NCSHA 2012 Awards

Category:	Management Innovation
Sub-Category:	Financial
Entry Name:	Helping Responsible Homeowners: The Interest Only Step-up Initiative

Largely ignored during the recession were those homeowners who managed to remain current on their monthly mortgage obligations even though they were "underwater" – with the amount of their mortgage in excess of the market value of their home. In Maryland, some of these homeowners took advantage of the Maryland Department of Housing and Community Development's (DHCD) CDA mortgages offering fixed-rate, interest only (IO) loans. These IO loans allowed responsible home buyers to purchase a home during a period of rapidly escalating prices in the high-priced State of Maryland. Like many homeowners who purchased during the pricing "bubble," these Maryland IO mortgage holders were vulnerable to market shocks due to economic instability. DHCD and its CDA portfolio could also be perceived to be at risk.

After identifying the cohort of credit-worthy IO borrowers in its portfolio, DHCD developed an initiative to transition those homeowners into amortizing loans before their interest-only period was scheduled to end. The initiative provided current IO borrowers with an opportunity to avoid the sharply increased monthly payments they would otherwise face at the end of the interest-only period of their loan.

This program provided critical support to those homeowners who remained current in spite of difficult circumstances. While resources were being made available to help those facing delinquency and foreclosure, DHCD's Interest Only Step-up Initiative ("Step-up") became the cornerstone of DHCD's outreach to help responsible borrowers who remained current on their monthly mortgage payments. DHCD reached out to all of its current IO borrowers and achieved remarkable results (see attached). As of March 31, 2012, nearly 2,000 borrowers were contacted with over 20% taking advantage of the Step-up Initiative.

A. BACKGROUND

The Community Development Administration, DHCD's housing financing division, has a large portfolio of single family mortgages, all with fixed interest rates, but some of which are IO mortgages. These IO loans were made from 2005 to 2008, with the vast majority being closed in 2006 and 2007. When DHCD first offered its fixed-rate mortgages with an initial interest-only period, it was a way for Maryland to help home buyers during a period of skyrocketing house prices. All of the loans made by DHCD during that period, both "Interest Only" and "Amortizing," were whole loans owned by CDA. The mortgages were all fixed rate loans and were a safe and sane alternative to adjustable rate mortgages or other exotic loans, which at that time were easily obtainable by home buyers. During this period, the fixed-rate IO mortgages offered by CDA helped DHCD ensure that Marylanders could obtain the best mortgage product to meet their financial needs without taking undue risks. DHCD placed many safeguards on the mortgages, including:

- Fixed interest rates throughout the life of the loans;
- Long amortizing periods (i.e., in most cases an initial 5-year IO period followed by a 30-year amortizing period);
- Frequent contact by the servicer -- all IO borrowers receive an annual statement with reminders that their loan payments will increase at the start of the amortization period.

With economic conditions radically altered by an extended economic recession, new arrangements were needed to sustain homeownership in Maryland. Sustaining successful homeownership is a core mission for DHCD and the State of Maryland.

To help the IO borrowers in its portfolio, DHCD designed and launched an early-action initiative to extend additional support to the IO borrowers.

B. STEP-UP INITIATIVE OVERVIEW

The initiative was developed to support IO borrowers, but also to allow the agency to balance its financial obligations to bondholders. The initiative allows borrowers to secure a reduced interest rate by starting their amortizing period sooner and lengthening the term. This allows the IO borrower to ease into their principal payments with lower, gradually-increasing, monthly payments. This new repayment plan will also reduce their overall repayment amount over the life of the loan.

Borrowers start their amortization period within two months of accepting an offer letter from CDA by agreeing to higher monthly payments. The typical payment increase is in the $35-50 range depending on the individual loan. This plan is followed by three more payment increases in this same range over the next three years. Ultimately, the homeowner's monthly payment will go up by about $150 when the full 30-year amortization cycle starts. This is much lower than the average one-time scheduled increase of $220. The payment increases are done through a series of interest rate and term changes over this four-year transition period, as described below; however, ultimately the IO borrower will have a lower interest rate and only extend their loan by about 18-24 months on average from the initial schedule.

- First Year Mortgage Change: Rate reduction of 100 basis points (bp) from the current (original) note rate with a 33-year amortization period on the current outstanding principal (any principal payments during the IO period will be used in calculating the new payments). This payment will be in effect for 12 months.
- Second Year Mortgage Change: Rate reduction of 75 bp from the original note rate with a 32-year amortization period on the current outstanding principal (any principal amortization during the above period will be used in calculating the new payments). This payment will be in effect for 12 months.
- Third Year Mortgage Change: Rate reduction of 50 bp from the original note rate with a 31-year amortization period on the current outstanding principal (any principal amortization during the above period will be used in calculating the new payments). This payment will be in effect for 12 months.
- Fourth Year (and for the remainder of the loan term) Mortgage Change: Rate reduction of 12.5 bp from the original note rate with a 30-year amortization period on the current outstanding principal (any principal amortization during the above period will be used in calculating the new payments). This payment will be in effect for the remainder of the mortgage (30 years).

C. STEP-UP INITIATIVE RATIONALE

DHCD believed there were many reasons to start this initiative. These included:

- An opportunity to provide viable options for financial assistance to DHCD's "good" borrowers who were current with their IO loans

- An ability to offer a financially sound method to gradually step-up IO borrowers into a higher payment; thus, reducing payment shock
- A measure to reduce the overall percentage of IO loans in the CDA portfolio, which could improve CDA's bond rating outlook with the credit rating agencies
- A method to improve short-term bond indenture cash flow (use capital to assist with more challenging borrowers) with only a modest long-term financial impact
- A workable model for assisting other IO borrowers who are more financially challenged borrowers
- A forum for DHCD to reach out to its borrowers

D. INITIATIVE IMPLEMENTATION

DHCD developed an Excel template that could be used with every borrower to quickly explain the program and financial parameters of the initiatives. This same spreadsheet prepares all the necessary disclosure and legal paperwork to expedite the whole process and ensure quick implementation of the IO step-up payment.

DHCD wanted to reach as many borrowers as efficiently as possible, while ensuring the IO borrower gets the best possible customer service. DHCD decided to phase the outreach campaign to about 500 borrowers at a time. The plan called for reaching the borrowers closest to the scheduled end of their interest-only period first. DHCD developed a carefully balanced plan of follow-up communication to ensure all borrowers are reached at the same time with clear communications, but without inundating a current borrower with too much literature. A sample of the letter DHCD sent the borrowers is included as an exhibit.

E. POSITIVE RESULTS

- *People were Helped*: Over 20% of borrowers who were contacted have taken advantage of the program; delinquencies are much lower in the Step-up loans.
- *CDA Portfolio Improved*: The overall percentage of IO loans in the CDA portfolio is improved, which:
  - Enhanced CDA's bond rating outlook with the credit rating agencies
  - Provided a method to improve short-term bond indenture cash flow (freeing up capital to assist with more challenging borrowers) with only a modest long-term financial impact
  - Established a workable model for assisting other IO borrowers who are more financially challenged borrowers
- *Created a Replicable Model*: Other housing finance agencies could use this model to transition IO mortgages in their portfolios.
- *Strengthened Future Relationships: The initiative created a forum and method for DHCD to reach out to its borrowers:*
  - DHCD gained an opportunity to reinforce positive communication with its borrowers by taking time to directly discuss the financial parameters of each borrower's loan and strengthen relationships for the future.

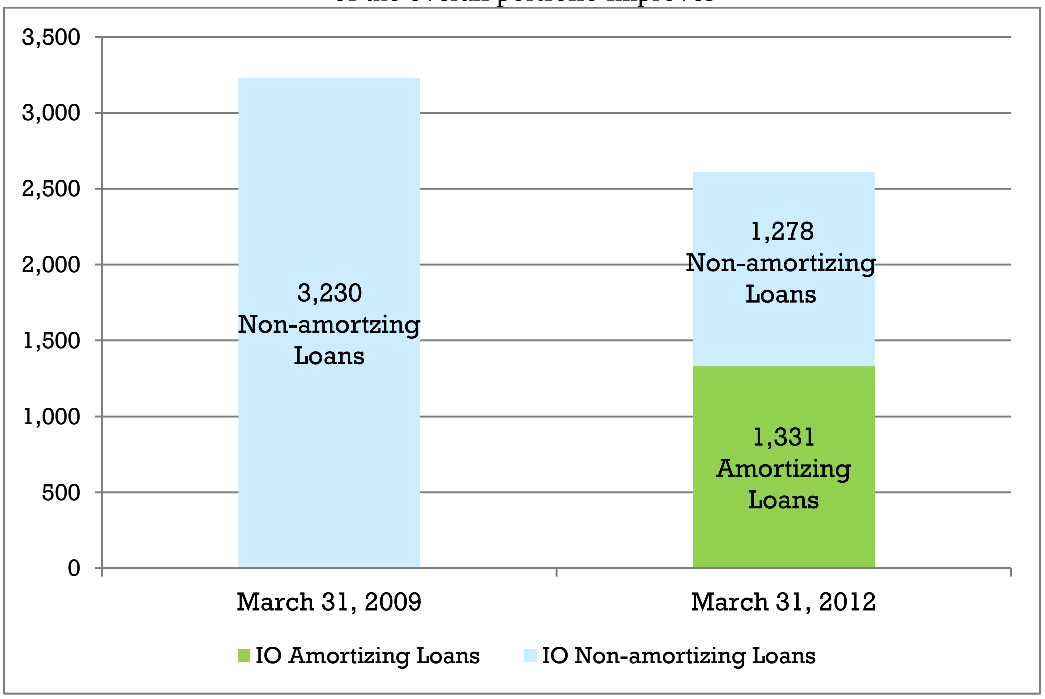
ATTACHMENT

Helping Responsible Homeowners: The Interest Only Step-up Initiative

CDA IO portfolio results as of March 2012 include:

Increased Amortizing Loans in IO Portfolio

Borrowers' loans are more stable and credit rating agency outlook of the overall portfolio improves



Note: The decrease in the overall number of loans in the IO Portfolio from 2009 to 2012 reflects intervening loan payoffs and foreclosures (including short sales).

Improved Delinquency Rates in the IO portfolio

Step-up IO loans compare favorably to other IO amortizing loans (those that converted to amortizing through loan modification, advance claim initiative, or regularly-scheduled amortizations) and IO non-amortizing loans.

IO Portfolio Loans (*as of 3/31/12)*	Number of Loans	Delinquency Rate
Step-up Amortizing	429	2.10%
Regularly Scheduled Amortizing	902	18.50%
Non-amortizing (in IO payments)	1,278	15.81%
TOTAL IO LOAN PORTFOLIO	2,609	14.49%