

A Mortgage and Consumer Finance Law Update

03/17/08

Federal Legislation Update — New Mortgage Rescue Proposal Leverages Federal Housing Administration Guarantees to Refinance Loans

On March 13, 2008, House Financial Services Committee Chairman Barney Frank and Senate Banking Committee Chairman Chris Dodd announced proposed legislation designed to further combat the rising tide of mortgage foreclosures by allowing the Federal Housing Administration ("FHA") to insure and guarantee refinanced mortgages in exchange for significant write-downs by mortgage holders and lenders.

The plan is specifically targeted at addressing widespread "negative equity" problems, in which mortgage values exceed the currently declining values of homes securing the loans. It is estimated that between one and two million loans could potentially be refinanced in this way, helping to slow the rate of mortgage foreclosures.

The two proposals seek to authorize FHA to issue up to \$400 billion in guarantees to help maneuver at-risk borrowers into viable mortgages. Mortgage holders that agree to write down a substantial portion of principal to more accurately reflect current market values would be eligible to have the entire, reduced loan amount paid off by an FHA-approved lender. The borrower would then continue to make payments to the new FHA-approved lender on the basis of the reduced loan amount. The cash buyout and the FHA guarantees mean the original lender would have no further credit risk from the borrower.

The plan falls on the heels of policies encouraged one week earlier by Federal Reserve Chairman Ben Bernanke, who urged banks to forgive substantial portions of loans held by troubled borrowers. Chairman Bernanke has also advocated giving authority to FHA to regulate underwriting standards and risk premiums.

Because the voluntary plan largely offers insurance for re-written loans — as opposed to large cash disbursements by the government — the plan dodges criticism from opponents of a federal bail-out, including the White House. Nevertheless, the plan could prove expensive for the government if housing prices continue to drop, resulting in mortgages backed by properties of insufficient market value. Senator Dodd observed that "[t]here is no bailout for those who made the loans. ... The lenders are going to have to take their losses. This will be some help to homeowners, but not with tax dollars," reports *The Washington Post*.

Unlike the bipartisan support characterizing the \$170 billion economic stimulus package passed only a few weeks prior, the Frank and Dodd proposals have met with less uniform support. One outspoken critic, Treasury Secretary Hank Paulson says new FHA legislation is unnecessary and

recommends that Congress pass existing proposals for FHA reform, instead, reports the *Financial Times*.

What This Means for the Mortgage Industry

The two proposals are currently in draft form and may change significantly over the next few weeks as the House and the Senate negotiate, and as the public responds. If legislation is passed, it will create substantial incentive for mortgage holders and lenders to write-down loans, reducing profits, but potentially ensuring that the bulk of loan repayments will be made by borrowers. The program as conceived is entirely voluntary, but it may provide a welcome alternative to foreclosure for borrowers and lenders alike.

For More Information:

Representative Frank's Proposed Bill

- [Info and summary](http://www.house.gov/apps/list/press/financialsvcs_dem/press031308.shtml)
(http://www.house.gov/apps/list/press/financialsvcs_dem/press031308.shtml)
- [Text of the current proposal \(PDF\)](http://www.house.gov/apps/list/press/financialsvcs_dem/frank_158_xml.pdf)
(http://www.house.gov/apps/list/press/financialsvcs_dem/frank_158_xml.pdf)

Senator Dodd's Proposed Bill

- [Info and summary](http://dodd.senate.gov/index.php?q=node/4324)
(<http://dodd.senate.gov/index.php?q=node/4324>)
- [Additional information](http://banking.senate.gov/index.cfm?Fuseaction=Articles.Detail&Article_id=248)
(http://banking.senate.gov/index.cfm?Fuseaction=Articles.Detail&Article_id=248)

(As of March 17, 2008, Senator Dodd had not yet released the text of his proposed bill.)

For more information, please contact the Mortgage and Consumer Finance Law Industry Team at Lane Powell:

206.223.7000 Seattle
503.778.2100 Portland
360.754.6001 Olympia
MortgageAndFinance@lanepowell.com
www.lanepowell.com

We provide the *Mortgage and Consumer Finance Law Hotsheet* as a service to our clients, colleagues and friends. It is intended to be a source of general information, not an opinion or legal advice on any specific situation, and does not create an attorney-client relationship with our readers. If you would like more information regarding whether we may assist you in any particular matter, please contact one of our lawyers, using care not to provide us any confidential

information until we have notified you in writing that there are no conflicts of interest and that we have agreed to represent you on the specific matter that is the subject of your inquiry.

Copyright © 2008 [Lane Powell PC](http://www.lanepowell.com) www.lanepowell.com
Seattle - Portland - Anchorage - Olympia - Tacoma - London