



The Fannie Mae Flex Modification program

Applying lessons learned from the housing crisis

Fannie Mae recently announced the Fannie Mae Flex Modification, which was designed to address lessons learned from the recent housing crisis. The Fannie Mae Flex Modification is a proactive approach, designed to be an efficient and effective program that will be responsive to any future housing crisis similar to the one experienced between 2006 and 2008.

The Fannie Mae Flex Modification program was developed jointly with Freddie Mac at the direction of our conservator, the Federal Housing Finance Agency (FHFA). It leverages components of Fannie Mae’s Home Affordable Modification Program (HAMP®), which will no longer accept borrower applications after December 30, 2016, and Fannie Mae’s Standard and Streamlined Modifications, and will generally be our sole modification program going forward. Lenders may begin to implement the new program as early as March 1, 2017 but must implement the program no later than October 1, 2017. After a servicer implements the Fannie Mae Flex Modification, it may no longer evaluate borrowers for a Fannie Mae Standard or Streamlined Modification.

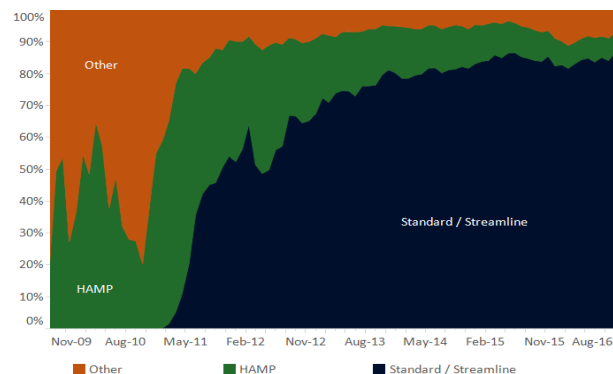
This commentary explores how the Fannie Mae Flex Modification program compares to the combination of crisis-era modification programs (HAMP, Fannie Mae Standard Modification, and Fannie Mae Streamlined Modification) in four key areas: (1) Coverage of the program; (2) Payment reduction; (3) Cost of the modification; and (4) Re-performance rates post modification.

The analysis shows that with the Fannie Mae Flex Modification, a similar or larger population of borrowers would be eligible for this program relative to the combination of those eligible under Fannie Mae’s HAMP, Standard Modification, and Streamlined Modification programs (the “predecessor programs”). The analysis further shows that the Fannie Mae Flex Modification offers a payment reduction similar to its predecessor programs. As such, re-performance rates after modification are anticipated to be virtually the same when compared to those of the combination of predecessor programs. Lastly, Fannie Mae believes that its modification programs should be net present value (NPV) positive at the program level. We estimate that the Fannie Mae Flex Modification meets this criteria, and when compared to the combination of predecessor programs, is expected to have a lower overall program cost of modification.

Background

In early 2009, a government-sponsored program – Making Home Affordable® (MHA) – was established to provide foreclosure alternatives to homeowners impacted by the financial crisis. HAMP, the first and largest program under MHA, was created with the goal of reducing struggling homeowners’ monthly mortgage payments to an affordable and sustainable amount. While Fannie Mae has historically offered a combination of loan modification programs, the HAMP modification was the predominant program in the 2009 through 2011 timeframe. Since mid-2012, an increasing number of our modifications have leveraged Fannie Mae’s Standard and Streamlined Modification Programs.

Figure 1 – Modification distribution over time – September 2009 through September 2016



This commentary contains forward-looking statements, including statements regarding the expected future performance of Fannie Mae’s modified loans. These forward-looking statements are based on the company’s current assumptions regarding numerous factors and are subject to change. Actual outcomes may differ materially from those reflected in these forward-looking statements due to a variety of factors, including, but not limited to, those described in “Executive Summary,” “Forward-Looking Statements” and “Risk Factors” in the company’s quarterly report on Form 10-Q for the quarter ended September 30, 2016 and its annual report on Form 10-K for the year ended December 31, 2015.



In designing the Fannie Mae Flex Modification, Fannie Mae sought to proactively create a program that is broad enough to respond to crisis scenarios such that another HAMP-like program would not be necessary. The program was shaped by a white paper published in July 2016 by the U.S. Department of the Treasury in conjunction with the U.S. Department of Housing and Urban Development (HUD) and FHFA, titled [Guiding Principles for the Future of Loss Mitigation](#). It laid out five factors – accessibility, affordability, accountability, sustainability, and transparency – that should form the foundation of future loss mitigation programs. These principles were aimed to help maximize participation in foreclosure-avoidance efforts and reduce losses on mortgage assets, creating mutually beneficial outcomes for homeowners, taxpayers, and investors.

Comparing the Fannie Mae Flex Modification to its predecessors

When comparing the Fannie Mae Flex Modification program to its predecessors, it is important to understand the payment reduction path, as differences in the steps impact the overall cost of the programs. An important part of the comparison is that the Fannie Mae HAMP modification focused on a waterfall, stepping through each component one at a time until a 31 percent debt-to-income (DTI) ratio is achieved. The Standard and Streamlined Modifications, as well as the Flex Modification, first capitalize arrearages and then pull multiple levers at one time to achieve their benefit.

Table 1. Program payment path comparison

HAMP	Standard/Streamlined Modification	Flex Modification
1 Capitalize arrearages	1 Capitalize arrearages	1 Capitalize arrearages
2 Convert to step-rate mortgage. Decrease rate in 1/8 increments to as low as 2%	2 a) If MTMLTV > 80%, set rate to standard modification rate. If MTMLTV <80%, no change to rate if fixed-rate mortgage and set rate to higher of current note rate or Standard Mod rate if ARM or step-rate mortgage ²	2 a) Set interest rate to lesser of current note rate or standard modification rate (if MTMLTV is > 80%) or to the current note rate (if MTMLTV <80%) ³
3 Extend term up to 480 months	b) Extend term up to 480 months	b) Extend term up to 480 months
4 Forbear incrementally to achieve a 31% housing debt-to-income (HTI) ratio ¹	c) If MTMLTV > 115%, forbear principal to establish 115% MTMLTV (not to exceed 30% of post-mod UPB)	c) If MTMLTV > 100%, forbear principal to establish 100% MTMLTV
		3 Provide or increase principal forbearance until a 20% payment reduction is achieved ^{4 5}

¹Not required to forbear more than the greater of 30% of the post-modification UPB or an amount that would result in 100% MTMLTV, using the interest-bearing UPB

²The post-modification MTMLTV ratio is defined as the gross unpaid principal balance (UPB) of the mortgage loan including capitalized arrearages, divided by the current value of the property

³This logic applies to a fixed-rate mortgage, including adjustable-rate mortgages (ARMs) and step rate mortgages that are at their final note rate. For ARMs and step rate mortgages that have not reached their final note rate, those mortgages are converted to fixed-rate mortgages and the note rate is then set to the lesser of the standard modification rate or the lifetime cap (in the case of an ARM loan) or the maximum step rate (in the case of a step rate mortgage loan)

⁴The servicer must not forbear more than 30% of the gross post-modification UPB of the mortgage loan

⁵In the case of a borrower that is 89 days or less delinquent and who submitted a complete BRP, principal forbearance is increased until there is a minimum 20% payment reduction and a Housing expense-to-income (HTI) ratio of 40% is achieved. See Fannie Mae Lender Letter LL 2016-06 for a detailed explanation of the HTI calculation

Program coverage, payment reduction, and cost

For this comparison exercise, we leverage [Fannie Mae's Single-Family Loan Performance database](#), our transparent, loan-level application that provides historical performance information for over 23 million single-family loans that Fannie Mae has acquired since 2000. To illustrate the Fannie Mae Flex Modification program coverage, payment reduction, and cost, we examine the cohort of single-family loans in Fannie Mae's book of business that were originated in 2006 and subsequently modified through Fannie Mae's HAMP or one of Fannie Mae's proprietary modification programs.

- In the database, over 891,000 loans were originated in 2006¹.
- Approximately 57,000 of the loans received at least one modification as of June 2016.
- To compare the Fannie Mae Flex Modification program to its predecessor programs, we evaluated each of the approximately 57,000 modified loans under the Fannie Mae Flex Modification structure and eligibility guidelines as if the program were available at the time of the predecessor loan modification.

¹ Loans originated in Puerto Rico and the U.S. Virgin Islands were excluded for purposes of this analysis.



In the 2006 vintage, out of the nearly 57,000 loans that received a modification as of June 2016, approximately 93 percent of the modifications resulted in the reduction of the monthly principal and interest payment, with an average monthly payment reduction of just over 30 percent. Most of the payment concession provided to the borrowers in this vintage was achieved by providing reductions on the monthly interest amount, resulting in an average interest rate reduction of 2.76 percent (6.45 percent down to 3.69 percent).

Table 2 compares the actual modification for this cohort of loans with the outcome that these loans would have experienced if they were to have been modified with the Fannie Mae Flex Modification Program. Based on this comparison, the Fannie Mae Flex Modification is consistent with legacy modification programs in terms of eligibility and payment reduction. For the same loans,

1. It is estimated that the Fannie Mae Flex Modification would have reduced the monthly principal and interest (P&I) payment for over 99 percent, or nearly all, of the borrowers.
2. The average payment reduction would be similar to what the borrowers actually received. The key difference is that while the predecessor modifications relied primarily on interest rate concession to achieve the payment reduction, the Fannie Mae Flex Modification payment reduction was driven by both of the following:
 - a. The use of both term extension (all borrowers in this analysis received a 480 month term).
 - b. An increased use of forbearance (53.9 percent versus 20.9 percent).

Table 2. Loan modification comparison: Actual vs Flex Modification

		Predecessor Modification	Flex Modification	
Population	Loan count	56,998	56,998	
	Percent with P&I payment reduction	92.8%	↑ 99.5%	1
Average principal & interest payment	Pre-modification	\$1,633	\$1,633	
	Post-modification	\$1,118	\$1,097	
	% change	-31.52%	↑ -32.90%	2
Average note rate	Pre-modification	6.45%	6.45%	
	Post-modification	3.69%	↑ 4.85%	
Average term	Pre-modification	304	304	
	Post-modification	392	↑ 480	2a
Average forbearance amount*	Unpaid Principal Balance	\$9,150	\$20,874	

*The denominator for Average forbearance amount is inclusive of 56,998 loans in the analysis, regardless of whether or not they received principal forbearance.

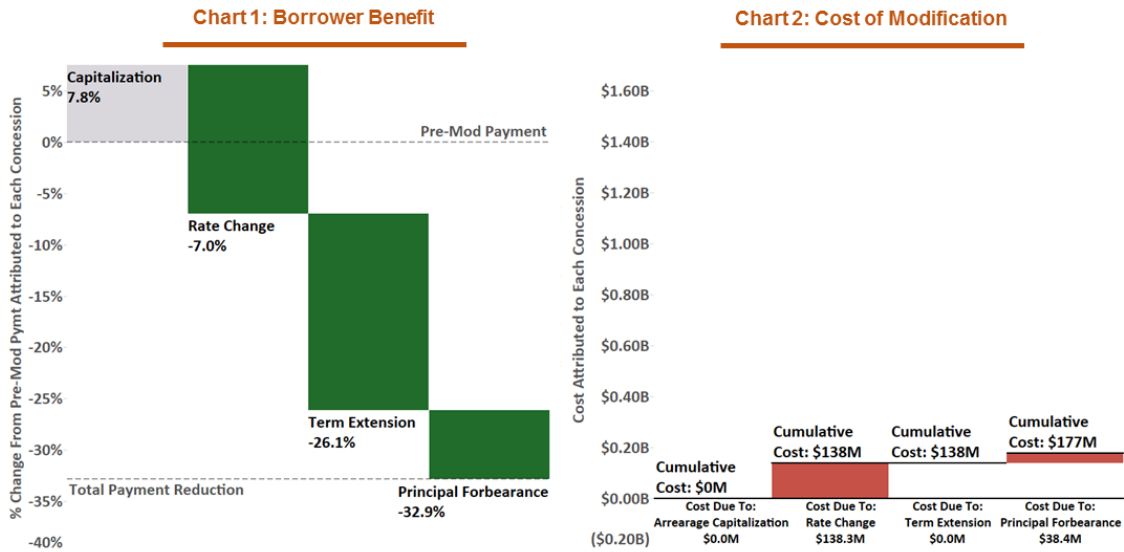
Arrows denote change relative to actual modifications received in predecessor programs for the given population



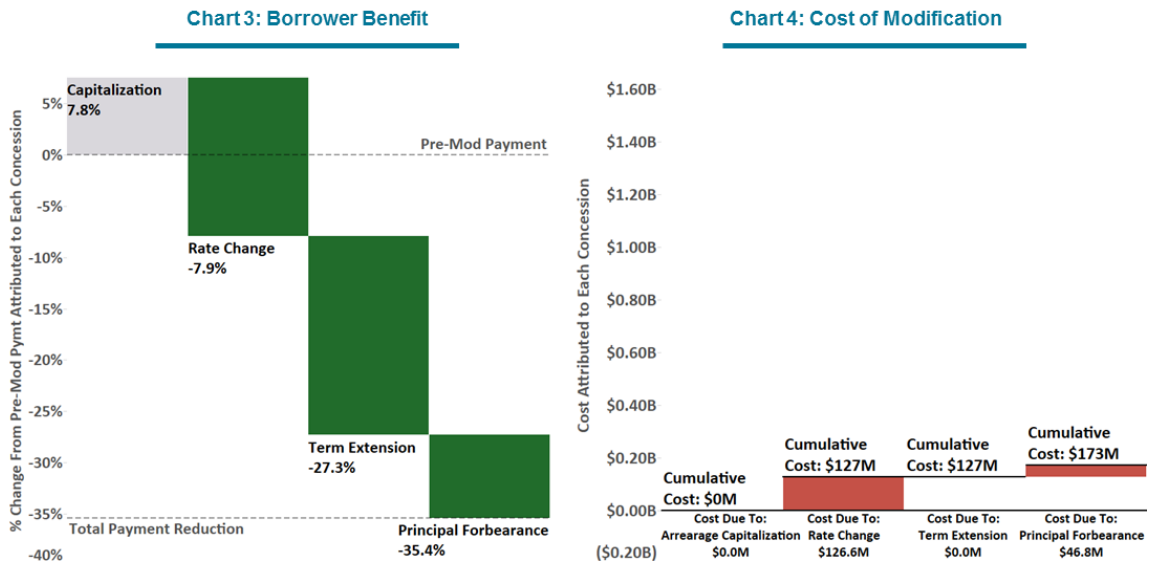
The charts on this page and the following page illustrate the payment reduction benefit to borrowers, as well as the cost of the modification for the respective modification programs.

Charts 1 through 4 illustrate the comparison between Fannie Mae's Standard and Streamlined Modification programs and the Fannie Mae Flex Modification. The charts demonstrate that the Fannie Mae Flex Modification provides an all-in payment reduction that is slightly higher than that of the Standard and Streamlined modifications. This is a result of the interest rate logic in the Fannie Mae Flex Modification, which reduces the interest rate to the lesser of the current note rate or the standard modification rate. The Standard and Streamlined modification programs adjusted the interest rate to the standard modification rate, which at times could have been higher than the current note rate.

Fannie Mae Standard/Streamlined Modification



Fannie Mae Flex Modification

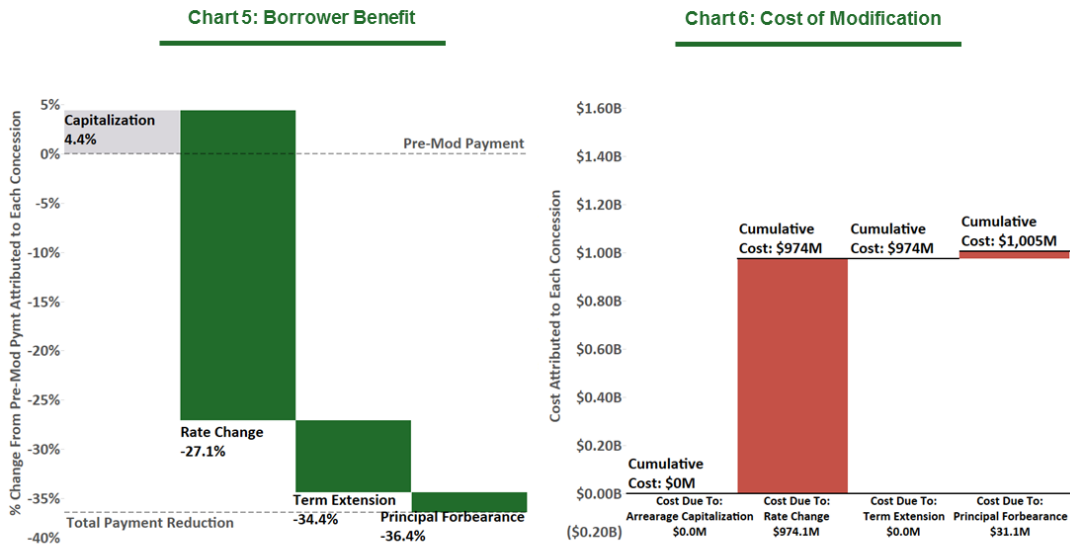


Cost analysis performed in cumulative terms, not reflective of the time value of money.

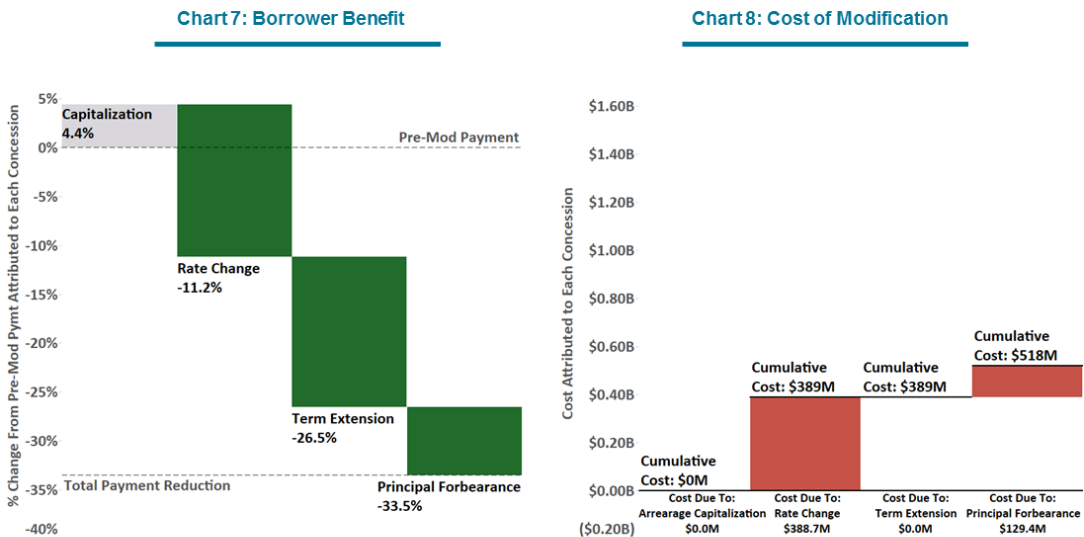


Charts 5 through 8 illustrate the comparison between Fannie Mae's HAMP and the Fannie Mae Flex Modification. Specifically, charts 5 and 6 demonstrate that the reduction in interest rate in the Fannie Mae HAMP program provides the largest borrower benefit related to payment reduction, as well as the largest cost of modification. This is a result of the waterfall logic, whereby in HAMP the first step in the waterfall was a note rate reduction provided to borrowers to as low as 2 percent in order to help achieve a 31 percent debt-to-income target ratio. Charts 7 and 8 illustrate that in the Fannie Mae Flex Modification, the removal of the waterfall results in pulling the interest rate, term, and forbearance levers at the same time, generating a payment reduction benefit for the borrower across all three levers and spreading the cost of the modification across these same levers but resulting in an equally effective modification with lower costs. Note that arrearage capitalization and term extension do not generate explicit modification costs.

Fannie Mae HAMP



Fannie Mae Flex Modification



Cost analysis performed in cumulative terms, not reflective of the time value of money.

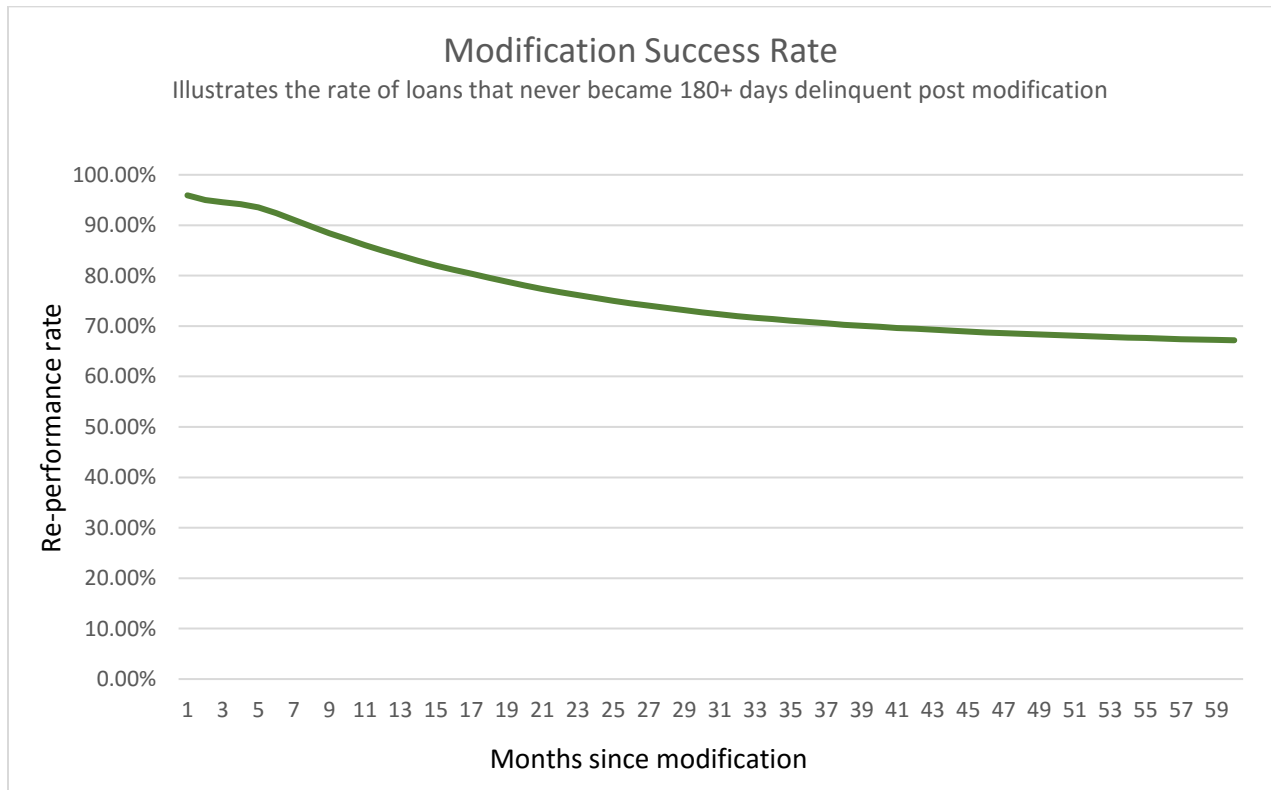


Re-performance expectations

As a result of similar levels of payment reduction relative to the predecessor programs, it can be expected that had these borrowers received a Fannie Mae Flex Modification the performance would have been similar to what was actually experienced².

While the 2006 origination vintage provides the opportunity to evaluate a large population of loans that experienced stressful economic scenarios and a long time window to evaluate performance, these loans have higher note rates than what is seen in more recent vintages. In analyzing the Fannie Mae Flex Modification using a lower note rate, and as such seeing less payment reduction impact from a reduction in note rate, we observe that the program achieves an equally effective modification solution by using a combination of multiple levers (interest rate, term, and forbearance).

Figure 3. Re-performance expectations of the Fannie Mae Flex Modification assuming similar levels of payment reduction relative to predecessor programs – ever 180 day delinquent



Summary

The Fannie Mae Flex Modification Program was designed as a proactive modification solution, replacing Fannie Mae's HAMP and Standard and Streamlined Modifications and enabling Fannie Mae to be responsive to any future housing crisis, similar to that from the 2006-2008 timeframe. The features of the Fannie Mae Flex Modification program will result in broad coverage, helping a large population of borrowers and offering similar principal and interest payment reductions for those borrowers relative to the predecessor programs. The Fannie Mae Flex Modification is designed to be a cost-effective solution, putting borrowers in the best position to succeed while limiting the modification costs to taxpayers, investors, and to Fannie Mae.

² The United States Treasury whitepaper, [Comparing the Performance of Home Affordable Modification Program \(HAMP\) Modifications and Non-HAMP Modifications: Early Results](#) examines the correlation between payment reduction and mortgage loan re-performance.



Additional resources

[Frequently Asked Questions](#)

[Lender Letter 2016-06](#)

[Fannie Mae's Single-Family Loan Performance Database](#) Our historical research dataset consisting of over 23 million loans, to enable market participants to analyze Fannie Mae's loan-level credit performance.

[Data Dynamics™](#) Fannie Mae's credit risk-sharing data analytics web tool, designed to allow users to interact with and analyze the historical loan performance data, deal issuance data, and ongoing disclosure data that Fannie Mae makes available to support our credit risk-sharing programs.

Contact information

Investors may contact Fannie Mae's Investor Help line at 1-800-2FANNIE, Option 2 or via [e-mail](#) with any questions.

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