

Servicing Maturing Balloon/Reset Mortgages

Freddie Mac expects that many Borrowers with Balloon/Reset Mortgages will want to exercise their Reset Option upon their Balloon Maturity Date. Balloon/Reset Mortgages must be serviced according to the requirements in Chapter 83 of the *Single Family Seller/Servicer Guide* (the Guide). This quick reference summarizes our requirements from Chapter 83 of the Guide and from our *Servicing Maturing Balloon/Reset Mortgages Manual* (Publication 212) for servicing maturing Balloon/Reset Mortgages. It incorporates glossary terms from both of these publications to assist in understanding the Balloon/Reset process.

What is a Balloon Reset Mortgage?

A Balloon/Reset Mortgage is a fixed-rate, level payment, First Lien Mortgage with the following characteristics:

- The monthly principal and interest payment is based on an amortization schedule calculated to pay the original principal balance in full, in 360 months.
- The unpaid principal balance (UPB) of the Balloon Note is due in a lump sum (Balloon Payment) on the Balloon Maturity Date.
- The Borrower has a Reset Option on the Balloon Maturity Date.



When the term Balloon/Reset Mortgage is used it means it has a Balloon Note with an original term of 5 or 7 years and a Balloon Note Addendum and Balloon Rider (collectively referred to as Reset Rider) giving the Borrower a Reset Option.

What is a Reset Option?

A reset option is a Borrower's option to extend the term to 30 years and modify the interest rate for the Balloon/Reset Mortgage on the Balloon Maturity Date. The option is subject to the satisfaction of all the Reset Conditions defined in the Balloon Note Addendum and Balloon Rider.

What are the Reset Conditions?

Unless modified or deleted in the Balloon Note Addendum and Balloon Rider for a particular Balloon/Reset Mortgage, the Reset Conditions are:

- The Borrower must still be the owner and occupant of the property.
- The Borrower must be current in his or her monthly Mortgage payments and can not have been more than 30 days late on any of the 12 scheduled monthly payments due immediately preceding the Balloon Maturity Date.
- There are no liens, defects or encumbrances against the property, or other adverse matters affecting title to the property (except for real estate taxes and special assessments not yet due and payable) arising after the Security Instrument was recorded.
- The Reset Note Rate cannot be more than 5 percent (5%) above the original Balloon Note Rate.
- The Borrower must make a written request to exercise the Reset Option.

Who Can Reset?

An Eligible Borrower is a Borrower who meets all of the Reset Conditions contained in the Reset Rider and has elected to exercise the Reset Option.

An Ineligible Borrower is a Borrower who does not meet one or more of the Reset Conditions contained in the Reset Rider and cannot pay the Balloon Payment in full.

The Process to Reset

The following are important steps in the process to reset a maturing Balloon Mortgage.

- Notifying the Borrower of the upcoming Balloon Maturity Date
- Determining the Borrower's Eligibility
- Communicating and Documenting the Reset
- Calculating the Reset Note Rate
- Calculating the Servicing Spread
- Calculating the New Monthly P&I Payment

Notifying the Borrower

The following are steps to notify the Borrower that the Balloon Maturity Date is approaching and a decision will need to be made.

1. Send an Early Notice to the Borrower 13 to 14 months prior to the Balloon Maturity Date.
2. Review the payment history to determine the type of Required Notice to send to Borrower.
3. Prepare appropriate Required Notice including estimated reset transaction costs and response deadline.
4. Send the Required Notice to the Borrower 100 - 120 days prior to the Balloon Maturity Date or earlier if the Property is located in a state that requires earlier notification.

Determining the Borrowers Eligibility

Once the Borrower responds to the Required Notice, you must determine whether or not the Borrower is an Eligible Borrower by verifying the Reset Conditions.

Communicating and Documenting the Reset

You must provide Freddie Mac notification on each maturing Balloon/Reset Mortgage, whether or not they have received a response from the Borrower. This notification can be done by either transmitting the applicable disposition code (see codes below) via the Balloon Rate Lock Transmission function in MIDANET for the PC, or by calling 1-800-FREDDIE.

Disposition Codes	Definitions
R	Borrower elects to reset and meets all Reset Conditions
S	Borrower wants to reset but does not meet one or more of the Reset Conditions and you have approved the Reset through the Servicer-Delegated review path
P	Borrower wants to reset but does not meet one or more of the Reset Conditions and request must be submitted through the Freddie Mac review path
I	Borrower intends to payoff the Balloon/Reset Mortgage
N	Borrower has not responded to the Required Notice

Once it is determined that the Borrower is either an Eligible Borrower or an Ineligible Borrower approved for a Reset by either you or by us, notify Freddie Mac of the Borrower's intent to reset and obtain the RNY. We will then provide a confirmation of the RNY on the Form 1074.



If the Borrower has not responded to the Required Notice by the approaching deadline, contact the Borrower to verify receipt of the Required Notice and remind them of the deadline.

Processing a reset request for an Ineligible Borrower

If the Borrower does not meet one or more of the Reset Conditions, you must determine if you have the authority to process the reset request through the Servicer-delegated review path. The specific requirements for processing a reset request through the Servicer-delegated review path are set forth in the Guide.

If you do not have the authority to approve the reset request through the Servicer-delegated review path, then process the reset request through the Freddie Mac review path.

Alternative Balloon Loan Modification Program

The Alternative Balloon Loan Modification Program is a program offered to Borrowers with Balloon/Reset Mortgages that are ready to mature and that we have identified as potentially having an imminent danger of default.

Calculating the Reset Note Rate

Once you receive the Form 1074 with the required net yield through Midanet for the PC, you can calculate the Reset Note Rate as follows. Be sure to round the subtotal to the nearest 1/8th of 1 percent (.0125%).

RNY (either Freddie Mac's or Fannie Mae's, as applicable)	8.060%
Add ½ of 1 percent (.50% or 50 basis points)	+ <u>0.500%</u>
Subtotal	8.560%
New Reset Note Rate	8.500%

If the Borrower is an	Then
Eligible Borrower	The RNY used to calculate the Reset Note Rate will be indicated by the Balloon Note Addendum and Rider
Ineligible Borrower	The Freddie Mac RNY will be used to calculate the Reset Note Rate, even if the Balloon Note Addendum and Rider indicate the use of the Fannie Mae RNY.



If the Freddie Mac RNY is used to calculate the Reset Note Rate, the Reset Note Rate Reset Condition will be verified at this time. If however, the Fannie Mae RNY is used to calculate the Reset Note Rate, you will verify the Reset Note Rate Reset Condition manually.

Calculating the Servicing Spread

Once you determine the Reset Note Rate, you can calculate the Servicing Spread as follows:

Reset Note Rate	8.500%
Minus the Freddie Mac RNY	- <u>8.060%</u>
Equals Servicing Spread	0.440%

Calculating the New Monthly P&I Payment

Calculate the new monthly P&I payment based on the Reset Note Rate, the scheduled unpaid principal balance (UPB) at the Maturity Date, and the new extended maturity date of the Reset Mortgage.

Completing the Reset Process

1. Request title insurance endorsement or new policy.
2. Complete Form 1074 and send to Freddie Mac to obtain Form 1034B (Custodial Certification Schedule and Balloon Loan Modification).
3. Prepare two Balloon Loan Modifications (Form 3293) and any disclosures required by applicable law, for borrower signature.
4. Prepare cover letter and send with the Reset Mortgage package to the Borrower.
5. Receive and review the documents returned by Borrower. Post funds received.
6. Send one Balloon Loan Modification to be recorded.
7. Complete Form 1034B and attach to the original unrecorded Balloon Loan Modification (Form 3293), and

If	Then
Freddie Mac is the document custodian	Deliver the above documents to Freddie Mac's Document Custodial Services Department no later than 10 calendar days after the Balloon Maturity Date.
Freddie Mac is not the document custodian	Deliver the above documents to the document custodian. Then send the certified Form 1034B only, to Freddie Mac's Document Custodial Services Department no later than 10 calendar days after the Balloon Maturity Date.

8. Notify the Mortgage Insurer, if applicable.
9. Modify the Mortgage on your servicing system. Coordinate any changes with your Investor Accounting area to avoid any reporting and remitting edits.
10. Report and remit the Reset information during the accounting cycle cut off in the month following the Balloon Maturity Date.

Investor Reporting after the Reset

The terms of the Mortgage must be changed in your servicing system to reflect the terms of the Reset Mortgage.

For the accounting cycle cut off that occurs in the same month as the Balloon Maturity Date, you will report the original Balloon/Reset Mortgage data prior to the reset. In this cycle, you are reporting activity that occurred in the month before the Balloon Maturity Date.

For the accounting cycle cut off in the month following the Balloon Maturity Date, you will report the new Reset Mortgage data. In this cycle, you are reporting activity for the same month that the reset terms took effect on the Reset Mortgage.