administration (FHA) program for refinancing troubled loans. Some policymakers believe that a moratorium on foreclosures (more accurately, a delay in executing foreclosures) could help stabilize housing markets and alleviate problems from the subprime financial turmoil.

The bill would allow borrowers with subprime and negative amortization mortgages to delay foreclosure proceedings if they continued to make monthly payments established by the bill and maintained the property. Payments during the foreclosure are based on the lesser of the original minimum payment and a rate based on current market conditions. The bill also provides funds for housing counseling.

Introduction

This report details the Home Retention and Economic Stabilization Act of 2008 (H.R. 6076), which would delay foreclosure for up to 270 days and set minimum payments for borrowers during the deferment period. A foreclosure deferment may be of increased interest to policymakers because it might allow more people to consider the new Hope for Homeowners program, passed by Congress on July 26, 2008.¹ Hope for Homeowners is a voluntary program to enable troubled mortgage borrowers and lenders to refinance their loans through the Federal Housing Administration (FHA). Having created the voluntary program, it remains to be seen if people will be willing and able to

¹ Passed as H.R. 3221, Housing and Economic Recovery Act of 2008, and enacted as P.L. 110-289 on July 30, 2008. See CRS Report RL34623, *Housing and Economic Recovery Act of 2008*, by N. Eric Weiss, Darryl E. Getter, Mark Jickling, Mark P. Keightley, Edward Vincent Murphy, and Bruce E. Foote.

participate under current financial market conditions. Meanwhile, the pace of foreclosures continues to rise, even as another category of loans, Alt-A, approaches the peak of its payment resets. Some have argued for a moratorium on foreclosures to give distressed borrowers and lenders time to seek financial relief. Others might argue that delaying foreclosures may also delay the recapitalization of the banking system and ultimately delay restoration of stability in financial markets. Proponents might respond that providing additional time to keep current borrowers in their homes will ultimately reduce the magnitude of bank losses and lessen the need for recapitalization. H.R. 6076 provides one method of granting borrowers and lenders additional time to avoid foreclosure.²

Home Retention and Economic Stabilization Act of 2008 (H.R. 6076)

The Home Retention and Economic Stabilization Act of 2008 (H.R. 6076) was introduced by Representative Matsui on May 15, 2008.³ The expressed purpose of the bill is to “permit deferrals on certain home mortgage foreclosures for a limited period to allow homeowners to take remedial action, to require home mortgage servicers to provide advance notice of any upcoming reset of the mortgage interest rate, and for other purposes.” H.R. 6076 seeks to achieve these goals by establishing a 270 day deferment period for eligible mortgages during which foreclosure proceedings are halted, requiring borrowers to continue making loan payments during the deferment period, and requiring lenders to provide borrowers notice of any upcoming payment changes due to interest rate changes or other mortgage features.

Deferment Period

In general, the deferment period for an eligible borrower starts when the borrower notifies the lender or servicer of an intent to exercise the right to defer foreclosure and the deferment period lasts for 270 days. (Section 2(a)). The bill provides for an earlier end of the deferment period if (1) the borrower ceases payment for 30 days or more, (2) the lender (or servicer) and the borrower agree to a qualified loan modification, or (3) there is a judicial order to end the deferment period.

Eligibility. Both the borrower and the mortgage must meet certain criteria for the deferment period to apply. The bill defines an eligible deferred-foreclosure mortgage as a subprime mortgage or a negative amortization mortgage originated prior to January 1, 2008, that has reached its deferment trigger. In the following discussion, the section

² This report does not address any constitutional issues regarding a mortgage moratorium. For a discussion of constitutional issues, see CRS Report RL34369, *Constitutional Issues Relating to Proposals for Foreclosure Moratorium Legislation That Affects Existing Mortgages*, by David H. Carpenter.

³ This section is based on the May 15, 2008 draft as referred to the House Committee on Financial Services. As of August 22, 2008, the bill had 44 cosponsors.

numbers refer to subsections of section 128A that would be added to the Truth in Lending Act as described in the bill.⁴

(1) *Subprime Mortgage Eligibility* (Section 2(a)(8)). In general, subprime mortgages have higher interest rates than prime mortgages because of greater risk of default; therefore, subprime is defined within the bill in terms of interest rates. For first-lien loans on residential mortgages, a loan is subprime if its interest rate equals or exceeds the yield on treasuries of comparable maturity by more than 3 percentage points or has an annual percentage rate that equals or exceeds the most recent conventional mortgage rate by more than 175 basis points.⁵ For mortgages that are second liens on a residential property, subprime is defined as more than 5 percentage points above treasuries of comparable maturity or 375 basis points above the most recent conventional mortgages.

(2) *Negative Amortization Mortgage Eligibility* (Section 2(a)(6)). In general, a fully amortizing loan pays off the full principal gradually over the term of the mortgage while a negatively amortizing mortgage allows periods in which the outstanding balance grows. H.R. 6076 defines a negative amortization mortgage as a consumer credit transaction secured by the consumer's principal residence with the potential for negative amortization of the outstanding principal balance and under which the minimum monthly payment of principal and interest required increases after the date of origination.

(3) *Borrower Eligibility* (Section 2(a)(5)). The bill establishes four criteria for borrower eligibility. The borrower must (1) have an eligible mortgage, either subprime or negative amortization; (2) reside at the mortgaged property and intend to continue to reside there for the duration of the deferment period; (3) have an annual income not more than twice the state median income, adjusted for family size; and (4) respond to any reasonable inquiries from the loan's servicers or creditors.

(4) *The Deferment Trigger* (Section 2(a)(3)). The date on which the borrower becomes eligible for deferment depends on whether the eligibility of the mortgage is based on subprime or negative amortization. For subprime mortgages, the deferment trigger is the earlier of (1) any interest rate reset or (2) the date on which the consumer becomes 60 days delinquent. For negative amortization mortgages, the deferment trigger is the date of the first increase in the minimum monthly mortgage payment (after origination). A specific rule for any mortgages that are both subprime and negative amortization is not separately specified.

⁴ 15 U.S.C. 1631 et seq.

⁵ A basis point is 1/100 of a percentage point. Defining subprime with the 3 percentage point threshold matches the threshold used by the Federal Reserve to designate higher risk mortgages in its Home Mortgage Disclosure Act (HMDA) database. These mortgages are commonly referred to as rate-spread mortgages and several industry sources now provide data on rate-spread mortgages in lieu of presenting information on mortgages from the Department of Housing and Urban Development's (HUD) list of lenders who specialize in the subprime market. For example, the *2007 Mortgage Market Statistical Annual - Volume I* (pp. 226-227) uses the rate-spread definition for 2004 and later when HMDA began reporting rate-spread mortgages but uses HUD's lender list for 2003 and earlier when rate-spread information was not available. Inside Mortgage Publications, Bethesda, Maryland, 2007. Rate-spread mortgages for HMDA should not be confused with mortgages subject to the Home Owners Equity Protection Act (HOEPA), which has a higher interest rate threshold.

Borrower Rights in the Foreclosure Deferment Period. Under the bill, borrowers would have the right to defer any initiation of a foreclosure with respect to any eligible mortgage until the end of the deferment period, which in general is 270 days. The deferment applies to foreclosures initiated by both judicial and non-judicial authorities. (section b1).

(1) *Enforcement* (Section 2(b)(2)). A borrower may enforce the deferment period through a defense in any foreclosure proceeding or by bringing an action in the appropriate court of jurisdiction.

(2) *Notice to Consumers of Foreclosure Actions* (Section 2(c)). The creditor or loan servicer must notify a borrower with an eligible mortgage prior to initiating foreclosure. The notification must be through personal service. The bill delegates to the Board the authority to issue regulations for notifications. Possible regulations include the content of notice, format of notice, and sample notification forms. In addition to any Board issued regulations, the notice must include the contact information of (1) the loan servicer and creditor, (2) any other parties to the foreclosure proceeding, such as state or local officials, and (3) sources of information for obtaining counseling from a HUD-approved counselor. Notice must be provided 30 days prior to instituting foreclosure proceedings and at least once every 30 days until foreclosure becomes final.

(3) *Exercising the Right to Foreclosure Deferment* (Section (d)). Assuming there has been, or will be, a deferment trigger for an eligible mortgage, the borrower notifies the loan representative and can notify officials. The borrower must notify the loan servicer or other creditor representative described in the creditor's notice above of the intent to exercise the right. (section d1). The borrower's notification to the loan servicer may be through any reasonable delivery means, including by mail. The borrower's notice must clearly identify the address of the property and must certify that at least one eligible borrower (with respect to the mortgage) resides at the property and intends to continue to reside at the property until the end of the deferment period. An official, such as a court or sheriff, that receives notice (directly from the borrower or indirectly) may not take foreclosure action during the deferment period.

(4) *Lender or Servicer Acknowledgment* (Section 2(d)(3)). Once the borrower has notified the lender or loan servicer of deferment, the borrower must receive an acknowledgment that also includes information on required payments during the deferment period. Within 10 business days, the borrower must receive notice of the deferment period payments and consequences of missed payments as discussed below.

Payments During the Foreclosure Deferment Period. During the deferment period, the borrower must continue to make monthly mortgage payments. The amount of the mortgage payment required during the deferment period depends on if the mortgage is a subprime mortgage or a negative amortization mortgage. A borrower who fails to make the required monthly payment risks terminating the deferment period.

(1) *Deferment Payment Amounts* (Section 2(e)(2)). For subprime loans, the required monthly payment during the deferment period is the lesser of the minimum monthly payment of principal and interest on the date the loan was originated or a monthly payment to be calculated based on recent market conditions. The formula for this second monthly payment calculation (recent conditions) is the monthly payment required for a

30-year fixed-rate loan applied to the outstanding balance using an interest rate equal to the most recent conventional mortgage rate plus 100 basis points. Section 2(g) defines the most recent conventional mortgage rate as the fixed rate mortgage rate listed in the Federal Reserve's H.15 release in the week prior to the determination of the deferment period payment.⁶ For example, if the most recent conventional rate reported by the Federal Reserve is 6.30%, then the rate used to calculate the monthly payment under the current conditions approach would be 7.30%.

Many subprime loans had a two-year introductory period followed by a 28-year period at an adjustable interest rate to fully pay off the loan (so-called 2-28s).⁷ In many cases, the introductory period's interest rate was lower than the contemporaneous market rate, called a teaser, so that the effective interest rate would be likely to rise for a given borrower even if market rates were not rising. In some cases, the two-year introductory period may also have been interest-only, in which case the monthly payment would rise when the loan became fully amortizing even if market interest rates fell. The bill sets the required payment during the deferment period for subprime loans as the lesser of the original minimum payment and what a current 30-year fixed-rate mortgage might require for the remaining balance.

For negative amortization loans, the required payment during the deferment period is the minimum monthly mortgage payment required at the time the mortgage was originated. A formula for any mortgages that are both subprime and negative amortization is not separately specified.

(2) *Amortization of Deferment Balances* (Section 2(e)(3)). In some months (perhaps most months), the minimum required payment during the deferment period, as specified in Section 2(e)(2), will be less than the amount due in that month under the original terms of the mortgage. Any difference is to be amortized over the life of the loan after the termination of the deferment period, as specified by regulations to be issued by the Board.

(3) *Prohibition of Fees* (Section 2(e)(4)). No late charges can be imposed during the deferment period. No other fees or charges may be imposed during the deferment period.

Requiring Advance Notice of Payment Reset

In addition to establishing a foreclosure deferment period, H.R. 6076 requires lenders to notify borrowers of any upcoming changes in their mortgage payment. (Section 2(f)). In general, borrowers must be provided approximately 120 days' notice of a change in their monthly payment, as described below. In general, the notice must disclose the new payment and interest rate, how they are calculated, and a list of alternatives for the borrower.

⁶ The H.15 release refers to information available through the Federal Reserve's data download program. Find current rates using the tabs for (selected interest rates) and (MORTG) at [<https://www.federalreserve.gov/datadownload/Choose.aspx?rel=H.15>].

⁷ Loans with three-year introductory periods (3-27s) and other similar combinations were also in common use.

Timing. Borrowers must be notified during the one-month period that ends 120 days prior to reset. For subprime mortgages, the 120-day period is prior to the reset of any introductory interest rate or prior to any adjustment to a variable interest rate. For negative amortization mortgages, the 120-day period is prior to the first change in the minimum monthly payment required.

Notice. Notice of payment reset must include the formula used to determine the interest rate and minimum monthly payment, a good faith estimate of the applicable monthly payment after reset⁸, and a list of alternatives for the borrower. Alternatives for the borrower include refinancing the loan (possibly with the new mortgage rescue plan), renegotiating loan terms with the existing lender, payment forbearance with the existing lender, pre-foreclosure sales, and third-party payment assistance (including any assistance from the state). The advance notice must also include contact information for HUD-approved consumer counseling agencies and the state housing finance authority.

Duty of Borrowers to Maintain the Property

The bill contains some features to encourage borrowers to maintain the value of the property during the foreclosure deferment period (Section 2(h)). In general, borrowers may not destroy, damage, or impair the property, or allow the property to deteriorate. Consumers are made liable to creditors for any violations.

Housing Counseling

The bill authorizes \$200 million to be appropriated for housing counseling in FY2008. The funds are provided to the Neighborhood Reinvestment Corporation, created by Congress in 1978.⁹ The Neighborhood Reinvestment Corporation now encompasses a larger network of agencies and community organizations through NeighborWorks America, a non-profit organization.

⁸ The exact monthly payment may not be able to be known 120 days in advance because the reference interest rate that the mortgage rate is indexed to could change over a four month period.

⁹ Created in 1978 by P.L. 95-557 to promote reinvestment in older neighborhoods by local financial institutions, residents, and other community stakeholders.