Help for America's Homeowners

MAKING HOME AFFORDABLE℠

Supplemental Directive 10-14 *October 15, 2010*

Making Home Affordable Program – Principal Reduction Alternative Update

In February 2009, the Obama Administration introduced the Making Home Affordable Program (MHA) to stabilize the housing market and help struggling homeowners get relief and avoid foreclosure. In June 2010, the Treasury Department (Treasury) issued Supplemental Directive 10-05, which introduced guidance about the Principal Reduction Alternative (PRA). PRA provides financial incentives to investors that agree to forgive principal for borrowers whose homes are worth significantly less than the remaining amounts owed under their first lien mortgage loans. This guidance is being issued as a new Section 6.4 of Chapter II, *Principal Reduction Alternative*, of the *Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages* (*Handbook)*, which also incorporates and supersedes Supplemental Directive 10-05. In addition, this Supplemental Directive includes the following new guidance:

- Servicers that forgive at least five percent of the borrower's unpaid principal balance in conjunction with a HAMP modification will have new flexibility in the application of the alternative modification waterfall steps, allowing them to substitute principal forgiveness for discounted interest rates or extended terms in accordance with investor guidelines.

- Investors that enter into equity share arrangements with borrowers in conjunction with a PRA modification may be eligible for PRA investor incentives so long as certain borrower protections are included in the equity share agreement. These arrangements provide investors the potential to recoup some or all of the unreimbursed portion of the principal forgiveness if the value of the property increases in the future.

- Guidance is provided regarding PRA consideration of loans that were in trial period plans or permanently modified under HAMP prior to the PRA Effective Date. Servicers are required to develop written policies and procedures that describe the basis on which the servicer will retroactively identify loans potentially eligible for PRA. If the policy permits the retroactive evaluation for PRA, then those loans must be evaluated no later than January 31, 2011.

- Guidance is provided regarding the impact of applying PRA retroactively on second lien mortgage loans through the Second Lien Modification Program (2MP).

This Supplemental Directive provides guidance to servicers of first and second lien mortgage loans that are not owned or guaranteed by Fannie Mae or Freddie Mac, or insured or guaranteed by a federal agency, such as the Federal Housing Administration, Veterans Administration or the Department of Agriculture's Rural Housing Service.

I. NEW HANDBOOK SECTIONS

A. The text below is being inserted in its entirety as Section 6.4 of Chapter II. The substance of Supplemental Directive 10-05 has not changed; however, revisions were made to conform that guidance to the *Handbook*. Text that was not included in Supplemental Directive 10-05 is indicated in italics. Text that is lined through has been deleted from Supplemental Directive 10-05.

6.4 Principal Reduction Alternative

Beginning on ~~the later of (i)~~ October 1, 2010~~; or (ii) the implementation date for version 4.0 of the Base NPV Model~~ (PRA Effective Date), servicers must evaluate any *mortgage* loan that is being considered for HAMP with a mark-to-market LTV ratio greater than 115 percent using both the standard modification waterfall (*as described in Section 6.3)* and the alternative modification waterfall (*as described in Section 6.4.3*), that includes principal reduction as the required second step in the waterfall. When determining the loan's UPB, servicers should include any amounts that would be capitalized in accordance with ~~HAMP guidelines~~ *Section 6.3.1*. *Although servicers are only required to evaluate loans that are being considered for HAMP with a mark-to-market LTV ratio greater than 115 percent for PRA, servicers may evaluate loans with a lower mark-to-market LTV ratio using the alternative modification waterfall.*

The primary purpose of completing the alternative modification waterfall analysis is to demonstrate whether reducing principal on *a mortgage* loan~~s~~ with a mark-to-market LTV ratio~~s~~ greater than 115 percent *will produce a positive NPV* result~~s in a positive NPV~~. However, when making the determination to reduce principal, servicers may, consistent with investor guidelines and contractual obligations, reduce the UPB of a loan to an amount that results in a mark-to-market LTV ratio that is greater or lesser than the 115 percent target ratio in the alternative modification waterfall. Because servicers have this discretion in offering principal reduction, servicers must develop and adhere to a written policy for making principal reduction determinations *(PRA Policy)* that treats all similarly situated loans in a consistent manner and in compliance with ~~fair lending and other applicable laws and regulations~~ *Section 1.6 of Chapter I. If applicable, the PRA Policy must clearly identify if and how the servicer will exercise the option to vary the alternative modification waterfall. Also, if the servicer plans to enter into equity share arrangements, a copy of the arrangement must be included in the PRA Policy. The servicer's written PRA Policy must be provided to MHA-C by January 1, 2011.*

For modifications that include PRA principal reduction, if the UPB established when determining the terms of the permanent modification differs from the UPB used to determine the terms of the TPP, the servicer must, in the permanent modification, grant as PRA principal reduction the lesser of (i) the amount necessary to achieve the mark-to-market LTV generated by the TPP terms or (ii) the amount necessary to achieve the target monthly mortgage payment ratio as established in the TPP. At the time of establishing the permanent modification terms, additional PRA principal reduction may be granted in the servicer's discretion in accordance with investor guidelines.

Investors are eligible for PRA incentives for permanent HAMP modifications utilizing PRA with effective dates on or after June 3, 2010.

All borrowers in a TPP or permanent modification as of the PRA Effective Date must be considered under the procedures in Section 6.4.1.

6.4.1 Retroactive Consideration of Loans Participating in HAMP prior to the PRA Effective Date

Servicers are not required to perform PRA analysis on every loan with a mark-to-market *LTV ratio greater than 115 percent that has been permanently modified or was in a TPP prior to the PRA Effective Date. However, since principal reduction may significantly reduce the re-default risk for some loans, servicers may perform a PRA analysis and use PRA for any loan with a* mark-to-market *LTV ratio greater than 105 percent at the time of the initial NPV evaluation that was permanently modified or in a TPP prior to the PRA Effective Date and not previously evaluated for PRA. Investors will be eligible for PRA incentives for these retroactive PRA modifications in accordance with Section 13.3.4.*

6.4.2 Retroactive PRA Policy

Each servicer must develop a written retroactive PRA evaluation policy (Retroactive PRA Policy), consistent with investor guidelines, that describes the basis on which the servicer will evaluate the use of PRA and cases where it will offer PRA to borrowers who were not evaluated for PRA and received a permanent modification or TPP prior to the PRA Effective Date. The Retroactive PRA Policy may incorporate such factors as mark-to-market LTV, credit score, home price depreciation data, and existing forbearance amounts. The Retroactive PRA Policy may include different criteria than the servicer's PRA Policy. Servicers are not required to evaluate such loans using the alternative modification waterfall. The Retroactive PRA Policy must treat all similarly situated loans in a consistent manner and in compliance with Section 1.6 of Chapter I. Further, if the servicer intends to enter into equity share arrangements, a copy of the equity share agreement that will be issued to the borrower must be included in the Retroactive PRA Policy. The servicer's written Retroactive PRA Policy must be provided to MHA-C by January 1, 2011.

With respect to a loan that was permanently modified or in a TPP prior to the PRA Effective Date and was not previously evaluated for PRA, a servicer may, subject to investor guidance, convert some or all of an existing principal forbearance amount to PRA principal reduction or otherwise offer any amount of PRA principal reduction pursuant as a principal curtailment, but may not change any other terms of the permanent HAMP modification. The servicer must memorialize this arrangement in a notice or agreement sent to the borrower that:

- *Explains how the deferred principal reduction will be applied to the loan;*
- *States that the principal reduction amount will be reported to the IRS in the year in which the curtailment is applied and advises the borrower to seek guidance from a tax professional to determine any potential tax consequences; and*

- *Explains that the borrower may elect not to accept the offered principal reduction and provide opt-out instructions.*

Servicers should, in accordance with investor guidelines, perform a financial analysis to determine if PRA principal reduction on a previously modified loan is in the best interest of the investor. The results of the financial analysis must be documented and retained in the servicing file. The Base NPV Model *is not* *an accurate tool for performing this financial analysis on permanently modified loans.*

If the servicer's Retroactive PRA Policy requires the evaluation of any previously modified loans, then those loans must be evaluated for PRA no later than January 31, 2011.

6.4.3 *Alternative Modification Waterfall*

Under the alternative modification waterfall, servicers use principal reduction between Step 1 – Capitalization and Step 2 – Interest Rate Reduction of the standard modification waterfall. After the servicer has performed Step 1 – Capitalization, the servicer will perform the alternative modification waterfall as follows:

- Reduce the UPB by an amount necessary to achieve either the target monthly mortgage payment ratio or a mark-to-market LTV ratio equal to 115 percent, whichever is reached first;
- If the UPB is reduced to create a mark-to-market LTV ratio of 115 percent and the target monthly mortgage payment ratio has not been achieved (based on a fully amortizing principal and interest payment over the remainder of the current loan term and using the current mortgage interest rate), continue with the standard modification waterfall steps of interest rate reduction, term extension and principal forbearance, each as necessary, until the target monthly mortgage payment ratio is achieved.

6.4.4 *Variation from the Alternative Modification Waterfall Steps*

If principal is forgiven in an amount equal to or greater than five percent of the pre-modification UPB (including any capitalized amounts as described in Section 6.3.1), servicers will have flexibility in the application of subsequent steps in the alternative modification waterfall to either:

- *Elect not to reduce the interest rate all the way down to the two percent interest rate floor before applying a term extension, provided that the servicer must fix the reduced interest rate and treat it as the modified rate for purposes of the Interest Rate Cap; or*
- *Apply term extension before interest rate reduction, provided that, if the interest rate is not reduced, the servicer must fix the existing interest rate and treat it as the modified rate for purposes of the Interest Rate Cap.*

6.4.5 Application of Deferred Principal Reduction

If the loan is modified pursuant to PRA, the principal reduction amount should be initially treated as non-interest bearing principal forbearance (PRA Forbearance Amount). The PRA Forbearance Amount is separate and exclusive of any other forbearance that may be offered in conjunction with a permanent modification.

If the borrower is in good standing on the first, second and third anniversaries of the TPP Effective Date, the servicer must reduce the UPB of the loan on each anniversary date in installments equal to one-third of the initial PRA Forbearance Amount.

If a borrower is in good standing and pays the loan in full (i) at any time more than 30 calendar days after the Modification Effective Date; (ii) after the PRA reporting and payment processes are made available; and (iii) prior to application of the entire PRA Forbearance Amount, the borrower shall immediately be fully vested in and entitled to the unapplied PRA Forbearance Amount as a curtailment. When the servicer receives a payoff request on behalf of a borrower that meets these requirements, the unapplied PRA Forbearance Amount will be deducted from the payoff balance.

6.4.6 *Equity Share Arrangements*

Investors that enter into equity share arrangements with borrowers in conjunction with a PRA modification will be eligible to receive the PRA investor incentive if the equity share arrangement includes the following borrower protections:

- *The borrower is not required to make any equity share payments until the loan is fully satisfied and may not be assessed a pre-payment penalty;*
- *The agreement includes a reasonable method to credit the borrower for the cost of capital improvements;*
- *The borrower is entitled to at least 50 percent of any increase in property value, after credit for the capital improvements, between the date of the permanent modification and the date the loan is fully satisfied;*
- *The investor is only entitled to recover the amount of principal reduction actually applied to the loan balance less the PRA investor incentive; and*
- *A method for independently assessing the value of the property at time of loan satisfaction that is acceptable to both the investor and the borrower. The assessment of the property value at the date of the permanent modification must be the property value obtained by the servicer in accordance with Section 6.8 as part of the evaluation of the borrower for a HAMP modification.*

B. A new Section 10.2 of Chapter II is inserted with the following text:

10.2 Principal Reduction Alternative Documents

The documents for PRA are the same as those required under HAMP. However, the TPP Notice, the Modification Agreement *and the Modification Agreement document summary*~~must be~~ *were* modified to include language regarding the deferred principal reduction terms. This language ~~will be~~ *is* set forth in the revised documents that ~~will be~~ *are* available on www.HMPadmin.com ~~prior to the PRA Effective Date~~. This language ~~will~~ include*s:* ~~a notification to the borrower that principal reduction is reported to the Internal Revenue Service and may have tax consequences. The language will also advise borrowers to seek guidance from a tax professional.~~

- *An explanation of how the deferred principal reduction will be applied to the loan;*
- *A statement that the principal reduction amount will be reported to the IRS in the year in which the curtailment is applied; and*
- *Advice to the borrower to seek guidance from a tax professional to determine any potential tax consequences.*

In addition, the TPP Notice and the Modification Agreement Cover Letter must explain that the borrower may decline any offered principal reduction and include a phone number the borrower may use to decline the offer.

Servicers that offer*ed* permanent modifications utilizing PRA prior to issuance of the revised documents must *have* modif~~y~~*ied* the Modification Agreement to include the deferred principal reduction terms.

C. A new Section 11.5 of Chapter II is inserted with the following text:

11.5 Principal Reduction Alternative Reporting

PRA reporting and payment processes are currently under development by the Program Administrator. Subsequent guidance will be provided describing the PRA reporting and payment processes and when they will be available.

The HAMP Data Dictionary and the HAMP Additional Data Requirements Data Dictionary will be revised to reflect new and modified edits for PRA and will be posted on www.HMPadmin.com.

11.5.1 Interim Period Reporting

The time period between June 3, 2010 and the date the PRA reporting and payment processes are available shall be referred to herein as the Interim Period. Servicers who offer permanent modifications with PRA during the Interim Period will be required to report the transaction to the HAMP Reporting Tool. Any PRA principal reduction on Interim Period loans should be reported in the existing principal write-down field. Servicers should not, however, reduce the UPB by the amount of any PRA principal reduction in the HAMP Reporting Tool for Interim Period loans (though servicers should reduce the UPB by any principal reduction that is not related to PRA). When the PRA reporting and payment processes are implemented, servicers shall submit a correction transaction that will move the PRA principal reduction to a new PRA specific principal forgiveness field. During the Interim Period, servicers must collect and retain PRA specific information so that the necessary data can be reported when the processes become available.

11.5.2 Reporting PRA Retroactively

The following guidance applies to loans where principal reduction is offered after the loan has been permanently modified in accordance with Section 6.4.1.

During the time period between the application of PRA retroactively and the time the system is available to report such a transaction, servicers must hold their reporting of the principal reduction until such time as the system can accept the values.

D. A new Section 12.2.3 of Chapter II is inserted with the following text:

12.2.3 Principal Reduction Alternative Reporting

For loans modified using PRA, when each installment of the PRA Forbearance Amount is applied to the UPB of the loan, the servicer should update the credit repositories with the current balance owed and amend the K4 segment to reflect the reduced UPB.

The "due date" in the K4 Segment should reflect the scheduled maturity date of the permanent modification. However, if the Principal Forbearance Amount no longer applies after the portion of the loan is forgiven, the servicer should no longer report the K4 Segment.

E. A new Section 13.3.4 of Chapter II is inserted with the following text:

13.3.4 Principal Reduction Alternative Investor Incentive Payments

~~Servicers~~ *Investors* will qualify for PRA investor incentive payments for reductions creating a mark-to-market LTV ratio as low as 105 percent, even if *(i)* the reduction results in a monthly mortgage payment ratio below the 31 percent target *or (ii) the pre-modification mark-to-market LTV ratio is greater than 105 percent but less than or equal to 115 percent*. Servicers are not precluded from reducing principal below a 105 percent mark-to-market LTV ratio; however, PRA investor incentives will not be paid on the portion of any principal reduction that reduces the mark-to-market LTV ratio below 105 percent. Additionally, *pursuant to Section 13.3.1*, Investor Payment Reduction Cost Share Incentives will only be paid based on modification terms that reflect the target monthly mortgage payment ratio. PRA investor incentives will only be paid in conjunction with principal reduction that is deferred over three years *in accordance with the requirements of Section 6.4.5*.

13.3.4.1 Principal Reduction Incentive Schedule

Principal Reduction Incentive Schedule:
Per Dollar of UPB Forgiven in Mark-to-Market LTV Ratio Range
(Loans Less than or Equal to Six Months Past Due)

Mark-to-Market LTV Ratio Range		
105% to <115%	**115% to 140%**	**>140%**
0.21	0.15	0.10

With respect to loans that were less than or equal to six months past due at all times during the 12-month period prior to the NPV Date, investors will be entitled to receive $0.21 per dollar of principal reduction equal to or greater than 105 percent and less than 115 percent mark-to-market LTV ratio; $0.15 per dollar of principal reduction equal to or greater than 115 percent and less than or equal to 140 percent mark-to-market LTV ratio; and $0.10 per dollar of principal reduction in excess of 140 percent mark-to-market LTV ratio.

With respect to loans that were more than six months past due at any time during the 12-month period prior to the NPV Date, irrespective of mark-to-market LTV ratio range, investors will be paid $0.06 per dollar of principal reduction and will not be eligible for incentives in the above extinguishment schedule. PRA investor incentive payments will be earned by investors in the month in which the applicable principal reduction amount is actually applied to reduce the borrower's UPB as set forth *in Section 6.4.5*.

13.3.4.2 Interim Period Incentive Compensation

Loans with a pre-modification mark-to-market LTV greater than *105* percent that are permanently modified under HAMP during the Interim Period and include PRA principal reduction may be eligible for PRA investor incentives in compliance with *Section 13.3.4.1* so long as:

- The loan remains in good standing *as defined in Section 9.4* on the implementation date of the PRA reporting and payment processes by the Program Administrator;
- The modification otherwise complies with HAMP requirements;
- The modification terms are accurately entered into the HAMP Reporting Tool at the time of modification *in compliance with the guidance set forth in Section 13.3.4*; and
- When the PRA reporting and payment processes become available, a correction transaction is submitted moving the PRA principal reduction to the new PRA specific principal forgiveness field and all additional PRA specific data retained by the servicer is reported to the HAMP Reporting Tool.

Servicers providing principal reduction during the Interim Period will not be required to perform an alternative NPV evaluation for loans modified prior to the PRA Effective Date. Notwithstanding the foregoing, Interim Period loans that are fully satisfied prior to implementation of the PRA reporting and payment processes are not eligible for PRA investor incentives.

II. Conforming Changes to Existing Handbook Sections

The following guidance amends and supersedes the notated portions of the *Handbook*:

A. The Foreword is replaced in its entirety with the text below. Changed or new text is indicated in italics. Text that has been lined out has been deleted.

In February 2009, the Obama Administration introduced the Making Home Affordable Program, a plan to stabilize the housing market and help struggling homeowners get relief and avoid foreclosure. In March 2009, the Treasury Department (Treasury) issued uniform guidance for loan modifications across the mortgage industry and subsequently updated and expanded that guidance in a series of policy announcements.

The Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages (Handbook) is intended to provide a consolidated resource for programmatic guidance related to the MHA Program for mortgage loans that are not owned or guaranteed by Fannie Mae or Freddie Mac (Non-GSE Mortgages). Servicers of mortgage loans that are owned or guaranteed by Fannie Mae or Freddie Mac should refer to any relevant guidance issued by the applicable GSE.

This Handbook incorporates and supersedes in their entirety the following Supplemental Directives (SDs), as well as related frequently asked questions (FAQs) and waivers: SD 09-01; 09-02; 09-03; 09-04; 09-06; 09-07; 09-08; 09-10; 10-01; 10-02; 10-04; *10-05; and* 10-10. ~~In addition, this Handbook incorporates and supersedes in its entirety the guidance set forth in SD 10-05 under the headings “Servicer Safe Harbor” and “Treatment of Principal Forbearance in HAMP.”~~ Should a servicer identify a discrepancy between this Handbook and a previously issued SD, FAQ or waiver, the servicer should rely on the guidance in this Handbook. Unless otherwise noted, each reference to a “Section” in a Chapter of this Handbook is a reference to the applicable Section of that Chapter.

This Handbook will be expanded in the near future to include policy guidance on related programs, including the Home Affordable Foreclosure Alternatives Program~~,~~ *and* the Second Lien Modification Program ~~Principal Reduction Alternatives~~. Until such expansion, the relevant SDs, FAQs and waivers apply, and any references in such documents to guidance that has been incorporated into this Handbook are deemed to refer to the applicable Chapter and Section of this Handbook containing such guidance. This Handbook constitutes Program Documentation under the Servicer Participation Agreement and is incorporated by reference into the Servicer Participation Agreement.

This Handbook will be updated periodically with new policy or procedural changes as they are announced. Questions about the Handbook or compliance with Handbook guidance should be referred to the Program Administrator and the Compliance Agent, respectively. Fannie Mae serves as the Program Administrator and Freddie Mac serves as the Compliance Agent, each in its capacity as financial agent of the United States (as designated by Treasury).

B. The Overview is amended to include the following text as the penultimate row in the chart related to Supplemental Directives:

10-05	June 3, 2010	October 1, 2010	Modifications of Loans with Principal Reduction Alternative

C. **Section 2.2 of Chapter I is amended to include the following text related to compliance which will follow all other bullets in that section:**

- The servicer's documented process for evaluating and approving borrowers for the Principal Reduction Alternative (PRA) including policies and procedures related to consistent application of PRA, *variations of alternative modification waterfall steps, equity share arrangements*, and the circumstances under which the servicer would reduce principal ~~below 105 percent~~ *to create (i) a* mark-to-market loan-to-value (LTV) ratio *below 105 percent* or *(ii) a monthly mortgage payment ratio below* the target monthly mortgage payment ratio.
- All documents and information related to the determination of eligibility for PRA, *including the determination of eligibility for PRA retroactively for loans in trial period plans or permanent modifications prior to the PRA Effective Date.*
- All documents and information related to the alternative modification waterfall and NPV process including accurately uploading required data into the HAMP Reporting Tool.
- *For each loan file, documentation relating to variations in the alternative modification waterfall sequence or application as outlined in Section 6.4.3 of Chapter II.*
- *For each loan file, copies of any equity share agreements between the investor and the borrower.*

D. **In Section 2.2 of Chapter I, the seventh bullet is amended to include the text in italics related to compliance documentation for standard and alternative modification waterfalls.**

- All documents and information received during the process of determining borrower eligibility, including:
  - Evidence of receipt of the Initial Package;
  - Borrower income verification;
  - Total monthly mortgage payment calculations;
  - Total monthly gross debt payment calculations;
  - NPV calculations (assumptions, inputs and outputs);
  - Evidence of application of each step of the standard *modification* waterfall;
  - *Evidence of application of each step of the alternative modification waterfall, including any variations*;
  - Escrow analysis;
  - Escrow advances; and
  - Escrow set-up.

E. **Section 2.3.1 of Chapter II is amended to include the following text as a new second paragraph related to borrower notices:**

If a borrower *or an authorized representative* submits a written request related to principal reduction, the servicer must, within 30 calendar days of receipt of the request, respond in writing. The response, when applicable, must include the reason(s) that principal reduction was not offered to the borrower.

F. Section 6.3.5 of Chapter II is amended to include the text in italics related to principal forgiveness.

There is no requirement to forgive principal under HAMP. However, servicers may forgive principal *either up front or on a deferred basis under PRA* to achieve the target monthly mortgage payment ratio. *Up front principal forgiveness may be granted* on a standalone basis or before any step in the standard waterfall process. If principal is forgiven *up front*, subsequent steps in the standard waterfall may not be skipped. If principal is forgiven *either up front or on a deferred basis under PRA* and the interest rate is not reduced, the existing rate will be fixed and treated as the modified rate for the purposes of the Interest Rate Cap.

G. Section 6.5 of Chapter II, the first sentence of the first paragraph is amended to include the text in italics referencing standard or alternative modification waterfalls.

If a servicing agreement, investor guidelines or applicable law restricts or prohibits a modification step in the *standard or alternative* modification waterfall and the servicer partially performs it or skips it, the modification still qualifies for HAMP.

H. Section 6.8 of Chapter II, the second paragraph is amended to include the text in italics related to the PRA mark-to-market LTV ratio calculation:

If a GSE AVM or the servicer AVM is unable to render a value with a reliable confidence score, the servicer must obtain an assessment of the property value utilizing a BPO, an appraisal or a property valuation method acceptable to the servicer's Federal regulatory supervisor. Such assessment must be rendered in accordance with the Interagency Appraisal and Evaluation Guidelines (as if such guidelines apply to loan modifications). In all cases, the property valuation used cannot be more than 90 days old as of the date the servicer first evaluates the borrower for a TPP using the NPV model. The information will remain valid for the duration of the TPP and does not need to be updated for any subsequent NPV evaluation. *Servicers should follow regulatory and investor guidance when selecting the appropriate valuation method to determine the mark-to-market value of the property and use this value for both the NPV model and the PRA* mark-to-market LTV *ratio calculation.*

I. The introduction to Section 7 of Chapter II is replaced in its entirety to include the text in italics related to Net Present Value (NPV) Testing of standard and alternative modification waterfalls.

All loans that meet HAMP eligibility criteria and are either deemed to be in imminent default or delinquent as to two or more payments must be evaluated using a standardized NPV test that compares the NPV result for a modification to the NPV result for no modification.

- *Using the standard modification waterfall*, if the NPV result for the modification scenario is greater than the NPV result for no modification, the result is deemed "positive" and the servicer must offer the modification.

- If the NPV result for no modification is greater than *the* NPV result for the modification scenario *using the standard modification waterfall*, the modification result is deemed "negative" and the servicer has the option of performing the modification in its discretion. For mortgages serviced on behalf of a third-party investor for which the modification result is deemed "negative," however, the servicer may not perform the modification without express permission of the investor.
- *With respect to loans with a* mark-to-market LTV *ratio greater than 115 percent, if the NPV result for the proposed modification generated by applying the alternative modification waterfall is positive, servicers are encouraged, but are not required, to perform a loan modification utilizing PRA, even in instances where the NPV result from the standard modification waterfall is negative or is less positive than the NPV result generated by application of the alternative modification waterfall.*

If a modification is not pursued when the NPV result is "negative," the servicer must send a Non-Approval Notice and consider the borrower for other foreclosure prevention options, including alternative modification programs, deeds-in-lieu, and pre-foreclosure sale programs.

Whether or not a modification is pursued, the servicer must maintain detailed documentation of the NPV model used, all NPV inputs and assumptions and the NPV results.

As of October 1, 2010, the Base NPV Model reflects principal reduction incentives and will compare the NPV result of modifications with and without principal reduction with the NPV result without modification. In addition to the evaluation using the Base NPV Model, servicers may conduct other evaluations to determine the level of principal reduction that is in the best interest of investors. However, servicers must only submit the results of the standard modification waterfall and alternative modification waterfall evaluations completed with the Base NPV Model to the HAMP Reporting Tool.

J. The following text from Section 10 of Chapter II is moved under a new Section 10.1 of Chapter II:

Servicers must amend the Modification Agreement and TPP Notice as necessary to comply with applicable federal, state and local law. Servicers may, and in some instances must, make the applicable changes to the Modification Agreement as set forth in the Document Summary available on www.HMPadmin.com. In addition, servicers may amend HAMP documents as follows without prior written approval.

Event	Detail
Non-uniform documents	The servicer may revise non-uniform HAMP documents in accordance with investor requirements, regulations or local real estate practice and may customize the forms with servicer specific logos.

Event	Detail
Bankruptcy	If the borrower previously received a Chapter 7 bankruptcy discharge but did not reaffirm the mortgage debt under applicable law, the following language must be inserted in Section 1 of the Modification Agreement: “I was discharged in a Chapter 7 bankruptcy proceeding subsequent to the execution of the Loan Documents. Based on this representation, Lender agrees that I will not have personal liability on the debt pursuant to this Agreement.”
Automated payment method	The servicer may include language in the TPP Notice providing instructions for borrowers who elect to use an automated payment method to make the trial period payments.
Prepayment or assumption provisions	The servicer may insert conditional language in the Modification Agreement to avoid having to review each set of original loan documents to determine if they contain prepayment or assumption provisions to retain first lien position, require subordination agreements and/or title policy endorsements. No prepayment penalties may be assessed in connection with modifications under HAMP. If any provision in the note or in any addendum or amendment to the note allows for the assessment of a penalty for full or partial prepayment of the note, such provision must be waived.
Conditional Prepayment language for Modification Agreement	If the servicer is subject to a PSA or other servicing contract that requires payment by the servicer of a material sum to investors if any applicable prepayment penalties are waived, and servicers must use reasonable efforts to eliminate the PSA provision requiring payment by the servicer if the prepayment penalty is waived. However, if the servicer is unable to eliminate the PSA provision, the servicer is not required to waive the prepayment penalty as part of the modification, provided that the prepayment penalty must be waived with respect to any borrower “pay for performance” principal balance reduction payments that are applied to the borrower’s mortgage loan. In such a case, servicers should replace Section 4.I. of the Modification Agreement with the following language: “That, as of the Modification Effective Date, any provision in the Note, as amended, for the assessment of a penalty for full or partial prepayment of the Note must be waived with respect to any borrower “pay for performance” principal balance reduction payments that are applied to the Loan.”

K. Section 13 of Chapter II is amended to include the text in italics related to remittance of compensation in the first paragraph.

Borrowers, servicers and investors are eligible for incentive compensation under HAMP. The Program Administrator will make incentive payments to the servicer via wire transfer in a consolidated fashion and will provide detailed loan-level accounting for incentives on a monthly basis. Upon receipt of such incentive compensation, each servicer must promptly*, but not later than 30 calendar days after receipt,* apply or remit, as applicable, all borrower and investor compensation with respect to any modified loan*, including with respect to any PRA modified loan.* Treasury is not providing guidance on how funds are to be passed through to security holders of securitization trusts. However, MHA-C will monitor to ensure that cost share reduction payments are remitted to security holders and borrower pay for performance incentive payments are applied to borrower accounts in accordance with program guidelines.

L. Section 13.2 of Chapter II is amended to include the text in italics related to loss of good standing:

If the loan ceases to be in good standing or is paid in full, the borrower will forfeit any incentive payments that have accrued but are unpaid and will cease to be eligible for any further incentive payments after that time, even if the borrower subsequently cures his or her delinquency. *With respect to PRA, if a borrower loses good standing before the entire PRA Forbearance Amount has been applied as principal reduction to the UPB, the unapplied PRA Forbearance Amount shall remain as non-interest bearing principal forbearance for the remaining life of the loan.*

M. Section 13.3 of Chapter II is amended to include the text in italics related to investor incentives.

An investor will be entitled to the payment reduction cost share and, if applicable, *the PRA investor incentive* and the current borrower incentive, once the borrower enters into a permanent modification.

III. IMPACT ON THE SECOND LIEN MODIFICATION PROGRAM

The *Handbook* will be expanded in the near future to include policy guidance on the 2MP. Until such expansion, servicers should follow the relevant 2MP sections from SD 10-05 as replicated below and the additional new 2MP guidance as set forth below in italics.

A. Impact of PRA Retroactivity on 2MP

With respect to borrowers who have been offered a 2MP trial period plan or received a permanent 2MP modification and principal reduction under PRA is retroactively applied to the related first lien, the 2MP servicer may, but is not required to, apply PRA retroactively to the second lien under 2MP. With respect to borrowers who have not yet been offered a 2MP trial period plan, if the 2MP servicer is notified of a matching first lien modification that includes retroactive PRA principal reduction, the 2MP servicer must include the retroactive PRA principal reduction when determining the amount of principal forgiveness required as part of the 2MP modification as set forth below in Section B.

A 2MP servicer may, subject to investor guidance, convert some or all of an existing principal forbearance amount to principal reduction or otherwise offer any amount of principal reduction pursuant to a principal curtailment, but may not change any other terms of the permanent 2MP *modification. The servicer must memorialize this arrangement in a notice or agreement sent to the borrower that:*

- *Explains how the deferred principal reduction will be applied to the loan;*
- *States that the principal reduction amount will be reported to the IRS in the year in which the curtailment is applied and advises the borrower to seek guidance from a tax professional to determine any potential tax consequences; and*
- *Explains that the borrower may elect not to accept the offered principal reduction and provide opt-out instructions.*

Because 2MP servicers have this discretion in offering PRA retroactively on second liens, this treatment should be addressed in the servicer's Retroactive PRA Policy that treats all similarly-situated loans in a consistent manner and in compliance with Section 1.6 of Chapter I.

B. Impact on Second Lien Modifications

When a first lien mortgage loan is modified under PRA and a servicer that has executed a Servicer Participation Agreement for ~~the Second Lien Modification Program (~~2MP-services a second lien mortgage loan secured by the same property (whether or not that servicer also services the first lien mortgage loan), that 2MP servicer must also reduce principal in conjunction with the modification of the second lien. As of the publication date of this Supplemental Directive, the text below replaces in its entirety the text in Supplement Directive 09-05 *Revised*, describing "Step 4: Principal Forbearance".

Step 4: Principal Forbearance and Forgiveness

If there was principal forbearance or forgiveness on the HAMP-modified first lien, a servicer must forbear or forgive principal on the second lien in the same proportion, based on the ratio of the principal forbearance or forgiveness amount of the HAMP-modified first lien to the total UPB of the HAMP-modified first lien on its modification effective date. If the servicer has deferred accrued interest in lieu of capitalization in Step 1, the deferred amount will be in addition to any principal forbearance or forgiveness required under this Step 4. The servicer may, at its discretion and as permitted under the applicable pooling and servicing agreement, choose to forgive any amounts that are required to be forborne. All principal forgiveness required or provided under 2MP will be applied at the time of the permanent 2MP modification and will not be deferred.

> Example: The total unpaid principal balance plus the forgiveness amount of the HAMP-modified first lien on its modification effective date is $100,000, the amount of principal forbearance on the first lien is $5,000 and the amount of principal forgiveness is $5,000. Therefore, the servicer must forbear five percent of the second lien and must forgive five percent of the second lien. If the total unpaid principal balance of the second lien on the modification effective date is $40,000, the servicer must forbear $2,000 and must forgive $2,000, or the servicer may elect to forgive a larger amount.

Additionally, the first two sentences from the section titled "Principal Forgiveness Option" in Supplemental Directive 09-05 *Revised*, are deleted and replaced with the following sentence:

> In addition to any required forgiveness in Step 4 of the standard modification waterfall, servicers may, at their discretion and when permitted under the applicable pooling and servicing agreement or other investor servicing agreement, agree to forgive additional principal as part of a 2MP modification and will be eligible for both modification incentives and extinguishment incentives on any partial amount of principal that is forgiven so long as the unpaid principal balance of the second lien (at initial consideration for the second lien modification) is equal to or greater than $5,000 and has a premodification scheduled monthly payment equal to or greater than $100.

IV. IMPACT ON ANNUAL SERVICER CERTIFICATION

PRA, as updated by the guidance in this Supplemental Directive, will continue to be covered, as applicable, by Initial Certifications with initial certification effective dates as of June 30, 2011 and Subsequent Certifications as set forth in Supplemental Directive 10-06. The *Handbook* will be expanded in the near future to incorporate the guidance set forth in Supplemental Directive 10-06.