

## **A Mortgage and Consumer Finance Law Update**

**08/01/08**

### **Bush Enacts Watershed Housing Bill Providing New Funding and Regulation for Mortgage Industry**

On July 30, 2008, President Bush quietly signed one of the largest housing bills in decades to shore up struggling financial markets and a housing industry slump that is second only to that of the Great Depression. The Housing Assistance Act of 2008, signed after months of contentious negotiations, creates a \$300 billion program to refinance troubled mortgages and creates new regulatory oversight of Fannie Mae ("Fannie") and Freddie Mac ("Freddie"), which finance almost half of the country's \$12 trillion in home mortgage debt.

It is estimated that 2.8 million homeowners will be at risk of losing their homes due to foreclosure by 2009. Funding provided by the new law is expected to help 400,000 such homeowners avoid that fate by trading their current loans for new affordable mortgages guaranteed through the Federal Housing Administration ("FHA"). The current mortgage-holder bank will have to agree to the trade. The benefit to the bank is a guaranteed loan and the avoidance of costly and time-consuming foreclosure proceedings.

Although Bush previously threatened to veto the measure, overwhelming support in Congress and desperate financial markets carried the day.

Key to the bill is an expanded line of credit for Fannie and Freddie to stem an impending crisis in investor confidence in the two private corporations that hold \$1.6 trillion in combined debt to fund mortgage purchases. The new funding, however, is accompanied by the creation of new regulatory authority over the mortgage giants and an overhaul of the FHA.

Shares of Fannie and Freddie rallied shortly after the bill became law, and as securities regulators enforced an emergency rule to prevent "short selling," or betting against 19 major financial firms, including Fannie and Freddie. Earlier in the month, shares of Fannie and Freddie had been down 50 percent.

The law provides \$300 billion in new loan authority to permit the government to guarantee cheaper mortgages for at-risk homeowners, but the Congressional Budget Office estimates that only \$68 billion of that authority will likely be used. The bill also provides \$3.9 billion in grant funding to maintain and repair foreclosed properties causing blight and market depression in hard-hit communities; \$15 billion in tax cuts, including additional tax credits for low-income households; credits for first-time home buyers; and the first national licensing system for mortgage brokers and loan officers. To accommodate the rescue plan and the Bush

administration's record budget deficit, the bill extends the national debt limit to \$10.6 trillion, an increase of \$800 billion.

### **Mixed Criticism**

As large as the funding provisions are, the bill is expected to rescue only about 15 percent of homeowners at risk of foreclosure within the next year, and some wonder whether the new programs will be sufficient to address an ongoing real estate slump that many believe has not yet hit bottom.

Some criticize the government's effort to salvage the mortgage giants, Fannie and Freddie, in their hybrid private/public configuration, because the plan privatizes profits for company shareholders but socializes the risks and losses. The critics believe that this is nothing more than a federal bail-out bill that benefits private investors.

In addition, some apparent funding "gifts" in the plan are not quite what they seem: for example, a tax credit of up to \$7,500 for first-time home buyers is in reality a loan, as the credit must be repaid within 15 years.

Despite these and other flaws, supporters of the legislation say this is the best possible way to stabilize a troubled housing market and to re-energize a stagnant economy.

### **Key Provisions of the New Law**

- Provides \$300 billion in new lending authority to the FHA.
- Relaxes standards to provide affordable, fixed-rate mortgages to potentially 400,000 debt-ridden homeowners; losses will be covered by an affordable housing fund to be generated by Fannie and Freddie.
- Gives temporary authorization — expiring Dec. 31, 2009 — to the Treasury Dept. to lend money to Fannie and Freddie or buy their stock to avert a collapse of one or both mortgage companies.
- Establishes a new regulatory office to oversee Fannie and Freddie, including authority to approve compensation packages for company executives.
- Creates a new affordable housing fund — financed by profits from Fannie and Freddie — to address nearly 3 million extremely low-income households that lack affordable housing.
- Provides nearly \$4 billion in grants to the most affected communities to buy and fix up foreclosed properties to prevent complete real estate collapse in hard-hit neighborhoods.
- Prohibits FHA from insuring mortgages where the buyer's down payment is made by the seller as of Oct. 1, 2008.
- Sets a one-year moratorium prohibiting agencies from charging premiums based on the riskiness of the homeowner, effective through Oct. 1, 2009.
- Provides \$15 billion in housing tax breaks, including breaks for low-income housing, and credits of up to \$7,500 for first-time home buyers between April 9, 2008, and July 1, 2009.

- Provides states with \$11 billion tax-free municipal bond authority for low-interest loans to first-time home buyers, construction of low-income rental housing and refinanced subprime mortgages (amounts available vary by state).
- Provides protection from investor lawsuits for mortgage holders that modify loans to benefit borrowers who are in default or at risk of default.
- Homeowners at risk of default on high-interest mortgages can contact their banks and convert their loans into government-backed, 30-year fixed-rate mortgages; this \$300 billion program is expected to assist 400,000 homeowners.
- Provides \$180 million in pre-foreclosure financial counseling and legal services to homeowners at risk of default.

### **What This Means for the Mortgage Lending Industry**

The mortgage lending industry has been searching for funding solutions to resolve ballooning numbers of defaulting mortgages, and this new bill provides an immediate infusion of dollars. In order to take advantage of the funding, banks and lenders must agree to trade existing at-risk mortgages for new loans at terms that borrowers can reasonably afford. The benefit to both the banks and borrowers is the addition of a federal guarantee provided by the FHA. To qualify, homeowners would have to be paying more than 31 percent of their incomes toward their mortgages and show they could afford to make the payments on a new, smaller loan. The trade-off for lenders, however, is that they will end up taking a substantial loss on the original loan.

While the percentage of at-risk borrowers immediately and directly benefited by this plan is fairly small — 15 percent — the effect of expanding available credit lines and the stabilization of Fannie and Freddie are intended to have a calming effect throughout the entire financial market. With greater confidence in the markets, the hope is that multiple economic indicators will rise again, and as the wider economy strengthens, banking and mortgage lending industries will begin to see financial improvement.

Mortgage holders should also feel some relief at receiving some protection against investor lawsuits when they modify loans to benefit borrowers who are in default or at risk of default.

One fairly immediate effect of the bill involves the creation of the first national licensing system for mortgage brokers and loan officers. Brokers and lenders should monitor the development of this program in coming months.

#### **For more information:**

[Text of the New Law, H.R. 3221 \(PDF\)](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3221enr.txt.pdf) ([http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:h3221enr.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3221enr.txt.pdf))

[Summary](http://www.thomas.gov/cgi-bin/bdquery/z?d110:h.r.03221) of the bill and [related links](http://www.thomas.gov/cgi-bin/bdquery/z?d110:h.r.03221) (<http://www.thomas.gov/cgi-bin/bdquery/z?d110:h.r.03221>.)

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