



June 14, 2017

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street S.W., Room 10276
Washington, DC 20410-0500

RE: Comments to Office of Secretary, HUD on 82 Federal Register 22344; Docket No. FR-6030-N-01; Reducing Regulatory Burden; Enforcing the Regulatory Reform Agenda Under Executive Order 13777

Dear Regulations Division:

On behalf of the low-income borrowers and communities that we represent, the National Consumer Law Center and the Legal Aid Society of Southwest Ohio write in response to HUD’s request for input on its regulatory program. HUD’s stated goal is to make its regulations more effective and less burdensome in achieving its mission to create strong, sustainable, inclusive communities, and quality affordable homes for all.

These comments focus primarily on the FHA’s loss mitigation program for single-family forward mortgages. As explained in detail below, we urge HUD to:

- **Retain its loss mitigation procedural rules**, which protect both borrowers and the mortgage insurance fund. These rules have been reviewed and revised so that they are efficient and effective. We discuss below, however, suggestions for improving and modernizing particular regulations.
- **Retain the loss mitigation waterfall for FHA-insured loans**, which HUD has improved significantly by responding to lessons it learned throughout the housing crisis.
- **Revise its program for selling loans through the Distressed Asset Stabilization Program (DASP)**, by ensuring that HUD does not pay unnecessary claims by requiring pre-auction notice to borrowers and by enhancing its pre-claim screening process.

The National Consumer Law Center¹ and the Legal Aid Society of Southwest Ohio² have decades of experience working with and on behalf of low- and moderate-income borrowers with FHA-insured loans and are intimately familiar with the challenges faced by these borrowers.

Introduction: HUD's loss mitigation program for FHA-insured loans protects the mortgage insurance fund, homeowners, and communities.

Our comments will primarily focus on how HUD's current loss mitigation program for FHA-insured loans avoids the unnecessary payment of insurance claims and thus protects the mortgage insurance fund (Fund), homeowners, and our communities. Under the National Housing Act, Congress made clear that HUD's administration of the insurance fund must promote sustainable homeownership and protect the financial solvency of the Fund.³ HUD's continued long-term commitment to mandatory loss mitigation, as spelled out in its regulations, is essential to the ability of the agency to meet both goals.

Payment of unnecessary claims harms the Fund and destabilizes neighborhoods. As a result, these comments will demonstrate why HUD should preserve crucial loss mitigation regulations that promote a strong Fund and should, in a few instances, provide further guidance to strengthen the Fund. Such regulations are not outdated, do not cost jobs, and do not impose undue costs. HUD should maintain regulations that promote a strong Fund. We oppose actions that undermine the mortgage program.

The strength of the Fund is especially important given the role that HUD's insured mortgage program plays in building wealth and providing opportunity for low- and moderate-income homeowners, including those in communities of color. The mortgage insurance program facilitates the funding for approximately half of all home purchases made by African American

¹ **The National Consumer Law Center®** (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including Mortgage Lending, Truth in Lending, and Foreclosures.. These authors have for many years provided assistance to attorneys and housing counselors helping consumers with problem mortgages across the country. These comments are based on these efforts as well as our knowledge and expertise in Truth in Lending, the mortgage market, and consumer law in general. Geoff Walsh and Alys Cohen, Staff Attorneys with NCLC, contributed to these comments.

² **The Legal Aid Society of Southwest Ohio, LLC** is a non-profit law firm that represents low income and elderly clients in seven counties in Southwest Ohio. Each year, the Legal Aid Society helps children and adults resolve legal problems that are barriers to their future, a stable life and economic self-sufficiency. Legal Aid also works collaboratively with other nonprofits and government agencies on issues that have significant community impact or are targeted towards specific client populations The Legal Aid Society has significant experience representing homeowners with FHA-insured loans and advocating for homeowners seeking loss mitigation. These comments were written by Steven Sharpe, Senior Attorney.

³ 12 U.S.C § 1708(a)(7).

and Latino households.⁴ Similarly, we also support HUD's Affirmatively Furthering Fair Housing (AFFH) rule and the Disparate Impact rule as key mechanisms for further supporting fair credit access.

As HUD stated in its *Federal Register* notice, its "mission is to create strong, sustainable, inclusive communities and quality affordable homes for all. ... [Its] regulatory programs and initiatives aid the creation of suitable living environments, and help to ensure that all citizens have access to decent, safe, and sanitary housing."⁵ To fulfill this mission, HUD must take the interests of homeowners into account when reviewing its FHA regulations. We also urge HUD to appoint consumers with FHA-insured mortgages or advocates working directly with these consumers to the Regulatory Reform Task Force established pursuant to Executive Order 13777.

Moreover, in considering Executive Order 13777, HUD should avoid duplication of work already done on retrospective reviews of regulations in the previous Administration under Executive Orders 13610 and 13563. In addition, it is critically important to note that Executive Orders do not override the legal obligations that apply to HUD when it interprets statutes. HUD must continue to engage in a well-reasoned administrative process that considers any benefits that regulations will provide in addition to costs, and it must recognize that its current regulations were developed through such a process.

While HUD has requested input on regulations that should be repealed, replaced or modified, we focus our comments on the preservation and strengthening of crucial FHA loss mitigation regulations. We offer the following recommendations for HUD to avoid costs associated with unnecessary claims and to stabilize homeownership and communities.

- 1) *HUD's well-tested, modest loss mitigation procedural requirements should be preserved because they avoid unnecessary payment of insurance claims by ensuring that lenders fully evaluate foreclosure avoidance options.*

For decades, HUD has required lenders to take specified yet modest steps to ensure that they are actively working with homeowners to avoid foreclosure.⁶ These steps include notice requirements,⁷ a duty to have a face-to-face meeting,⁸ and an obligation to periodically evaluate a borrower's eligibility for foreclosure alternatives.⁹ The regulations do not require lenders to make impractical loan modifications or waive amounts owed on the loans. Rather the

⁴ Federal Housing Administration, Annual Report to Congress at pg. 5 (Nov. 15, 2016), *available at* <https://portal.hud.gov/hudportal/documents/huddoc?id=2016fhaannualreport1.pdf>.

⁵ 82 Fed. Reg. 22344 (May 15, 2017).

⁶ 24 C.F.R. §§ 203.500; 203.600 - .616.

⁷ 24 C.F.R. §§ 203.602, .606(a).

⁸ 24 C.F.R. § 203.604.

⁹ 24 C.F.R. § 203.605(a).

regulations require mortgage servicers to take limited steps to avoid unnecessary claims and ensure that borrowers are treated fairly and uniformly.¹⁰

HUD's requirement for lenders to engage face-to-face with borrowers has special value.¹¹ The requirement recognizes the challenge that FHA borrowers have in communicating over the phone by requiring a lender representative with authority to have a face-to-face meeting with the borrower early in the default process or to at least make a reasonable effort to have such a meeting. It is particularly important for borrowers who may have limited communication ability, including elderly borrowers and those with disabilities or limited English proficiency, and borrowers without access to technology. In our recent comments regarding the proposed change to the FHA form mortgage, we shared a story from Atlanta, Georgia of an elderly couple that was overwhelmed by the phone contact and who would have greatly benefited from a face-to-face meeting that they were not provided.¹² The couple eventually received a modification, but could have done so much sooner had the lender followed the regulation. The face-to-face meeting requirement helps to avoid such delays in evaluating loss mitigation options. Delays can lead to increased costs to the homeowners, increased transaction costs for all parties, and, in some cases, unnecessary claim payments when delays cause homeowners to lose eligibility for programs and the homeowners do not have access to assistance.

Because the face-to-face meeting should happen early in the process, it can prevent extended and costly defaults. This requirement prevents the payment of claims by better facilitating cost-saving loss mitigation. The cost of compliance is outweighed by improved outcomes for homeowners and for the Fund. In addition, to increase the requirement's efficiency and scope, HUD may wish to allow borrowers with access to technology to opt in to video meetings with loan servicers. For borrowers with access to technology, videoconferencing may provide additional convenience while imposing a limited burden on lenders.

HUD's loss mitigation regulations require lenders to take modest steps to ensure that their focus is on avoiding unnecessary insurance claim payments and unnecessary foreclosures. These regulations do not cost the economy jobs or impose undue costs. The regulations are not outdated or irrelevant. Moreover, HUD's requirements are consistent with and complement the CFPB's mortgage servicing regulations, while addressing the particular needs of HUD's low- and moderate-income FHA borrowers. Simply put, HUD's loss mitigation regulations promote a healthy insurance Fund.

¹⁰ See, e.g., 12 U.S.C. 1715u(a); 24 C.F.R. §§ 203.602, .604(b), .605.

¹¹ 24 C.F.R. § 203.604.

¹² Comments on 60-Day Notice of Proposed Information Collection: FHA Single Family Model Mortgage Documents, 81 Fed. Reg. 85997 submitted January 30, 2017.

- 2) *HUD's significantly improved menu of FHA loss mitigation foreclosure alternatives should be maintained because it promotes payment relief for FHA's unique borrower profile while limiting unnecessary insurance claims.*

Since 2009, FHA's options for loss mitigation, including FHA's version of the Home Affordable Modification Program, have steadily improved and have provided better savings for the Fund and better relief for FHA's borrowers.¹³ HUD has learned lessons throughout the foreclosure crisis and has made amendments to its loss mitigation waterfall to put those lessons into practice. HUD should continue the progress it has made while preserving access to options that are essential for FHA's low- and moderate-income borrowers. HUD should not eliminate the waterfall program it has worked hard to develop and that it has amended in response to developments.

HUD reached its current loss mitigation waterfall after several years of developing options and responding to the lessons learned. Prior to 2009, HUD loan modifications frequently provided no payment relief, and HUD borrowers with modifications had an extremely high rate of redefault.¹⁴ According to the OCC metrics, over 70% of borrowers with government-guaranteed loans modified in 2008 redefaulted within 18 months of their modifications.¹⁵

HUD recognized the problem it faced and amended the program in response to the financial crisis and in response to statutes Congress passed in 2009.¹⁶ According to Mortgagee Letter 2009-35:

*FHA reviewed its recent insured loan modifications and found that, generally, they resulted in higher payments to the borrower. The higher payment was the result of not lowering the interest rate to the current market rate and/or not extending the term to the maximum of thirty years authorized under 24 CFR 203.616. Generally, the loan modifications simply capitalized the past due amounts and allowable charges and did not extend the term of the loan.*¹⁷

Under Mortgagee Letter 2009-35, HUD allowed for modifications that reduced interest rates for improved payment relief.

¹³ See Dep't Housing and Urban Dev't, Mortgagee Letter 2012-22 (Nov. 16, 2012).

¹⁴ See Dep't Housing and Urban Dev't, Mortgagee Letter 2009-35 (Sept. 23, 2009); Mortgagee Letter 2008-21 (Aug. 14, 2008); Mortgagee Letter 2000-05 (Jan. 19, 2000).

¹⁵ Office of Comptroller of Currency, OCC Mortgage Metrics Report: Third Quarter 2015 at pg. 33 (Dec. 2015), available at <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics/mortgage-metrics-q3-2015.pdf>. It is important to note that this was the most recent OCC Metrics Report that separately lists the redefault rate for government-insured loans. Further, while the government-insured figures include VA and USDA, FHA's loans make up the most significant share.

¹⁶ Helping Families Save Their Homes Act of 2009, Pub.L. 111-22 (May 20, 2009).

¹⁷ Mortgagee Letter 2009-35 at pg. 1.

Through Mortgagee Letter 2009-23, HUD released its version of the Home Affordable Modification Program (FHA-HAMP).¹⁸ Like the Department of Treasury's HAMP, HUD implemented affordability measures through the use of a target payment. It also expanded HUD's Partial Claim option in order to provide forbearance of principal in addition to curing arrears. FHA-HAMP included several strict eligibility rules, however, that unnecessarily limited borrower access and that were not included in Treasury's HAMP.

Unfortunately, with the eligibility restrictions that HUD imposed, FHA-HAMP only had limited success.¹⁹ Very few loan modifications were made through this original FHA-HAMP program, which meant that most modifications for FHA borrowers at that time were made without the benefit of considering an affordable target payment for borrowers. The Department of the Treasury's December 2012 "Making Home Affordable" report, which tracked incentive payments made for FHA-HAMP loans, stated that through October of 2012 there were fewer than 10,000 final FHA-HAMP modifications since the program started compared with over one million HAMP modifications.²⁰ In addition, FHA modifications still did not perform well in terms of redefault rate. In June of 2012, the Government Accountability Office (GAO) issued a report regarding improvements that HUD should make and highlighted the importance of providing payment relief to borrowers in loan modifications.²¹

HUD analyzed problems and again made adjustments to FHA-HAMP. Through the issuance of Mortgagee Letter 2012-22, HUD eliminated overly stringent eligibility rules that prevented reasonable loan modifications and changed the order in which it evaluated borrowers' options (the waterfall) so that FHA-HAMP, the modification program that included an affordable payment standard, was the first option for many borrowers.²² Mortgagee Letter 2012-22 also built payment relief explicitly into the waterfall by expanding operation of the target payment. Some issues remained with income and other matters with the FHA waterfall, and HUD responded with Mortgagee Letter 2013-32 and a 2014 Frequently Asked Questions (FAQ).

The 2012 and 2013 amendments that HUD made to FHA-HAMP and the FHA waterfall greatly expanded access to FHA-HAMP and, as a result, expanded borrower access to modifications that included payment relief. As a result, the Fund has benefitted as well. Through FHA-HAMP, modifications perform better and help avoid unnecessary claim payments and foreclosures. The redefault rate on FHA-insured mortgages shows these improvements. According to the OCC

¹⁸ Dep't Housing and Urban Dev't, Mortgagee Letter 2009-23 (July 30, 2009).

¹⁹ For a full discussion, see National Consumer Law Center, *Foreclosures and Mortgage Servicing* at 6.2.2.2 (5th ed. 2014).

²⁰ U.S. Dep't of Treasury, *Making Home Affordable Program Performance Report Through October 2012*, available at <https://www.treasury.gov/initiatives/financial-stability/reports/Documents/October%202012%20MHA%20Report%20Final.pdf>; see also National Consumer Law Center, *Foreclosures and Mortgage Servicing* at 6.2.2.2 (5th ed. 2014).

²¹ Gov't Accountability Office, *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis*, at 61–62 (June 28, 2012), available at <http://www.gao.gov/products/GAO-12-296>.

²² Dep't Housing and Urban Dev't, Mortgagee Letter 2012-22 (Nov. 16, 2012).

metrics, the redefault rate at 18 months for government-guaranteed loan modifications made in 2014 was almost three times lower than modifications made in 2008 (25% for 2014 vs. 70% for 2008).²³ These amendments greatly increased the efficiency of the loan modification program for homeowners and lenders alike. Instead of requiring lenders to evaluate borrowers for a loan modification program that often failed, thus burdening lenders without benefiting borrowers, the revised rules created a more effective program that helped borrowers by enabling them to save their homes and helped lenders and the Fund by returning loans to performing status.

HUD learned lessons from the financial crisis and amended its waterfall to address those issues. It made significant progress since 2009 on developing a loss mitigation waterfall that has improved outcomes while still using HUD's standard options. It would be counterproductive and would undermine the purposes of the FHA program to weaken the important cost-saving measures that have been developed in recent years.

- 3) *In order to reduce costs to the Fund, HUD should amend the regulation that requires HUD to pay claims even in cases of lender non-compliance with loss mitigation regulations.*

Current HUD regulations do not allow HUD to deny payment of a claim to a lender that fails to comply with loss mitigation regulations. Instead, HUD relies on an after-the-fact compliance mechanism that only evaluates cases after the money already has been paid.

In 24 C.F.R. § 203.500, HUD explains its system for monitoring compliance with loss mitigation regulation.

*This subpart identifies servicing practices of lending institutions that HUD considers acceptable for mortgages insured by HUD. **Failure to comply with this subpart shall not be a basis for denial of insurance benefits, but failure to comply will be cause for imposition of a civil money penalty, including a penalty under § 30.35(c)(2), or withdrawal of HUD's approval of a mortgagee.** It is the intent of the Department that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed.*²⁴

As the highlighted language demonstrates, HUD will not deny an insurance claim payment for loss mitigation failure. Rather, HUD will only assess a penalty when the money has already been paid. This not only allows for payment of unnecessary claims, but the penalty process as a general matter only applies when the homeowner has already lost the home in foreclosure.

²³ Office of Comptroller of Currency, OCC Mortgage Metrics Report: Third Quarter 2015 at pg. 33-35 (Dec. 2015), available at <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics/mortgage-metrics-q3-2015.pdf>

²⁴ 24 C.F.R. § 203.500 (emphasis added).

This significantly reduces the incentive for lenders to comply with claims-saving regulations. HUD should revise this rule so that it has the ability to deny claims to non-compliant lenders where sufficient evidence of material non-compliance has been documented.

- 4) *HUD should revise its program for selling loans through the Distressed Asset Stabilization Program (DASP) to ensure that HUD does not pay unnecessary claims by requiring pre-auction notice to borrowers and by enhancing its pre-claim screening process.*

Under the Distressed Asset Stabilization Program (DASP), HUD makes full insurance payouts to lenders that claim to have exhausted foreclosure alternatives. Through DASP, HUD pools loans that are in default and that lenders choose to include in the pools and then sells these pools of mortgages at auction. After the loan is sold and the insurance claim is paid, HUD takes the position that the loan is no longer FHA-insured and that FHA loss mitigation options no longer apply. Many FHA homeowners, however, have had their loans sold before they have been properly reviewed for loss mitigation.²⁵ The way in which DASP is administered is thus frustrating the goals of HUD's FHA loss mitigation regulations.

When HUD is considering inclusion of a loan in an upcoming auction, it should require the lender to notify the borrower of the proposed action. The notice should inform the borrower that the servicer claims it has satisfied its FHA loss mitigation obligations, and that if the borrower has not been fully evaluated or is currently performing on a loss mitigation option, the borrower may contact HUD's National Servicing Center. Borrowers now do not receive such a notice and instead only find out about the sale and loss of FHA loss mitigation options after their loans are sold.

Providing such a notice would not materially increase costs because the notice could be incorporated into existing systems for sending HUD-required notices. Under 24 C.F.R. § 203.602 and 24 C.F.R. § 203.606, HUD already requires servicers to send specific notices for borrowers in default. The notice will help HUD avoid payment of unnecessary claims because borrowers who have not received a full evaluation will be able to ensure the loan is properly assessed by working with HUD's National Servicing Center. Borrowers who have had a full evaluation are likely to welcome additional home retention opportunities available to them after a DASP sale rather than seeking additional review by HUD.

As described in the recent NCLC report on DASP, HUD must create a system to require lenders to document compliance with loss mitigation prior to a DASP sale.²⁶ FHA-insured loans are routinely processed through foreclosure by servicers who fail to comply with FHA loss

²⁵ For further analysis and details, see Geoff Walsh, National Consumer Law Center, *Opportunity Denied: How HUD's Note Sale Program Deprives Homeowners of the Basic Benefits of Their Government-Insured Loans* (May 2016), available at <https://www.nclc.org/images/pdf/pr-reports/opportunity-denied-report.pdf>.

²⁶ *Id.* at 39.

mitigation guidelines. DASP currently rewards those servicers and loan owners by paying off their claims early, saving them the time and expense of completing or avoiding foreclosures in compliance with FHA rules. Yet, FHA guidelines are intended to promote homeownership even in the face of hardship, providing a flexible menu of options geared to low- and moderate-income homeowners. While current oversight measures primarily rely on self-certification by servicers, a system in which servicers would be required to document the steps taken to follow FHA rules would enhance compliance and improve outcomes. The simple act of requiring documentation and certification is likely to increase up-front compliance more than any back-end supervision program.

- 5) *HUD should preserve its fair housing and disparate impact rules, its funding for low-income housing programs, and its regulations that protect the rights of low-income tenants.*

In addition to our comments on single-family mortgage loans, we want to emphasize the importance of preserving HUD's rules addressing Affirmatively Furthering Fair Housing (AFFH) and Disparate Impact under the Fair Housing Act. These are important tools for ensuring housing opportunity and fair credit access for communities of color. With respect to the AFFH rule, HUD embarked in a lengthy rulemaking process that considered a significant amount of public input prior to the release of the final rule. The accompanying AFFH data and mapping tools are extremely important resources for communities that HUD should not abandon. The Disparate Impact rule provides clarity and consistency for housing professionals and also should not be eliminated.

In addition, we support continued funding for low-income housing programs, and we believe that HUD should preserve regulations that protect the rights of low-income tenants.

Conclusion

HUD should continue its long-term commitment to mandatory loss mitigation, as spelled out in its regulations, and its waterfall of loss mitigation options, including FHA-HAMP, because these programs are essential to the ability of the agency to meet its goals of protecting the Fund and stabilizing homeownership.

Sincerely,

National Consumer Law Center (on behalf of its low-income clients)

Legal Aid Society of Southwest Ohio (on behalf of its low-income clients)