

H.R. 3221, the "Housing and Economic Recovery Act of 2008," passed the House on July 23, 2008, by a vote of 272-152. On Saturday, July 26, 2008, the Senate passed the bill by a vote of 72-13. The President signed the bill on July 30, 2008. The bill includes the following provisions:

* **GSE Reform** - including a strong independent regulator, and permanent conforming loan limits up to the greater of \$417,000 or 115% local area median home price, capped at \$625,500. The effective date for reforms is immediate upon enactment, but the loan limits will not go into effect until the expiration of the Economic Stimulus limits (December 31, 2008).

* **GSE Stabilization** - includes language proposed by the Treasury Department to authorize Treasury to make loans to and buy stock from the GSEs to make sure that Freddie Mac and Fannie Mae could not fail.

* **FHA Reform** - including permanent FHA loan limits at the greater of \$271,050 or 115% of local area median home price, capped at \$625,500; streamlined processing for FHA condos; reforms to the HECM program, and reforms to the FHA manufactured housing program. The downpayment requirement on FHA loans will go up to 3.5% (from 3%). The effective date for reforms is immediate upon enactment, but the loan limits will not go into effect until the expiration of the Economic Stimulus limits (December 31, 2008).

* **Loan Originator Requirements** - Strengthens the existing state-run nationwide mortgage originator licensing and registration system (and requires a parallel HUD system for states that fail to participate). Federal bank regulators will establish a parallel registration system for FDIC-insured banks. The purpose is to prevent fraud and require minimum licensing and education requirements. The bill exempts those who only perform real estate brokerage activities and are licensed or registered by a state, unless they are compensated by a lender, mortgage broker, or other loan originator.

* **FHA foreclosure rescue** - development of a refinance program for homebuyers with problematic subprime loans. Lenders would write down qualified mortgages to 90% of the current appraised value and qualified borrowers would get a new FHA 30-year fixed mortgage at 90% of appraised value. Borrowers would have to share 50% of all future appreciation with FHA. The loan limit for this program is \$550,440 nationwide. Program is effective on October 1, 2008.

* **Homebuyer Tax Credit** - a \$7500 tax credit that would be available for any qualified purchase between April 9, 2008 and June 30, 2009. The credit is repayable over 15 years (making it, in effect, an interest free loan).

* **Additional Property Tax Deduction** - HERA provides a one-year benefit that will be available to all homeowners. Under current law, property taxes are deductible only if an individual itemizes his/her deductions on Schedule A of their tax return. The new provision will permit a deduction of up to \$500 (\$1000 on a joint return) for all individuals who utilize the standard deduction and do not itemize. Instructions will be provided on the 2008 tax return when it is distributed at year-end.

* **Seller-funded downpayment assistance programs** - codifies existing FHA proposal to prohibit the use of downpayment assistance programs funded by those who have a financial interest in the sale; does not prohibit other assistance programs provided by nonprofits funded by other sources, churches, employers, or family members. This prohibition does not go into effect until October 1, 2008.

* **National Affordable Housing Trust Fund** - Develops a Trust Fund funded by a percentage of profits from the GSEs. In its first years, the Trust Fund would cover costs of any defaulted loans in FHA foreclosure program. In out years, the Trust Fund would be used for the development of affordable housing.

* **VA loan limits** - temporarily increases the VA home loan guarantee loan limits to the same level as the Economic Stimulus limits through December 31, 2008.

* **Risk-based pricing** - puts a moratorium on FHA using risk-based pricing for one year. This provision is effective from October 1, 2008 through September 30, 2009.

* **Mortgage Revenue Bond Authority** - authorizes \$10 billion in mortgage revenue bonds for refinancing subprime mortgages.

* **CDBG Funding** - Provides \$4 billion in neighborhood revitalization funds for communities to purchase foreclosed homes.

* **LIHTC** - Modernizes the Low Income Housing Tax Credit program to make it more efficient.

* **Modification of \$250,000/\$500,000 Exclusion** - The sole real-estate related "pay-for" among the tax incentives modifies the \$250,000/\$500,000 exclusion of gain on the sale of a principal residence. Beginning in 2009, the exclusion, as it applies to a second home (or rental property) that is converted to a principal residence will be allocated. When the second home is sold, any gain attributable to use as a second home (or rental property) will be taxed at capital gains rates. Any gain attributable to use as a principal residence will remain excludable, up to the \$250,000 and \$500,000 limits. A formula is provided for computing the proper treatment of these gains.

Summary of the "Housing and Economic Recovery Act of 2008"

A. Summary of the "Federal Housing Finance Regulatory Reform Act of 2008"

This legislation strengthens and modernizes the regulation of the housing government-sponsored enterprises – Fannie Mae and Freddie Mac (the enterprises) and the Federal Home Loan Banks (FHLBs or Banks) – and expands the housing mission of these GSEs. In addition, it creates a new program at FHA that will help at least 400,000 families save their homes from foreclosure by providing for new FHA loans after lenders take deep discounts.

I. Safety and Soundness Regulation of the Housing GSEs

The "Federal Housing Finance Regulatory Reform Act of 2008" establishes a new, independent, "world class" regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, the housing government-sponsored enterprises (GSEs). The legislation endows this regulator with broad new authority, equivalent to the authority of other federal financial regulators, to ensure the safe and sound operations of the GSEs, including the power to:

- establish capital standards;
- establish prudential management standards, including internal controls, audits, risk management, and management of the portfolio;
- enforce its orders through cease and desist authority, civil money penalties, and the authority to remove officers and directors;
- restrict asset growth and capital distributions for undercapitalized institutions;
- put a regulated entity into receivership; and
- review and approve (subject to notice and comment) new product offerings.

II. Mission Improvement

The new legislation also significantly enhances the affordable housing component of the GSEs' mission, and expands the number of families Fannie Mae and Freddie Mac (the enterprises) can serve by raising the loan limits in high cost areas (areas with median house prices that are higher than the regular conforming limit) to 150% of the conforming loan limit. Currently, this would be \$625,000.

For the enterprises, the legislation tightens targeting requirements of the affordable housing goals, and rewrites those goals to ensure that the enterprises provide liquidity to both ownership and rental housing markets for low and very-low income families. The legislation requires the enterprises to serve a variety of underserved markets, such as rural areas, manufactured housing, and the preservation market. The legislation improves reporting requirements for affordable housing activities, including the expansion of the public use data base, and strengthens the new regulator's ability to enforce compliance with the housing goals.

Finally, the legislation creates a new Housing Trust Fund and a Capital Magnet Fund, financed by annual contributions from the enterprises, which will be used for the construction of affordable rental housing.

For the Federal Home Loan Banks (FHLBs), the legislation requires new affordable housing goals similar to those that apply to the enterprises for FHLB mortgage purchase programs. The legislation also requires the FHLBs to create a public use data base for such programs. Treasury-certified Community Development Financial Institutions (CDFIs) would become eligible to join FHLBs. Finally, community financial institution members of the FHLBs may use FHLB advances for community development purposes.

B. Summary of the "HOPE for Homeowners Act of 2008"

The "HOPE for Homeowners Act of 2008" creates a new, temporary, voluntary program within FHA to back FHA-insured mortgages to distressed borrowers. The new mortgages offered by FHA-approved lenders will refinance distressed loans at a significant discount for owner-occupants at risk of losing their homes to foreclosure. In exchange, homeowners will share future appreciation with FHA.

The program is built on five principles:

1. Long-term affordability. The program is built on the idea, expressed by Federal Reserve Chairman Bernanke, that creating new equity for troubled homeowners is likely to be a more effective way to avoid foreclosures. New loans will be based on a family's ability to repay the loan, ensuring affordability and sustainable homeownership.
2. No investor or lender bailout. Investors and/or lenders will have to take significant losses in order to benefit from the proceeds of the loans refinanced with government insurance. However, these losses would be less than the losses associated with foreclosure.
3. No windfall for borrowers. Borrowers will share their new equity and future appreciation equally with FHA. Borrowers will pay for the FHA insurance.
4. Voluntary participation. This will be a voluntary program. No lenders, servicers, or investors will be compelled to participate.
5. Restore confidence, liquidity, and transparency. Credit markets are fearful and frozen in part because banks and other financial institutions do not know what their subprime mortgages and related securities are worth. The uncertainty is forcing lenders to hoard capital and stop the lending necessary for economic growth. This program will help restore confidence and get markets flowing again.

Program Oversight. The new program will be overseen by a Board made up of the Secretary of HUD, the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and the Chairman of the Federal Deposit Insurance Corporation (FDIC). The Board will have the authority to develop standards within the framework of the legislation.

Eligible Borrowers. Only owner-occupants who are unable to afford their mortgage payments are eligible for the program. No investors or investor properties will qualify. Homeowners must certify, under penalty of law, that they have not intentionally defaulted on their loan to qualify for the program and must have a mortgage debt to income ratio greater than 31 percent as of March 1, 2008. Lenders must document and verify borrowers' income with the IRS.

New Loan Amount. The size of the new FHA-insured loan will be lesser of the amount the borrower can afford to repay, as determined by the current affordability requirements of FHA; or, 90% of the current value of the home. Loans must be 30-year, fixed rate loans.

Equity & Appreciation Sharing. In order to avoid a windfall to the borrower created by the new 90% loan-to-value FHA-insured mortgage, the borrower must share the newly-created equity and future appreciation equally with FHA. This obligation will continue until the borrower sells the home or refinances the FHA-insured mortgage. Moreover, the homeowner's access to the newly created equity will be phased-in over 5 years.

Eligible Mortgages. In order to protect against adverse selection, the program prohibits the Secretary from paying an insurance claim whenever the representations and warranties required to be made by lenders are violated, or in cases in which a borrower has an early payment default and misses the first payment. The Act provides the Board the authority to establish other protections against adverse selection, such as requiring "seasoning" for certain higher risk loans before they can be insured under the program. Appraisers of property insured by FHA must be certified by the state where the property is located, or by a nationally recognized professional appraisal organization, and have "demonstrated verifiable education" in FHA appraisal requirements.

Existing Subordinate Liens. Before participating in this program, all subordinate liens must be extinguished. This will have to be done through negotiation with the first lien holder.

Qualified Safe Harbor. The legislation provides servicers with an incentive to participate in the program by offering a safe harbor against legal liability.

Program Size. The program is authorized to insure up to \$300 billion in mortgages and is expected to serve approximately 400,000 homeowners.

Program Sunset. The program will begin October 1, 2008 and sunset on September 30, 2011. CBO say the program will net nearly \$250 million for taxpayers. The program is paid for by using part of the Affordable Housing Trust Fund; the GSE bill provides a further \$2 billion cushion for the government by establishing a reserve fund at Treasury over ten years. If the program costs less than projected, the unused funds are returned to the Affordable Housing Trust Fund. If the program more than pays for itself (as was the case during the Roosevelt Administration), any excess savings are dedicated to reducing the national debt.

C. Summary of the "Foreclosure Prevention Act of 2008"

The Foreclosure bill passed by the Senate on April 10 contains the following provisions designed to address the problems faced by families and their communities in light of the foreclosure crisis:

- **FHA Modernization.** To ensure that additional families can access the FHA program, which provides safe, fixed-rate mortgages, significant FHA reform is included to modernize, streamline and expand the reach of the FHA program. Under this bill, the FHA loan limit is

increased from 95% to 110% of area median home price with a cap at 150% of GSE limit (currently, \$625,000), allowing families in all areas of the country to access homeownership through FHA. Downpayments of 3.5% will be required for any FHA loan and counseling requirements are enhanced to help provide for stable homeownership.

- **Assisting Communities Devastated by Foreclosures.** Homes that have been foreclosed upon and are sitting unoccupied lead to declines in neighboring house values, increased crime and significant disinvestment. To ensure that communities can mitigate these harmful effects of foreclosures, \$3.92 billion is provided to communities hardest hit by foreclosures and delinquencies. These supplemental Community Development Block Grant Funds will be used to purchase foreclosed homes, at a discount, and rehabilitate or redevelop the homes to stabilize neighborhoods and stem the significant losses in house values of neighboring homes.
- **Providing Pre-Foreclosure Counseling for Families in Need.** To help families avoid foreclosure, this bill provides \$150 million in additional funding for housing counseling. These funds will be distributed by the Neighborhood Reinvestment Corporation by the end of 2008 to ensure families can quickly get the help they need. As many as 250,000 additional families connect with their mortgage servicer or lender to explore options that will keep them in their homes as a result of these counseling funds. In addition, \$30 million is provided to help provide legal services to distressed borrowers.
- **Enhancing Mortgage Disclosure.** To ensure that consumers are provided with timely and meaningful disclosures in connection with mortgages, the bill expands the types of home loans subject to early disclosures (within three days of application) under the Truth In Lending Act (TILA) including refinancings. The bill requires that disclosures be provided no later than 7 days prior to closing so borrowers can shop for another loan if not satisfied with the terms. The bill requires a new disclosure that informs borrowers of the maximum monthly payments possible under their loan, and also increases the range of statutory damages for TILA violations from the current \$200 to \$2000 to \$400 to \$4000.
- **Preserving the American Dream for Our Nation's Veterans.** To assist returning soldiers avoid foreclosure, this bill lengthens the time a lender must wait before starting foreclosure from three months to nine months after a soldier returns from service and also provides returning soldiers with one year relief from increases in mortgage interest rates. In addition, the Department of Defense is required to establish a counseling program to ensure veterans and active service members can access assistance if facing financial difficulties. Also included is a provision that increases the VA loan guarantee amount, so that veterans have additional homeownership opportunities. The bill contains provisions to do the following: increase benefits paid to veterans with disabilities such as blindness for the purpose of adapting their housing; provide a moving benefit to servicemen and woman who are forced to move out of rental housing because the owner of the housing was foreclosed on; provide that veterans benefits received in a lump sum are treated the same for the purposes of eligibility for housing assistance as monthly benefits; and to allow the Veterans Administration to provide for improvements and structural alterations to homes of veterans with service-connected disabilities.

Examples of mortgage fraud

Occupancy fraud: This occurs where the borrower wishes to obtain a mortgage to acquire an investment property, but states on the loan application that the borrower will occupy the property as the primary residence or as a second home. If undetected, the borrower typically obtains a lower interest rate than was warranted. Because lenders typically charge a higher interest rate for non-owner-occupied properties, which historically have higher delinquency rates, the lender receives insufficient return on capital and is over-exposed to loss relative to what was expected in the transaction. It is considered fraud because the borrower has materially misrepresented the risk to the lender in order to obtain more favorable loan terms.

Income fraud: This occurs when a borrower overstates his/her income in order to qualify for a mortgage or for a larger loan amount. This was most often seen with so-called "stated income" mortgage loans (popularly referred to as "liar loans"), where the borrower, or a loan officer acting for a borrower with or without the borrower's knowledge, stated without verification the income needed to qualify for the loan. Because mortgage lenders have begun to tighten underwriting standards and "stated income" loans are less available, income fraud is increasingly seen in traditional full-documentation loans where the borrower forges or alters an employer-issued Form W-2, tax returns and/or bank account records to provide support for the inflated income. It is considered fraud because in most cases the borrower would not have qualified for the loan had the true income been disclosed. The "mortgage meltdown" was caused, in part, when large numbers of borrowers in areas of rapidly increasing home prices lied about their income, acquired homes they could not afford, and then defaulted.

Employment fraud: This occurs when a borrower claims self-employment in a non-existent company or claims a higher position (e.g., manager) in a real company, in order to provide justification for a fraudulent representation of the borrower's income.

Failure to disclose liabilities: Borrowers may conceal obligations, such as mortgage loans on other properties or newly acquired credit card debt, in order to reduce the amount of monthly debt declared on the loan application. This omission of liabilities artificially lowers the debt-to-income ratio, which is a key underwriting criterion used to determine eligibility for most mortgage loans. It is considered fraud because it allows the borrower to qualify for a loan which otherwise would not have been granted, or to qualify for a bigger loan than what would have been granted had the borrower's true debt been disclosed.

Fraud for profit: A complex scheme involving multiple parties, including mortgage lending professionals, in a financially motivated attempt to defraud the lender of large sums of money. Fraud for profit schemes frequently include a straw borrower whose credit report is used, a dishonest appraiser who intentionally and significantly overstates the value of the subject property, a dishonest settlement agent who prepares two sets of HUD settlement statements or makes disbursements from loan proceeds which are not disclosed on the settlement statement, and a property owner, all in a coordinated attempt to obtain an inappropriately large loan. The parties involved share the ill-gotten gains and the mortgage eventually goes into default. In other cases, naive "investors" are lured into the scheme with the organizer's promise that the home will be repaired, repairs and/or renovations will be made, tenants will be located, rents will be collected, mortgage payments made and profits will be split upon sale of the property, all without the active participation of the straw buyer. Once the loan is closed, the organizer disappears, no repairs are made nor renters found, and the "investor" is liable for paying the mortgage on a property that is not worth what is owed, leaving the "investor" financially ruined. If undetected, a bank may lend hundreds of thousands of dollars against a property that is actually worth far less and in large schemes with multiple transactions, banks may lend millions more than the properties are worth.

Appraisal fraud: Occurs when a home's appraised value is deliberately overstated or understated. When overstated, more money can be obtained by the borrower in the form of a cash-out refinance, by the seller in a purchase transaction, or by the organizers of a for-profit mortgage fraud scheme. Appraisal fraud also includes cases where the home's value is deliberately understated in order to obtain a lower price on a foreclosed home, or in a fraudulent attempt to induce a lender to decrease the amount owed on the mortgage in a loan modification. A dishonest appraiser may be involved in the preparation of the fraudulent appraisal, or an existing and accurate appraisal may be altered by someone with knowledge of graphic editing tools such as Adobe Photoshop.

Cash-Back Schemes: Occur where the true price of a property is illegally inflated in order to provide cash-back to transaction participants, most often the borrowers, who receive a "rebate" which is not disclosed to the lender. As a result the lender lends too much, and the buyer pockets the overage or splits it with other participants, including the seller or the real estate agent. This scheme requires appraisal fraud to deceive the lender. "Get Rich Quick" real-estate gurus' courses frequently rely heavily on this mechanism for profitability.

Shotgunning: Occurs when multiple loans for the same home are obtained simultaneously for a total amount greatly in excess of the actual value of the property. These schemes leave lenders exposed to large losses because the subsequent mortgages are junior to the first mortgage to be recorded and the property value is insufficient for the subsequent lenders to collect against the property in foreclosure.

Identity Theft: Occurs when a person assumes the identity another and uses that identity to obtain a mortgage without the knowledge or consent of the victim. In these schemes, the thieves disappear without making payments on the mortgage. The schemes are usually not discovered until the lender tries to collect from the victim, who may incur substantial costs trying to prove the theft of his/her identity.