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A legal update from Dechert's Finance and Real Estate Group

President Signs Housing and Economic Recovery Act of 2008

President Bush signed the Housing and Economic Recovery Act of 2008 ("Recovery Act") into law on July 30, 2008. The Recovery Act revamps oversight of the government-sponsored enterprises Fannie Mae and Freddie Mac ("GSEs"), overhauls the Federal Housing Administration ("FHA") program, and implements other measures intended to help stabilize the nation's housing market. Key provisions of the legislation include the following:

- New Regulator for Fannie Mae and Freddie Mac. The Recovery Act creates a new independent agency—the Federal Housing Finance Agency ("FHFA")—to provide enhanced oversight of the GSEs. The FHFA is tasked with overseeing "the prudential operations" of each GSE and ensuring that (i) each enterprise operates in a safe and sound manner; (ii) the activities of each enterprise foster "liquid, efficient, competitive, and resilient national housing finance markets;" (iii) each enterprise complies with the Recovery Act and related regulations; (iv) each enterprise carries out its statutory mission only through authorized activities; and (v) the activities and operation of each enterprise are consistent with the public interest. Because the FHFA will succeed to the functions of the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board, the Recovery Act abolishes these two agencies.

- Oversight of GSE Portfolios. The FHFA is to establish criteria governing the portfolio holdings of the GSEs, ensuring the holdings are "consistent with the mission and the safe and sound operations" of the GSEs. The FHFA will also actively monitor the GSEs' holdings, and may require a GSE to dispose of or acquire an asset if the FHFA determines such action is consistent with the agency's mission.

- GSE Minimum Capital Requirements. The FHFA is to control the capital standards of the GSEs, ensuring the enterprises maintain "sufficient capital and reserves to support the risks that arise in the operations and management of the enterprises."

- Treasury Emergency Authority. The Recovery Act temporarily authorizes the Treasury to purchase debt securities issued by the GSEs and to invest in their common stock. The Treasury is permitted to make these purchases only if it determines such action is necessary to (i) protect taxpayers; (ii) provide stability to the financial markets; and (iii) prevent disruptions in the availability of mortgages. This authority expires on the last day of 2009.

- Conforming Loan Limits. The Recovery Act authorizes the GSEs to acquire loans initially as large as $625,500 as of January 1, 2009, by permanently raising the conforming loan limit for "high-cost areas"—areas where the median price for a residence is greater than the general conforming loan limit. The general conforming loan limit, currently $417,000 for a single-family residence, will continue to be adjusted each year based on the movement of a housing price index. The loan limit for a high-cost area will be the lesser of (i) an amount equal to 150% of the general limit; or (ii) an amount equal to 115% of the median price in the area for residences of the same size.

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- FHA Modernization Provisions. The legislation raises the caps on FHA loans to match the new loan limits implemented for the GSEs (currently up to $625,500 for a single-family residence). Borrowers will be required to make a cash down payment of at least 3.5% for any FHA loan, and sellers will be prohibited from funding the down payment.

- HOPE for Homeowners Program. The Recovery Act creates a new FHA program, "HOPE for Homeowners," to insure refinanced loans for distressed borrowers. The program allows the FHA to insure a refinanced loan only if (i) the distressed borrower can afford to pay the new loan; (ii) the lender agrees to write-down the old loan's principal; and (iii) the borrower agrees to share the newly-created equity and any future appreciation with the federal government. More specifically, the refinanced loan must comply with the following requirements:

  - The borrower must have had a mortgage debt-to-income ratio of greater than 31% as of March 1, 2008.

  - Tax returns from the most recent two years must be used to verify the borrower's income.

  - The principal amount of the refinanced loan must not exceed the borrower's "reasonable ability" to pay as determined by the FHA.

  - The principal amount of the refinanced loan must not exceed 90% of the current appraised value of the related property.

  - The principal amount of the refinanced loan must not exceed 132% of the applicable conforming loan limit in effect for 2007.

  - The refinanced loan must have a fixed interest rate and a term of not less than 30 years.

  - The lender must waive all fees and penalties related to prepayment/refinancing of the original loan or default/delinquency on the original loan.

  - The residence covered by the loan must be the borrower's primary residence and the borrower must not have an ownership interest in any other residence.

  - All subordinate liens must be extinguished prior to program participation.

  - The borrower must agree to yield to the FHA a portion of any equity resulting from the sale of the property covered by the new loan (or resulting from any refinancing of the new loan): the borrower must yield to the FHA 100% of the equity if the sale or refinancing occurs within one year of the date the new loan is insured, 90% if the sale or refinancing occurs after one year but within two years, 80% if the sale or refinancing occurs after two years but within three years, 70% if the sale or refinancing occurs after three years but within four years, 60% if the sale or refinancing occurs after four years but within five years, and 50% if the sale or refinancing occurs after five years.

  - The borrower must agree to yield to the FHA 50% of any appreciation in value of the property covered by the loan upon any sale or disposition of the property.

- Voluntary Program. The HOPE for Homeowners program is voluntary. The Recovery Act does not compel any lender, servicer, investor, or borrower to participate in the program. The government estimates, however, that at least 400,000 loans will be refinanced under the program.

- $300 Billion Cap and Sunset Provision. The aggregate original principal obligation of all loans insured under the HOPE for Homeowners program will not exceed $300 billion. In addition, the FHA may not enter into any new commitment to insure a refinanced loan under the program after September 30, 2011.

- Redevelopment of Abandoned and Foreclosed Homes. The legislation provides $3.92 billion to state and local governments for the purchase and rehabilitation of abandoned and foreclosed properties. The funds will be distributed based on a formula established by the Secretary of Housing and Urban Development, with localities hit hardest by foreclosures receiving the most assistance.

- Loan Originator Licensing. The Recovery Act encourages the States (through the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators) to develop uniform licensing and registration requirements for all loan originators. The States are also encouraged to develop a comprehensive, publicly available licensing database.

- Tax Incentives. The Recovery Act contains significant tax incentives, including a first-time homebuyer credit (equal to 10% of the purchase price of the residence up to a cap of $7,500) and a property tax deduction for homeowners who do not itemize on their federal tax returns ($500 for single filers and $1,000 for joint filers).

- Affordable Housing Programs. The Recovery Act creates a Housing Trust Fund to provide grants to States for use (i) “to increase and preserve the supply of rental housing for extremely low- and very low-income families;” and (ii) “to increase homeownership for extremely low- and very low-income families.” The legislation also creates a Capital Magnet Fund to attract private capital for and increase investment in (i) “the development, preservation, rehabilitation, or purchase of affordable housing for primarily extremely low-, very low-, and low-income families;” and (ii) “economic development activities or community service facilities, such as day care centers, work force development centers, and health care clinics, which in conjunction with affordable housing activities implement a concerted strategy to stabilize or revitalize a low-income area or underserved rural area.”

- Funds for Counseling. The Recovery Act appropriates $150 million to provide pre-foreclosure counseling services to distressed borrowers. In addition, the Recovery Act appropriates $30 million to provide legal services to these borrowers.

To view the complete Housing and Economic Recovery Act of 2008, visit http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3221enr.txt.pdf.

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If you have questions regarding the information in this legal update, please contact Joseph V. Gatti (+1 202 261 3436; joseph.gatti@dechert.com), Ralph R. Mazzeo (+1 215 994 2417; ralph.mazzeo@dechert.com), or Steven J. Molitor (+1 215 994 2777; steven.molitor@dechert.com).

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work. Visit us at www.dechert.com/finance&realestate.

Kimberly S. Andrascik
London, Philadelphia
+1 215 994 2520
kimberly.andrascik@dechert.com

Timothy J. Boyce
Charlotte
+1 704 339 3129
timothy.boyce@dechert.com

Lewis A. Burleigh
Boston
+1 617 654 8601
lewis.burleigh@dechert.com

Katherine A. Burroughs
Hartford
+1 860 524 3953
katherine.burroughs@dechert.com

Ciaran P. Carvalho
London
+44 20 7184 7473
ciaran.carvalho@dechert.com

Lawrence A. Ceriello
New York
+1 212 698 3659
lawrence.ceriello@dechert.com

Steven Choo
London
+44 20 7184 7370
steven.choo@dechert.com

Laura G. Ciabarra
Hartford
+1 860 524 3926
laura.ciabarra@dechert.com

Patrick D. Dolan
New York
+1 212 698 3555
patrick.dolan@dechert.com

Malcolm S. Dorris
New York
+1 212 698 3519
malcolm.dorris@dechert.com

Dr. Olaf Fasshauer
Munich
+49 89 21 21 63 28
olaf.fasshauer@dechert.com

Steven A. Fogel
London
+44 20 7184 7444
steven.fogel@dechert.com

David W. Forti
Philadelphia
+1 215 994 2647
david.forti@dechert.com

William Fryzer
London
+44 20 7184 7454
william.fryzer@dechert.com

Joseph V. Gatti
Washington
+1 202 261 3436
joseph.gatti@dechert.com

John J. Gillies, Jr.
Hartford
+1 860 524 3938
john.gillies@dechert.com

Joseph B. Heil
San Francisco
+1 415 262 4510
joseph.heil@dechert.com

Bruce D. Hickey
Boston
+1 617 654 8602
bruce.hickey@dechert.com

Geoffrey K. Hurley
New York
+1 212 698 3598
geoffrey.hurley@dechert.com

Andrew Hutchinson
London
+44 20 7184 7428
andrew.hutchinson@dechert.com

Eric P. Iversen
New York
+1 212 698 3538
eric.iversen@dechert.com

Les Jacobowitz
New York
+1 212 698 3814
les.jacobowitz@dechert.com

Richard D. Jones
Philadelphia
+1 215 994 2501
richard.jones@dechert.com

Andreas Junius
New York
+1 212 698 3578
andreas.junius@dechert.com

Abradat Kamalpour
London
+44 20 7184 7856
abradat.kamalpour@dechert.com

David M. Linder
San Francisco
+1 415 262 4511
david.linder@dechert.com

Ralph R. Mazzeo
Philadelphia
+1 215 994 2417
ralph.mazzeo@dechert.com

Steven J. Molitor
Philadelphia
+1 215 994 2777
steven.molitor@dechert.com

Sean H. Porter
New York
+1 212 698 3579
sean.porter@dechert.com

Jason S. Rozes
Philadelphia
+1 215 994 2830
jason.rozes@dechert.com

Timothy A. Stafford
New York
+1 212 698 3504
timothy.stafford@dechert.com

William C. Stefko
New York
+1 212 698 3895
william.stefko@dechert.com

Barry J. Thorne
London
+44 20 7184 7413
barry.thorne@dechert.com

John M. Timperio
Charlotte
+1 704 339 3180
john.timperio@dechert.com

Stephanie M. Tita
New York
+1 212 698 3896
stephanie.tita@dechert.com

Cynthia J. Williams
Boston
+1 617 654 8604
cindy.williams@dechert.com

Jay Zagoren
Philadelphia
+1 215 994 2644
jay.zagoren@dechert.com

Dechert LLP

www.dechert.com

U.S. Austin • Boston • Charlotte • Hartford • Newport Beach • New York • Philadelphia Princeton • San Francisco • Silicon Valley • Washington, D.C. • **EUROPE** Brussels London • Luxembourg • Munich • Paris • **ASIA** Hong Kong