Home Affordable Modification Program

Modification of Loans with Principal Reduction Alternative (PRA) SD 10-05

For Use By:	*This guide is designed for HAMP SPA Servicers.*
Description	Supplemental Directive 10-05 provides guidance to servicers on the adoption and implementation of a Principal Reduction Alternative (PRA). PRA gives servicers the flexibility to offer principal reduction relief to borrowers whose homes are worth significantly less than the remaining amounts due on their first lien mortgage loan. This information is applicable to **non-GSE loans only** and does not cover loans owned, guaranteed or insured by FHA/VA, Freddie Mac, or Fannie Mae.
Effective Date	The program is effective for participating HAMP servicers on the later of October 1, 2010 or the implementation date for version 4.0 of the HAMP NPV model, however, servicers may immediately offer PRA. Principal reductions made between the publication date and the effective date are eligible for incentives if modification terms are the same as PRA terms (105% floor, deferred over 3 years), however, no Alternative NPV is required.
Eligibility	Borrowers are eligible for PRA when the loan: • Meets the HAMP eligibility criteria and the borrower is either in imminent default or delinquent. • Has a current mark-to-market loan-to-value (MTMLTV) ratio greater than 115%.
Terms	• PRA is a deferred principal reduction program which allows a borrower to earn principal reduction over a three-year period. • The deferred principal reduction amount will be initially treated as non-interest bearing principal forbearance. • On the first, second and third anniversaries of the borrower's trial period effective date, one-third of the original principal reduction amount will be forgiven as long as the borrower remains in good standing. • Subject to eligibility, borrower, investor, and servicer incentives announced in SD 09-01 still apply.
Costs	There is no cost to the borrower for applying for the PRA program.
Loan Evaluation	Under PRA, servicers are required to evaluate the benefit of principal reduction for every HAMP eligible loan with a MTMLTV ratio greater than 115% and are encouraged to offer principal reduction whenever the net present value (NPV) result of a HAMP modification using PRA is positive. • Servicers must use both the standard HAMP modification waterfall (Standard Waterfall) and an Alternative modification waterfall that includes principal reduction as the second step in the waterfall (Alternative Waterfall). • Servicers are required to evaluate all such loans using a standard NPV test that compares the NPV results for modifications both with and without PRA to the NPV result without a modification. In addition to the required NPV test, servicers may conduct other evaluations to determine the level of principal reduction that is in the best interest of investors.

Alternative Waterfall	Servicers must use the Alternative Waterfall analysis to demonstrate whether reducing principal is in the best interest of the investor. Under the Alternative Waterfall, servicers use principal reduction between Step 1 (capitalization) and Step 2 (interest rate reduction) of the Standard Waterfall set forth in Supplemental Directive 09-01 as follows: If the MTMLTV is greater than 115%, servicers will: • Reduce the UPB by the amount necessary to reach the target monthly mortgage payment ratio of 31%or an MTMLTV ratio equal to 115%, whichever is reached first; • If the UPB is reduced to create an MTMLTV ratio of 115%and the target monthly mortgage payment ratio of 31% has not been reached, the servicer must continue with the standard HAMP modification waterfall steps of interest rate reduction, term extension and principal forbearance, each as necessary, in order to reach the target monthly mortgage payment ratio of 31%. Servicers may, at their discretion and consistent with investor guidelines, reduce the UPB down to an amount that creates a 105% MTMLTV ratio. Servicers are not precluded from reducing principal below a 105% MTMLTV ratio; however, PRA investor incentives will not be paid on the portion of any principal reduction that reduces the MTMLTV below 105%.
NPV Model	• The servicer must use the NPV model to evaluate the proposed modifications generated by applying the Standard Waterfall and the Alternative Waterfall. As set forth in Supplemental Directive 09-01, if the NPV result for the proposed modification generated by applying the Standard Waterfall is positive, servicers must modify the loan. If the NPV result for the proposed modification generated by applying the Alternative Waterfall is positive, servicers may, but are not required to, reduce principal in conjunction with a HAMP loan modification, even in instance where the NPV result from the Standard Waterfall is negative. • If neither the HAMP standard waterfall NPV nor the Alternative Waterfall NPV is positive, the servicer is not required to modify the loan.
Servicer Application/ Principal Reduction	• Servicers must initially treat principal reduction on PRA loans as non-interest bearing principal forbearance. If the borrower is in good standing on each of the first, second and third anniversaries of the trial period effective date, the servicer must apply a third of the original principal reduction amount to reduce the unpaid principal balance. • Servicers must treat borrowers that are in good standing and pay the loan in full at any time (i) more than 30 days after the HAMP modification effective date; and (ii) after implementation of the PRA reporting and payment processes as fully vested and entitled to the benefit of the entire amount of any unearned principal reduction.
Retroactivity	• Guidance relating to principal reduction and related investor incentives for loans currently in HAMP Trial Period Plans or permanent HAMP modifications will be provided in a future Supplemental Directive.
Second Liens	• Participating 2MP servicers must forgive an amount of principal on 2nd liens in equal proportion to the amount forgiven on the first lien loan by the 1st lien servicer.

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<td>Incentive Compensation</td>
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<u>Investor</u>
Investors will receive a PRA investor incentive based on the delinquency status of the loan, the MTMLTV ratio used to complete the Alternative Waterfall analysis and the amount of principal reduction actually applied by the servicer.
Investor Principal Reduction Incentive Schedule:
Per Dollar of Unpaid Principal Balance Forgiven in MTMLTV Range
(Loans Less than or Equal to Six Months Past Due)
MTMLTV Range
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<tr><th><u>105 to <115%</u></th><th><u>115% to 140%</u></th><th><u>>140%</u></th></tr>
<tr><td>0.21</td><td>0.15</td><td>0.10</td></tr>
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With respect to loans which were more than six months past due at any time during the 12 month period ended on the date of the modification, irrespective of MTMLTV range, investors will be paid $0.06 for each dollar of principal reduction. PRA investor incentive payments will be paid to investors in the month in which the applicable principal reduction amount is actually applied to reduce the borrower’s UPB as set forth above.

No incentives of any kind will be paid if (i) the servicer has not executed the Servicer Participation Agreement to participate in HAMP, or (ii) the borrower’s monthly mortgage payment ratio starts below 31% prior to the HAMP evaluation.
A loan that is not in good standing is not eligible to receive borrower, servicer or investor incentives and reimbursements and such payments will no longer accrue for that mortgage loan.
Investors receive the Investor Payment Reduction Cost Share and Up Front Incentive payments described in Supplemental Directive 09-01 and, as applicable the Home Price Decline Protection incentive payments described in Supplemental Directive 09-04.
No PRA incentive will be paid for that portion of the principal reduction amount that reduces the MTMLTV ratio below 105%.

No PRA incentive will be paid if the loan is fully satisfied prior to implementation of the PRA reporting and payment processes.
<u>Borrower/Servicer</u>
Borrower/Servicer Incentives will continue to accrue and be paid according to SD 09-01.
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<td>Documentation & Reporting</td>
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The modification documentation requirements for PRA are the same as those required under HAMP. However, the Home Affordable Modification Agreement and the HAMP Trial Period Plan should be modified to include language regarding the deferred principal reduction terms to be available on www.HMPadmin.com. Additionally, the Agreement must include a notification that principal reduction may have tax consequences for the borrower.
The PRA reporting and payment processes are currently under development by Fannie Mae, in its capacity as Treasury’s administrative agent. Subsequent guidance will be provided describing the reporting processes and when they will be available.
Servicers who offer principal reduction before the reporting processes are in place (Interim Period) will be required to report the transaction to the Treasury System of Record. Any PRA principal reduction on Interim Period loans should be reported in the existing principal write-down field. Servicers should not, however, reduce the UPB by the amount of any PRA principal reduction for Interim Period loans in the Treasury system of record (but should, of course, reduce the UPB by any principal reduction that is not related to PRA). When the reporting and payment processes are in place, servicers shall submit a correction transaction that will move the PRA principal reduction to a new PRA specific principal forgiveness field. During the Interim Period, Servicers must collect and retain PRA specific information so that the necessary data can be reported when the processes become available. (The HAMP Data Dictionary and the SD 09-06 Data Dictionary currently available on www.HMPadmin.com are expected to be revised to include new and modified edits for PRA)

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