



Recommendations to Improve FHA's Foreclosure Avoidance Program

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The U.S. Department of Housing and Urban Development's Federal Housing Administration (FHA) insures mortgage loans made by private lenders to encourage the lenders to make home loans to low- and moderate-income homeowners. Borrowers with FHA-insured mortgages who experience financial hardship during their mortgage term may be eligible for FHA's loss mitigation program, which includes options, such as loan modifications, to enable them to save their homes. For many borrowers who face a financial hardship, the opportunity to lower their mortgage payment, a change known as a loan modification, is the most effective and appropriate means to avoid foreclosure. Loan modifications help prevent avoidable foreclosures and benefit communities and the FHA mutual mortgage insurance fund.

FHA adopted its current structure for loss mitigation in 2012 and has continually improved the program since then. Homeowners who fall behind on their FHA mortgage are eligible for these options based primarily on household income. FHA's Home Affordable Modification Program (FHA-HAMP) considers the pre-default mortgage terms along with borrowers' income to calculate an affordable payment. Importantly, FHA-HAMP considers the borrowers' individual circumstance provides them with a tailored monthly payment reduction. Studies have shown that lowering the monthly payment facilitates successful loan performance.

While FHA should retain the overall structure of its loss mitigation program, including FHA-HAMP, FHA's servicing rules¹ should be updated to streamline procedures, provide clarity, enhance compliance, and allow for additional flexibility.

Because FHA's current guidance on verifying borrower income lacks clarity, we have seen borrowers required to document ordinary living expenses in excessive detail. **FHA should clarify that verification of expenses for current monthly payment exceeding 31% can be satisfied by the IRS Collection Financial Standards, which provide uniform estimates of expenses without requiring provision of individualized receipts.**²

Borrowers who face hardship because of an absent co-borrower, including hardships resulting from domestic violence, must have clear access to loss mitigation.

FHA has failed to make clear which options are available for borrowers, including borrowers facing domestic violence, who are occupying the home after a co-borrower has left the home. This same problem occurs when a co-borrower is absent because of death, divorce, or separation. This lack of clarity promotes unnecessary home loss, which hurts servicers and borrowers as well as the FHA insurance fund. **FHA should**

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adopt clear rules that allow the co-borrower who remains in the home to access the full range of loss mitigation options.³

FHA rules must allow borrowers to verify financial hardship, especially complicated financial problems, through an affidavit or other signed statement.

FHA loss mitigation is available for borrowers who face financial hardship, and often those hardships are complicated and challenging to document. Because current guidance is unclear, we have seen borrowers face requests for excessive documentation of hardship, which is particularly difficult when the hardship has multiple causes or roots. In similar loss mitigation programs, borrowers have been able to document hardship through the preparation of a signed hardship statement, which gives them an opportunity to explain and document their situation. **HUD's system should not undermine a borrower's ability to use a hardship statement to explain complicated situations by relying solely on forms with listed categories, and HUD's guidance should explicitly allow documentation by signed statement.⁴**

HUD should confirm that borrowers may use verified non-borrower household income in loss mitigation applications, including income of spouses and relatives.

Servicers do not appear to have a consistent policy on the important topic of the use of non-borrower household income for loss mitigation purposes. This is extremely important because this can involve the use of spousal income because spouses are not listed as co-borrowers in many FHA-insured loans. Any income would be from individuals living in the household.⁵ **HUD should provide a clear and inclusive policy that allows use of verified non-borrower household income.**

Borrowers should receive notices when faced with the possibility of losing the FHA-insured status of their loan or when foreclosure is imminent to ensure all loss mitigation has been reviewed, and servicers should document their compliance.

Homeowners with FHA loans who are facing hardship often find that they have been put into foreclosure or have had their loan sold even while they are in the process of applying for FHA loss mitigation after submission of a complete application. Under FHA's rules, this process should be complete prior to initiation of foreclosure or placement of the loan in a loan sale pool. **Before a servicer initiates foreclosure or selects a loan for the Loan Sale Program, servicers should be required to provide a specified notice informing the borrower that the loss mitigation review process has been completed and is unavailable, and that there is an opportunity to appeal any incorrect information.** The notice should include documentation of compliance with the loss mitigation waterfall, the order of foreclosure avoidance options under which a homeowner is evaluated, and provide

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contact information for the servicer and for HUD in case the borrower believes that there has been an error regarding loss mitigation status. Preparing and mailing a form notice, which HUD already requires servicers to do in many situations, would add only minimal costs.⁶

Additionally, HUD should require servicers to document full compliance with FHA-HAMP; the FHA-HAMP waterfall⁷ provides a template for documentation.⁸

As HUD reviews its current regulatory requirements for FHA-insured lenders, it should retain the monthly loss mitigation evaluation early in the default period and the face-to-face meeting between the borrower and the servicer, as they each contribute to foreclosure avoidance.

- The face-to-face meeting requires servicers with offices near their borrowers to have or make a reasonable effort to have an in-person meeting with the borrower in default. For homeowners with communication challenges or with limited transportation, these meetings are critical. This has been a stable feature of loss mitigation and is a regulatory requirement as provided for in 24 C.F.R. 203.604.
- The mandate on mortgage servicers to evaluate for loss mitigation on a monthly basis, especially early in the default period as required by 24 C.F.R. 230.605, is also critical in ensuring that foreclosure alternatives are explicitly considered throughout the delinquency period. A borrower's financial situation may be in flux during the delinquency period, and the requirement for servicers to make an evaluation on a monthly basis ensures that the full range of options to avoid foreclosure are not unnecessarily closed to borrowers.

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Endnotes

¹ The rules in question are set out in HUD Handbook 4000.1, *available at* https://www.hud.gov/sites/dfiles/OCHCO/documents/4000.1hsggh_Update7.pdf. All page citations are to the version released on October 24, 2019, which is fully effective on January 2, 2020.

² FHA can accomplish this change by revising page 658 of Handbook 4000.1, section III(a)(2)(i)(iii)((A)(1)(a), to read: "The Mortgagee must confirm all Borrowers' monthly living expenses with appropriate supporting documentation when the existing total Mortgage Payment (i.e., PITI) is equal to or less than 31 percent of the Borrowers' current monthly gross income. To determine the living expenses, the Mortgagee shall use the IRS Collection Financial Standards as a default. Borrowers shall only have to provide further support for expenses if they have been notified about the availability of the IRS standards, choose to claim an expense amount higher than the IRS standards, and this expense claim has an impact on their loss mitigation eligibility. The Mortgagee shall not routinely request expense documentation."

³ FHA can accomplish this change by revising page 659 of Handbook 4000.1, section, III(a)(2)(i)(iii)((A)(1)(b), to read: "Death, Divorce, or Separation of Co-Borrower: An occupying co-borrower may be considered for loss mitigation if a quitclaim deed evidencing that the non-occupying co-borrower has relinquished all rights to the property has been recorded or there has been a death or divorce. All changes in ownership due to death or divorce of the current owner must be supported by legal documentation. In such a case, the occupying co-borrower need not supply the income information of the non-occupant co-borrower or have the non-occupant co-borrower sign loss mitigation documents. If a final divorce judgment or decree gives full ownership and financial responsibility for the property to the occupying

borrower, a quitclaim deed is not required. The servicer may waive the need for a quitclaim deed in exceptional instances such as domestic violence.”

⁴ FHA can accomplish this change by revising page 659, Section III(a)(2)(i)(iii)(A)(1)(c), to read: “Hardship for purposes of FHA’s Loss Mitigation Options is demonstrated through verification of an increase in living expenses or a loss of income through an affidavit or other means.”

⁵ FHA can accomplish this change by revising page 660 to add Section III(a)(2)(i)(iv)(C): “Non-borrower Income: For purposes of this Section, a non-borrower is someone who is not on the original note (and may or may not be on the original security instrument), but whose income has been relied upon to support the mortgage payment. Non-borrower household income that may be considered for qualification must come from a person who resides in the borrower’s principal residence and supports the borrower’s ability to pay the mortgage on the subject property. Examples include a non-borrower spouse, parent, child or a non-relative, but in each case, a person who shares in the occupancy of the borrower’s principal residence and provides some support for the household expenses. Servicers should include non-borrower household income in monthly gross income if it is voluntarily provided by the borrower and if, in the servicer’s business judgment, that income reasonably can continue to be relied upon to support the household. Non-borrower household income included in the monthly gross income must be documented and verified by the servicer using the same standards for verifying a borrower’s income. The servicer must verify the occupancy of a non-borrower in the same manner it verifies the occupancy of a borrower. A non-borrower occupant shall not be required to assume the loan the non-borrower’s contribution to count towards the borrower’s continuous income.”

⁶ FHA can accomplish this by adding a new section at Page 655, Section III(a)(2)(h)(xiii): “Before a servicer initiates foreclosure or selects any loan for inclusion in the Loan Sale Program, the Mortgagee must send a notice to borrowers stating the following: (i) a summary explaining how the servicer applied the loss mitigation option priority analysis established by the Secretary, including the loss mitigation review waterfall under section III.A.2.j.iii of the Secretary’s Handbook 4000.1 or any successor provision, and setting forth the actual information the servicer entered in applying such analysis; (ii) with respect to any mortgage for which the servicer did not conduct the analysis referred to in clause (i) because the servicer determined that the mortgagor did not express any interest in loss mitigation or provide appropriate documents, the notice shall include— (I) a statement of such determination; (II) a description of the actions that the servicer took to solicit the mortgagor for loss mitigation review and obtain appropriate documents; and (III) a statement of the dates that the servicer took such actions; and (iii) a statement setting forth the results of the servicers’ monthly loss mitigation evaluations for the mortgage required under section 203.605(a) of the Secretary’s regulations (24 C.F.R. 17 203.605(a)) or any successor provision; (iv) with respect to any loss mitigation action for which the mortgagor was determined to be ineligible, an explanation of, and documentation showing, why the mortgagor was determined to be ineligible; (v) a statement informing the mortgagor in plain language, that, upon the request of the mortgagor, the servicer will provide the mortgagor with documentation demonstrating that the servicer has evaluated the borrower for all applicable FHA loss mitigation retention options, and include contact information for the servicer via phone, mail, and electronic mail; and (vi) information describing the functions of and contact information for the HUD National Servicing Center.”

⁷ HUD Handbook 4000.1 at 669-670, *available* at https://www.hud.gov/sites/dfiles/OCHCO/documents/4000.1hsgH_Update7.pdf (FHA loss mitigation waterfall options).

⁸ FHA can accomplish this by adding a new section at Page 655, Section III(a)(2)(h)(xiii): “Before a servicer initiates foreclosure or selects any loan for inclusion in the Loan Sale Program, the Mortgagee must provide HUD with documentation showing that all loss mitigation retention options were evaluated prior to selection for the sale. This documentation should also be provided to the borrower in the mandatory notice.”