

## ***Lender Letter LL-2016-02***

April 14, 2016

**To: All Fannie Mae Single-Family Servicers**

### **Fannie Mae Principal Reduction Modification**

Fannie Mae is introducing a new mortgage loan modification program, the Fannie Mae Principal Reduction Modification, as directed by the Federal Housing Finance Agency and jointly developed with Freddie Mac in order to help seriously delinquent underwater borrowers recover from home value depreciation that occurred as a result of the housing crisis. The Fannie Mae Principal Reduction Modification offers principal reduction and targets mortgage loans with negative equity that are at least 90 days delinquent as of March 1, 2016, and meet the eligibility requirements provided below.

This *Lender Letter* covers the following parameters for the Fannie Mae Principal Reduction Modification:

- Effective Date
- Fannie Mae Streamlined Modification Solicitations Prior to Implementation
- Determining Eligibility for a Fannie Mae Principal Reduction Modification
- Verifying a Disputed Occupancy Status
- Determining the Fannie Mae Principal Reduction Modification Terms
- Soliciting a Borrower for a Fannie Mae Principal Reduction Modification
- Handling a Complete Borrower Response Package
- Handling an Active Trial Period Plan
- Sending the Fannie Mae Principal Reduction Modification Opt-Out Letter
- Preparing the Loan Modification Agreement for Fannie Mae Principal Reduction Modifications
- Executing and Recording the Loan Modification Agreement with Principal Reduction
- Completing the Principal Reduction
- Mortgage Insurer Approval
- Handling a Payoff Request After a Fannie Mae Principal Reduction Modification Offer
- Incentive Fees
- Issuing IRS Form 1099-C for Cancelled Debt

The Fannie Mae Principal Reduction Modification generally follows the processing requirements of Fannie Mae Streamlined Modification. Except as described in this *Lender Letter*, the servicer must follow the Fannie Mae Streamlined Modification requirements in the *Servicing Guide*:

- *Servicing Guide D2-3.2-08, Fannie Mae Streamlined Modification* for the following:
  - *Determining Eligibility for a Texas 50(a)(6) loan*

- *Performing an Escrow Analysis*
- *Handling a Borrower Response Package if Received*
- *Offering a Trial Period Plan and Completing a Fannie Mae Streamlined Modification*
- *Handling Fees and Late Charges in Connection with a Fannie Mae Streamlined Modification*
- *Servicing Guide F-1-24, Processing a Fannie Mae Streamlined Modification* for the following:
  - *Obtaining a Property Valuation*
  - *Preparing the Loan Modification Agreement*
  - *Executing and Recording the Loan Modification Agreement*
  - *Adjusting the Mortgage Loan Account Post-Mortgage Loan Modification*

**Effective Date**

The servicer is encouraged to implement the policies in this *Lender Letter* as soon as possible; however, the servicer must begin evaluating borrowers no later than October 1, 2016. The servicer must not solicit a borrower for the Fannie Mae Principal Reduction Modification after December 31, 2016.

**Fannie Mae Streamlined Modification Solicitations Prior to Implementation**

On or before July 15, 2016, the servicer must send an additional solicitation for a Fannie Mae Streamlined Modification to all eligible borrowers, including any borrower whose mortgage loan is secured by a property located in a MyCity Modification location pursuant to the *Servicing Guide D2-3.2-11, Fannie Mae MyCity Modification*, whose mortgage loan is on the Fannie Mae Principal Reduction Eligible List (described below) and has a post-modification MTMLTV ratio greater than 115%, if the servicer has not already implemented Fannie Mae Principal Reduction Modification by such date.

**Determining Eligibility for a Fannie Mae Principal Reduction Modification**

The servicer must not require a complete Borrower Response Package (BRP) to consider a borrower for a Fannie Mae Principal Reduction Modification. In order to be eligible for a Fannie Mae Principal Reduction Modification, all of the criteria in the following table must be met at the time of evaluation.

✓	<b>Eligibility Criteria for a Fannie Mae Principal Reduction Modification</b>
	<p>The mortgage loan must be on the Fannie Mae Principal Reduction Eligible List, which requires the following as of March 1, 2016:</p> <ul style="list-style-type: none"> <li>▪ The mortgage loan must have an unpaid principal balance (UPB), including any deferred (forborne) principal, of less than or equal to \$250,000, before capitalizing eligible arrearages;</li> <li>▪ the mortgage loan must be at least 90 days delinquent; and</li> <li>▪ the property securing the mortgage loan at origination must not be an investment property.</li> </ul> <p>The Fannie Mae Principal Reduction Eligible List includes all mortgage loans meeting the requirements above and is available on the <a href="#">Fannie Mae website</a>. If a mortgage loan is not included in the Fannie Mae Principal Reduction Eligible List but the servicer believes the mortgage loan meets the above criteria, the servicer must evaluate the mortgage loan for</p>

✓	<b>Eligibility Criteria for a Fannie Mae Principal Reduction Modification</b>
	all eligibility requirements within this table and submit a request to Fannie Mae through HSSN for approval.
	The mortgage loan must have a post-modification MTMLTV ratio greater than 115%.
	The mortgage loan must be a conventional first lien mortgage loan.
	The mortgage loan must be at least 30 days delinquent on the evaluation date.
	The property securing the mortgage loan may be vacant or condemned.
	The mortgage loan must not have been originated less than 12 months prior to the evaluation date.
	The mortgage loan must not have been previously modified in accordance with the <i>Servicing Guide D2-3.2-05, Fannie Mae Standard Modification</i> , and become 60 days or more delinquent within 12 months of the modification effective date without being reinstated.
	The mortgage loan must not have been modified three or more times previously, regardless of the mortgage loan modification program or dates of prior mortgage loan modifications.
	The mortgage loan must not be subject to: <ul style="list-style-type: none"> <li>▪ a recourse or indemnification arrangement under which Fannie Mae purchased or securitized the mortgage loan or that was imposed by Fannie Mae after the mortgage loan was purchased or securitized;</li> <li>▪ an approved liquidation workout option;</li> <li>▪ an active and performing forbearance plan or repayment plan, unless otherwise directed by Fannie Mae;</li> <li>▪ a current offer for another mortgage loan modification or other workout option, except as described in <a href="#">Handling an Active Trial Period Plan</a>; or</li> <li>▪ an active and performing Trial Period Plan, except as described in <a href="#">Handling an Active Trial Period Plan</a>.</li> </ul>
	The property must not have a scheduled foreclosure sale date within 60 days of the evaluation date if the property is in a judicial state, or within 30 days of the evaluation date if the property is in a non-judicial state.
	The borrower must not have previously defaulted on a Fannie Mae Streamlined Modification Trial Period Plan or a Fannie Mae Streamlined Modification.
	The borrower must not have failed a Trial Period Plan under a Fannie Mae Standard Modification in accordance with the <i>Servicing Guide D2-3.2-05, Fannie Mae Standard Modification</i> , within 12 months of being evaluated for eligibility for a Fannie Mae Principal Reduction Modification.
	The mortgage loan must not be on the most recent Fannie Mae Non-Eligible List at the time the servicer is evaluating eligibility for solicitation. <p style="margin-left: 20px;">NOTE: The servicer must check a mortgage loan against Fannie Mae's most recent Non-Eligible List prior to sending the borrower an initial or subsequent <a href="#">Fannie Mae Principal Reduction Modification Solicitation Letter</a>. If a mortgage loan is on Fannie Mae's Non-Eligible</p>

✓	<b>Eligibility Criteria for a Fannie Mae Principal Reduction Modification</b>
	List, the servicer must pursue receipt of the BRP to evaluate the borrower for another workout option in accordance with the requirements in the <i>Servicing Guide</i> .

If the borrower is not eligible for principal reduction in accordance with the requirements of this *Lender Letter* and the servicer determines that there are acceptable mitigating circumstances that should be considered by Fannie Mae, the servicer must submit a request to Fannie Mae through HSSN for approval.

### **Verifying a Disputed Occupancy Status**

The servicer must obtain a recent credit report for the borrower to verify a disputed occupancy status. The following table describes the servicer's actions after reviewing the borrower's credit report.

<b>If the current property address on the credit report is ...</b>	<b>Then the servicer...</b>
the borrower's current principal residence	is authorized to rely solely on the address indicated on the credit report to verify the property is not an investment property.
not the borrower's current principal residence	must perform additional due diligence to determine whether the property is not an investment property.

### **Determining the Fannie Mae Principal Reduction Modification Terms**

The servicer must determine the borrower's new modified mortgage loan terms by taking the steps in the following table. The first four steps are the same as a Fannie Mae Streamlined Modification.

<b>Step</b>	<b>Action</b>
1	<p>Capitalize eligible arrearages. The following are considered as acceptable arrearages for capitalization:</p> <ul style="list-style-type: none"> <li>▪ accrued interest,</li> <li>▪ out-of-pocket escrow advances to third parties,</li> <li>▪ any required escrow advances that will be paid to third parties by the servicer during the Trial Period Plan, and</li> <li>▪ servicing advances paid to third parties in the ordinary course of business and not retained by the servicer, if allowed by state laws.</li> </ul> <p>NOTE: If applicable state law prohibits capitalization of past due interest or any other amount, the servicer must collect such funds from the borrower over a period not to exceed 60 months unless the borrower decides to pay the amount upfront. Late charges may not be capitalized and must be waived if the borrower satisfies all conditions of the Trial Period Plan.</p>

Step	Action
	See <i>Administering an Escrow Account in Connection With a Mortgage Loan Modification</i> in the <i>Servicing Guide B-1-01, Administering an Escrow Account and Paying Expenses</i> for additional information.
2	Set the interest rate to the current Fannie Mae Standard Modification Interest Rate.
3	<p>Extend the term to 480 months from the modification effective date.</p> <p>NOTE: When the mortgage loan is secured by a property where the title is held as a leasehold estate, the term of the leasehold estate must not expire prior to the date that is five years beyond the new maturity date of the modified mortgage loan. In the event that the current term of the leasehold estate would expire prior to such date, the term of the leasehold estate must be renegotiated to satisfy this requirement for the mortgage loan to be eligible for the mortgage loan modification.</p>
4	<p>Forbear principal in an amount that is the lesser of:</p> <ul style="list-style-type: none"> <li>▪ an amount that would create a post-modified MTMLTV ratio of 115% using the interest-bearing principal balance, or</li> <li>▪ 30% of the gross post-modified UPB of the mortgage loan.</li> </ul>
5	<p>Cancel the amount of deferred principal balance no later than 90 days after receipt of the executed Loan Modification Agreement from the borrower if the borrower has not opted out of the Fannie Mae Principal Reduction Modification as described in the <a href="#">Sending the Fannie Mae Principal Reduction Modification Opt-Out Letter</a> section below.</p>

The Fannie Mae Principal Reduction Modification must result in a fixed-rate mortgage loan with a monthly P&I payment that is less than or equal to the borrower's current contractual P&I payment obligation.

### ***Soliciting a Borrower for a Fannie Mae Principal Reduction Modification***

Within 15 days of the servicer's implementation of the program, but no later than October 15, 2016, the servicer must mail the [Fannie Mae Principal Reduction Modification Solicitation Letter](#) with an [Evaluation Notice](#) to an eligible borrower who is not in an active Trial Period Plan as described in [Handling an Active Trial Period Plan](#), including any borrower whose mortgage loan is secured by a property located in a MyCity Modification location pursuant to the *Servicing Guide D2-3.2-11, Fannie Mae MyCity Modification*.

For purposes of the Fannie Mae Principal Reduction Modification, the servicer must use the *Fannie Mae Streamlined Modification Trial Period Plan Notice – Based on MTMLTV Ratio Greater Than or Equal to 80% Trial Period Plan Evaluation Notice*. Use of the model letter is optional; however, it reflects a minimum level of information that the servicer must communicate and illustrates a level of specificity that complies with the requirements of the *Servicing Guide* and this *Lender Letter*. The servicer that elects to use the model letter must revise it as necessary to comply with applicable law. The servicer is authorized to continue proactive solicitation for a Fannie Mae Principal Reduction Modification at its discretion within the terms of this *Lender Letter* provided that all [Fannie Mae Principal Reduction Modification Solicitation Letters](#) are sent on or before December 31, 2016.

## Handling a Complete Borrower Response Package

The servicer must process a BRP in accordance with the *Servicing Guide* and applicable law. If the servicer receives a complete BRP from the borrower during the Principal Reduction Trial Period Plan, the servicer must evaluate the borrower for another Fannie Mae mortgage loan modification in accordance with *Fannie Mae's Workout Hierarchy*.

## Handling an Active Trial Period Plan

A borrower in an active Trial Period Plan for another Fannie Mae mortgage loan modification with a first Trial Period Plan payment due date on or after May 1, 2016 but no later than December 1, 2016 is eligible to have the UPB reduced in an amount equal to the deferred principal balance. The servicer must send the borrower the [Fannie Mae Principal Reduction Modification Opt-Out Letter](#) as described herein, provided:

- the mortgage loan is on the Fannie Mae Principal Reduction Eligible List;
- the mortgage loan has a post-modification MTMLTV ratio greater than 115%;
- the Trial Period Plan includes principal forbearance in accordance with the requirements of the applicable mortgage loan modification program; and
- the borrower successfully completes the Trial Period Plan and executes and returns the Loan Modification Agreement.

## Sending the Fannie Mae Principal Reduction Modification Opt-Out Letter

The following table provides the servicer's requirements for sending the [Fannie Mae Principal Reduction Modification Opt-Out Letter](#).

If the borrower ...	The servicer must...
starts a Trial Period Plan in connection with a <a href="#">Fannie Mae Principal Reduction Modification Solicitation Letter</a>	send the <a href="#">Fannie Mae Principal Reduction Modification Opt-Out Letter</a> no later than 30 days after the receipt of the executed Loan Modification Agreement from the borrower.
is in an active Trial Period Plan in connection with another Fannie Mae modification (as described in <a href="#">Handling an Active Trial Period Plan</a> )	send the <a href="#">Fannie Mae Principal Reduction Modification Opt-Out Letter</a> the later of: <ul style="list-style-type: none"><li>▪ 30 days after implementation, or</li><li>▪ 30 days after receipt of the executed Loan Modification Agreement from the borrower.</li></ul>

NOTE: For a borrower in an active Trial Period Plan for another Fannie Mae mortgage loan modification (as described in [Handling an Active Trial Period Plan](#)) the servicer must send the [Fannie Mae Principal Reduction Modification Opt-Out Letter](#) no later than December 31, 2016. In all instances the servicer is authorized to send the [Fannie Mae Principal Reduction Opt-Out Letter](#) earlier than as required above.

If the servicer sends the [Fannie Mae Principal Reduction Modification Opt-Out Letter](#) prior to determining the final deferred principal balance, the servicer must specify in the [Fannie Mae Principal Reduction Modification](#)

[Opt-Out Letter](#) that the amount of deferred principal balance provided in the [Fannie Mae Principal Reduction Modification Opt-Out Letter](#) is an estimate, and the precise amount of deferred principal balance will be stated in the Loan Modification Agreement when the mortgage loan is permanently modified. [The Fannie Mae Principal Reduction Modification Opt-Out Letter](#) includes alternative language reflective of this notification requirement.

Use of the model opt-out letter is optional; however, it reflects a minimum level of information that servicer must communicate and illustrates a level of specificity that complies with the requirements of this *Lender Letter*. The servicer that elects to use the model opt-out letter must revise it as necessary to comply with applicable law.

The servicer must allow the borrower 30 days to call or write the servicer to exercise their right to opt out of principal reduction. If the borrower elects to opt out of principal reduction, the servicer must not cancel the deferred principal balance, which continues to be due and payable in accordance with the Loan Modification Agreement.

### ***Preparing the Loan Modification Agreement for Fannie Mae Principal Reduction Modifications***

The servicer must complete the Loan Modification Agreement in accordance with the *Servicing Guide F-1-24, Preparing the Loan Modification Agreement*. The servicer must incorporate into the [Loan Modification Agreement \(Form 3179\)](#) the applicable provisions relating to the deferred principal balance in accordance with the requirements in [Summary: Modification Agreement Form 3179](#).

### ***Executing and Recording the Loan Modification Agreement with Principal Reduction***

The servicer must ensure that a mortgage loan modified with principal reduction pursuant to this *Lender Letter* complies with applicable laws, preserves Fannie Mae's lien position, and is enforceable against the borrower as required by the *Servicing Guide*, taking into consideration cancellation of the deferred principal balance associated with the modification.

### ***Completing the Principal Reduction***

The deferred principal balance relating to the Fannie Mae Principal Reduction Modification Trial Period Plan, or other active Trial Period Plan as described in [Handling an Active Trial Period Plan](#), must be cancelled following conversion to the permanent mortgage loan modification if the borrower does not opt out of the principal reduction in accordance with this *Lender Letter*. Upon completion of the mortgage loan modification, the servicer must notify Fannie Mae of the cancellation of the deferred principal balance by submitting a case into HSSN no later than 90 days from receipt of the fully executed Loan Modification Agreement.

### ***Mortgage Insurer Approval***

For purposes of the Fannie Mae Principal Reduction Modification, the servicer must refer to *Servicing Guide F-2-07, Mortgage Insurer Delegations for Workout Options*, for the list of conventional mortgage insurers from which Fannie Mae has obtained delegation of authority on behalf of all servicers. The Streamlined Modification delegations also apply to the Fannie Mae Principal Reduction Modification.

If the terms of the mortgage loan modification require Fannie Mae's prior written approval, the servicer must request the mortgage insurer's approval, if required, after receiving notification of Fannie Mae's terms and conditions through HSSN.

### ***Handling a Payoff Request after a Fannie Mae Principal Reduction Modification Offer***

The servicer must provide payoff statements in accordance with the *Servicing Guide C-1.2-03, Processing Payments in Full*. Mortgage loan payoff statements do not include the impact of principal reduction until the Loan Modification Agreement has been executed by the borrower, received by the servicer and the borrower has made their opt-out selection.

### ***Incentive Fees***

The servicer is eligible for incentive fees in accordance with *Servicing Guide F-2-03, Incentive Fees for Workout Options* as described for a Fannie Mae Streamlined Modification.

### ***Issuing IRS Form 1099-C for Cancelled Debt***

The Servicers must complete the appropriate reporting to the IRS in accordance with *Servicing Guide C-4.2-01, Filing IRS Forms 1099-A, 1099-C and 1099-MISC and F-1-34, Reporting to Third Parties*.

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The servicer should contact its Servicing Consultant, Portfolio Manager, or Fannie Mae's Single-Family Servicing Servicer Support Center at 1-800-2FANNIE (1-800-232-6643) with any questions regarding this *Lender Letter*.

Malloy Evans  
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