Straight-Cap Modifications

A Presentation for Housing Counselors and Loan Modification Specialists
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Straight Capitalization Modification

- General Definition – Arrearage (Unpaid interest and fees) is added to the Unpaid Principal Balance and then re-amortized under the same terms as the original loan (Interest rate and remaining term stay the same).

- Result – Higher monthly mortgage payment for the homeowner
Straight-Cap Variations

- In order to keep the payment the SAME (typically payment will not decrease because these are not situations where this should be necessary or where the investor has the incentive to do so) as the pre-modification payment, an investor can........
- Extend the term
- Reduce the interest rate
Why do we need to push for Straight-Caps?

- Most investors do not have this as part of their waterfall
- There are several scenarios that were overlooked when modifications were created
- In most cases this is the only way a homeowner will be able to get into a 2\textsuperscript{nd} modification
- This is not something that banks will come out and offer because the investor does not delegate them to do so, yet when shown the facts most investors will approve.
3 Most Common Reasons for Straight-Caps

- DTI is already below 31%
- LTV is below 80%
- Previously modified (especially at 2%)
DTI Below 31%

- Payment is viewed as already affordable by most modification guidelines
- Even if LTV is well over 100% the homeowner will still be declined for all modifications based on affordability
- Common Scenario: Homeowner was out of work for some time, fell behind, got a new job, his new Gross Monthly Income (GMI) makes his DTI well below 31%, he can now make monthly mortgage payments but cannot catch up on the arrearage, denied for HAMP and In-House for affordability
Loan to Value Ratio Below 80%

- Loan Modifications have never been devised for people with equity in their property (LTV below 100%).
- Typically to refinance you need a LTV under 80%, good credit and the income to support the payment (DTI requirements are more strict in refi’s).
- LTV ratios below 80% will fail NPV every time (an investor simply does not have the incentive to modify a risky loan that at that point they can walk away from getting all their money back).
- LTV ratios between 80-100% may also fail NPV because of equity.
LTV Below 80% Example

• Homeowner is $31K behind because of job loss
• MMP is $2500 w/escrow
• Current gross monthly income is 10K (so DTI 25%)
• UPB 165K + 38K arrearage = 203K New Capitalized Balance
• 203K owed/ 600K value = 33% LTV
• So this homeowner would not only be denied for affordability but also for failing NPV due to the equity
So what are the options?

STRAIGHT CAP MOD (If Fannie or Freddie a Streamline Mod may be offered after falling 3 full months behind for the first time)

You should ask the servicer to explore this option

In this case the original term had 16 more years fixed at 6.75% and the homeowner was denied repeatedly

After requesting a straight-cap review he was offered a 40 yr mod at 6.75% (they will never reduce the interest rate with this much equity), which actually lowered his monthly mortgage payment

Once he gets his credit back on track he should be able to refi into a shorter term and lower rate
Previously Modified

- In most cases any 2nd modification that a homeowner receives will be some version of a straight-cap mod.
- If a loan has been modified at 2% the homeowner can be told with 100% certainty that any future modification they were to be offered would increase their payment (usually by putting them at market rate and capitalizing the arrearage) – this can only be done if they have had a significant increase in income since falling behind.
Steps to take in evaluating someone for a Straight-Cap (after other mod options exhausted)

- Calculate what the monthly mortgage payment would be if the arrearage was capitalized and the term and interest rate stayed the same. (If the DTI is under 31% you should ask for a straight-cap)
- If it is not below 31%, see if it would be if the term was extended to 30 or 40 years (if there is equity in the property the investor may not have the incentive to extend the term but it can’t hurt to try)
- Typically the interest rate will stay the same (if above market rate) or be put at market rate through a straight-cap
Summary

- This is not something that most servicers offer as part of their waterfall
- Most investors will participate if the request is made and it is financially reasonable
- Look out for below 31% DTI, below 80% LTV and 2nd modifications, as this may be the only option out there.