Open House: New law will help alleviate taxes for certain homeowners

by Jim_Woodard

New federal laws and regulations have created major changes in the mortgage industry. They impact the way lenders qualify borrowers this year, and in some cases will put more money in the pockets of homeowners.

The president has signed legislation implementing a law that eases the tax burden for homeowners who have had debt forgiven on a mortgage due to a foreclosure or short sale.

Previously, the tax code required a lender who forgives debt to provide a Form 1099 to the IRS stating the amount the borrower had been forgiven. Then, if the property was sold at foreclosure or was sold for less than what was borrowed, the difference was considered income and subject to be taxed.

The new legislation provides a temporary, three-year change to the tax code to eliminate taxes homeowners might face when banks renegotiate the terms of a home loan and forgive a portion of the outstanding mortgage balance. The change in the tax law will cap untaxable forgiven debt at $2 million and apply only to principal residences.

Most real estate and mortgage organizations support the new law.

"This bill helps address the subprime lending crisis by preventing strapped homeowners from taking a tax hit to restructure their mortgages and allow them to stay in their homes," said Brian Catalde, president of the National Association of Home Builders.

The law - Mortgage Forgiveness Debt Relief Act - removes the tax burden on mortgage indebtedness, encourages market-based restructuring between lenders and homeowners, and discourages foreclosures.

The bill also extends the tax deductibility of the Federal Housing Administration and private mortgage insurance premiums over the next three years. That tax break had been scheduled to expire at the end of 2007. It has been estimated that this bill would give an average tax break of about $350 to taxpayers who pay premiums for mortgage insurance.

Yet another much-publicized plan is to allow modifications of certain mortgage loans or freezing the interest rates for up to five years.

"The dream of homeownership should not turn into a family's worst nightmare," said Richard Gaylord, president of the National Association of Realtors. "The loan modification program is a good first step in helping deserving families keep their home."

To prevent abuses of the past, new rules on mortgage lenders are being proposed by the Federal Reserve. Acknowledging that many home mortgage lenders aggressively sold deceptive loans to borrowers who had little chance of repaying them, the Fed is proposing a broad set of restrictions on exotic mortgages and high-cost loans for people with weak credit.

The new rules would force mortgage companies to show that customers can realistically afford their mortgages. They would also require lenders to disclose the hidden sales fees often rolled into interest payment, and they would prohibit deceptive advertising. Borrowers would be able to sue their lenders if they violated the new rules, but homeowners would be allowed to seek only a limited amount of compensation.

"Unfair and deceptive acts and practices hurt not just borrowers and their families but entire communities and the economy as a whole," said Ben Bernanke, chairman of the Federal Reserve.

An increasing number of regional groups are launching public education programs in their area to help consumers avoid predatory lending practices. For example, in Ventura County, Calif., a coalition of private and public companies has organized an education campaign to "prevent predatory lending and protect homeownership."

It's called the "Don't Borrow Trouble" campaign. Its principal sponsor is Freddie Mac, a major government-sponsored buyer of existing home mortgages.

Q: What's the FHA Modernization Act all about?

A: FHA home loans may soon experience a major revival as a favored type of home financing. Pending legislation would reduce the minimum down payment required (possibly to 0 percent) and will increase the maximum amount that can be borrowed.

The FHA Modernization Act has finally been approved by Congress. After a bit of fine-tuning by a conference committee, it will be ready for the president's signature. When signed, it will be the biggest overhaul of loans insured by FHA in many years, and will serve the needs of home buyers and owners who want to refinance their mortgage much more effectively.

"The bill itself is really very simple, the proposal straightforward," said Brian Montgomery, with the Dept. of Housing and Urban Development. "It does just what its name suggests. It modernizes the 72-year-old Federal Housing Administration and restores the agency to its intended place in the mortgage market - nothing more, nothing less. Yet, the impact of this bill may be tremendous."

One segment of home buyers most benefited from the changes is persons and families living in particularly high priced areas. The new law would either raise the FHA loan limit to $417,000, the current limit for conforming home loans, or the maximum could be tied to the median home price in local regions. Either way, it would make the loans viable for many more buyers and owners, particularly in coastal California and Northeast communities where home prices are highest.

The required minimum down payment, now 3 percent, would be reduced to 0 percent (House version) or 1.5 percent (Senate version). In the House version, the FHA would be able to vary the insurance premiums by applicant risk levels. The more high-risk applicants could pay higher premiums. The Senate version includes a one-year moratorium on a risk-based pricing system. These items will be worked out in a conference committee.

The changes will inevitably bring FHA loans back into the home financing arena as a major type of loan, as it once was. And it will be the "refinancing loan of choice" by many homeowners who now face possible foreclosure proceedings.

Send inquiries to Jim Woodard, P.O. Box 120190, San Diego, CA 92112-0190. Questions may be used in future columns; personal responses should not be expected.

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