# PRINCIPAL PAYDOWN PLAN FOR UNDERSECURED MORTGAGES

***A Detailed Proposal by the***

*National Association of Consumer Bankruptcy Attorneys*

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1. *Summary.* This proposal involves a restructuring of certain underwater mortgages to enable homeowners to eliminate negative equity and acquire modest equity, and then re-amortize the mortgage into a market rate loan. This reduction of principal ***is not a bankruptcy cramdown***, but rather is achieved by temporarily reducing the interest rate to 0% for Chapter 13 homeowners, so that all payments made by the homeowner are applied to pay down the principal. In exchange for this benefit, the homeowner agrees to a general settlement of claims against the servicer, trustee, and investor. This plan will achieve a significant improvement in the over-encumbered status of the home, will provide needed and justifiable hope for the homeowner who wishes to keep the home, and will stabilize the overall mortgage market and communities across the country.

2. Qualifying mortgages and real property

   a. Only principal residences are qualified.

   b. The first mortgage principal (the lower of the original principal amount or the unpaid principal of an already modified first mortgage) may not be higher than 125% of the FHFA Conforming Loan limits for the applicable area.

   c. Home value on the date of value determination may not exceed 95% of the total value of all encumbrances on the property [e.g., maximum value of $380,000 if total encumbrances equal $400,000].

   d. First mortgages, junior mortgages, and any bridge or other loans secured by the property would be subject to the plan, if not otherwise avoided.

   e. A fully secured loan is exempt from treatment under this plan.

3. Basic borrower qualifications

   a. At least one borrower must be a debtor in a pending Chapter 13 case. The bankruptcy court shall have jurisdiction and the first mortgage may be modified under this plan even if a co-borrower is not a Chapter 13 debtor, provided the property is the principal residence of the borrower who is the Chapter 13 debtor.

   b. Current monthly housing costs (all mortgages, real property taxes, insurance, homeowners association dues, etc.) are not less than 31% of borrower's gross income; or if the borrower's household income is not more than 80% of the applicable HUD median income, the housing costs are not less than 25% of borrower's gross income.

   c. Mortgage payments used in the calculation under section 3(b) above are calculated based upon the highest monthly payment amount anticipated or likely to be due under the mortgage within five years. If the loan is currently in a negatively- or partially-amortized (not fully amortized, leaving an unpaid balance) or interest-only period, the borrower is automatically qualified, notwithstanding 3(b) above. For purposes of this calculation for a variable interest loan, the interest rate shall be the greater of double the current interest rate, or 65% of the interest rate cap applicable within the five year period, since the interest rates are exceedingly low at this time.

4. Chapter 13 bankruptcy debtors may include a plan provision, modifying mortgages on principal residences as follows:

a. ***Zero Interest – Five Year Modification*** – <u>on undersecured first mortgages</u>

(1) The balance on the mortgage on the effective date of the modification (including allowed arrears, escrow shortages, and similar charges) shall be modified to accrue interest at 0% for a period of five years.

(2) The borrower's minimum monthly principal payment shall be calculated similar to the HAMP calculation. 31% of the borrower's gross monthly income on Chapter 13 Schedule I (projected income) shall be devoted to total housing costs, including "other housing costs" consisting of real property taxes, insurance, homeowners association and other required fees related to this property. The minimum monthly amount to be paid to the first mortgage lender shall be this 31% minus other housing costs. Unemployment benefits, social security benefits, disability benefits, retirement benefits, alimony and family support, etc., shall all count in this calculation. However, the minimum monthly principal payment shall not be less than 0.2% of the mortgage balance owed [$1,000 on a $500,000 first mortgage]. The borrower may pay more than the minimum payment without penalty.

(3) The remaining balance due on the first mortgage at the end of the zero interest period shall be amortized over 25 additional years at the Freddie Mac Survey Rate in effect on the initial modification date (the commencement of the 0% period).

(4) The bankruptcy court will disallow portions of mortgage claims due to negative amortization, excessive interest and fees, and apply a discount for mortgages subject to a claim of invalidity due to forgery, stamped signatures, fraudulent declarations, etc.

(5) *Implementation:* The investors or insurers will need to instruct the servicers to affirmatively accept Chapter 13 plans with Principal Paydown Provisions.

b. ***Zero Interest – Five Year Modification*** – <u>on undersecured junior mortgages not otherwise voided</u>

(1) If at least one senior mortgage is modified pursuant to this plan, the junior mortgage would be modified to accrue interest at 0% during the five year period, with no monthly payments to the junior lender being required of the borrower during this period. This monthly payment deferral is intended to enable the borrower to maximize the payments to the first mortgage during the five year period. In order to assure that the junior mortgage lender does not improperly benefit from the principal paid down by the debtor to the first mortgage, any principal reduction on the first mortgage will also be credited against the balances of the junior mortgages (shared pro-rata, if there is more than one junior mortgage) that are not otherwise voided.

(2) If the most senior mortgage is not undersecured and is not modified under this plan, an undersecured or wholly unsecured junior mortgage, not otherwise voided, would be modified as follows.

(a) The balance on the mortgage on the effective date of the modification (including allowed arrears, escrow shortages, and similar charges) shall be modified to accrue interest at 0% for a period of five years.

(b) The borrower's minimum monthly principal payment shall be calculated similar to 4(a)(2) above. 31% of the borrower's gross monthly income on Chapter 13 Schedule I (projected income) shall be devoted to total housing costs, including "other housing costs" consisting of real property taxes, insurance, homeowners association and other required fees related to this property. The minimum monthly amount to be paid to the junior mortgage lender shall be this 31% after subtracting other housing costs and monthly payments due on all senior mortgages. Unemployment benefits, social security benefits, disability benefits, retirement benefits, alimony and family support, etc., shall all count in this calculation. There shall be no minimum monthly principal payment on such junior mortgages. The borrower may pay more than the minimum payment without penalty.

(c) The remaining balance due on the junior mortgage at the end of the zero interest period shall be amortized over 25 additional years at the Freddie Mac Survey Rate in effect on the initial modification date (the commencement of the 0% period).

(3) *Implementation:* The investors or insurers will need to instruct the servicers to affirmatively accept Chapter 13 plans with Principal Paydown Provisions. For some undersecured junior mortgages, the investor may be the same party as the servicer for the first mortgage.

c. ***Void Wholly Unsecured Junior Mortgages***

Junior liens that are secured by no value in the borrower's real property (making them "wholly unsecured") will be voided, as under current Chapter 13 bankruptcy law in most jurisdictions. This right would continue to be utilized by the borrower and would enhance the viability of senior liens. All junior mortgages encumbering properties with a first mortgage that is modified with a zero-interest period pursuant to section 4(a) above, are wholly unsecured mortgages, and consequently, shall be voided in Chapter 13 cases.

5. In exchange for the benefits of obtaining a loan modification, ***the borrower will agree to a general settlement*** of all claims against the servicer, trustee, and investor that are specifically disclosed by said parties to the borrower in connection with obtaining this loan modification.

6. Upon noticed motion by the borrower, the bankruptcy court will make a legal determination of the identity of the servicer, the trustee, and the investors, with respect to the loan, in order that all rights are settled – a short-form ***quiet title*** procedure.