Clear as Mud

Mortgage Interest Differential Payments

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IRWA Education Conference
Portland 2019

Background & Intent
A Brief History Lesson

Why was the increased interest cost (mortgage interest differential) payment included in the Uniform Act?

Legislative History

Senate Committee on Government Operations – February 26, 1969
Colloquy between Senators Moss and Muskie

Senator Moss. As to the difference between the interest rate on the mortgage, that is perhaps harder to calculate but I think, nevertheless, some computation should be made to compensate a landowner for that, . . .

But it is astonishing, the difference in the interest rate, now and the rate of just 5 years ago, and certainly 10 years ago, for money that was borrowed on real estate, on property.

Senator Muskie. Yes; we know here in this area.

Legislative History (cont.)

Senator Moss. To be shopping in the housing market soon establishes that in one's mind.

Senator Muskie. And 2 percent difference is not a rarity at all.

Senator Moss. No; and that projected out for a 25-year payment on a piece of property that has considerable value make a lot of dollars.

Senator Muskie. Two percent of $10,000 would be what? $200. It is a lot of money.

Senator Moss. Yes, it is.

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Legislative History (cont.)

House Committee on Public Works

House Report No. 91-1656 - December 7, 1970

"Replacement housing satisfying these requirements must be available to the homeowner before displacement, at terms he can reasonably afford and that do not worsen his economic condition. In other words, the displaced person should not have to spend more for monthly payments of principal and interest on a mortgage for the comparable replacement dwelling."

The 1970 Mortgage

- Fixed rate, amortizing mortgage
- Interest typically paid in arrears
- Monthly payments applied to interest for prior month and then principal reduction

Amount	Rate	Term	Payment	Interest	Principal	Balance
$20,000	8.5%	30 yrs	153.78	141.67	12.11	19,987.89
				141.58	12.20	19,975.69
				141.49	12.29	19,963.40

Original Calculation of Mortgage Interest Differential Payments

- Based on the increased monthly interest amount discounted to a present value
- Uniform Act prescribed this calculation method
- When interest rates increased (as high as 18%) in early 1980's, interest differential payments were BIG
- The 1987 Uniform Act amendments deleted this calculation method

What is the Payment?
A Simple Definition

A payment to compensate homeowner-occupants of at least 90-days, who have had a mortgage in place for at least 180-days, for the loss of favorable financing.

Note: In the MAP-21 Uniform Act amendments, Congress elected to reduce the ownership/occupant term requirement for "long-term" owner-occupants to 90-days but did not extend that same reduction to the increased mortgage interest payment.

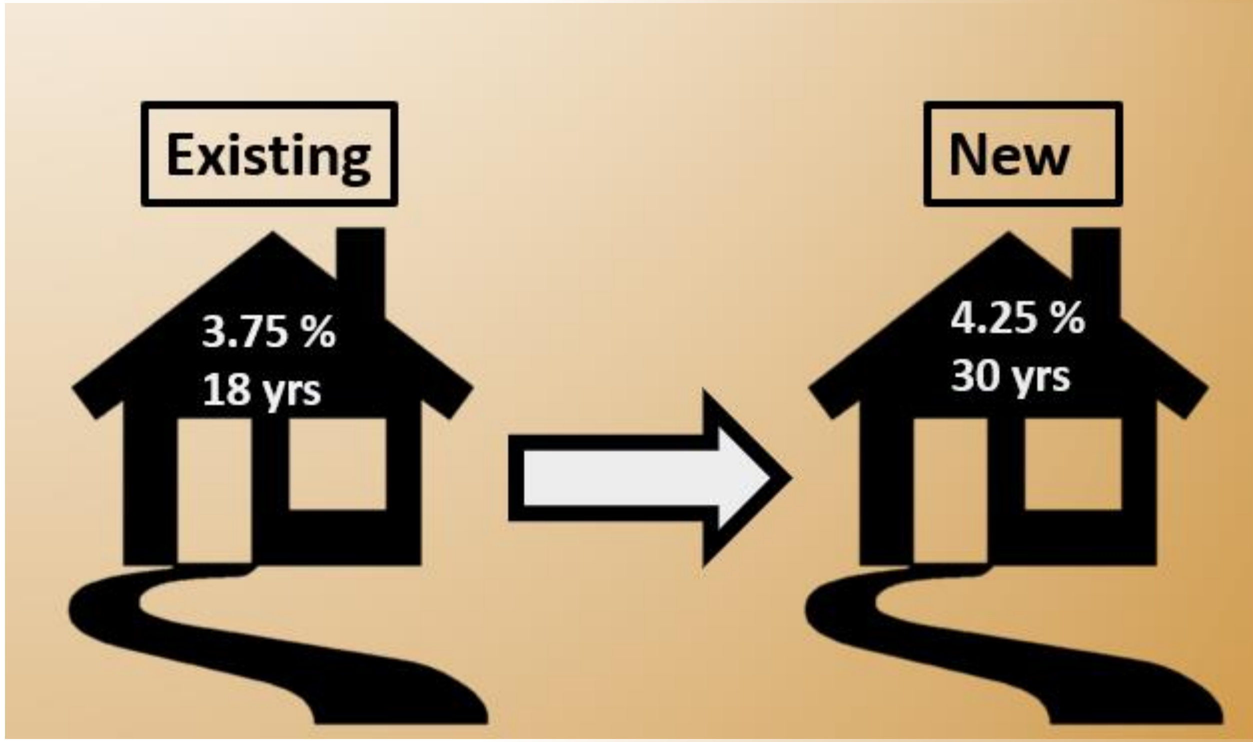
What is the Payment?
A Formal Definition

The amount that will reduce the mortgage balance on the new mortgage to an amount which could be amortized with the same monthly payment for principal and interest as that for the mortgage on the displacement dwelling.

49 CFR 24.401(d)

Review Purpose of the Payment

- Compensate displaced homeowner-occupant for loss of favorable interest rate
- Consider what the owner is losing by comparing terms of existing (displacement) mortgage to terms of new (replacement) mortgage



What You Need For Calculation

Existing Loan		New Mortgage
Remaining principal balance	**Whichever is Less**	Principal amount
Remaining term	**Whichever is Less**	The term
Interest rate	**Rate on New Mortgage Must Be Higher**	Interest rate (prevailing rate)
Monthly principal & interest payment		Points & origination fees

Rephrase the Problem

- How much money can the displaced homeowner borrow at the higher rate of interest for the remaining term of the mortgage and keep the same monthly principal and interest payments?

- It’s a mathematically computed payment – you are solving for the present value with known factors of payment, term and interest rate.

Payment Includes Debt Service Costs

Purchaser’s points and loan origination or assumption fees, to the extent:

- Not paid as incidental expenses;
- Do not exceed rates normal in area;
- Agency determines costs are necessary; and
- Based on unpaid mortgage balance of displacement dwelling ***less*** amount computed for reduction, i.e., the “**BOUGHTDOWN**” mortgage amount

Advisory Services

- Agency must advise displacee of approximate amount of payment when facts relative to mortgage are known (preferably at or near initiation of negotiations)
- Coordinate with displacee's lender for reduction of replacement mortgagae
- Make payment available at or near closing for replacement dwelling

Remember

- No eligibility for payment if new mortgage has lower interest rate than old mortgage

- Displaced homeowner may still be eligible for payment of points and origination fees, limited by old mortgage balance

House Report No. 91-1656
December 2, 1970
The Committee on Public Works

"The tools in the reported bill are adequate to deal with the problem. The Congress, however, can only provide such tools. Their effective use depends upon the attitudes and skill of the officials in the executive branch of the government responsible for their administration. The principle of adequate housing, for example, will require not only the use of more liberal financial allowances authorized by the reported bill, but also imagination, ingenuity, and a desire on the part of its administrators to translate this authorization into equitable and satisfactory conditions for the people affected."

Let's Look at an Example

Original Loan (June 2012)	$120,000.00
Interest Rate	3.31%
Monthly payments (p&i)	$526.21
Date of displacement	Today
Principal balance	$101,575.77
Remaining term	276 months
Prevailing interest rate	4.5%

MIDP Calculation Buydown Method

Remaining principal balance	$101,575.77
Remaining term	276 months
Monthly principal & interest payment	$526.21
Interest rate on replacement mortgage	4.5%

How much can displacee borrow at 4.5% for 276 months and have principal and interest payments of $526.21

Answer: $90,379.38

Existing principal balance	$101,575.77
Reduced principal balance	$90,379.38
Mortgage interest differential payment	$11,196.39

Adjustable Rate Mortgage

- Authorized by Congress in 1982
- Interest rate periodically adjusts based on an index and specified margin
- Typically has a cap on the periodic rate adjustment and total rate adjustment for life of loan
- Generally offer lower rates up front in exchange for risk assumed by borrower
- Represents only 4% of recent mortgages

What You Need For Calculation

1. Terms of existing ARM:

- Current interest rate
- Index
- Cap rate (initial interest +lifetime cap)
- Remaining term of ARM

2. Current prevailing rate for fixed rate mortgage

Interest-Only Mortgages

- The maximum payment eligibility and actual payment calculation use the same basic considerations as the adjustable rate mortgage – determine the “lesser of” differences between current cap rates and current rates paid

- MIDP is calculated based on the remaining interest-only period of the loan

Example

Remaining principal balance	$200,000.00
Remaining term for interest-only payments	60 months
Current interest rate	4.0%
Monthly interest payments	$666.67
Interest rate on replacement mortgage	4.25%
New monthly interest-only payments	$708.33
Less existing interest-only payments	$666.67
Difference	$41.66
Remaining term for interest-only payments	60 months
MIDP payment	$2,499.60

Mortgage Interest Differential Payment (MIDP) Calculators

Available on FHWA Office of Real Estate Website:

- Traditional Buy Down Method
- Adjustable Rate Mortgage
- Interest Only Mortgage

www.fhwa.dot.gov/real_estate/practitioners/uniform_act/relocation/midpcalcs/

Questions??

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