

NCSHA 2011 Awards

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

Largely ignored during the current Great Recession are those homeowners who have managed to remain current on their monthly mortgage obligations even though they are “underwater” – with the amount of their mortgage in excess of the market value of their home. Some of these homeowners took advantage of interest only (IO) mortgage programs offered by the Maryland Department of Housing and Community Development, which allowed for affordable workforce homeownership during a period of rapidly escalating home prices in high-priced Maryland. Having purchased during the pricing “bubble,” these Maryland homeowners with IO mortgages are particularly vulnerable to future shocks; their economic stability is threatened and, consequently, so too is the agency’s.

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

While resources have been made available to help those facing severe delinquency and foreclosure, DHCD’s Interest Only Step-up Initiative became the cornerstone of DHCD’s outreach and program activities designed to help current borrowers. To date, DHCD has reached out to about 1,500 current IO borrowers (two-thirds of the current IO borrowers), with nearly 15 percent taking advantage of the initiative. This success has generated significant financial benefits for DHCD, while perpetuating DHCD’s mission of ensuring affordable housing payments for its borrowers. An overview of some of the financial benefits include: increased cash flows with the sooner than expected cash flows; improved portfolio in the view of the credit rating agencies by increasing the percentage of amortizing loans; and, reduced delinquencies by managing the expected borrower payment increases.

A. BACKGROUND

The Community Development Administration (CDA), 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, both “Interest Only” and “Amortizing,” are whole loans owned by CDA. The CDA IO 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 CDA IO mortgages 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 CDA IO 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.

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These safeguards have been crucial in allowing CDA's IO portfolio to outperform a similar cohort of 30-year amortizing loans made during the same period. With economic conditions radically altered by an extended economic recession, new arrangements are needed that can sustain homeownership in Maryland by allowing DHCD to help keep all borrowers in their homes by ensuring they can afford their mortgages now and over the life of their loans. 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 who face monthly payment increases over the next few years.

B. STEP-UP INITIATIVE OVERVIEW

The initiative was developed to support IO borrowers, but also to allow CDA to balance its financial obligations to bondholders. The initiative is an option for CDA IO borrowers. It 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

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- 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.

To date, DHCD has rolled out three phases of the initiative reaching 1,500 families. Over 40 percent of these borrowers responded to DHCD and requested more information.

E. POSITIVE RESULTS

- *People were Helped:* 195 IO borrowers have taken advantage of the program to date; many more are still deciding on taking advantage of this opportunity. Many of these borrowers have been very appreciative of DHCD's efforts and all have remained current with their higher step-up payment schedule. Two typically compelling cases are described below:
 - A young couple who were very appreciative of DHCD's help and patience. Because of pregnancy they had delays because of personal demands, but after they delivered the baby DHCD allowed them to complete the modification. The IO step-up was just what they needed to balance the financial obligations of their growing family.
 - A senior citizen who needed DHCD's cooperation and assistance after a major surgery and multiple medical procedures during the process. DHCD provided superior customer service and worked with the gentlemen several times to redo his paperwork. With a fixed income the IO step-up provided him the opportunity to remain in the home within his means.
- *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
- *Strengthened Future Relationships: The initiative created a forum and method for DHCD to reach out to its borrowers:*
 - DHCD has had meaningful dialogues with half of its IO borrowers, which was a new opportunity to reiterate and discuss the financial parameters of their loan and strengthen relationships for the future.

January 14, 2011

Dear :

Here is important information from the Department of Housing and Community Development about your fixed-rate, interest-only, Maryland Mortgage Program (MMP) loan!!

As you know, your current mortgage allows you to pay interest-only payments each month for the first five years, after which you will enter the amortization period of your loan and your monthly payments of principal and interest will increase.

DHCH is offering an innovative new program which may help you with that increase! This program enables you to begin paying your principal payments a few months earlier than scheduled. We invite you to call us to hear how you may be able to lower that upcoming mortgage payment. We are here to explain these benefits to you:

- A lower monthly payment over the life of your amortized loan.
- A lower fixed interest rate on your loan.

You are a valued borrower who has made monthly payments on time, so we want to offer you this unique opportunity to reap the continued rewards of home ownership.

Whether or not you choose to take advantage of this program, your MMP loan servicer, Bogman Inc., will contact you with the exact details of your scheduled monthly payment increase.

If you are interested in saving money and increasing the equity in your home sooner, please call: **Maxine Chappell, (410) 514-7543** or e-mail sfioi@mdhousing.org to discuss your options and potential benefits.

We look forward to hearing from you soon!

Sincerely,



Frank B. Coakley
Assistant Secretary