Lender Letter (LL-2024-02)

Updated Oct. 2, 2024

To: All Fannie Mae Single-Family Servicers
Updates to Determining the Flex Modification Terms

We remain committed to ensuring our retention workout options provide appropriate borrower assistance regardless of the economic environment. Accordingly, we are updating the steps for determining the Fannie Mae Flex Modification terms in alignment with Freddie Mac and at the direction of FHFA. The updates expand eligibility by revising the mark-to-market loan-to-value (MTMLTV) based requirements and provide more equitable payment reduction to eligible borrowers by applying the terms incrementally and targeting a 20% P&I payment reduction. In accordance with these policy updates, we are also publishing revised Evaluation Notices that must be implemented as of the effective date below.

Oct. 2, 2024

We are clarifying that when determining the final Fannie Mae Flex Modification terms, the servicer must use the same interest rate as established when determining the terms for the Trial Period Plan.

This clarification is effective upon the servicer's implementation of the updated Fannie Mae Flex Modification policy in accordance with this Lender Letter.

This Lender Letter contains

- Updates to the Fannie Mae Flex Modification terms
- Appendix

With the exception of the updates in this Lender Letter that replace the referenced Guide policy, the servicer must otherwise refer to the existing requirements in *Servicing Guide* D2-3.2-06, Fannie Mae Flex Modification and F-1-27, Processing a Fannie Mae Flex Modification for evaluating, processing, and completing a Fannie Mae Flex Modification. Additionally, when we update the *Servicing Guide* with the revised steps, we will replace the term "interim month" with "processing month" in relation to a Fannie Mae Flex Modification to align the terminology with that used for payment deferral.

Effective: As early as Nov. 1, 2024, but no later than Dec. 1, 2024, servicers must determine the borrower's new modified mortgage loan terms for a Fannie Mae Flex Modification in accordance with this Lender Letter. Once implemented, the servicer must offer the Fannie Mae Flex Modification to all eligible borrowers according to the requirements in this Lender Letter. These policy changes will be reflected in the November 2024 *Servicing Guide* update.

Updates to the Fannie Mae Flex Modification terms

The following updates will replace the referenced Guide policy in its entirety upon the effective date described above. While only the steps for determining the new modified mortgage loan terms are being updated, we included other related policies as they will appear in the Guide update for clarity.

Determining the Fannie Mae Flex Modification Terms in D2-3.2-06, Fannie Mae Flex Modification

The servicer must follow the procedures in *Obtaining a Property Valuation* in F-1-27, Processing a Fannie Mae Flex Modification and *Determining the New Modified Mortgage Loan Terms* below for determining the property value and determining the borrower's new modified mortgage loan terms, including calculating the post-modification MTMLTV.

Also see A4-2.1-07, Servicer's Duties and Responsibilities Related to Mortgage Loans with an Outstanding Non-Interest-Bearing Balance for additional information.

The following table lists additional Fannie Mae Flex Modification criteria that must be met when determining the borrower's new modified mortgage loan terms.

<table>
<tr><th>✓</th><th colspan="2">The Fannie Mae Flex Modification must result in...</th></tr>
<tr><td></td><td colspan="2">A fixed rate mortgage loan.

NOTE: An ARM or interest-only mortgage loan must be converted to a fully amortizing mortgage loan and may not be a biweekly or daily simple interest mortgage loan.</td></tr>
<tr><td rowspan="4"></td><td colspan="2">A monthly P&I payment as described in the following table.</td></tr>
<tr><td>If at the time of evaluation the mortgage loan is...</td><td>Then the monthly P&I payment must be...</td></tr>
<tr><td>current or less than 31 days delinquent</td><td>less than the borrower's pre-modification P&I payment.</td></tr>
<tr><td>31 or more days delinquent</td><td>less than or equal to the pre-modification P&I payment.</td></tr>
</table>

Prior to granting a permanent mortgage loan modification, the servicer must place the borrower in a Trial Period Plan using the new modified mortgage loan terms.

The servicer must request our prior written approval through our servicing solutions system to deviate from the prescribed steps for determining the new modified mortgage payment terms, unless a certain step is prohibited by applicable state law.

When the servicer submits a request through Fannie Mae's servicing solutions system for our approval of a Fannie Mae Flex Modification based on the borrower's submission of a BRP, in accordance with applicable law it must

- immediately provide the borrower with notice of the right to receive a copy of all appraisals and other valuations developed in connection with the mortgage loan modification, and
- provide the borrower a copy of all appraisals and other valuations developed in connection with the mortgage loan modification.

Determining the New Modified Mortgage Loan Terms in F-1-27, Processing a Fannie Mae Flex Modification Updated Oct. 2, 2024

The servicer must determine the borrower's new modified mortgage loan terms in accordance with *Determining the Fannie Mae Flex Modification Terms* above and the requirements below.

The servicer must determine the post-modification MTMLTV ratio, which is defined as the gross UPB of the mortgage loan including capitalized arrearages, divided by the current value of the property.

In order to determine the borrower’s new modified mortgage loan terms, the servicer must apply the steps in the order shown in the following table, unless prohibited by applicable law, until the earlier of

- achieving a 20% P&I payment reduction target, or
- exhausting the steps for determining the Fannie Mae Flex Modification terms.

NOTE: *With regard to achieving the 20% P&I payment reduction target, the servicer must apply the increment or amount as described in each step of the following table to result in a payment reduction that exceeds but is as close as possible to 20% (e.g., 20.01%). Refer to the Appendix for examples on achieving the 20% P&I payment reduction target.*

NOTE: *When determining the final Fannie Mae Flex Modification terms prior to granting the permanent mortgage loan modification, the servicer must use the same interest rate as established when determining the terms for the Trial Period Plan.*

<table>
<tr><th>Step</th><th>Action</th></tr>
<tr><td>1</td><td>Capitalize eligible arrearages. The following are considered as acceptable arrearages for capitalization:

accrued interest;
out-of-pocket escrow advances to third parties, provided they are paid prior to the effective date of the mortgage loan modification;
servicing advances paid to third parties in the ordinary course of business and not retained by the servicer, provided they are paid prior to the effective date of the mortgage loan modification, if allowed by state laws; and
any outstanding non-interest bearing balance from a previously completed loan modification or a previously completed payment deferral.

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 up-front. Late charges may not be capitalized and must be waived if the borrower satisfies all conditions of the Trial Period Plan.

See Administering an Escrow Account in Connection With a Mortgage Loan Modification in B-1-01, Administering an Escrow Account and Paying Expenses for additional information.</td></tr>
<tr><td>2</td><td>Set the interest rate to a fixed rate based on the requirements in the following table.
<table>
<tr><th>If the mortgage loan is…</th><th>Then the servicer must…</th></tr>
<tr><td>a fixed rate (including an ARM or step-rate that has reached its final step)</td><td>set the interest rate to the contractual interest rate in effect for the periodic payment due in the month of the evaluation date.</td></tr>
<tr><td>an ARM or step-rate that has not reached its final interest rate</td><td>set the interest rate to the greater of

the contractual interest rate in effect for the periodic payment due in the month of the evaluation date, or
the Fannie Mae Modification Interest Rate.

NOTE: If the Fannie Mae Modification Interest Rate exceeds the lifetime interest rate cap of the ARM or the final interest rate for the step-rate, then the servicer must set the contractual interest rate to the lifetime interest rate cap for the ARM or the final interest rate for the step-rate, as applicable.</td></tr>
</table>
</td></tr>
</table>

3	If the mortgage loan has a post-modification MTMLTV greater than or equal to 50% and the interest rate as determined in step 2 is greater than the Fannie Mae Modification Interest Rate, then the servicer must reduce the rate in 0.125% increments until the earlier of ▪ achieving the 20% P&I payment reduction target, or ▪ reaching the Fannie Mae Modification Interest Rate. ***NOTE:*** *In instances where the 20% P&I payment reduction target has not yet been achieved but applying a full 0.125% increment would set the modified interest rate to a rate below the Fannie Mae Modification Interest Rate, the servicer must apply a partial rate reduction increment (i.e., an amount less than 0.125%) to reach the Fannie Mae Modification Interest Rate. Refer to the Appendix for examples on applying the interest rate reduction increments.*
4	Extend the term in monthly increments until the earlier of ▪ achieving the 20% P&I payment reduction target, or ▪ reaching a term that is 480 months from the mortgage loan modification effective date. ***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.*
5	Forbear principal if the post-modification MTMLTV ratio is greater than 50%, in an amount that is the lesser of ▪ an amount that would achieve the 20% P&I payment reduction target, ▪ an amount that would create a post-modification MTMLTV of 50% using the interest-bearing principal balance, or ▪ 30% of the gross post-modification UPB of the mortgage loan. ***NOTE****: Interest must not accrue on any principal forbearance. Principal forbearance is payable upon the earliest of the maturity of the mortgage loan modification, sale or transfer of the property, refinance of the mortgage loan, or payoff of the interest-bearing UPB.*

If the steps are exhausted without achieving the 20% P&I payment reduction target, then the servicer must offer the resulting terms to the borrower provided the monthly P&I payment satisfies the P&I-specific requirements in *Determining the Fannie Mae Flex Modification Terms* above.

Calculating the Housing Expense-to-Income Ratio in F-1-27, Processing a Fannie Mae Flex Modification

This topic has been deleted.

Servicers who have questions about this Lender Letter should contact their Fannie Mae Account Team, Portfolio Manager, or Fannie Mae's Single-Family Servicer Support Center at 1-800-2FANNIE (1-800-232-6643).
Have Guide questions? Get answers to all your policy questions, straight from the source. Ask Poli.

Appendix

Examples Related to Achieving the 20% P&I Payment Reduction Target

Refer to the examples below related to applying the increment or amount to result in a payment reduction that exceeds but is as close as possible to 20%.

Example 1: 20% P&I Payment Reduction Target Achieved Before the Fannie Mae Modification Interest Rate is Reached

Loan Information

Pre-modification P&I: $1,778.50

Pre-modification remaining term: 335 months

Post-capitalization UPB: $250,000

Fannie Mae Modification Interest Rate: 5.00%

Interest rate after completing Steps 1 and 2: 7.625%

P&I after completing Steps 1 and 2: $1,804.76

<table>
<tr><th>Modified Interest Rate</th><th>Modified P&I</th><th>Payment Reduction %</th></tr>
<tr><td>7.625%</td><td>$1,804.76</td><td>N/A – Payment increase</td></tr>
<tr><td colspan="3">Reduce the interest rate in 0.125% increments until the earlier of achieving a 20% payment reduction or reaching the Fannie Mae Modification Interest Rate.</td></tr>
<tr><td>7.500%</td><td>$1,783.74</td><td>N/A – Payment increase</td></tr>
<tr><td colspan="3">Continue to reduce the interest rate in 0.125% increments…</td></tr>
<tr><td>… 5.250%</td><td>$1,423.55</td><td>19.96%</td></tr>
<tr><td>5.125%</td><td>$1,404.63</td><td>21.02%</td></tr>
<tr><td colspan="3">The 20% P&I payment reduction target has been achieved prior to reaching the Fannie Mae Modification Interest Rate. The servicer must offer the resulting terms of the modification to the borrower and must not proceed to Step 4.</td></tr>
</table>

Example 2: 20% P&I Payment Reduction Target is Achieved via Term Extension

Loan Information

Pre-Modification P&I: $1,696.05

Remaining Mortgage Term: 312 months

Post capitalized UPB: $280,000

Modified Interest Rate after completing Step 1-3: 5.00%

P&I after completing Steps 1-3: $1,605.36

Modified Term	Modified P&I	Payment Reduction %
312 Months	$1,605.36	5.35%
Extend the term in monthly increments until the earlier of achieving the 20% P&I payment reduction target or reaching a term that is 480 months from the mortgage loan modification effective date		
313 Months	$1,602.86	5.49%
Continue to increase term in monthly increments…		
…471 Months	$1,358.30	19.91%
472 Months	$1,357.37	19.97%
473 Months	$1,356.45	**20.02%**
The 20% P&I payment reduction target has been achieved. The servicer must offer the resulting terms of the modification to the borrower and must not proceed to Step 5.		

Example 3: 20% P&I Payment Reduction Target is Achieved via Principal Forbearance

Loan Information

Pre-Modification P&I: $1,235.98

Property Value: $321,739.00

Post capitalized UPB: $215,206.50

Modified Interest Rate after completing Step 1-3: 5.125%

Remaining Mortgage Term after completing Step 4: 480 months

P&I after completing Steps 1-4: $1,055.60

Interest Bearing UPB	Forborne Principal	Modified P&I	MTMLTV Ratio – Interest Bearing UPB	Forborne Principal % of gross post-modification UPB	Payment Reduction %
$215,206.50	N/A	$1,055.60	66.69%	N/A	14.59%
Forbear principal in an amount that is the lesser of: an amount that would achieve the 20% P&I payment reduction target, an amount that would create a post-modification MTMLTV of 50% using the interest-bearing principal balance, or 30% of the gross post-modification UPB.					
$201,585.24	$13,621.26	$988.78	62.65%	6.33%	**20.0003%**
A modified P&I of $988.78 achieves a payment reduction that exceeds but is as close as possible to 20% (any modified P&I payment greater than $988.78 fails to achieve the 20% P&I payment reduction target). The servicer must offer the resulting terms of the modification to the borrower.					

Example 4: 20% P&I Payment Reduction Target is Achieved via Principal Forbearance

Loan Information

Pre-Modification P&I: $1,000.00

Property Value: $171,500

Post capitalized UPB: $154,750.00

Modified Interest Rate after completing Step 1-3: 6.875%

Remaining Mortgage Term after completing Step 4: 480 months

P&I after completing Steps 1-4: $947.65

<table>
<tr><th>Interest Bearing UPB</th><th>Forborne Principal</th><th>Modified P&I</th><th>MTMLTV Ratio – Interest Bearing UPB</th><th>Forborne Principal % of gross post-modification UPB</th><th>Payment Reduction %</th></tr>
<tr><td>$154,750.00</td><td>N/A</td><td>$947.65</td><td>90.23%</td><td>N/A</td><td>5.24%</td></tr>
<tr><td colspan="6">Forbear principal in an amount that is the lesser of: an amount that would achieve the 20% P&I payment reduction target, an amount that would create a post-modification MTMLTV of 50% using the interest-bearing principal balance, or 30% of the gross post-modification UPB.</td></tr>
<tr><td>$130,640.19</td><td>$24,109.81</td><td>$800.00</td><td>76.18%</td><td>15.58%</td><td>20.00%</td></tr>
<tr><td colspan="6">At this point, the payment reduction is exactly equal to 20% and additional principal must be forborne to achieve a payment reduction that exceeds but is as close as possible to 20%.</td></tr>
<tr><td>$130,638.56</td><td>$24,111.44</td><td>$799.99</td><td>76.17%</td><td>15.58%</td><td>20.001%</td></tr>
<tr><td colspan="6">A modified P&I of $799.99 achieves a payment reduction that exceeds but is as close as possible to 20% (any modified P&I payment greater than $799.99 fails to achieve the 20% P&I payment reduction target). The servicer must offer the resulting terms of the modification to the borrower.</td></tr>
</table>

Examples Related to Applying the Interest Rate Reduction Increments

Refer to the examples below related to applying the interest rate reduction increments as described in Step 3 to achieve the Flex Modification Payment Reduction Target or reaching the Fannie Mae Modification Interest Rate.

Example 1: Fannie Mae Modification Interest Rate Reached Before 20% P&I Payment Reduction Target is Achieved

Loan Information

Pre-modification P&I: $1,684.75

Pre-modification remaining term: 335 months

Post-capitalization UPB: $250,000

Fannie Mae Modification Interest Rate: 5.00%

Interest rate after completing Steps 1 and 2: 7.150%

P&I after completing Steps 1 and 2: $1,725.41

Modified Interest Rate	Modified P&I	Payment Reduction %
7.150%	$1,725.41	N/A – Payment increase
Reduce the interest rate in 0.125% increments until the earlier of achieving a 20% payment reduction or reaching the Fannie Mae Modification Interest Rate.		
7.025%	$1,704.77	N/A – Payment increase
Continue to reduce the interest rate in 0.125% increments…		
… 5.150%	$1,408.40	16.40%
5.025%	$1,389.58	17.52%
Reduce the interest rate by a partial increment of 0.025% rather than the full 0.125% to reach the Fannie Mae Modification Interest Rate.		
5.00%	$1,385.83	17.74%
The Fannie Mae Modification Interest Rate has been reached prior to achieving the 20% P&I payment reduction target. The servicer must proceed to Step 4.		

Example 2: Fannie Mae Modification Interest Rate Reached and 20% P&I Payment Reduction Target is Achieved

Loan Information

Pre-modification P&I: $1,630.05

Pre-modification remaining term: 335

Post-capitalization UPB: $235,000

Fannie Mae Modification Interest Rate: 5.00%

Interest rate after completing Steps 1 and 2: 7.525%

P&I after completing Steps 1 and 2: $1,680.66

Modified Interest Rate	Modified P&I	Payment Reduction %
7.525%	$1,680.66	N/A – Payment increase
Reduce the interest rate in 0.125% increments until the earlier of achieving a 20% P&I payment reduction or reaching the Fannie Mae Modification Interest Rate.		
7.400%	$1,660.97	N/A – Payment increase
Continue to reduce the interest rate in 0.125% increments…		
… 5.150%	$1,323.90	18.78%
5.025%	$1,306.21	19.87%
Reduce the interest rate by a partial increment of 0.025% rather than the full 0.125% to reach the Fannie Mae Modification Interest Rate.		
5.00%	$1,302.68	20.08%
The Fannie Mae Modification Interest Rate has been reached while also achieving the 20% P&I payment reduction target. In this instance the servicer must offer the resulting terms of the modification to the borrower and must not proceed to Step 4.		