

A Mortgage and Consumer Finance Law Update

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Bush Announces Five-Year Interest Rate Freeze Agreement

President Bush released details of a new mortgage relief agreement on December 6, 2007. The plan provides a five-year interest rate freeze for certain borrowers who are current with their monthly payments but face unaffordable rate increases when their Adjustable Rate Mortgages ("ARMs") reset before July 31, 2010. The agreement resulted from weeks of negotiations between the White House, Treasury Department officials, mortgage lenders, and the Wall Street firms to whom mortgage debt has been sold. Bush described the plan not as a cure-all, but as an effort to "limit the disruption" caused by the subprime lending crisis, reported *The Washington Post*.

While the accord promises some measure of relief, it does not provide a soft landing across the board. Describing the limited nature of the program, Bush said "[w]e should not bail out lenders, real estate speculators or those who made the reckless decision to buy a home they knew they could not afford," according to *The New York Times*.

At the moment, it appears that no tax dollars will be used to fund the program. Instead, the cost of freezing rates would be absorbed by lenders and investors, in addition to some homeowners who may be assessed fees to modify their loans. However, noting the voluntary nature of the agreement, Mark Zandi, chief economist for Moody's Economy.com, observed that "[t]here's no stick in the plan; it depends on moral suasion." Despite the "handshake" agreement the plan represents between lenders and investors, critics note that the plan provides no guarantee against lawsuits.

Scope of the Plan

The plan only applies to ARMs granted between January 1, 2005 and July 31, 2007 and scheduled to adjust before July 31, 2010. The rate freeze largely applies to borrowers with reasonably good credit history. For example, the plan does not apply to the approximately 22 percent of all subprime borrowers who are more than 30 days late on their payments, or to borrowers who have been more than 60 days late at any time within the previous 12 months. Some bankers indicate they will not apply these standards too rigidly.

However, borrowers who are capable of making payments at the new, higher rates will not be able to take advantage of the freeze. Other borrowers who were not able to afford their mortgages at the lower introductory rates are also excluded, observed Anne Canfield, executive director of the Consumer Mortgage Coalition. Further, in an effort to avoid bailing out real estate

developers and speculators, the rate freeze only applies to those who occupy the mortgaged homes.

The financial exposure to those excluded from the plan is significant. Among those excluded are borrowers whose initial interest rates expire in the final three months of this year, prior to January 1, 2008. This group represents approximately \$57 billion in subprime loans, according to First American Loan Performance.

Projected Beneficiaries

President Bush projects that the plan will benefit 1.2 million borrowers, but this figure is in some dispute. Approximately 2.2 million subprime ARMs are scheduled to reset to higher rates by the end of 2008, and of those, Barclays Capital's analysis indicates that only 240,000 will benefit from the plan, representing approximately 12 percent of all subprime borrowers, as reported in *The New York Times*. Further, Office of Thrift Supervision Director John Reich put the figure at "tens of thousands" — not 1.2 million — who may be helped by the freeze, *The Wall Street Journal* reported.

Criticism and the Campaign Trail

As elements of the agreement were surfacing in the days prior to Bush's announcement, critics faulted the plan as too limited in its scope and impact. Democratic presidential candidate Hillary Clinton faulted the plan as "giv[ing] homeowners far less than they need" and criticized Wall Street for the overall crisis. As an alternative, Senator Clinton has proposed a 90-day moratorium on subprime foreclosures and a sweeping five-year rate freeze that would apply to all ARMs on owner-occupied residences, including some that are behind in their payments.

Fellow Democratic candidate John Edwards has called for a seven-year subprime interest rate freeze, the establishment of a fund to assist troubled borrowers, and changes to bankruptcy laws in order to give borrowers more leverage in negotiating new loan terms. Similarly, Democratic candidate Barack Obama has proposed a new tax credit on mortgage interest for homeowners who do not itemize their taxes and cannot deduct interest payments, among other proposals.

Republican presidential candidates have been more reticent, viewing government remedies as a "bailout" for either the industry or borrowers, or both, but they, too, are warming to the need for action. Senator John McCain, for example, has emphasized the need to avoid rewarding real estate speculators, but recognizes the need to "stop the bleeding," as reported in *The New York Times*.

John Berlau, director of the Center for Entrepreneurship at the Competitive Enterprise Institute, a conservative think tank, criticized the plan as "worse than a taxpayer bailout" because "[i]t pressures the industry to essentially alter the terms of millions of contracts, and it's going to make investors think twice about investing in America again," according to *The Washington Post*.

Voices of Support

Despite the wide-ranging reactions for and against the plan, the agreement has garnered significant industry support from such key private-sector players as Countrywide and Citigroup, *The Washington Post* reported. Federal Reserve Chairman Ben Bernanke called the rate-freeze "a welcome step in helping Americans protect their homes and communities from the consequences of unnecessary foreclosures," reported *The Wall Street Journal*.

Next Steps

The rate freeze announced on December 6 is viewed as only one piece of a larger project. President Bush is expected to ask Congress to temporarily grant states the authority to issue tax-exempt mortgage-revenue bonds to provide additional assistance to borrowers seeking mortgage refinancing. Moreover, treasury officials have expressed interest that the mortgage industry develop more efficient means for helping subprime borrowers move to more conventional, lower rate mortgages.

President Bush is urging the Justice Department to "continue pursuing wrongdoing in the banking and housing industries, so we can help ensure that those who defraud American consumers face justice," and he is urging Congress to make more loan assistance available through the Federal Housing Administration ("FHA"), *The New York Times* reported. President Bush also encouraged passage of legislation to reform oversight of Fannie Mae and Freddie Mac, and singled out the Senate for failing to pass a bill to modernize the FHA.

What This Means for the Mortgage Industry

As dramatic as the Bush agreement is, the ultimate fallout remains somewhat unpredictable. As noted above, there is some dispute about how many borrowers may be affected — President Bush cites 1.2 million borrowers, while others point to more conservative numbers in the tens of thousands. The voluntary nature of the plan also renders the final outcome a wildcard.

Additionally, there is substantial concern about lawsuits in the secondary market from investors who calculated risks and returns based on the terms of existing mortgages. Can mortgage lenders and Wall Street unilaterally rewrite the terms of existing contracts? State attorneys general have voiced skepticism about the legality of such actions, and surely plaintiff's lawyers are scanning the field for opportunities. While those questions cloud the forecast, this agreement has all the appearances of a first step among many more possible steps that could be taken to address the growing mortgage crisis. The President's personal involvement, ongoing discussion in Congress, and scrutiny by the Federal Reserve, among others, make additional market reform the only bankable certainty.

Read a [transcript](http://www.whitehouse.gov/news/releases/2007/12/20071206-9.html) (<http://www.whitehouse.gov/news/releases/2007/12/20071206-9.html>) of President Bush's speech on December 6 regarding the new mortgage relief agreement.

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