COMMENTS

to the

U.S. Department of Housing and Urban Development,

Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD

on

Federal Housing Administration (FHA): Single-Family Loan Sale Program; Advance Notice of Proposed Rulemaking and Request for Public Comment

84 FR 19748; Docket No. FR-6051-A-01

by

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The Legal Aid Society of Cleveland,

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

July 5, 2019

On behalf of the low-income client homeowners and communities we represent,[1] we write in response to the questions posed by the United States Department of Housing and Urban Development ("HUD") through the Advanced Notice of Proposed Rulemaking, Docket No. FR-6051-A-1 (hereinafter "ANPR") related to the impact of the Loan Sale Program[2] on our clients and the communities in which they live, specifically questions 3.1(1), (2), and (3). The comments below address these three questions.

I. Summary

HUD's operation of the Loan Sale Program has stripped borrowers of their rights and weakened neighborhoods without providing positive impact to communities and without meeting obligations under federal law.

HUD's Loan Sale Program as it is currently structured is seriously flawed. The program fails to require any specific pre-sale notice to borrowers, so loans are sold without their knowledge or consent, even though HUD asserts that the sales result in borrowers losing access to HUD's loss mitigation opportunities. The program also does not require servicers to document and certify that they complied with HUD loss mitigation guidelines before referring loans for sale.

HUD has also failed to require that purchasers of loans have a reasonable loss mitigation program for borrowers whose loans have been sold. This failure has encouraged speculators to participate in the Loan Sale Program and has harmed communities.

Given the serious consequences of loan sales for borrowers and communities, HUD should consider a loan sale program as an option only when the insurance fund is under a clear financial threat and other options have been exhausted. In addition,

[1] These comments are submitted by the non-profit organizations listed on the cover page. The National Consumer Law Center was the primary drafter of these comments. Since 1969, the nonprofit **National Consumer Law Center®** (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. www.nclc.org. Questions about the comments can be directed to Steven Sharpe, Of Counsel at NCLC, ssharpe@nclc.org.

[2] For these comments, the term "Loan Sales Program" includes all programs that HUD has recently operated to auction single family homes pursuant to 12 U.S.C. § 1710, including, but not limited to, the Distressed Asset Stabilization Program (DASP), Single Family Loan Sales (SFLS), the HUD-Held Vacant Loan Sales, and the Aged Delinquent Portfolio Loan Sale (ADPLS).

HUD must provide more detailed ongoing data showing how loans perform after sales. This data must include information to assess compliance with the Fair Housing Act, including HUD's duty to affirmatively further fair housing. Finally, before implementing any further sales, HUD must complete the notice and comment process mandated by the Administrative Procedure Act (APA).

We propose policy changes that HUD must make to support homeowners and to minimize the harm to communities. These proposals are simple and cost effective. For example, HUD should require servicers to send borrowers a pre-sale notice explaining that their loans have been selected for sale. Requiring a specific notice about a proposed loan sale will allow borrowers who believe that servicers have not completed loss mitigation to alert the servicer and the agency of this issue, and as a result, help avoid unnecessary sales and claims. HUD already requires servicers to send notices to borrowers who are in default. Sending a notice is a simple and inexpensive task. HUD should also require servicers to document and certify compliance with loss mitigation by using the HUD waterfall from Handbook 4000.1.[3] Servicers should already have this waterfall completed, which can demonstrate that the home retention options have been exhausted. These, and other cost-effective options, can reduce unnecessary sales and claims.

II. Loan Sale Program Basics

A brief outline of the recent history and mechanics of the Loan Sale Program follows.

- The Program

HUD's authority to operate the Loan Sale Program was provided by Pub L. 105-276 (October 21, 1998). It allows HUD to pay insurance claims on loans as long as the loan is three months in payment default or in non-monetary default. 12 U.S.C. § 1710(a)(1)(A). HUD had historically paid claims to lenders *after* they completed the foreclosure process. The note sales, however, trigger the insurance payment earlier in the timeline, as described below.

HUD has not promulgated regulations for the Loan Sale Program pursuant to the APA and it has not issued any Handbooks on the program. Its guidance has been contained in press releases, information sheets, Power Point presentations, and the contract terms between HUD and buyers that are not publicly posted.

HUD has sold over 108,000 loans, with a total value of over $18 billion, through the Loan Sales Program.

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[3] U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook, 4000.1, 609-11 (Mar. 27, 2019).

- Loan Sale Process

Under the Loan Sale Program for single family mortgages, HUD sells pools of loans by auction. These pools have included loans from across the county ("national" pools) or from a specific geographical area ("Neighborhood Stabilization Outcome" or "NSO" pools).

Servicers select the loans to include in the pools. According to HUD, a servicer can include a loan in a pool only if it exhausted all loss mitigation options prior to inclusion. If HUD has specific guidelines that describe how it screens for situations where the loss mitigation review was not completed, HUD has never made these guidelines public. The failure to establish and publish these guidelines violates the APA.

In addition to single family mortgages, HUD has also held auctions of agency-owned homes reported as vacant that had Home Equity Conversion Mortgages (HECM), or reverse mortgages, on them. While truly empty homes do not affect homeowners, their sale does affect what happens in the neighborhood. The guidelines for HECM loans sales must be published and available for comment just like those for the general loan sale program.

- Limited Homeowner Options Post-Sale

Once the FHA insurance claim is paid off and the loan transferred to a buyer, the loan no longer has FHA-insurance. HUD takes the position that this relieves the servicer for the new owner of the loan of the obligation to consider the borrower for FHA-specific loss mitigation options. Despite this significant change, a borrower with a loan selected for the Loan Sale Program does not receive a specific notice in advance of the sale explaining that the current servicer claims to have evaluated the loan for all FHA loss mitigation options and that the borrower will lose FHA-insurance and the rights that go with it if the loan is sold.

- The Results of the Loan Sales for Homeowners and Communities

Private equity entities have purchased the vast majority of loans. Servicers for private equity purchasers foreclose or dispose of loans through short sales and deeds in lieu of foreclosure more often than they modify loans. Moreover, the loan modifications they offer are often unsustainable short-term options that do not allow the borrowers to maintain long-term homeownership.

NSO pools, which make up only a small percentage of loan sales, are promoted as a means of stabilizing neighborhoods, but even these loan sales have contributed to displacement and destabilization. HUD has required purchasers of NSO pools to meet particular benchmarks regarding the disposition of loans, but the purchasers have to meet the benchmarks for only half of the loans in the pool. In addition, the benchmarks include dispositions such as short sales that involve the homeowners losing their homes.

III. Overview of Responses to Questions Included in HUD's ANPR

In these comments we are responding to the questions set forth as 3.1 in HUD's Federal Register notice, 84 FR 19748. Our responses can be summarized as follows:

3.1 Community Impacts

(1) What benefits has the Program provided communities?

As described in IV(A) and (B) below, HUD has stripped important protections against foreclosure from borrowers without replacing the lost protections with anything clear and effective. This failure has limited any positive impact that the Loan Sale Program has had on communities. Moreover, as discussed in IV(D), HUD's failure to provided updated, comprehensive data on outcomes has limited any ability to fully engage in a policy debate about costs and benefits.

(2) What, if any, adverse effects has the Program had on communities?

As described in IV(A) and IV(B), the Program has harmed borrowers and communities by causing unnecessary sales and foreclosures and placing properties in the hands of speculators focused solely on profit. Many loan sales could have been avoided as detailed in IV(C). Further harm is caused, as outlined in IV(E) and IV(F), through HUD's failure to implement and analyze the Loan Sale Program as required by the APA and the Fair Housing Act.

(3) What changes, if any, in the sale structure, loan eligibility criteria, or post-sale requirements on purchasers would improve community impacts? What are the policy trade-offs (e.g., potential adverse impact on bid pricing) of such changes?

We detail specific reforms in section V below. While we recognize that a trade-off from these reforms may be a reduction in any price HUD receives, it is important to note that HUD should first fully explore enforcement and compliance monitoring before engaging in any sale as detailed in IV(C). HUD cannot only focus on its obligations under the MMI fund in engaging in sales, but also must fulfill its homeownership mission. Finally, as discussed in IV(D), HUD must do a better job of collecting data, analyzing it, and, most importantly, making the data and the analysis publicly available. Without data detailing the outcomes and comparing outcomes from engaging in sales versus not engaging in sales, HUD cannot truly determine the costs of the program or justify any claim that it has caused a net benefit to communities.

IV. Responses to Questions 3.1(1), (2), and (3)

A. The Lack of Pre-Sale Safeguards for Borrowers

1. There is Clear Evidence of Failed Screening for Loss Mitigation Compliance.

In considering the harm the Loan Sale Program has caused to communities, HUD need look no further than its own borrowers. The Loan Sale Program barred thousands of borrowers from access to HUD's much-improved loss mitigation options. Despite claims from HUD that sales should only include loans that were fully evaluated for loss mitigation, borrowers who were in the middle of loss mitigation reviews were included in pools of loans to be auctioned off to the highest bidder. These borrowers were moved from a clearly defined loss mitigation system into a system with only vague standards.

For years, advocates have provided HUD with policy suggestions to minimize unnecessary sales, including NCLC's detailed report into the Loan Sale Program entitled *Opportunity Denied: How HUD's Note Sale Program Deprives Homeowners of the Basic Benefits of Their Government-Insured Loans* ("*Opportunity Denied*"), which we have attached.[4] Advocates have consistently sought a requirement for a simple, pre-sale notice and a standard for documenting compliance with FHA loss mitigation. It is the lack of such safeguards that has caused so many loans to be sold before loss mitigation options were exhausted, and has resulted in so many sold loans ending in foreclosure.

In response to problems that consumer advocates and others raised, HUD substantially revamped FHA-HAMP in 2012.[5] The revised FHA-HAMP removed

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[4] *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* 39-43 (May 2016) (hereinafter, "Opportunity Denied"), https://www.nclc.org/images/pdf/pr-reports/opportunity-denied-report.pdf, attached as Exhibit 1; Sarah Edelman, Michela Zonta, and Shiv Rawal, Center for American Progress, *Protecting Communities on the Road to Recovery: Why Strong Standards are Critical for the Distressed Asset Stabilization Program* 26-27 (June 2016) (hereinafter, "CAP Report"), available at https://cdn.americanprogress.org/wp-content/uploads/2016/06/27153616/CommunitiesLeftBehind-report.pdf; Coalition Letter to FHA Commissioner Biniam Gebre (February 4, 2015), attached as Exhibit 2; National Consumer Law Center, *FHA's Distressed Asset Sale Program Should Strengthen Home Retention Goals* (Dec. 26, 2012), attached as Exhibit 3.

[5] U.S. Department of Housing and Urban Development, Mortgagee Letter 2012-22 (Nov. 16, 2012).

problematic barriers to eligibility and made payment relief for borrowers a factor in determining a borrower's target payment. In addition to improving the options available, HUD created a chart that borrowers can use to see how their servicers determined their eligibility for the available options. Following the release of the revised program, modification performance improved and more borrowers were able to access modifications and keep their homes.[6]

Unfortunately, servicers have not consistently complied with these improved loss mitigation protocols. On September 14, 2017, HUD Office of Inspector General (OIG) issued a report entitled *HUD Did Not Have Adequate Controls To Ensure That Servicers Properly Engaged in Loss Mitigation*.[7] This OIG Report outlined significant problems with FHA loss mitigation and stated that "a review of 90 statistically sampled claims that closed from January 1, 2012, to December 31, 2015, determined that 26 had significant servicing deficiencies."[8] The report recognized that these significant servicing deficiencies, which included failure to properly review borrowers for HUD required loss mitigation, unnecessarily put borrowers at risk of foreclosure. These failures also "resulted in an increased overall risk to the program of a projected $120.9 million for losses in which servicers did not properly engage in loss mitigation."[9]

Servicer failure to consistently comply with HUD regulatory requirements was further documented in an October 2016 OIG Report.[10] In that report, the OIG described how it reviewed a sample of HUD insurance claims paid out over a five-year period. The OIG found that HUD paid $141.9 million for servicers' claims for

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[6] 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

[7] U.S. Department of Housing and Urban Development, Office of Inspector General, *HUD Did Not Have Adequate Controls To Ensure That Servicers Properly Engaged in Loss Mitigation*, 2017-LA-0004 (Sept. 14, 2017), https://www.hudoig.gov/sites/default/files/documents/2017-LA-0004.pdf.

[8] *Id*. at 4.

[9] *Id*. While OIG later issued a report revealing no issues with Bank of America's handling of loans that later were sold through DASP, the report itself acknowledged that it analyzed a "non-statistical" sample of only ten loans to reach its conclusion. U.S. Department of Housing and Urban Development, Office of Inspector General, *Bank of America, Plano, TX, Followed the Loss Mitigation Requirements for All of the Loans Reviewed*, 2019-DE-1001, 6 (April 9, 2019). OIG's broad conclusion is not supported by the data. It is also contradicted by the experience of Philadelphia borrowers described below.

[10] U.S. Department of Housing and Urban Development, Office of Inspector General, *FHA Paid Claims for an Estimated 239,000 Properties That Servicers Did Not Foreclose Upon or Convey on Time*, 2017-KC-0001 (October 14, 2016), https://www.hudoig.gov/sites/default/files/documents/2017-KC-0001.pdf.

interest improperly charged after the servicers had missed foreclosures timelines. It is important to note that HUD guidelines build in ample time for considering alternatives to foreclosure, and, as a result, the non-compliance was attributable to unauthorized servicer delays. According to the October 2016 report, HUD incurred $2.09 billion for servicers' claims for unreasonable and unnecessary holding costs (legal fees, property maintenance charges, tax advances) incurred after the servicers missed foreclosure process deadlines set out in HUD guidelines.

What was particularly disturbing about the OIG's 2016 findings was the frequency with which servicers misrepresented their actions when filing insurance claims with HUD. According to the OIG's survey sample, in approximately 45% of the cases in which the servicers should have reduced their claim amounts due to their non-compliance with HUD guidelines, they failed to do so. Instead, they asked for and received full insurance claims as if they had complied with the guidelines.[11]

The OIG found that, when HUD was processing servicers' claims, the agency was not effectively monitoring servicers' compliance with HUD regulations. HUD monitored only a small number of claims.[12] HUD's methods of review were not effective, and the agency did not dedicate adequate staffing resources to conduct hands-on reviews. HUD has never documented how its system of reviews for servicers' compliance with HUD loss mitigation rules before sales is any different from the review system that the OIG found to be so grossly inadequate.

The OIG reports confirm the consistent experience of HUD-insured borrowers. Simply put, we have seen widespread, persistent non-compliance with HUD loss mitigation for many years. Borrower advocates have also consistently raised non-compliance with HUD loss mitigation guidelines in court proceedings and in complaints to HUD. For example, in connection with comments made in January 2017, we collected numerous stories of servicer non-compliance. We have attached those comments as an appendix.[13] In addition, in foreclosure cases across the country borrower advocates have successfully shown servicers' failure to comply with HUD guidelines.[14] These were cases that the servicers should never have brought to court.

This failure by servicers to correctly analyze loss mitigation is critically important with respect to the Loan Sale Program because it means loans are sold that have not been fully analyzed for FHA-HAMP and other options. These transfers, according to

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[11] *Id*. at 7.
[12] *Id*. at 8.
[13] Coalition Comments on 60-Day Notice of Proposed Information Collection: FHA Single Family Model Mortgage Documents, 81 Fed. Reg. 85997, 10-16 (Jan. 30, 2017), attached as Exhibit 4.
[14] For a full discussion of borrowers raising defenses to foreclosures, please see National Consumer Law Center, Home Foreclosures 6.2.5.1 (2019).

HUD, eliminate the borrower's ability to access FHA-HAMP and other HUD loss mitigation obligations.

2. The Lack of Pre-Sale Notice to Borrowers Encourages Servicer Non-Compliance.

After a loan sale, servicing of the loan is transferred to a new servicer working for the investor who won the auction. [15] At some point after the sale, homeowners receive notice that they have a new mortgage servicer. For most homeowners, the notice about a new servicer is how they first learn that their mortgage was sold. Their participation in the HUD insurance program was terminated without warning. They receive no clear explanation from HUD or anyone else of the severe consequences flowing from their inclusion in the Loan Sale Program. In fact, when notified of the new servicer, homeowners have often received no formal notice that their FHA insurance was removed. The homeowners have no opportunity to object to the sale even if they were in the process of being reviewed for a HUD loan modification as their loans were sold.

If HUD required a pre-sale notice, a servicer would notify the borrower that the servicer believed it had exhausted all HUD loss mitigation options and was planning to include the loan in the Loan Sale Program. If the borrower had in fact not exhausted loss mitigation, the notice would provide the borrower with a process for raising this issue.

Providing such a notice would give borrowers an opportunity to inform the servicer and potentially HUD of any disagreement regarding loss mitigation status. The notice would alert borrowers to the potential for a fundamental change in the status of their loans. These borrowers pay FHA premiums and deserve to know their loan's status. Preparing and mailing a form notice, which HUD already requires servicers to do in many situations, would add only minimal costs.

HUD currently requires that a servicer's loss mitigation evaluation notice to the borrower only mention the possibility of a loan sale. Rather than specifically state that a loan has been selected for auction because loss mitigation was exhausted and rather than provide an avenue for addressing issues, HUD's boilerplate language simply offers a loan sale as one possible outcome that could happen along with foreclosure.[16] It is insufficient and not responsive to the needs of borrowers. It also fails to prevent loan sales during the loss mitigation process, causing HUD to pay unnecessary claims.

[15] For a longer discussion of this system, see *Opportunity Denied* at 11.
[16] U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook 4000.1 at 602 (Mar. 27, 2019).

After loan sales, borrowers who have raised concerns with the National Servicing Center generally have been told that their loans have been sold and have not received clear direction on how to address disputes. Advocates working with borrowers have been directed to the Asset Sales team at HUD, and have had some success in undoing sales. However, HUD has not publicized this avenue as a means for addressing problems, so it is not truly accessible.

3. The Failure to Require a Certification of Compliance with HUD Loss Mitigation Guidelines Allows Servicers to Avoid Accountability.

HUD has failed to adopt our suggested requirement for certification and documentation of servicers' evaluation of FHA-HAMP prior to sale.[17] As explained above, in improving the FHA-HAMP system, HUD has prepared a detailed waterfall document to guide servicer eligibility. It is a flow chart that all servicers must use to run through all available options. From the outset of the Loan Sale Program, we have advocated that servicers demonstrate, through such a waterfall chart, that they have fully evaluated the borrower for HUD loss mitigation and certify that that the document is accurate. This would provide another safeguard against a defective or omitted evaluation.

4. Bank of America's Fiasco in Philadelphia- What Happens When HUD Does not Require Pre-Sale Notice and Certification.

HUD's failure to prevent unnecessary loan sales has led to borrowers losing their rights to loss mitigation over the entire life of their loans. These concerns are not theoretical. We have seen evidence of these problems in our clients' cases.

The experience of 23 Philadelphia homeowners who had their Bank of America - serviced loans sold while in active mediation reflects the problems with HUD's system. These stories are detailed in depth in NCLC's *Opportunity Denied* report, which we have attached.[18] These homeowners were appearing for court-supervised settlement conferences because they wanted Bank of America to review them for FHA loss mitigation options. Several had met with Bank of America numerous times. In each case, evaluation of the borrower for loss mitigation options was ongoing and Bank of America had requested documentation from them.

Despite this, Bank of America elected to have these loans sold through the Loan Sale Program, and despite their ongoing participation in mediation, homeowners were told they had no further access to HUD loss mitigation. They received no notice prior to the sale. In fact, they discovered that sales happened while Bank of America's representatives were continuing to request information and process forms for HUD loss mitigation.

[17] *Opportunity Denied* at 39.
[18] *Id.* at 13-16, Exhibit 1.

These incidents are clear evidence of a deep systemic problem. In each case the servicer falsely reported to HUD that it had completed all required loss mitigation reviews. HUD accepted the false statements at face value and allowed the loans to be sold. This happened 23 times with one servicer in one location over a short time period. Under a minimally competent system of oversight, this would never have happened. It was only by virtue of a unique local mediation program with its own well-trained oversight staff that these incidents came to light. Elsewhere in the country these abuses would have likely have gone undetected.

Borrowers in active mediation had an undeniably clear basis to dispute their servicers' contentions that they had exhausted the loss mitigation review process. Moreover, a requirement to document and certify full evaluation of loss mitigation would likely stop a servicer in active mediation from submitting the loan to HUD for a sale.

B. The Lack of Post-Sale Safeguards for Borrowers and Communities

1. <u>HUD has failed to require a reasonable modification program for borrowers whose loans have been sold.</u>

In sharp contrast to the required FHA-HAMP protocol for HUD-insured servicers, HUD has not required loan sale purchasers to consider specific options for borrowers in default. Borrowers who have their loans sold lose access to a stable and transparent program without any clear replacement for it.

Prior to 2015, HUD did not impose any requirements on servicers that detailed what post-sale loan modification programs must include. For loans sold through the national pools, there were no limits on how servicers could handle the properties and notes they acquired. Purchasers simply had to meet minimal reporting requirements. While HUD imposed additional obligations on purchasers of NSO pools, even these did not have specific requirements for loan modifications. Instead, the purchasers simply had to meet one of several outcomes for half of the loans in the pool. One of the outcomes was a broadly defined loan modification, but others were dispositions such as short sales that involved the homeowners losing their homes.

Starting in 2015, after most of the sales had already occurred, HUD imposed some guidance on servicer evaluation of loan modifications, but the obligations are vague and may no longer apply. In an April 2015 press release, HUD required that all loans be evaluated for a HAMP-like modification, which apparently referred to the

Department of Treasury's HAMP program, which expired in 2016.[19] HUD updated this requirement in a June 2016 press release by adding a requirement that lenders consider principal reduction first in evaluating for HAMP-like modifications and that lenders limit payment changes by capping interest rate increases in modifications that have stepped up interest rates.[20] None of these requirements, however, were promulgated through a public process and the HUD Handbook addressing single family mortgages does not include them.[21]

HUD's 2015 and 2016 amendments were too vague to provide any clear avenue for relief for homeowners. Most importantly, the guidance references a program that no longer exists. HAMP expired over two years ago and its program rules are no longer updated. In addition, even the 2016 press release with its updated requirements does not address the basic eligibility and waterfall issues that a modification program must include. Most importantly, HUD has released no data since the changes were made to determine whether these improvements produced better outcomes for borrowers than they would have seen had no sales taken place and the HUD servicers properly implemented mandatory guidelines.

The data that HUD has released through its reports (which do not capture the impact of the policy changes) show that HUD's requirements have not led to consistent modifications. As illustrated in NCLC's *Opportunity Denied* report, modifications of loans were not widespread.[22] Moreover, HUD's data were based on self-reporting of data by Loan Sale Purchasers and did not include loans that were re-sold.[23]

2. <u>Without broadly applicable rules to avoid it, note sales have fueled activity by speculators and other investors with little interest in preserving stable and affordable neighborhoods</u>

The harms that the Loan Sale Program caused extend beyond the borrowers who had their loans sold. Unfortunately, as bulk sales of distressed assets have increased, so too have predatory practices that use sold homes as collateral. FHA's loan sale program, along with the programs from the Government Sponsored Entities (GSEs), makes homes available for sale by predatory land installment contracts after

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[19] U.S. Department of Housing and Urban Development, Press Release: HUD Announces Changes to Distressed Asset Stabilization Program, No. 15-048 (April 24, 2015).
[20] U.S. Department of Housing and Urban Development, Press Release: FHA Announces Most Significant Improvements to Date For Distressed Notes Sales Program, No. 16-105 (June 30, 2016).
[21] U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook 4000.1 at 664 (Mar. 27, 2019).
[22] *See Opportunity Denied* at 32.
[23] *See id. at* 33-34.

foreclosure on these homes is completed. These programs have also facilitated the increased participation of Wall Street firms in the single family rental business, which takes homes off the market for families and which has led to increased rent and fees on already rent-burdened tenants. HUD has failed to curb these pipelines.

Sales through the Loan Sale Program have overwhelmingly gone to private equity funds and hedge funds as opposed to non-profit or other mission driven entities.[24] The stark imbalance favoring private equity is not limited to the unrestricted national pools, but it has occurred in the NSO pools as well.[25] According to HUD's March 2017 report on the Loan Sale Program, approximately 5% of NSO loans have gone to non-profits.[26]

For the private equity funds and hedge funds that have been the primary buyers of defaulted FHA loans, their interest is to maximize profits upon resale of the loans they buy. As discussed in the Center for American Progress's report on FHA's loan sales, many auctioned loans were in weak housing markets hit hard by the foreclosure crisis. "While profit-motivated private investors may have an economic incentive to rehabilitate and resell the homes acquired through auctions in stronger markets, they may be less inclined to do so in weaker markets. In the absence of strong economic incentives, investors may neglect their properties in weaker market."[27] These private equity entities do not act to further the goals of preserving homeownership for low- to moderate-income Americans, a goal that Congress directed HUD to achieve.

Importantly, the private equity firms also do not operate with the interests of the municipalities and neighborhoods in mind. As stated in the CAP report, "DASP in its current form appears to shift some of the costs associated with foreclosures from the federal government to neighborhoods and local governments."[28]

HUD failed to curb these interests. The overwhelming majority of loans were sold through national pools and did not have any restrictions on what buyers could do with them. Only NSO pools had post-sale disposition requirements imposed by HUD, and these requirements were inadequate as they only applied to half of the loans sold in a given pool and included disposition options that did not promote sustainable homeownership.

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[24] U.S. Department of Housing and Urban Development, Report to the Commissioner on Post Sale Reporting Distressed Asset Stabilization Program 9 (March 2017), https://www.hud.gov/sites/documents/SFLSCREPORT.DOCX; *Opportunity Denied* at 37.
[25] *Id*.
[26] *Id*.
[27] CAP Report at 23.
[28] *Id*. at 1.

Bulk sales of defaulted loans have fueled the rise of predatory land contracts and similar transactions.[29] Predatory land contracts have a racist history related to historical redlining and the failure of policy makers to redress it.[30] The current predatory land installment contracts we see in the market are designed to fail. They involve the sale of uninhabitable homes to prospective purchasers who have no chance of adequately repairing the homes and few protections from repossession, especially since the contracts often include extremely high interest rates that impose a significant financial burden.

In the current market, we have seen large-scale origination of these predatory contracts by larger firms supported by private equity. As illustrated in a New York Times article, "[d]ozens of these houses were scooped up after the financial crisis by investors, who then make deals with low-income home buyers unable to get traditional mortgages."[31] The private entities making the predatory loans have been the subject of several local, state, and national investigation and enforcement actions.[32] These entities have failed to create homeownership opportunities, but instead have caused harm.

According to a recently-released academic paper, bulk sales of loans have supplied these entities with homes to use for sale.[33] While the paper focuses primarily on Fannie Mae's role in supplying homes eventually put up for sale by installment contract, it shows that one entity obtained a significant part of its portfolio from HUD. Critically important is the role that bulk sales have in transferring properties from the government to private equity entities that act under no restrictions and foreclose on the properties, making these homes available for speculation.

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[29] *See* Eric Seymour and Joshua Akers, *Portfolio solutions, bulk sales of bank-owned properties, and the reemergence of racially exploitative land contracts*, Cities 89 (2019) 46-56 (hereinafter, "Seymour and Akers"); CAP Report at 23; Matthew Goldstein and Alexandra Stevenson, *Market for Fixer-Uppers Traps Low-Income Buyers*, New York Times (Feb. 20, 2016).

[30] National Consumer Law Center, *Toxic Transactions: How Land Installment Contracts Once Again Threaten Communities of Color* (July 14, 2016), https://www.nclc.org/images/pdf/pr-reports/report-land-contracts.pdf

[31] Matthew Goldstein and Alexandra Stevenson, *Market for Fixer-Uppers Traps Low-Income Buyers*, New York Times (Feb. 20, 2016).

[32] Matthew Goldstein and Alexandra Stevenson, *Cincinnati Sues Seller of Foreclosed Homes, Claiming Predatory Behavior*, New York Times (April 20, 2017); Wisconsin Department of Justice, Press Release: Wisconsin DOJ Files Lawsuit Against Deceptive Property Management Company and its Many Affiliates (June 5, 2017);Consumer Financial Protection Bureau, *Decision and Order on Petition by Harbour Portfolio LLC to Set Aside or Modify Civil Investigative Demand*, 2016-MISC-Harbour Portfolio-0001 (Nov. 1, 2016), https://files.consumerfinance.gov/f/documents/Decision_and_Order_on_Petition_by_Harbour_Portfolio_LLC_to_Set_Aside_or_....pdf.

[33] *See* Seymour and Akers at 46-47.

In addition to predatory land contracts, bulk sales have helped private equity firms buy a significant number of single family homes for high-cost rental. This trend takes homes off the market for individuals to purchase, yet it does not supply quality affordable housing to people who need it. As discussed in a recent Americans for Financial Reform report, "Wall Street landlords are accountable to investors to increase profits. . . . Tenants are negatively impacted, with large annual rent increases, fee gouging, a high rate of evictions, and rampant habitability issues."[34] The report cites FHA's bulk loan sales as a provider of the rental homes.[35]

C. HUD Engaged in Loan Sales Without Exhausting Other Avenues to Reduce Financial Losses Without Harming Borrowers and Communities.

It is clear that HUD faced a very challenging financial situation in the aftermath of the financial crisis. As described in its own reports and detailed in *Opportunity Denied*, a large backlog of insured claims developed during the early years of the foreclosure crisis and caused stress to its MMI insurance fund.[36]

However, HUD failed to exhaust other options—options that would have preserved homeownership, protected communities, and avoided rewarding services that had delayed in resolving delinquencies—before embarking on loan sales. Despite the regulations and guidance in place directing servicers to act in a diligent and timely manner in handling loans in default, the large servicers chose to delay foreclosure. They did so for a number of reasons, including as a response to investigations into their misdeeds during the foreclosure crisis. In delaying the process and not timely handling loss mitigation, the servicers caused the backlog of claims. HUD's liability for these claims grew exponentially as the servicers refrained from completing foreclosures.[37]

The Loan Sale Program addressed the servicers' backlog by giving them a shortcut. Rather than requiring them to do their jobs of managing foreclosure and loss mitigation, it allowed them to pool loans in default for auction. As a result, despite their failures to meet foreclosure timelines, the servicers were paid their full claims.

HUD had ample legal authority to make its servicers review borrowers for loss mitigation and follow reasonable foreclosure time frames. It could have used its authority to impose significant sanctions on servicers that failed to meet clear

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[34] Americans For Financial Reform, ACCE Institute, and Public Advocates, *Wall Street Landlord Turn American Dream into Nightmare* at 5 (January 2018), https://d3n8a8pro7vhmx.cloudfront.net/acceinstitute/pages/100/attachments/original/1516388955/WallstreetLandlordsFinalReport.pdf?1516388955.
[35] *Id.* at 10.
[36] *See Opportunity Denied* at 24-25.
[37] *Id*. at 18-25.

foreclosure timelines and increased its compliance monitoring to ensure that servicers had systems in place to meet HUD standards.[38]

Vigorous enforcement of HUD's loss mitigation requirements for servicers would have allowed homeowners to reinstate loans to performing status through FHA-HAMP modifications. Effective use of HUD loss mitigation tools would have reduced losses to the insurance fund and preserved homeownership.

Although HUD was clearly aware of the potential of better loss mitigation to improve the financial status of the fund while simultaneously saving homes, it does not appear that HUD performed any significant analysis to quantify the benefit of effective loss mitigation or to enable any comparison to the effect of the Loan Sale Program.

The Loan Sale Program has provided financial benefits to the same servicers (many of them large banks) who sidestepped HUD's rules, absolving them of any responsibility for the servicing problems they created. This was avoidable and favored servicers to the detriment of borrowers and communities.

D. HUD has failed to adequately analyze and share data with communities, and the data it has provided does not justify its continued operation of the program under current guidelines.

In order to fully assess the impact of the Loan Sale Program on communities and borrowers, HUD should collect significant data on the loans it has sold, analyze that data, and report its findings and analysis to the public. HUD has failed to meet this standard, and, in fact, it has failed to publicly release any reporting for two years. Because of this lack of data, we have asked HUD to delay this ANPR process. HUD has responded to this request by acknowledging updated data exists, but the agency has not yet provided it.

HUD cannot engage in responsible decision-making without collecting and analyzing data about these sales, and making the data and analysis available to the public for review and comment. Without more recent data, it is difficult to answer the questions posted in the ANPR concerning the impact and outcomes of the program. Most loans sold under DASP were sold during 2013-2014. The reporting periods for these sales ended during 2017-2018. To make informed comments, the public needs the opportunity to review the data for the completed reporting periods for the significant 2013-2014 sales.

In addition, without this reporting, it is impossible to tell whether the 2015-2016 changes to the DASP guidelines had any effect on DASP outcomes. Given that the 2015-2016 changes were specifically put into place to better help homeowners

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[38] *See*, *e.g.*, 24 C.F.R. § 203.500.

avoid foreclosure and increase nonprofit participation, access to this information is necessary for interested parties to meaningfully answer the questions raised in the ANPR.

HUD has also provided no public reporting at all on the ongoing sales of Home Equity Conversion Mortgage (HECM) pools. These loans are sold through the same statutory authority as all other Loan Sale Program auctions, and are therefore included in this ANPR.

Since 2013, we have consistently asked HUD to provide reporting on all aspects of its distressed loan sale program.[39] We made these requests through letters, in-person discussions, and Freedom of Information Act (FOIA) requests. HUD is aware that this data is important, yet it is either not producing the necessary data or not sharing it. Most recently, HUD has acknowledged that it has data about more recent sales, but despite our requests, it has not yet made this data available to the public.

Moreover, there are significant holes in the data analysis that HUD provided up through early 2017. First, the reports exclude data on a significant number of loans that were re-sold by the original purchasers to other investors. Second, HUD has never reported data on re-default rates after certain loans were supposedly brought to re-performing status after sales. HUD's reporting terminology categorizes a loan as "performing" if the borrower made a fixed number of payments after a buyer acquired the loan. Given that buyers often used deceptive practices to delay foreclosures after sales, such as temporarily allowing interest-only payments without permanently modifying the loans, it is likely that many of these "re-performing" loans were short-lived.

E. HUD has failed to operate its Loan Sale Program in accordance with the Administrative Procedure Act, and this lack of program rules has caused harm to communities.

Although Congress granted HUD statutory authority to engage in the Loan Sale Program starting with the passage of a 1998 bill, HUD has not completed a rulemaking process to implement the program prior to engaging in note sales. In fact, as noted in HUD's current ANPR, the agency withdrew its previous ANPR in 2007.

HUD's decision to commence sales without a full consideration of the program's impact on the agency's obligations to homeowners and communities and without clear rules to govern the program violated the Administrative Procedure Act (APA). In order for HUD to operate the Loan Sale Program under the statutory authority

[39] For examples of data requests made, see the February 28, 2013 letter to HUD, attached as Exhibit 5, and April 29, 2019 FOIA request, attached as Exhibit 6, included with these comments.

Congress granted it, HUD had to promulgate regulations to guide its operation. HUD started the process but failed to follow through on adopting them before selling thousands of loans.

HUD's failure was made very clear in a July 2017 HUD OIG report.[40] The OIG made it clear that in order for HUD to exercise its statutory authority to sell distressed loans, HUD had to pursue rulemaking. The OIG first noted the basic principles of the APA and the process for implementing statutes:

> This process includes publishing a statement of rulemaking authority in the Federal Register for all proposed and final rules. The proposed rule, or notice of proposed rulemaking, is the official document that announces and explains the agency's plan to address a problem or accomplish a goal. Agencies must publish proposed rules in the Federal Register to notify the public and to give citizens an opportunity to submit comments.[41]

After stating this standard, OIG found that the Loan Sale Program (using the name of DASP in its analysis) is a substantive rule that is subject to these requirements.[42]

The report then outlines how the agency failed to meet the applicable APA standards. HUD created several different documents setting out rules and policies for the loan sales that it conducted, but it did not publish these in any way. This failure to publish, the OIG noted, was critically important. "As a result of HUD's not conducting rulemaking, public officials, citizens, and industry participants were not given the opportunity to provide comments for a more than $18 billion program. Additionally, with no formal procedures or guidebooks, HUD lacked a consistent standard for administering its program."[43] The OIG recommended that HUD complete formal rulemaking.[44]

HUD also sold notes through what it termed as the Vacant HECM and Aged Delinquency Sale. The agency has continued to sell HECM loans even after the critical OIG report on its failure to comply with the APA. These programs are operated under the same statutory authority and also lack transparent rules and reporting.

Finally, any claim by HUD that the program thus far has only been a demonstration and not a full version of the Loan Sale Program is belied by the facts. HUD has sold

[40] U.S. Department of Housing and Urban Development, Office of Inspector General, *HUD Did Not Conduct Rulemaking or Develop Formal Procedures for Its Single- Family Note Sales Program*, 2017-KC -0006 (July. 14, 2017), https://www.hudoig.gov/sites/default/files/documents/2017-KC-0006.pdf.
[41] *Id*. at 4.
[42] *Id* at. 5-6.
[43] *Id*. at 6.
[44] *Id*. at 2.

over 108,000 loans, amounting to billions of dollars in asset value. Given the scope of these figures and the broad impacts on borrowers and communities, HUD's attempts to avoid the APA issues by claiming that it only it ran a demonstration does not hold up to scrutiny.

F. HUD has failed to comply with its mandates under the Fair Housing Act.

Under the Fair Housing Act, HUD has an obligation to operate the Loan Sale Program in a non-discriminatory manner and in a way that in fact affirmatively furthers fair housing (AFFH).

Since its passage in 1968, the Fair Housing Act has imposed dual mandates. First, it prohibits discrimination against protected classes with respect to the real estate transactions. According to the United States Supreme Court, this prohibition against discrimination covers policies that have a disparate impact on protected classes.[45]

Second, the Fair Housing Act imposes a duty on HUD to operate its loan program in a manner that affirmatively furthers fair housing. According to 42 U.S.C. § 3608(e)(5), the Secretary of HUD must "administer the programs and activities relating to housing and urban development in a manner affirmatively to further the policies of this subchapter."

The FHA-insured mortgage program is inextricably tied to race. For decades, HUD imposed a practice of redlining when it evaluated locations for issuing insurance contracts for the single family loans.[46] The agency also required restrictive covenants in deeds covered by insured loans to exclude African Americans from purchasing homes.[47] These racist practices insured that African Americans and other communities of color had no access to this critical pipeline for purchasing homes and creating wealth. The damage that this redlining caused and continues to cause has been detailed in many outlets.

However, HUD has now become the key supplier of credit to communities of color. In 2017, 34 percent of all minority borrowers used HUD insured mortgages to purchase their homes.[48] It is not surprising, as a result, that auctions have occurred in places with high minority concentration. According to the Center for American Progress's 2016 analysis of loan sales, "about 84 percent of notes in the sample

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[45] Texas Dep't of Hous. & Cmty. Affairs v. Inclusive Communities Project, Inc., 135 S. Ct. 2507, 2510, 192 L. Ed. 2d 514 (U.S. 2015).
[46] Richard Rothstein, The Color of Law 65-66 (2017).
[47] *Id*. at 83.
[48] U.S. Department of Housing and Urban Development, *Annual Report to Congress Regarding Financial Status of the FHA Mutual Mortgage Insurance Fund* 24 (Nov. 15, 2018).

were sold in ZIP codes with a higher concentration of people of color than the national median."[49]

With the HUD program's role in supplying mortgages to communities of color and with the high frequency of sales in communities of color, HUD's decisions with respect to its loans and their disposition necessarily implicate race. In order to determine whether the Loan Sale Program affirmatively furthers fair housing, the agency must engage in an analysis. It is critical that HUD's assessment consider the extent to which its Loan Sale Program actually serves to improve and further fair housing for its borrowers and communities. HUD must also analyze the anticipated effects of the Loan Sale Program on borrowers of color to prevent avoidable disparate impact.

Yet HUD has provided no documentation demonstrating that it has considered how the Loan Sale Program meets its obligations to affirmatively further fair housing or the potential for the program to cause negative impacts on borrowers of color and their communities. If HUD has completed such an assessment, interested parties should have an opportunity to review it.

The evidence available to us shows that the Loan Sale Program in practice has not only fallen short of affirmatively furthering fair housing, but actually harms communities of color. A current lawsuit that is pending the Eastern District of New York details how the Loan Sale Program has had a disparate impact on African-American borrowers in the New York City region by putting them at greater risk of foreclosure and threatening the stability of their neighborhoods.[50] HUD has failed to meet both the AFFH and anti-discrimination mandates of its Fair Housing Act obligations in its operation of the Loan Sale Program.

V. Necessary Policy Reforms

As described above, HUD's operation of the Loan Sales Program has caused significant harm to borrowers and the communities in which they reside. Drastic change to the program is needed. Below we specify critical amendments to protect borrowers. These specifically address the question posed in 3.1(3), which seeks comments for changes to the programs.

The reforms we propose here should apply to all sales through the Loan Sales Program, including HECM sales and Aged Delinquency sales, and not only to sales that HUD labels as DASP.[51]

[49] CAP Report at 12.
[50] Washington v. U.S. Department of Housing and Urban Development, No. 16-cv-03948 (E.D.N.Y. 2016).
[51] For further detail on these recommendations, see *Opportunity Denied* at 39-43.

A. HUD should not engage in any note sales unless the agency faces unusual financial difficulty with the MMI fund and has exhausted all avenues to reduce financial losses through increased compliance monitoring and enforcement. HUD should:
    a. Resort to loan sales only when HUD can document an imminent threat of a negative balance to the MMI. Distressed loan sales should not become a "normal" or routine feature of the HUD single family insured loan program.
    b. Require servicers to document and certify compliance with each step of HUD's sequential loss mitigation review, including documentation of the grounds for denial of foreclosure alternatives, before HUD allows any loan to be sold in a loan sale.
    c. Impose meaningful penalties on servicers who delay processing loss mitigation requests or systemically circumvent FHA loss mitigation requirements.
    d. Promote servicers' compliance with state and local laws, including mediation requirements.
B. HUD must propose and promulgate, through an APA-compliant process, regulations to avoid unnecessary sales of loans that have not been fully evaluated for loss mitigation. The regulations should:
    a. Require servicers to provide notice to homeowners prior to sale informing them that the loan is being proposed for sale as a result of the exhaustion of loss mitigation alternatives.
    b. Provide a specific avenue for borrowers to dispute unnecessary inclusion in loan sales pools.
    c. For all HUD insured loans, create a full appeal process for denials of loss mitigation options in order to ensure that borrowers are fully evaluated for loss mitigation.
C. HUD should create a comprehensive and publicly accessible loss mitigation protocol to ensure that borrowers, including those borrowers who lose access to FHA-HAMP through a loan sale, have access to reasonable home-saving options. Specifically, HUD should:
    a. Implement a detailed loss mitigation protocol that provides home-saving loss mitigation protections (at least as effective as FHA-HAMP) to homeowners, including homeowners with loans in significant default and HECM loans, and prioritizes principal balance forgiveness.
    b. Require purchasers to publicly disclose their loss mitigation options.
    c. Establish an effective system of monitoring and enforcing loss mitigation requirements for new owners and servicers.
    d. Bar from future auctions buyers who have purchased FHA loans in the past but systemically violated loss mitigation standards and other program requirements.
    e. Apply these requirements to all types of loan sales and not just those that it labels as DASP.

D. HUD should adopt specific and comprehensive requirements for servicer reporting and HUD's release of data analysis to assess compliance. In particular, HUD should:
    a. Make collected data public, and release reports analyzing the data on a quarterly basis.
    b. Require reporting of post-sale loss mitigation activities, including data to show the levels and nature of payment changes, old and new borrower debt-to-income ratios, and re-default rates after modifications.
    c. Mandate post-sale reporting of demographic and geographic data about homeowners, loss mitigation, and loan performance.
    d. Report data on subsequent sales and rentals involving the properties.
    e. Establish a clear rule that post-sale reporting requirements are binding on subsequent buyers of the loans.
    f. Assess meaningful financial penalties for substantial noncompliance with reporting requirements and bidding contract terms.
E. To protect communities of color from displacement and predatory practices, HUD should impose restrictions on the disposition of properties acquired by all loan sale purchasers after foreclosure. HUD should:
    a. Prohibit purchasers from using land installment contracts in the sale of properties unless they are non-profits.
    b. Place publicly accessible limits on the number of properties that can be disposed through an outcome that is not one of the following: (1) sold at or below the current value to an owner occupant, (2) occupied by a tenant at or below Area Median Income (AMI) paying an affordable rent; or (3) sold or donated to a non-profit or local government entity that will commit to one of those outcomes.
F. HUD should create individualized local pools for mission-minded nonprofits and for local governments through direct sale using a pricing model that supports the desired neighborhood outcomes. The sales must be made to organizations that have the capacity to work with borrowers and reach reasonable alternatives to foreclosure with them. This will allow community organizations to access loans to further neighborhood stability.

Thank you for the opportunity to comment on this important rulemaking. For further discussion, please contact Steve Sharpe at ssharpe@nclc.org

APPENDIX

Exhibit 1 2016 Report: Opportunity Denied: How HUD's Note Sale Program Deprives Homeowners of the Basic Benefits of Their Government-Insured Loans

Exhibit 2 2015 Consensus Letter to HUD with Recommendations for DASP

Exhibit 3 2012 Policy Brief: FHA's Distressed Asset Sale Program Should Strengthen Home Retention Goals

Exhibit 4 2017 Comments to HUD on 81 Fed. Reg. 85997 Demonstrating Instances of FHA Non-Compliance

Exhibit 5 2013 Data Request to HUD Inquiring about Loans Sold Through the Distressed Asset Sales Program

Exhibit 6 2019 FOIA Request to HUD

EXHIBIT 1

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OPPORTUNITY DENIED

How HUD's Note Sale Program Deprives Homeowners of the Basic Benefits of Their Government-Insured Loans

May 2016

By

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National Consumer Law Center®

ABOUT THE AUTHOR

Geoff Walsh is a staff attorney at the National Consumer Law Center (NCLC) who focuses on foreclosure prevention, consumer bankruptcy, and other consumer credit issues. He has provided written testimony and engaged in policy advocacy at the federal and state levels on foreclosure topics. He has served as a panelist and instructor at trainings and legal education seminars on foreclosure prevention and bankruptcy topics. Walsh is co-author of *Foreclosures and Mortgage Servicing*, *Foreclosure Prevention Counseling*, *Student Loan Law*, and *Credit Discrimination*. Walsh previously worked as an attorney with Vermont Legal Aid, Inc. in Springfield, Vt. from 1991 to 2008, specializing in housing, consumer, and bankruptcy areas. From 1980 to 1991, he worked as a staff attorney with Community Legal Services, Inc. in Philadelphia, Pa., where he also specialized in housing and consumer litigation. Walsh earned his B.A. from University of Michigan and is a graduate of Temple University Law School.

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REPORT HIGHLIGHTS

1. **HUD's loan sale program, the Distressed Asset Stabilization Program (DASP), has had a major negative impact on vulnerable homeowners and on federal housing funds.** DASP is the largest auctioning off of government-insured single family mortgage loans in the nation's history. To date, under DASP, HUD has sold over 105,000 FHA-insured home loans valued at $17 billion, and the private firms that bought most of the loans acquired them at a significant discount. FHA-insured mortgages represent the last recourse for middle and lower income American families, and particularly families of color, who seek to achieve homeownership at reasonable terms.
2. **A few large mortgage servicers caused the problem that DASP was created to fix.** HUD started DASP when the FHA insurance fund faced unprecedented budgetary challenges. A few large mortgage servicers, including Bank of America, Wells Fargo, and JP Morgan Chase, deliberately delayed foreclosures of FHA-insured mortgages. HUD needed to cut further losses and decided to sell off the loans rather than wait for servicers to complete the foreclosures.
3. **HUD has not held the servicers accountable for the problems they caused.** Even though the servicers' delays of foreclosure violated HUD timelines, HUD paid off the servicers' insurance claims when they offered their loans for DASP sales. HUD paid off claims of servicers who had not followed HUD's rules that require completion of loss mitigation reviews for homeowners before foreclosures.
4. **HUD failed to pursue other options for preserving the financial integrity of the FHA insurance fund, including making its servicers follow FHA's loss mitigation rules.** Vigorous enforcement of HUD's loss mitigation requirements for servicers would have allowed homeowners to reinstate loans to performing status. Effective use of FHA's loss mitigation tools reduces losses to the insurance fund and preserves homeownership
5. **DASP undercuts state foreclosure laws that help preserve homeownership and further HUD's housing goals.** Many state foreclosure laws require that the servicer establish valid authority to foreclose and consider homeowners for alternatives to foreclosure. DASP has allowed servicers to remove cases from the state law foreclosure process instead of complying with these laws.
6. **HUD has systematically excluded the affected homeowners from any role in the DASP loan sale process.** Homeowners who are directly affected by mortgage servicers' practices are in the best position to inform HUD that the servicers are not complying with HUD's rules. HUD has repeatedly rejected demands that it require notices to homeowners before their loans are sold through DASP.
7. **DASP has not helped homeowners in any significant way.** HUD's initial claims that DASP would help homeowners by allowing the buyers of the loans to offer generous loan modifications has not been substantiated by any evidence.
8. **HUD's reliance on financial speculators to generate quick cash has not furthered the policy goals of the FHA program.** Private equity funds and hedge funds are the primary buyers of defaulted FHA loans. These speculators' interest is to maximize profits upon resale of the loans they buy. They do not act to further the goals of preserving homeownership for middle-class Americans, a goal that Congress directed HUD to achieve. HUD has not implemented effective measures to ensure that these buyers further national housing policy goals.

EXECUTIVE SUMMARY

The U.S. Department of Housing and Urban Development's (HUD's) program for selling defaulted Federal Housing Administration (FHA) loans is the largest auctioning off of government-insured home mortgage loans in the nation's history, and it directly impacts low- and moderate-income homeowners. As a result of this series of auctions, known as the Distressed Asset Stabilization Program (DASP), many homeowners have lost the government backing of their loans, along with a wide array of tools that provide help in times of financial stress. To date, under DASP, HUD has sold off mortgage loans with unpaid principal balances totaling over $17 billion. While HUD has justified the sales as being a win-win for homeowners and its own insurance fund, the reality is that, in many cases, loans sold through the sales would have fared better and cost the insurance fund less if basic FHA rules were applied to address the defaults and loan sales were avoided. What's more, the DASP sales have provided financial benefits to the same servicers (many of them large banks) who sidestepped FHA's rules, absolving them of any responsibility for the servicing problems they created. Instead, HUD allowed the loans to be used as a source of profit.

To date, under DASP, HUD has sold off mortgage loans with unpaid principal balances totaling over $17 billion.

DASP's launch coincided with HUD's improvements to its loss mitigation options for homeowners facing financial hardship. Because many loans were processed through DASP without completion of FHA's loss mitigation review requirements, DASP undermined HUD's own home retention guidelines. Many homeowners who have sought loan modifications after their loans were sold have found that the speculators who bought the loans offered few to no affordable options. A more balanced approach of enforcing the FHA loss mitigation rules and resorting to loan sales only after the options under the rules are exhausted would yield better outcomes for homeowners, communities, taxpayers, and the FHA program.

National Consumer Law Center's (NCLC) review of cases during a short time period in 2014 found a pattern of homeowners having their loans sold through DASP even though they were in the process of working with a major FHA servicer, Bank of America, to obtain loss mitigation reviews. In fact, 23 Philadelphia homeowners with FHA-insured loans serviced by Bank of America were appearing for court-supervised settlement conferences when their loans were sold; several of the homeowners had met numerous times with the bank's representatives, some of them for five, six, or even as many as nine conference sessions. Neither Bank of America nor HUD informed the homeowners that their loans were going to be sold or that their protections under FHA rules would no longer be recognized. The homeowners discovered the facts only after the sales took place. The DASP sales happened while Bank of America's representatives were continuing to request information and process forms for FHA loss mitigation options. None of the homeowners received a final decision as to whether they qualified for FHA loss mitigation assistance. None of them ever received an FHA loss mitigation option.

Through the FHA Single-Family Mutual Mortgage Insurance Fund (the Fund), HUD insures private mortgage lenders against losses in order to encourage the lenders to make loans to low and moderate income households. HUD operates the Fund with a mandate from

Congress "to meet the housing needs of the borrowers that the single family mortgage insurance program under this subchapter is designed to serve." In exchange for the insurance, FHA-insured lenders must satisfy specific loss mitigation rules created to avoid unnecessary foreclosures. HUD has designed specific alternatives to foreclosure that lenders and their servicers must consider before they proceed with foreclosures.

Historically, mortgage lenders have only received FHA insurance proceeds *after* completing the foreclosure sale process, and evaluation for loss mitigation was always a precondition to foreclosure. DASP changes the timing of the insurance pay-out in an important way. Under DASP, HUD takes over ownership of the loans and pays off the FHA insurance claims *before* foreclosure takes place. The claims cover losses the loan's owners incurred as a result of the homeowners' default. So far through DASP, HUD has used the Fund to pay off claims for over 105,000 FHA-insured mortgage loans. None of these loans went through foreclosure before HUD auctioned them off. The private equity firms and hedge funds that bought most of the loans at DASP sales acquired them at significant discounts.

DASP is a fire sale that did not have to take place. The actions of a few large mortgage servicers, primarily Bank of America, Wells Fargo, and JP Morgan Chase, caused the long foreclosure delays that led HUD to implement DASP. HUD could have held these servicers accountable for the unprecedented delays they created, delays that harmed homeowners and threatened the soundness of the FHA insurance fund. HUD had ample legal authority to make its servicers review borrowers for loss mitigation and follow reasonable foreclosure time frames. Instead, HUD paid off the servicers' claims early in order to avoid even greater future losses from delayed foreclosures. In the end, the big winners were the same large mortgage servicers that created the problem. Through DASP, HUD paid off the servicers' claims and absolved them of responsibility for years of flouting the agency's mortgage servicing rules. Meanwhile, homeowners and their communities are left to struggle with the consequences.

> In the end, the big winners were the same large mortgage servicers that created the problem. Through DASP, HUD paid off the servicers' claims and absolved them of responsibility for years of flouting the agency's mortgage servicing rules. Meanwhile, homeowners and their communities are left to struggle with the consequences.

In 2012, when HUD began DASP, it was facing an insurance fund threatened by the burgeoning costs of the foreclosure delays that its servicers were orchestrating around the country. In addition, HUD's outdated loss mitigation protocols were unsuited to the demands of an unprecedented foreclosure crisis. Auctioning off defaulted loans to financial speculators was one option available to HUD for restoring the health of the insurance fund. However, strengthening loss mitigation oversight would also have reduced losses to the fund. A loan modification, for example, avoids a post-foreclosure insurance claim entirely by replacing a loan in default with a performing loan. During 2012 and 2013, HUD announced a long-overdue restructuring of its loss mitigation options. HUD began to implement modification protocols more in line with those available under other government-insured and guaranteed loan programs. Effective implementation of these new FHA options, beginning in 2012, would have significantly reduced losses to the insurance fund. Instead, HUD opted to sell tens of thousands of loans that were in the foreclosure pipeline, making these loans ineligible for the improved FHA loss mitigation options.

In implementing DASP, HUD accepted at face value its servicers' rationales for the unprecedented foreclosure delays that began in 2010. In many cases, these delays extended over several years. According to the servicers, the delays were due to either new state laws that made foreclosures more time-consuming, or else to the servicers' ramped-up efforts to help borrowers through reviews for loss mitigation. In reality, the state laws created during the foreclosure crisis did not impose burdensome new obstacles on foreclosing parties, and the servicers' reviews for loss mitigation were haphazard at best.

Certain state laws implemented in the wake of the financial crisis require that mortgage servicers review homeowners for loss mitigation before foreclosing. These laws have the potential to strengthen and reinforce compliance with HUD rules. For example, mediation laws make FHA servicers show that they followed FHA guidelines before they are allowed to foreclose. Unfortunately, DASP undermines the impact of these helpful laws. Through DASP, FHA servicers can simply transfer the loans to new owners who then assert they are no longer bound by FHA rules. HUD pays the insurance claims to the pre-sale FHA servicers and allows them to avoid any obligation to show a court that they complied with FHA loss mitigation rules. In one telling instance involving Philadelphia homeowners discussed in this report HUD paid off insurance claims for 23 FHA-insured loans while all the homeowners were in the middle of mediations over loss mitigation. In HUD's view, the DASP sales remove all FHA protections from a loan, even where the former FHA servicer did not comply with FHA rules. HUD's lack of proper oversight and use of DASP has aided servicers in routinely selling off FHA-insured loans in order to get FHA insurance benefits without following either FHA requirements or state laws.

HUD's claims of cost savings due to DASP necessarily assume two things: first, that the servicers conducted a thorough review for foreclosure alternatives for each loan before a DASP sale; and second, that all the borrowers were truly ineligible for any alternative to foreclosure under FHA's guidelines. The examples of the homeowners abruptly pulled out of the FHA program by DASP sales while in the middle of mediations clearly show that HUD's assumptions were wrong. Ignoring loss mitigation also entails costs. Any cost savings due to DASP cannot be evaluated without considering the costs of needless foreclosures and the resulting unnecessary insurance claims.

> One critical goal of HUD is to help borrowers who could not otherwise achieve homeownership to stay in their homes. Private equity firms and hedge fund operators, the primary purchasers of the defaulted loans through DASP, are under no obligation to further this goal.

HUD's contention that DASP helps homeowners is based on an abstract theory: That if you sell distressed loans to financial speculators at prices that seem like good deals to them, the speculators who buy the loans will modify them, reduce principal balances owed, or take similar steps to help the homeowners stay in their homes. The speculators will do this because they intend to sell the loans to someone else in a few years. At resale, the defaulted loans may bring in higher prices if they have turned into "performing" assets. The theory also assumes, of course, that whatever deal the speculator offers the homeowner after a DASP sale is better than any option the homeowner would have received had the loan remained an FHA loan serviced by a competent servicer.

HUD's theory suffers from two major problems. First, Congress directed HUD to manage the FHA program to further certain policy goals. One critical goal is to help borrowers who could not otherwise achieve homeownership to stay in their homes. Private equity firms and hedge fund operators, the primary purchasers of the defaulted loans through DASP, are under no obligation to further this goal. HUD, on the other hand, has an obligation to ensure its protocols are followed in order to satisfy this objective. Second, even the limited available data about the status of loans after DASP sales, including data provided by HUD, does not demonstrate that post-sale outcomes generally benefit homeowners. There is no evidence from the sales over the past four years that the speculative investors gave homeowners loan modifications that reduced the principal of the loans at any significant rate or that sustainable modifications were provided in substantial numbers. HUD has not produced any data showing the structure of modifications in the small number of cases where HUD claims loans were modified after DASP sales.

> Even the limited available data about the status of loans after DASP sales, including data provided by HUD, does not demonstrate that post-sale outcomes generally benefit homeowners.

In reality, investors do not need to modify loans to make them "performing" after a DASP sale. There are much easier ways to tack a "performing" label on a loan. Common practices of the DASP purchasers include offering borrowers' five-year "interest only" payment agreements that then revert to the original loan terms. These agreements do not modify basic loan terms. Instead, they simply postpone an inevitable re-default.

HUD's own data show that in most cases the speculative DASP buyers did not modify the loans, and did not turn them into performing loans. Instead, they foreclosed or arranged short sales. HUD more recently began requiring speculators to offer borrowers "HAMP-like" modifications after DASP sales. However, HUD has not defined this requirement or described how it will be enforced. Unless HUD enhances oversight of its servicers and commits substantial resources to rigorous enforcement, there is little likelihood that HUD can capably enforce this kind of requirement against non-participants in the FHA program.

HUD has long-standing rules that authorize it to assess penalties against servicers who exceed reasonable diligence time frames for the conduct of loss mitigation reviews and completion of foreclosures. Similarly, HUD may penalize servicers that fail to demonstrate compliance with the requirements to review for all options under the FHA loss mitigation guidelines. HUD should use this authority. Failure to document compliance with HUD's loss mitigation protocol must act as a complete bar to any loan sale. If HUD continues to conduct DASP sales, it must require that a servicer give the borrower clear advance notice of the intent to sell a loan. Borrowers must have an opportunity to raise and resolve with HUD servicers' unfounded claims of compliance with HUD's loss mitigation rules.

Since DASP's inception almost four years ago, HUD has released vague and incomplete data that obscure essential outcome trends. The absence of reliable data allowed HUD to portray DASP as providing a benefit for homeowners. At the same time HUD has minimized the problems that occur when it cuts off FHA loss mitigation reviews through DASP sales. More recently, HUD has suggested it took concrete steps to address servicers' inappropriate referrals of loans to DASP. However, HUD did not provide any clear, written explanation of these steps. Any such actions have not been effective. HUD should not continue to reply to criticism of DASP with periodic announcements of reforms that contain no specific details.

Vigorous enforcement of HUD's loss mitigation rules would preserve homeownership and stabilize communities better than essentially unrestricted sales of the loans, often to financial speculators. The note sale program should only continue if it can be transformed to benefit homeowners, communities, and the Fund while preventing FHA servicers from escaping their obligations under FHA's rules and avoiding accountability under state law for their conduct.

Historically, HUD has excluded homeowners from any role in the oversight of FHA servicers' loss mitigation performance. DASP has only aggravated this problem. Note sales under DASP are completed before homeowners are aware their loans are sold. They lose the protections of the FHA program before they can raise objections. Effective enforcement of HUD's loss mitigation rules with borrower participation through advance notice of sales and adherence to reasonable foreclosure timelines are the best ways to safeguard the FHA insurance fund from the costs of unnecessary or unduly delayed foreclosures. These changes must be prerequisites to any continued note sales.

The American homeownership rate is at a 20-year low. The ongoing erosion of homeownership from low-income families is likely to be of long duration, and for some families will be permanent. Low- and moderate-income communities have been substantially altered by mass foreclosures. In recent decades, FHA loans have been the primary means for African-American and Hispanic families to achieve homeownership. The unnecessary loss of FHA homeownership forces these households into the rental market. As rents around the country rise, the families pay increasingly high percentages of their income for housing, often 50% or more, while losing out on accruing wealth through homeownership. Instead of being pillars of stable communities, former homeowners must flee to wherever they can temporarily afford the rent. In a substantial number of cases, these outcomes are avoidable.

Vigorous enforcement of HUD's loss mitigation rules would preserve homeownership and stabilize communities better than essentially unrestricted sales of the loans, often to financial speculators. To date, however, HUD has not held its major servicers accountable for their non-compliance with HUD's own servicing rules. In the end, the mortgage servicers who caused the crisis for the FHA insurance fund walk away the winners. HUD pays the servicers' inflated claims and the servicers often evade state laws meant to promote sustainable homeownership. The note sale program should continue only if it can be transformed to benefit homeowners, communities, and the Fund while preventing FHA servicers from escaping their obligations under FHA's rules and avoiding accountability under state law for their conduct.

I. FOR DECADES, HUD'S FHA PROGRAM HAS PLAYED A CENTRAL ROLE IN AFFORDABLE HOMEOWNERSHIP

Congress created the Federal Housing Administration (FHA) under the National Housing Act in 1934 to help define federal housing policy during the Depression. FHA's programs further Congress' stated national housing goal of "a decent home and a suitable living environment for every American family."[1] The FHA is now part of the U.S. Department of Housing and Urban Development (HUD). FHA has insured over 34 million home mortgages since 1934. Currently, 4.8 million single-family mortgages are insured under FHA programs.[2]

The FHA's primary public purpose now is to expand homeownership for families not adequately served by the private mortgage markets. Over 80% of FHA-insured loans go to first-time homebuyers.[3] HUD has described the intent of Congress in creating the FHA program:

> *An important part of FHA's mission is to provide financing to homebuyers who, compared to those served by the conventional market, have lower wealth and pose moderately higher risks but are still creditworthy. For this reason, FHA-insured mortgages have been the product of choice, and sometimes necessity, for low-income Americans, offering a pathway to the middle class and a chance to build wealth that can be passed down through generations.*[4]

FHA's share of the home purchase mortgage market has varied over time. Its share shrank to less than 10% during the subprime boom of 2005-2007. Since the 2008 financial crisis, the portion of all new home loans created with FHA financing increased significantly, to over 20%.[5] In raw numbers, from 750,000 to one million families in the United States have obtained FHA-insured loans annually since 2009.[6]

Since the recent financial crisis, the rates at which individuals in communities of color achieved homeownership dropped dramatically. To the extent that families of color obtain home purchase loans today, FHA loans play a critically important role. In 2014, FHA provided financing for 43% of all African-American borrowers, and 44% of all Hispanic borrowers.[7]

In raw numbers, from 750,000 to one million families in the United States have obtained FHA-insured loans annually since 2009. In 2014, FHA provided financing for 43% of all African-American borrowers, and 44% of all Hispanic borrowers.

FHA's single family home loan program operates as an insurance program for mortgage loans made by private lenders. Contributions from borrowers support FHA's insurance fund. The fund covers the lenders' losses in the event of defaults. Federal law delegates to HUD the responsibility to protect the soundness of the FHA insurance fund. However, in managing the fund HUD must work to achieve dual objectives. Congress requires HUD "to meet the housing needs of the borrowers that the single family mortgage insurance program under this subchapter is designed to serve" while minimizing risk of default to the fund and to homeowners.[8] By implementing DASP, HUD appears to have improved the financial position of the insurance fund; however, it has not supplied clear data to show how DASP meets the needs of FHA-insured borrowers and the neighborhoods in which they live. Under its legal mandate, HUD must make borrower stability as high a priority as the solvency of the fund.

Key Players and Terms in the FHA Program

Who are the owners of FHA-insured loans? Private lending institutions, such as banks, savings and loan associations, and mortgage companies, originate FHA-insured loans. These originators have sold many of the loans to investors, with the result that ownership interests in FHA-insured loans have often been securitized. Securitized mortgages end up held by a trust and the investors in the trust become the real owners of the loans. These trusts have little day-to-day involvement with the management of the loans in a trust portfolio. More recently, a growing percentage of FHA loans are originated by non-bank lenders.[9]

Mortgage servicers play the key role. Mortgage servicing companies perform the core, ongoing work related to maintaining FHA-insured mortgage loans. The investors who own the loans enter into contracts with these servicers. It is the servicers who interact with homeowners, collect payments, manage escrow accounts, and make decisions regarding loss mitigation and foreclosure. The mortgage servicing industry is highly concentrated, with a few large servicers — Wells Fargo, Bank of America, JP Morgan Chase, and CitiMortgage — dominating the field. HUD must approve any financial institution that services an FHA loan. HUD publishes regulations, handbooks, and other directives that guide all aspects of servicing FHA mortgages. HUD has ample authority to supervise its servicers and ensure that they comply with the agency's servicing rules.

The FHA Single-Family Mutual Mortgage Insurance Fund. The FHA does not own mortgage loans. Instead, it manages an insurance fund that is available to cover losses incurred by the owner of a loan if the loan goes into default and must be foreclosed. The intent has always been that the FHA insurance fund be self-funding and not subsidized by taxpayers. Borrowers pay insurance premiums to FHA, and these premiums support the insurance fund. Borrowers pay a substantial part of their premium obligation when they take out an FHA-insured loan. They then make regular contributions to the fund along with each monthly mortgage payment. The FHA insurance fund incurred a significant deficit in the course of the 2008 financial crisis. For the first time since its inception, the fund required Congressional appropriations. Since 2012, the fund has recovered. In 2015 the net worth of the FHA insurance fund was $23.8 billion.[10]

The importance of loss mitigation. Federal statutes require that servicers of FHA-insured mortgages engage in loss mitigation when an FHA-insured mortgage goes into default.[11] As the name suggests, loss mitigation is a process of considering less costly alternatives to foreclosure when a borrower has defaulted. Loss mitigation begins with the recognition that foreclosures are very expensive. The loan's owners may lose 50% or more of the value of their investment when a loan must be foreclosed. An alternative to foreclosure, such as a loan modification, may cause the owners to lose some money. However, the ultimate loss from a modification is often smaller than the loss from foreclosure. Since the FHA insurance fund pays loan owners their losses on FHA loans, successful loan modifications also reduce losses to the fund.

FHA's loss mitigation guidelines. FHA has established loss mitigation guidelines that include a set of options that servicers must consider for each borrower in default.[12] The home retention options include forbearance and repayment plans as well as two types of loan modifications. HUD revised these options substantially during 2012 and 2013, including a new calculation designed to achieve more affordable payments under FHA's version of HAMP (a loan modification program created by the U.S. Treasury Department).[13] An FHA servicer may foreclose only if it has first reviewed the borrower for the mitigation options in a particular order and found the borrower ineligible for all of them.[14] HUD has set out clear timelines for servicers to assess these options.[15] Servicers must begin their efforts at the forty-fifth day of default.[16] They must evaluate the borrower for all options on a monthly basis before the loan becomes four months in default.[17] The servicer must continue to make loss mitigation available after initiating foreclosure.[18] Many courts have ruled that servicers who fail to comply with FHA loss mitigation regulations cannot foreclose.[19]

II. BACKGROUND ON THE DISTRESSED ASSET STABILIZATION PROGRAM (DASP)

A. HUD's launch of the DASP program

In 2010, HUD began a pilot program to auction off small pools of defaulted FHA-insured loans.[20] These pools typically contained a few hundred loans. Then, in 2012, HUD launched a stepped-up program to sell off much larger pools of loans. HUD called this new initiative the Distressed Asset Stabilization Program (DASP).[21] DASP involves sales of pools of thousands of loans. During 2014, for example, HUD sold off a total of 45,979 FHA loans in four auction sessions.[22]

DASP focuses on FHA-insured loans that are in default but have not yet gone through foreclosure sales. HUD auctions these loans in two types of pools. Most loans sold from 2012 through 2015 were included in what HUD calls national pools. Investors who buy loans in national pools can dispose of the loans and properties with few restrictions.[23] As the name suggests, the national pools may include loans from any state. However, servicers select the loans to be sold, and they have chosen loans primarily from a limited number of states that use judicial foreclosures, such as Florida, New York, Ohio, and Indiana. Judicial foreclosures require court approval before a foreclosure sale can take place. A smaller share of loans sold through DASP came from "non-judicial" foreclosure states. In these states, a servicer can conduct a foreclosure sale without court oversight.

Aside from the national pools, HUD collects other loans into what it calls Neighborhood Stabilization Outcome (NSO) pools. NSO pools are regional. They have had targeted locations such as Chicago, Detroit, and metropolitan areas in Ohio and Florida. The buyers of NSO pools enter into agreements with HUD to achieve certain objectives for half the loans in the pool over a four-year reporting period.[24] The qualifying objectives include accepting payments on a modified or unmodified loan for six months after purchase, selling the security property to an owner-occupant through a short sale or post-foreclosure sale, or renting out the property for three years. Under the terms of NSO bidding agreements, HUD can impose financial penalties on investors who buy an NSO pool and fail to meet one of the listed objectives for at least half the loans in the pool.

HUD conducted the first DASP auctions in September 2012. Since then, the volume of loans involved in DASP sales has increased significantly. [25] From 2010 through November 2015, HUD auctioned off just over 105,000 defaulted FHA loans. Almost all of these were sold since the expanded DASP sales began in 2012. HUD sold the loans in about 175 different pools.[26] Of the total loans sold, 80,983 loans were in national pools and 24,536 in NSO pools. The loans had a total unpaid principal balance of over $17.9 billion.[27] HUD sold these loans for substantially less than the outstanding principal balances owed on them. For example, in sales over the past two years HUD sold the loans for from 52% to 66% of the amounts owed.[28] The loans typically sold for less than the market values of the properties involved, as assessed by broker price opinions. The loans sold for 68% to 78% of the properties' estimated values.[29]

DASP represented a significant deviation from the way HUD typically paid off insurance claims. Under the pre-DASP practice, when a borrower defaulted on a mortgage, the servicer conducted a foreclosure sale. The foreclosure sale either transferred title to the property to a third party buyer or the servicer itself acquired title because no one else bid the amount of the debt. When the servicer ended up with the property, it was considered an REO (real estate owned) property. The REO property would eventually be sold. In the end, the proceeds from the foreclosure sale or the REO sale would be applied to reduce the underlying mortgage debt. The servicer would then submit a claim for FHA insurance benefits to HUD. FHA insurance covered most of the private owners' losses on the debt not recovered by the foreclosure sale process.

DASP changed the sequence in which HUD paid off an FHA insurance claim. Under DASP, the servicer assigns the mortgage to HUD *before* any foreclosure sale. The servicer receives the FHA insurance payoff when the loan is transferred to the DASP purchaser. A later foreclosure by the DASP purchaser has no impact on the pre-DASP owner of the loan or its servicer. At the same time, the purchaser will not be covered by FHA insurance and will not be able to submit an insurance claim to FHA.

The DASP sale has significant consequences for a homeowner. According to HUD, the sale immediately terminates the homeowner's participation in the FHA program. The homeowner loses the right to be considered for options such as FHA-HAMP, a mortgage modification that can re-set monthly payments to affordable levels, as low as 25% of the household's income. In HUD's view, upon completion of the sale, the guidelines used to determine eligibility for all FHA loss mitigation options no longer apply to the mortgage. This occurs even though the homeowner paid substantial premiums to participate in the FHA program, a program that includes valuable options to retain the home in the face of hardship. While HUD contends that these loans already have exhausted FHA program options, this often is not the case.

After a DASP sale, servicing of the loan is transferred to a new servicer working for the investor who won the auction. At some point after the sale, homeowners receive notice that they have a new mortgage servicer. For most homeowners, the notice about a new servicer is how they

By the Numbers

The 2008 economic crisis resulted in the largest number of foreclosures in U.S. history. HUD created a program to work through defaulted FHA-insured mortgage loans, eventually rolled out as the Distressed Asset Stabilization Program (DASP). Government data shows that the DASP program primarily sells the loans for quick cash to large private equity funds and hedge funds. The result? The same mortgage servicers that contributed to the initial foreclosure problems are rewarded by early payment of their FHA insurance claims, to the detriment of low- and moderate-income homeowners and taxpayers.

Year FHA begins defaulted loan sale pilot program:	2010
Year FHA ramps up the defaulted loan Distressed Asset Stabilization Program (DASP):	2012
Number of defaulted FHA loans sold from 2010 – Nov. 2015:	105,000
Number of FHA DASP loans sold in 2014:	45,979
Total value of unpaid principal balance of defaulted FHA Loans sold (2010 – Nov. 2015):	$17.9 billion
Average percentage of estimated market value of the properties received through DASP sales during 2014–2015:	68% to 78%
Average percentage of estimated outstanding principal balances of loans received through DASP sales in 2014–2015:	52% to 66%

first learn that their mortgage was sold. Their participation in the FHA program is terminated without warning. They receive no explanation from HUD or anyone else of the severe consequences flowing from the DASP sale. In fact, when notified of the new servicer, homeowners may not be formally notified their FHA insurance was removed. The homeowners have no opportunity to object to the DASP sale even if they are in the process of being reviewed for an FHA loan modification as their loans are sold.

HUD could easily adopt a policy of notifying homeowners about a planned DASP sale, and it has authority to require its servicers to do so.[30] The lack of notice to borrowers has been a consistent aspect of the DASP program since its inception.

B. Foreclosure Mediation Programs Reveal DASP's Impact on Enforcement of FHA Loss Mitigation Guidelines

1. Philadelphia's foreclosure conference system – a model program that stops foreclosures, promotes compliance with FHA rules, and helps lenders

The courts in Philadelphia led the way in developing a robust response to the foreclosure crisis. In 2008, the city's courts inaugurated a program of mandatory settlement conferences for all residential foreclosures. Under the program's rules the mortgage servicer must file a certificate of completion of a "conciliation" conference before it can proceed with a foreclosure sale. Conciliation sessions are scheduled automatically when a servicer files a foreclosure case involving an owner-occupied property.

Once the Philadelphia conference process is begun, the homeowner is expected to work with a housing counselor to complete and share documents. The housing counselor helps the homeowner prepare a proposal for the mortgage servicer to review before a conciliation conference. Most homeowners do not have direct legal representation in the conferences, but all have access to limited consultations with attorneys. Homeowners are represented by housing counselors at the sessions. For cases not resolved before a scheduled session, a civil case manager appointed by the court conducts the conciliation meeting. So long as the homeowner complies with the conciliation program rules, foreclosure proceedings, including the entry of judgment and the sheriff sale, are paused until the servicer files a certification that the conciliation process has concluded. If an agreement is not reached at an initial conference and additional review is needed, an order issues setting an additional session. The Philadelphia program has seen high rates of participation by homeowners, due in part to a system for direct door-to-door contacts by community groups to reach out to homeowners who have received notices of conciliation sessions.

A research firm's report analyzing extensive data about the Philadelphia mediation program has documented its effectiveness.[31] The firm examined court records of cases that went through the program from its inception in mid-2008 through March 2011. Based on court records and individual loan data, the authors created a long-term record of homeowners' circumstances as they participated. Looking at the status of these cases from 2008 to 2011, the Reinvestment Fund made the following findings that demonstrate the program saves home and does not unreasonably delay foreclosures:

- 70% of homeowners eligible to participate in the program appeared for their mediation sessions.[32]

- 3.5% of the homeowners who appeared for conferences in foreclosure cases filed since September 2008 had foreclosure sales of their homes ordered.[33]
- 35% of eligible homeowners who participated in conferences reached an agreement.[34]
- 53 days was the average that cases remained in the program, well within the 10-month time frame typical for the completion of a foreclosure in which the homeowner never appears.[35]
- 27% of eligible borrowers lost their homes as a consequence of a foreclosing filing before implementation of the program, but only 5.7% during a subsequent 6-month comparison period after the implementation of the program (looking at eligible cases before and after the program's inception).[36]
- 87.5% of homeowners who reached agreements in the program between June 2008 and June 2009 were still in their homes as of March 31, 2011 (at least 21 months after the dates of their agreements).[37]

2. DASP allowed large servicers to receive FHA insurance claim payments without having to comply with Philadelphia's foreclosure mediation program or FHA loss mitigation rules

Details from the Philadelphia mediation program make clear that large servicers have been able to use DASP to avoid participation in the court's settlement conferences as well as FHA's own loss mitigation program. For example, Bank of America has been one of the largest servicers of FHA-insured mortgages. It has also been the servicer most actively putting loans into DASP. An assumption underlying DASP is that a major servicer like Bank of America reviews its FHA-insured loans for all available loss mitigation options before referring the loans to HUD for a DASP sale. Another assumption is that HUD examines the status of servicers' loss mitigation reviews to make sure the reviews are complete before accepting loans for DASP sales.

Yet, what actually happened during a short time period in 2014 to a group of 23 Philadelphia homeowners with FHA-insured loans demonstrates that loans are sold through DASP before FHA options are exhausted and apparently without any substantial examination by HUD. Looking at a period of just a few months, we identified 23 homeowners who were actively engaged in loss mitigation reviews with Bank of America when HUD sold their loans through DASP. These homeowners were appearing for court-supervised settlement conferences because they wanted Bank of America to review them for FHA loss mitigation options. Several of the homeowners had met numerous times with the bank's representatives, some of them for five, six, or even as many as nine conference sessions. All the loss mitigation reviews in these cases were ongoing.

In each of the 23 cases, despite the fact that the mediations were scheduled to continue and FHA loss mitigation procedures were not completed, HUD sold the homeowners' loans to speculators who were not in the business of offering reasonable loss mitigation. The result? The homeowners were told they had lost all access to the FHA program, including the right to be considered for an affordable modification based on a clearly defined protocol. Neither Bank of America nor HUD informed the homeowners that their loans were going to be sold or that their protections under FHA rules would no longer be offered. The homeowners discovered the facts only after the sales had taken place. The DASP sales happened while Bank of America's representatives were continuing to request information and process forms for FHA loss mitigation options. None of the homeowners received a final decision as to whether they qualified for FHA loss mitigation assistance. None of them ever received an FHA loss mitigation option.

This type of *en masse* exclusion of cases from loss mitigation reviews through DASP could happen anywhere in the country. The only thing that was unusual here was that, due to the structure of the mediation program, evidence of Bank of America's DASP sales appeared

TABLE 1

FHA Distressed Asset Stabilization Program Cases in the Philadelphia Mediation Program (June–October 2014)

CASE DOCKET*	DATE MORTGAGE ASSIGNED TO HUD	STATUS AT DASP SALE
Bank of America v. S.D. 130700---	10/1/2014	conferences ongoing after 6 sessions
Bank of America v. T.H 120702---	10/2/2014	conferences ongoing after 4 sessions
Bank of America v. K.H. 140300---	10/2/2014	conferences ongoing after 4 sessions
Bank of America v. C.S. 140503---	10/2/2014	conferences ongoing 1 session
Bank of America v. S.T. 131000---	10/2/2014	conferences ongoing 2 sessions
Bank of America v. S.H. 140200---	10/1/2014	conferences ongoing 2 sessions
Bank of America v. M.S. 140601---	9/9/2014	conference ongoing 1 session
Bank of America v. E.C. 140400---	10/1/2014	conference ongoing 2 sessions
Bank of America v. A.S. 140600---	9/9/2014	conference ongoing 2 sessions
Bank of America v. T.J. 130803---	10/2/2014	conferences ongoing 6 sessions
Bank of America v. P.S. 140800---	9/9/2014	conferences ongoing 1 session
Bank of America v. J.K. 130502---	10/2/2014	conferences ongoing 5 conferences
Bank of America v. C.P. 140600---	10/2/2014	conferences ongoing 3 sessions
Bank of America v. R.C. 140602---	10/2/2014	conferences ongoing after 1 session
Bank of America v. C.R. 140704---	10/2/2014	conferences ongoing after 1 session
Bank of America v. S.C. 140501---	10/2/2014	conferences ongoing after 2 sessions
Bank of America v. B.B. 140703---	9/9/2014	conferences ongoing after 1 session
Bank of America v. T.K. 140801---	10/2/2014	conferences ongoing after 1 session
Bank of America v. A.A. 140403---	10/1/2014	conferences ongoing after 1 session
Bank of America v. E.R. 140603---	2/6/2015	conferences ongoing after 1 session
Bank of America v. L.V. 131000---	2/4/2015	conferences ongoing after 9 sessions
Bank of America v. F.W. 140402---	2/6/2015	conferences ongoing after 6 sessions
Bank of America v. D.M. 140602---	2/4/2015	conferences ongoing after 3 sessions

*Full names of plaintiffs and last three digits of docket numbers were removed for privacy reasons.
Source: Philadelphia Common Pleas Court Dockets and Philadelphia County Land Records.

conspicuously in court and land records. Bank of America had so many cases pending for conferences that the Philadelphia court scheduled special “Bank of America Days” for the bank’s cases. These took place on August 14, 2014 and on October 16, 2014. After the two dates, these cases were suddenly taken off the Bank of America scheduling lists. Land records show that in proximity to these dates the mortgages were assigned to HUD and then transferred by HUD to speculators. As Table 1 (see page 14) indicates, many homeowners were working their way through multiple conference sessions in an effort to be reviewed for the FHA loss mitigation options their insurance payments had made potentially available.

Philadelphia Homeowner Cases and Results of Exclusion from the FHA Program

In each of these cases the homeowner submitted a loss mitigation application to Bank of America or was preparing to submit one. The stories of some of these homeowners demonstrate the impact of selling FHA loans before loss mitigation is over.

Thomas and Beverly Henry’s case is a typical example. The Henrys are a retired couple in Philadelphia. They have owned their home since 1977 and raised their children there. The Henrys began to apply to Bank of America for an FHA loan modification in 2010, after one spouse had to stop working to receive cancer treatment. They went through years of back and forth with the bank, never getting a clear answer on their eligibility. They repeatedly provided information about their retirement income, finally appearing for a settlement conference with Bank of America on August 14, 2014. At the settlement conference the Bank of America’s representative told the Henrys that the bank finally had all the information it needed to consider them for a loan modification. In reality, HUD had already sold the Henrys’ loan to a speculator operating outside HUD’s control. This sale had taken place in June 2014 without notice to the Henrys. The Henrys did not find out until October 2014 that Bank of America no longer serviced their loan. According to the new owner, Newland Asset Holding Trust, FHA protections no longer applied to their mortgage. The Henrys are still pursuing litigation just to find out what loss mitigation the new owner of the loan offers, if any.

At the settlement conference the Bank of America’s representative told the Henrys that the bank finally had all the information it needed to consider them for a loan modification. In reality, HUD had already sold the Henrys’ loan to a speculator operating outside HUD’s control.

Edwin Cruz lives with his two daughters in the predominately Latino neighborhood of Juniata, in Northeast Philadelphia. Bank of America approved Mr. Cruz for a trial modification under FHA guidelines in 2013. Mr. Cruz made all the payments needed to comply with the trial modification terms. Bank of America went on to approve him for a permanent FHA modification. Later, the bank claimed there had been some unspecified paperwork problem with the modification. The bank canceled the modification and filed a foreclosure complaint instead. Mr. Cruz continued to seek a modification. During 2014 and into 2015 Mr. Cruz participated in the foreclosure conference program and continued to send Bank of America the documents it was demanding. Only in early 2015 did he discover that HUD had sold his loan under DASP in June 2014. The investor who bought the loan at the DASP sale would only offer a loan modification that was contingent on Mr. Cruz’s making a large unaffordable initial payment. Conditioning a loan modification on an unreasonable lump sum payment

During 2014 and into 2015 Mr. Cruz participated in the foreclosure conference program and continued to send Bank of America the documents it was demanding. Only in early 2015 did he discover that HUD had sold his loan under DASP in June 2014.

would not have been permitted under FHA rules. The new loan owner continues to refuse to offer an affordable long-term modification and Mr. Cruz's only recourse has been to continue to defend the foreclosure in court.[38] Other Philadelphia homeowners who were not assigned to a special "Bank of America Day" in the conference program had similar experiences.

Anthony Smith is a home health aide worker who has lived in his home financed with an FHA mortgage for 20 years. In September 2014 he was working with a Bank of America representative to complete his application for an FHA modification. According to his attorney and housing counselor, Mr. Smith appeared to meet all qualifications for eligibility for an FHA modification. Instead of implementing a modification, Bank of America claimed that Mr. Smith had submitted an incorrect tax form. It appeared that Mr. Smith had actually provided the correct tax documents, but before this dispute could be resolved, Bank of America sold the loan through DASP. Mr. Smith, like Mr. Cruz and the Henrys, must now resort to litigation to get a clear answer from the DASP buyer as to what its loss mitigation options are.

In response to incidents such as these, Philadelphia's City Council passed a resolution in February 2016 calling on HUD and other federal agencies to stop conducting sales of distressed loans through procedures like these that harm homeowners and communities.[39] The City has a strong interest in protecting the successful programs it has developed for preserving homeownership. DASP is a clear threat to those efforts.

The number of cases and clear pattern of loan sales during loss mitigation reviews is ample evidence of a structural problem with DASP and shows a significant lack of HUD oversight. A modest effort at competent oversight would have picked up that these loans were still in active loss mitigation review.

3. State and local foreclosure mediation programs to promote FHA loss mitigation

Since the foreclosure crisis began in 2008, foreclosure conference programs similar to Philadelphia's have appeared in about half the states.[40] Twelve states and the District of Columbia have enacted statutes requiring conferences. The supreme courts of several states, including Ohio and New Jersey, have issued statewide rules authorizing mediations in foreclosure cases. As in Philadelphia, many local court systems have also set up their own foreclosure conference programs.

Other mediation and conference programs around the country have success records as impressive as Philadelphia's. Connecticut has required mediation in residential foreclosure cases since 2008. Data provided by the Connecticut courts covering the period from July 2008 through December 31, 2015 showed that nearly 30,000 mediations were completed.[41] Of these, 70% resulted in settlements in which the borrower stayed in the home. Significantly, 84% of the Connecticut cases that settled with an agreement for the borrower to remain in the home involved a loan modification.

In New York, a high proportion of eligible homeowners appear for settlement conferences scheduled automatically in foreclosure cases.[42] Well over 100,000 conferences were held in a single year under the New York program. For certain reporting periods, homeowners appeared for conferences an average of 75% to 80% of the time. This represents a complete reversal of the status quo prior to the initiation of the mandatory conferences, when 75% to 80% of homeowners did not participate in their cases. The majority of homeowners appeared for conferences with attorney representation.

Mediation and conference programs benefit lenders and homeowners. The modifications that occur in place of foreclosures typically set terms based on a net present value test.[43] These tests determine that the modification is more in the financial interest of investors in the loan than a foreclosure sale. Of particular importance in the case of FHA loans, these conferences provide a valuable form of oversight over the servicers' compliance with HUD loss mitigation rules. The FHA's rules can form the basis for negotiations and reviews. The programs prevent unnecessary foreclosures of FHA-insured loans, benefitting the HUD insurance fund.

New York Conference Cases

In New York, DASP has also impeded mediations that could have improved the performance of FHA loans. For example, Brooklyn homeowner **Paulette Morrison** was participating in the New York foreclosure conference program during 2014. She repeatedly submitted documents to Bank of America for years without getting a decision on her eligibility for an FHA modification. Without notice to her, Bank of America sold her mortgage loan through DASP. Rushmore, as servicer for the DASP buyer, then appeared for settlement conferences and would not consider a loan modification unless Ms. Morrison first made an up-front payment equal to 25% of the overdue payments and fees. This outlandishly high payment was well beyond anything she could afford. Had her loan remained FHA insured, Ms. Morrison would never have faced such an unreasonable barrier to a modification. Servicers of FHA loans may not demand up-front payments to begin a modification.

Lorenzo Morrison had a similar experience in the New York settlement conferences.[44] He had submitted a full loss mitigation application to his servicer, JP Morgan Chase. His attorneys went through the eligibility requirements for an FHA loan modification. Mr. Morrison met all requirements without a hitch. However, while the conference sessions to review the application were taking place, HUD sold Mr. Morrison's loan to a private investor. Caliber, servicing the loan for the new owner, would only offer a five year interest-only forbearance as a loss mitigation alternative. Under Caliber's offer, Mr. Morrison would pay $70,000 over five years to the servicer and never reduce his principal balance. At the end of five years the payment level that drove him into foreclosure would be restored. A servicer subject to FHA rules would never be permitted to offer this kind of unfair and deceptive proposal.

III. DASP'S PRIMARY ROLE IS TO MANAGE SERVICERS' FORECLOSURE DELAYS

A. HUD Failed to Stop Servicer Delays and Then Responded with DASP

Since the goal of the FHA program is to expand homeownership, especially for lower-income families, HUD's efforts cannot stop once a family gets an FHA-backed mortgage and moves into a home. HUD must also help that family keep the home. Indeed, Congress has mandated that servicers of FHA-insured mortgages offer the borrower loss mitigation options if the loan goes into default.[45] HUD requires servicers to begin exploring these options within 45 days after default, and to move expeditiously to resolve the default either by working out a loss mitigation alternative or by bringing the case to foreclosure.

HUD's foreclosure processing timelines address its concern that long delays in a foreclosure process undermine the FHA insurance fund. To address this concern, HUD has authority to assess monetary penalties when servicers exceed foreclosure time frames,[46] and can even bar non-compliant servicers from participating in the FHA program.

Dragging out the foreclosure process can also hurt homeowners. Accruing interest, foreclosure costs, attorney fees, and servicing fees build up every month during a foreclosure, becoming an impediment to saving the home. More importantly, the foreclosure process in many states provides a mechanism for ensuring that options to save the home are considered. This has been particularly true in recent years, as states responded to the foreclosure crisis by creating foreclosure mediation and foreclosure diversion programs. These programs forced servicers to cut through the red tape that homeowners faced. It forced them to focus on the individual homeowner and address the question of whether the home could be saved. Unnecessary delays in the foreclosure process can mean postponing the exploration of these options until it is too late to save the home.

Since long delays in exploring loss mitigation or pursuing foreclosure undermine the FHA insurance fund, one would expect that during the foreclosure crisis FHA would have vigorously enforced its requirements that servicers adhere to schedules. But the opposite was true. Servicers delayed foreclosures on FHA loans for months or even years, including in states with strong, successful foreclosure mediation programs. Instead of taking steps to resolve these delays, HUD created the DASP program, which deprives the homeowners of both the benefits of FHA's loss mitigation guidelines and the foreclosure process's role in enforcing those guidelines. While selling the loan is one approach for loans that have exhausted the FHA loss mitigation guidelines, for those still midstream, the sales deny homeowners the benefits of the FHA program for which they have paid.

B. HUD's Requirements for Processing Foreclosures Are Sidestepped by Servicers Selling Loans Into DASP

HUD has employed DASP largely in response to its servicers' unwillingness to conduct foreclosures in a timely fashion. Yet, HUD has always had the power to ensure that its servicers complete foreclosures efficiently and without undue delays. For decades, HUD directives have required FHA servicers to exercise what HUD defines as "reasonable diligence" in prosecuting foreclosures to completion.[47] The Secretary of HUD establishes reasonable diligence time frames for all states. The reasonable diligence time frames take into account each state's foreclosure laws. Investors may not be fully reimbursed for unpaid interest when servicers delay foreclosures beyond these time frames. HUD revises the schedule periodically, as it did in 1990, 2001, 2005, 2013, and 2015.[48] Between 1990 and the appearance of DASP in 2012, HUD's reasonable diligence time frames did not change significantly. HUD generally allowed longer times for states that required judicial foreclosure as opposed to states that permitted non-judicial foreclosures.

HUD's due diligence time frames start with the first legal action that a state law requires to begin a foreclosure and end when the lender acquires title to and possession of the property.[49] The ten states with the longest allowable FHA foreclosure time frames have always been judicial foreclosure states. Table 2 shows the number of months HUD allowed to complete foreclosures in the ten judicial foreclosure states with the longest foreclosure timelines. The table also shows HUD's revisions of the allowed times between 1990 and 2016. Table 3 (see page 20) gives the same information for the ten states with the shortest FHA foreclosure time frames. The ten shortest periods all apply to non-judicial foreclosure states.

TABLE 2

FHA Foreclosure Time Frames in Ten Judicial Foreclosure States with Longest Foreclosure Time (by Months)

Year FHA Schedule Revised

	1990	2001	2005	2013	2016
FL	7	9	7	15	25
IA	17	17	17	17	17
IL	9	13	12	12	17
ME	22	22	12	14	27
NJ	12	14	14	15	19
NY	13	13	13	19	21/27*
OH	10	12	12	12	13
PA	9	10	10	11	21
VT	17	17	14	14	24
WI	12	12	12	12	12

(months from beginning to completion of foreclosure)

* 21 = New York City cases and 27 = Other New York cases

Source: The following HUD Mortgagee Letters (ML): ML 90-4 (August 14, 1990); ML 2001-19 (August 24, 2001); ML 2005-30 (July 12, 2005); ML 2013-38 (October 28, 2013); ML 2016-03 (Feb. 5, 2016) available at Hudclips.

Notably, there was little change to the allowed foreclosure time frames from the 1990s to 2013. HUD increased a few states' foreclosure time lines in 2013.[50] However, in a new schedule that went into effect in January 2016, HUD dramatically lengthened the allowed foreclosure time frames for several states[51] HUD took this action in response to patterns of delayed foreclosures in these states, particularly in New York. There were no compelling justifications for these changes based on newly enacted state laws.[52] With these changes, HUD did little more that ratify the unilateral actions its servicers had taken to slow down foreclosures in particular states.

TABLE 3

FHA Foreclosure Time Frames in Ten Non-Judicial Foreclosure States with Shortest Foreclosure Time (by Months)

Year FHA Schedule Revised

	1990	2001	2005	2013	2016
AL	5	4	4	4	6
AR	5	7	5	5	11
AZ	3	5	4	5	6
GA	4	4	4	4	6
MO	3	3	3	4	5
NH	4	4	4	4	11
TN	4	4	4	4	6
TX	3	3	3	3	8
VA	5	5	4	4	7
WV	5	5	5	5	7

(months from beginning to completion of foreclosure)

Source: The following HUD Mortgagee Letters (ML): ML 90-4 (August 14, 1990); ML 2001-19 (August 24, 2001); ML 2005-30 (July 12, 2005); ML 2013-38 (October 28, 2013); ML 2016-03 (Feb. 5, 2016) available at Hudclips.

The patterns of servicer delays were reflected in the make-up of DASP auction pools. More than 50% of the properties sold under DASP from 2012 through 2015 were located in six states: Florida, New Jersey, Illinois, New York, Ohio, and Pennsylvania.[53] All are judicial foreclosure states, and since 1990, the six consistently ranked among the states with the longest foreclosure time frames.

HUD's due diligence time frames play an important role in minimizing abuse of the FHA insurance fund. For example, if a servicer drags out a foreclosure for six months beyond the reasonable diligence time, the fund must pay out an additional six months of foreclosure fees and property maintenance costs when it pays the insurance claim after foreclosure. The property may deteriorate and have a reduced resale value. To deter servicer abuses of foreclosure delays, HUD has authority to assess monetary penalties when servicers exceed due diligence and loss mitigation time frames.[54] These penalties can include amounts equal to claim amounts improperly paid out. HUD can limit and even bar non-compliant servicers from participating in the FHA program.

The typical loan sold under DASP was in a stage of default that should never have existed if HUD had enforced its own requirements.

DASP sales have involved loans that were in default well beyond any reasonable due diligence foreclosure time frame. The loans sold so far through DASP were in default for an average of 29 months when the sales were completed.[55] Through 2015, HUD's due diligence time frames permitted foreclosures to last in excess of twelve months in only six states.[56] The longest allowed time applied to New York, at nineteen months. Thus, the typical loan sold under DASP was in a stage of default that should never have existed if HUD had enforced its own requirements.

In addition to setting time frames for completing foreclosures, HUD fixes times for servicers to perform other obligations while a mortgage is in default. Servicers have a duty to complete reviews for loss mitigation by certain benchmark dates. The obligation to perform these reviews in a timely fashion goes hand in hand with the duty to proceed to foreclose with due diligence. By the end of the second month of delinquency, the servicer must give the borrower a written solicitation for a loss mitigation review.[57] Before the loan is three months in default, the servicer has to make reasonable efforts to conduct a face-to-face meeting with the borrower to discuss loss mitigation.[58] An initial loss mitigation review must be completed within ninety days of the default. The servicer must conduct regular reviews thereafter.[59] Timely compliance with these loss mitigation review requirements is a condition to the valid foreclosure of an FHA mortgage.[60]

The unresolved delinquencies for DASP loans, extending on average 29 months when the sales are completed, have no place under FHA's servicing guidelines. HUD's regulations do not allow a servicer to create long "black hole" periods during foreclosures while the servicer refrains from reviewing the borrower for loss mitigation. Delays without any servicer intervention put the borrower in the worst possible position. The borrower faces mounting costs to reinstate while the options to maintain homeownership become less viable. Meanwhile, these long periods of servicer inactivity drain money unnecessarily from the FHA insurance fund.

C. Servicers Delayed Foreclosures in Key States after Their Systematic Mishandling of Foreclosure Proceedings Was Exposed

Foreclosure numbers rose to unprecedented levels in 2009. During the following year, nationwide media attention focused on mortgage servicers' systematic mishandling of foreclosure proceedings. By the end of 2010, multiple government agencies were investigating the servicers' foreclosure activities. At the same time, a major title insurer indicated it would cease insuring foreclosure titles for two of the largest servicers.[61] The Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision were beginning an interagency review of foreclosure practices of 14 large servicers. These federal agencies eventually found critical, pervasive weaknesses in the servicers' supervision of attorneys, oversight of contractors, and document preparation.[62] During 2010, the mortgage servicers faced investigations of their foreclosure activities at the state level as well. In October 2010, 49 state attorneys general launched a joint investigation into the foreclosure practices of the five largest mortgage servicers.[63] Several federal agencies, including the U.S. Department of Justice, joined the state officials' investigations. The entities under investigation included the largest servicers of FHA loans: Bank of America, Wells Fargo, CitiCorp, and JP Morgan Chase.

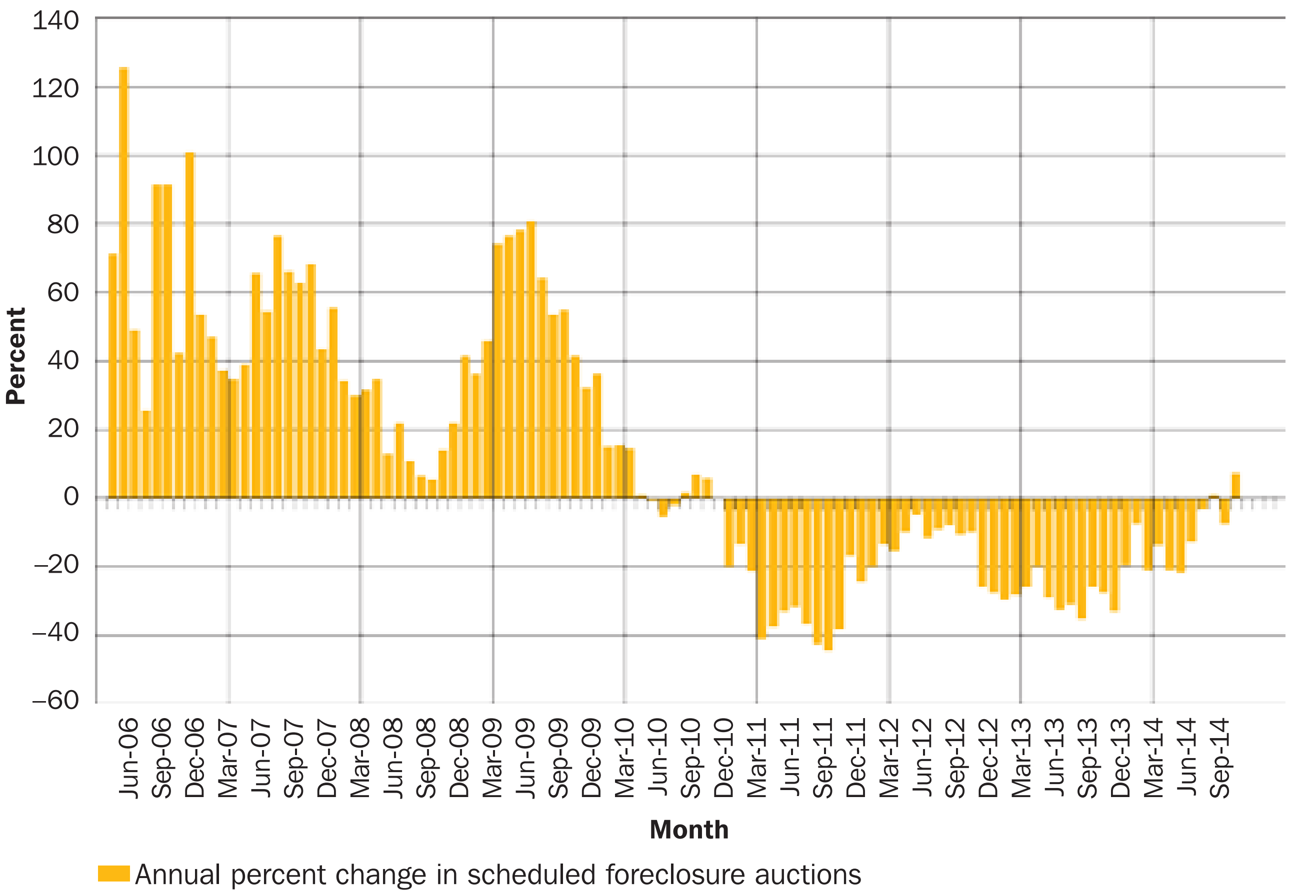
The mortgage servicers' pervasive misconduct came to light largely in judicial foreclosure states. The availability of court scrutiny in these states played a crucial role in uncovering the wrongdoing. Certain state courts took their own remedial action against the abuses. For example, the chief judges of the New York[64] and New Jersey[65] courts instituted new documentation requirements for foreclosure cases in an effort to combat the practice of robo-signing.

The mortgage servicers responded to this scrutiny in a variety of ways. In early 2011, Bank of America, JP Morgan Chase, and GMAC temporarily ceased all foreclosure activity.[66] What followed for the remainder of 2011 was a substantial slowdown of foreclosure activity. The new status quo involved both declines in commencement of new foreclosures as well as the suspension of cases already in the foreclosure pipeline. As of April 2011, the rate of commencement of new foreclosures and the conduct of foreclosure sales were at a 40-month low nationwide, down 34% from April 2010. In judicial foreclosure states these rates were down by 47%.[67] As of mid-2011 foreclosure filings in New Jersey were down by 87% for the year compared to one year earlier.[68] Through 2012, the inventory of delinquent loans in foreclosure continued to grow, with the "foreclosure pipeline" ratio in judicial states becoming more than twice the level in non-judicial states.[69]

The five largest mortgage servicers reached a settlement with the 49 state attorneys generals and federal agencies in March 2012. There was an expectation that this settlement would end servicers' concerns about their vulnerability to future legal challenges and lead to a resumption of normal foreclosure scheduling. This did not happen. The number of scheduled sales and the number of homes owned by banks after completed foreclosure sales decreased substantially during 2012.[70] As of early 2013, the inventory of properties in the foreclosure pipeline (foreclosure commenced but no auction scheduled) had increased nearly 60% from one year earlier.[71] Nationally, it would not be until late 2014 that the year-to-year comparisons in the number of foreclosure sales would show a true increase from the late 2010 levels.[72]

CHART 1

Annual Percentage Change in Scheduled Foreclosure Auctions (as of October 2014)



Source: RealtyTrac

In New York, the processing of foreclosure cases reflected this national trend. The filing of new foreclosure cases dropped precipitously after October 2010, when the state's Chief Judge issued the order requiring servicers' attorneys to execute certifications that they had properly verified loan documents. There had been 47,664 new foreclosure cases filed in New York during 2009 and 46,572 during 2010.[73] The filings dropped to 16,655 in 2011 and 25,411 in 2012. The new foreclosure filings did not rise again to the 2010 level until 2013.[74]

The resumption of a more typical rate of new foreclosure filings in New York did not tell the whole story. Toward the end of 2012, the New York Court Administrator observed that servicers were not moving cases ahead to foreclosure sales after they filed foreclosure complaints in the courts. In a 2012 report, the New York Court Administrator noted that due to this trend "there is an inventory of thousands of cases that have technically been commenced, but are not before the court."[75] These cases became a "shadow inventory."[76] During 2013, the New York court system faced a serious problem in dealing with this shadow inventory.[77] Because the servicers' attorneys were not filing required documents to move the cases forward, the court was forced to set up special procedures to compel them to do so.[78] Ultimately, the New York court system had to devote substantial personnel and resources to identifying the shadow foreclosure docket cases and making the servicers' attorneys prosecute them.[79]

The servicers' delays in New York had a direct negative impact on borrowers. Unless the servicers filed documents indicating that the case was ready to proceed to a judge, the borrowers could not participate in the court's foreclosure settlement conference program. Thus, the servicers' inaction effectively barred homeowners from this important opportunity for a loss mitigation review. The situation deteriorated to the point where legal services attorneys filed a class action lawsuit in federal court seeking redress from the servicers' failure to move their foreclosure cases forward.[80]

The servicers' delays in New York had a direct negative impact on borrowers: Unless the servicers filed documents indicating that the case was ready to proceed to a judge, the borrowers could not participate in the court's foreclosure settlement conference program; the servicers' inaction effectively barred homeowners from this important opportunity for a loss mitigation review.

If a case eventually made its way into New York's foreclosure settlement conference program, servicers created more delays by stalling in the conferences. In numerous instances, servicers failed to participate in the conferences in good faith. As a result, conference sessions were continued multiple times, delaying meaningful loss mitigation reviews. A 2013 survey of the New York foreclosure conferences revealed that 80% of the sessions were continued because servicers appeared without full authority or the necessary information to discuss loss mitigation.[81]

As of the end of 2011, New York and New Jersey were considered the states with the longest foreclosure time frames, at about two and one-half years for both states.[82] Yet there was nothing inherent about the foreclosure procedures in effect in these states that justified these extraordinary delays. In both states the chief judges had entered orders that essentially directed attorneys not to lie in documents they filed with the courts. New Jersey courts have interpreted this certification requirement to add nothing to an attorney's pre-existing duty to present facts truthfully to the courts.[83] Similarly, servicers have a duty under most investor guidelines, including under FHA rules, to review borrowers for all available loss mitigation options before they complete a foreclosure. The New York conference statute required only that the servicer show that it had conducted a good faith review of loss mitigation options before it could foreclose. Servicers in compliance with FHA rules should have had no problem meeting all requirements of the New York conference statute, and without any delay. Servicers' participation in settlement conferences such as those required under the New York law should play a vital role in reducing losses to the FHA insurance fund.

The mortgage servicers' pattern of stalling in loss mitigation conference programs was not limited to New York. Mortgage servicers went to great lengths in certain other states to avoid foreclosure mediation programs. For example, from 2010 to 2012, three non-judicial foreclosure jurisdictions—Oregon, Hawaii, and the District of Columbia—enacted new laws requiring foreclosure mediation. These laws applied to all non-judicial foreclosures in these states and required that servicers participate in a loss mitigation review before a foreclosure sale could take place. In each state, mortgage servicers reacted to the new mediation laws by stopping foreclosures almost entirely.[84] In the District of Columbia, there was on average 234 foreclosures monthly before the mediation law went into effect in 2010. In 2011 the number fell to 20 monthly, and in 2012 only 89 foreclosures took place over the entire year.[85] The servicers suspended foreclosure sales in the District of Columbia solely to avoid mediations. In Hawaii and Oregon servicers initially evaded mediations by avoiding non-judicial sales and resorting to lengthier judicial foreclosures. The mediation requirements in these two states did not apply to judicial foreclosures. Eventually the legislatures in Hawaii and Oregon had to amend their state statutes to require that mediations apply to judicial foreclosures as well.[86]

Florida is another state, like New York, associated with long delays during the foreclosure crisis. Like New York, Florida also had to devote substantial resources to forcing mortgage servicers to move their foreclosures cases forward. During 2010-2011, Florida spent $9.6 million to implement a "rocket docket" to speed up foreclosures.[87] Then, in 2013, Florida used $36 million in funds the state received from the 49-state National Mortgage Settlement[88] to expedite foreclosures. The state set a goal of closing out 700 foreclosure cases per day. An investigation into the reasons for this massive investment of public funds observed that "state court officials laid blame for the backlog of cases squarely in the laps of mortgage lenders, saying they weren't pursuing cases and they often didn't have the proper paperwork to prove they had the right to foreclose."[89]

D. HUD Recognized the Need to Protect the FHA Insurance Fund from the Impact of Servicers' Foreclosure Delays

By early 2011, HUD recognized that servicers' foreclosure delays had become a serious problem. In March 2011, HUD reported to Congress that the time FHA loans were spending in foreclosure "has risen due to various delays in foreclosure processing imposed by servicers."[90] FHA's in-foreclosure inventory was at a historic high, 27% higher than a year earlier.[91] These delays had a direct impact on the FHA insurance fund.

When the foreclosure crisis began, HUD allocated funds from its capital reserve account to pay the high volume of insurance claims it expected to receive from servicers over the next three years.[92] Up until late 2010, servicers submitted post-foreclosure insurance claims to HUD at rates consistent with actuarial predictions based on the number of loans in default.[93] But by early 2011, this trend had changed. Servicers' insurance claims were coming in at a total dollar amount 38% less than predicted.[94] Widespread foreclosure delays were causing this lower than anticipated level of new claims. In December 2009, only 5.8% of FHA loans in foreclosure were in foreclosure for 19 or more months. By the end of 2011, 25% of FHA loans in foreclosure were pending for this long.[95]

As servicers refrained from submitting FHA insurance claims, HUD realized that the major impact of the servicers' inaction would be felt in the future, when the insurance fund would face a high volume of inflated claims. Notably, the slowdown in servicers' submission of insurance claims did not reflect a decrease in the rate at which loans were going into default. FHA loans were continuing to default at rates consistent with actuarial predictions. The percentage of FHA-insured loans that were in seriously delinquent status remained at a consistently high level from 2010 through 2013.[96] If not for what HUD termed the servicers' "foreclosure process delays" the actual number of insurance claims being submitted from 2010 through 2013 would have been near or above projections.[97]

HUD was clearly aware of the reasons behind this slowdown. HUD explained the context in its 2011 Annual Report to Congress on the status of the FHA fund:

> *"Foreclosure processing delays began early in FY 2011, after revelations that major loan servicers had utilized so-called "robo-signing" procedures. Such practices included routine failure to properly validate legal standing to initiate foreclosure actions, or even to document borrower default. As a result of public revelations of these problems, several major U.S. mortgage lenders suspended foreclosures across the United States in the fall of 2010."*[98]

In the same report HUD went on to note that federal bank regulators and other federal agencies continued to investigate servicers' foreclosure documentation practices. Aside from the servicers' paperwork problems, HUD cited a second reason for the growing foreclosure delays. According to HUD, "additional process delays arise because numerous States have recently modified their laws to require servicer interaction with borrowers prior to foreclosure initiation, and the courts have been involved in declaring some foreclosure actions illegal."[99] HUD was referring to the new mediation and conference laws that were attempting to hold servicers accountable for reviewing borrowers for loss mitigation protocols, including FHA's guidelines, before foreclosure sales.[100] When servicers follow the mediation program rules in good faith, these programs do not delay foreclosures.[101] Most foreclosure mediation programs were set up to work within existing foreclosure time frames under state laws.

HUD reported in 2011 that delays were appearing at two distinct places in foreclosure proceedings. First, servicers were "purposefully delaying" filing claims after foreclosures, sometimes for up to 12 months, until potential challenges to improper foreclosures were resolved.[102] Second, the inventory of cases in foreclosure but pre-auction was increasing because servicers were reviewing documentation to make sure they would pass court scrutiny before a foreclosure sale.[103] The greatest concentration of cases with long delays was appearing in judicial foreclosure states. HUD noted that it had to adjust its foreclosure loss calculations to create different models for judicial and non-judicial states.[104]

The pattern of delayed foreclosures starts and delayed submission of insurance claims continued during 2011, 2012, and 2013. During 2011, the number of insurance claims submitted and the dollar amounts of the claims paid out was 25% to 35% below estimates that had assumed timely foreclosures.[105] HUD noted that "[a] contributing factor to this gap continues to be delays in foreclosure processing due to so-called robo-signing problems experienced by many major lenders."[106] During 2012, the prolonged delays led to the payout of claims at approximately half the level anticipated. [107]

HUD initially assumed that the settlement reached in the 49 state attorney generals' investigation would return the rate of submission of FHA insurance claims to the appropriate level.[108] However, at the beginning of 2013, the number of claims submitted continued to be roughly half what HUD had projected based on the high number of loans in default. According to HUD in early 2013, the "principal contributing factor to this gap continues to be delays in foreclosure processing in many areas of the country."[109] As of mid-2013, new foreclosure starts were still occurring at the same low level as at the end of 2011, before the state attorney generals' settlement.[110]

The delays in paying out FHA insurance claims meant that each claim, when paid late, would be substantially higher than it would have been if the servicer had timely completed the foreclosure. Each year's delay in completion of a foreclosure meant additional costs, fees, and property deterioration costs that HUD would have to pay from the FHA insurance fund.

E. DASP Responded to the Foreclosure Delays

HUD turned to DASP to reduce the losses caused by servicers' delayed submission of post-foreclosure insurance claims. The note sales avoid costs associated with waiting for servicers to conduct foreclosure sales and then to manage and market the underlying collateral as an REO property.[111]

At the time it implemented DASP, HUD had other options for compelling its servicers to comply with long-standing FHA requirements for timely completion of foreclosures. For example, HUD could have threatened to impose meaningful sanctions on servicers who deliberately delayed proceedings. Non-complying servicers could have been excluded from the FHA program. Instead, HUD developed DASP as a means to address delays while relieving servicers from compliance with the state foreclosure laws. This occurred despite the fact that some of these state laws, if properly followed, would ensure that servicers complied with FHA rules, including the rules requiring effective reviews for loss mitigation.

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The first large-scale DASP sale took place in September 2012. Through 2013, HUD reported that servicers' delays were continuing to keep insurance claims inappropriately low, but "[c]laims activity should move closer to the actuarial predications as HUD continues its efforts to sell delinquent mortgages out of the foreclosure pipeline through its Distressed Asset Sale Program (DASP)."[112] Gradually, as a consequence of DASP, HUD began to pay out more insurance claims earlier in the foreclosure process. During 2013, the FHA insurance fund had a net cash outflow of $3.6 billion. During 2014 the net cash outflow rose to $6.4 billion.[113] HUD attributed much of this increase to payment of claims through DASP.[114]

Payment of FHA insurance claims through DASP sales became the predominant HUD alternative to payment of the claims after servicers worked through the slower post-foreclosure REO sale process. At the time it implemented DASP, HUD acknowledged the program's direct effect on the rate of payment of insurance claims related to the foreclosure slowdowns. According to HUD, the "DASP auctions have enabled HUD to reduce potential loss exposure by directly addressing the large backlog of foreclosure actions that has accumulated since 2009."[115] According to HUD, "DASP was instrumental in FHA's efforts to reduce the backlog of seriously delinquent loans resulting from foreclosure moratoriums instituted by servicers prior to the completion of the National Servicing Settlement."[116] Considered solely as a means to accelerate payment of insurance claims, DASP appeared to work.

F. DASP Undermined HUD's Helpful Revisions to its Loss Mitigation Guidelines

DASP was part of a larger HUD strategy to relieve stress on the FHA insurance fund. Another means by which HUD hoped to reduce losses from the fund was to re-design the loss mitigation options that it offered to borrowers.[117] HUD recognized that improved loss mitigation strategies could benefit the insurance fund. Therefore, in 2012 the agency announced significant changes to its loan modification options. HUD indicated that the revised loss mitigation policies would be geared towards greater payment relief for borrowers, including allowing modifications to set payment levels as low as 25% of borrowers' household income.[118] HUD acknowledged that "[t]his approach will yield lower claim costs for FHA while also reducing repayment speeds for insured loans, both of which will positively impact the MMI Fund."[119]

In 2012 HUD chose to follow two paths to deal with the unprecedented losses from the insurance fund that had occurred since 2008.[120] One strategy was to implement more effective loss mitigation options designed to prevent foreclosure sales. The other was to terminate loans' participation in the FHA insurance program early, before foreclosures were completed. These strategies did not have to work at cross-purposes. A balanced approach that included rigorous application of the improved FHA loss mitigation protocols in conjunction with note sales could have worked harmoniously. Unfortunately, the servicers' loss mitigation compliance remained weak while the note sales accelerated. Although HUD was clearly aware of the potential of better loss mitigation to improve the financial status of the fund while simultaneously saving homes, it does not appear that HUD performed any significant analysis to quantify the benefit of effective loss mitigation or to enable any comparison to the effect of the DASP program.

Historically, servicers' compliance with FHA loss mitigation rules was consistently poor, with few repercussions for the servicers who ignored the rules. This lack of compliance continued with the DASP program, despite the simultaneous implementation of FHA's new loss mitigation rules. DASP became a tool servicers could use to evade FHA's loss mitigation requirements and have their insurance claims paid. At the same time DASP opened a path for servicers to avoid the application of state laws designed to promote compliance with FHA's loss mitigation rules. As discussed next, DASP marked a dramatic departure from long-standing HUD practices for payment of FHA insurance claims.

G. HUD's Troubling Shift to Payment of Insurance Claims Without Foreclosure

During 2012 and 2013 HUD embarked upon what it described as "new approaches to claim resolution and asset disposition."[121] These approaches, primarily involving DASP, marked a shift away from its traditional practice of payment of FHA insurance claims after completion of foreclosures.[122] Prior to 2012, HUD relied primarily on the foreclosure sale process to trigger lender insurance claims. Before DASP, HUD paid out only a small portion of all FHA insurance claims through alternatives, such as after short sales. For example, in 2011 approximately 80% of FHA insurance claims were paid through the traditional process after foreclosure sales, while only 20% of claims were paid through various alternatives. [123]

By 2013, HUD had concluded that REO sales were too expensive to serve as the primary property disposition method.[124] By 2014-15, HUD was paying most insurance claims (over 55%) through the alternatives processes that did not involve a completed foreclosure.[125] This was largely due to the increase in DASP sales. This change has meant that since 2013 HUD paid out most FHA insurance claims related to defaulted mortgages without a foreclosure sale.

HUD's assumption behind the new emphasis on alternatives to foreclosure sales was that this strategy would produce smaller losses from the insurance fund. Initially at least, this did not turn out to be true. Loans sold under DASP in 2013 produced greater losses on average than loans terminated through the traditional foreclosure sale process.[126] HUD explained these outcomes by pointing to "unique characteristics" of the loans selected for DASP sales.[127] HUD pointed out that "[t]he Note Sale program was used to assist in clearing the big foreclosure backlog created during the robo-signing litigation."[128] Therefore the properties secured by DASP loans were "mostly located in judicial states and which experience delayed foreclosure actions."[129] In other words, the concentration of DASP properties in judicial foreclosure states drove the higher loss rates for DASP sales. DASP sales involved loans that would have incurred particularly high losses if left to dispositions that involved completed judicial foreclosures. Compared to the cost incurred through foreclosure sales in the same judicial foreclosure jurisdictions, HUD still considered DASP sales to be the less costly alternative.[130]

During 2014 and 2015, the note sales produced smaller losses on average than completed foreclosure sales.[131] These results supported HUD's assumption that selling off loans early in the foreclosure process would result in smaller losses to the insurance fund than waiting until after a foreclosure sale to pay the claim. Given that servicers continue to select DASP loans primarily from a few judicial foreclosure states, the financial benefit to the insurance fund seems to hold true even when crisis-driven "backlogs" of foreclosure cases shrink.

Since the foreclosure crisis began, foreclosure losses in the range of 50%-60% of the loan balance have not been unusual for most types of loans.[132] On average, the loss rate from post-default dispositions of FHA-insured properties declined from 63.5% in the first quarter of 2010 to 51.3% in the fourth quarter of 2015.[133] These general FHA loss rates included losses from all types of default dispositions, including traditional REO sales after foreclosures, short sales, and DASP sales. HUD also touts DASP's success by reporting that from fiscal years 2012 through 2015 the amounts bid at DASP auctions improved from 40% of unpaid principal balance to approximately 60%.[134]

It must be noted, however, that significant causes unrelated to DASP have reduced losses from the FHA insurance fund since 2012. With new financial forces moving into the distressed asset sale market, bidding at foreclosure auctions has become more competitive.[135] As a result, losses per foreclosure have decreased across the board, both for HUD's traditional foreclosure sale dispositions and for alternative disposition methods such as DASP.[136] For example, the average loss rate from post-foreclosure REO sales of FHA loans was 71.7% in FY 2011.[137] The loss rate dropped to 56.7% in FY 2015.[138] These improved REO sale outcomes translate to a significant decline in the overall insurance fund loss rate even without DASP. It is true that loss rates from more recent DASP sales have been lower than losses from post-foreclosure REO sales (49.8% loss rate for DASP sales compared to 56.7% for traditional REO sales in 2015). However, the fund's loss rates would have shown a major decline after 2012 levels absent DASP. In addition, HUD is unable to quantify the losses caused by the failure to perform appropriate loss mitigation on many loans sold through DASP or otherwise improperly foreclosed. While some subset of DASP sales might be an appropriate measure, sales of loans that have not completed FHA loss mitigation reviews cannot be justified, even with the lower loss ratios.

There is obviously some financial benefit to the FHA insurance fund in cutting out the time needed to comply with procedures required by certain state foreclosure laws. The pertinent question, however, should not be whether we can identify some benefit in an analysis that looks at DASP in isolation. The real question is at what overall cost does this benefit come? Does the benefit outweigh other harm that DASP causes? Should DASP be one tool among many, rather than the primary tool to address foreclosure backlogs? These questions are particularly important because HUD restructured and improved its loss mitigation options to provide real alternatives to foreclosure at the same time that it expanded its note sales.

H. What Might Have Been: HUD's Missed Opportunity to Apply its Improved Loss Mitigation Program to the Backlog of Foreclosure Crisis Cases

The major participants in the mortgage servicing industry revised their loss mitigation options dramatically in response to the foreclosure crisis. Beginning in 2009, the overwhelming majority of home mortgages in default were eligible for review for some form of modification under the U.S. Treasury Department's Home Affordable Modification Program (HAMP). Nearly all large servicers signed on to the HAMP program. Servicers of loans owned or guaranteed by one of the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac were obligated to review borrowers in default for HAMP options. From 2009 through 2011, servicers permanently modified 933,000 mortgage loans under the Treasury and GSE HAMP programs. Significant payment reductions came with these modifications.[139] The typical Treasury HAMP modification reduced the borrower's payment by 36%.[140] Because these reductions created affordable payments, borrower re-default rates were consistently lower than under non-HAMP modifications.[141]

During the period of unprecedented mortgage modification activity from 2009 through 2011, FHA's loss mitigation program lagged behind market developments. FHA had not significantly revised its loss mitigation options since 1996.[142] In mid-2009, FHA announced its own version of the HAMP program (FHA-HAMP).[143] FHA-HAMP offered a formula for modifying a loan to achieve an affordable payment. However, the original design for FHA-HAMP was so flawed that it assured negligible participation. Borrowers who were more than 12 months in arrears were ineligible. Servicers routinely took more than 12 months to review a borrower for eligibility, leading inevitably to denials on timeliness grounds. In addition, FHA set debt-to-income ratio requirements that excluded many applicants. From the inception of FHA-HAMP in July 2009 through 2011, FHA servicers approved fewer than 12,000 FHA-HAMP modifications.[144] At the end of 2011, there were 711,000 FHA loans in seriously delinquent status.[145]

While servicers of other types of loans were implementing nearly one million HAMP modifications, FHA servicers continued to focus on non-modification options. These were typically short-term forbearance and repayment plans that did not provide sustainable solutions for unaffordable loans.[146] The modifications that FHA servicers did approve were overwhelmingly FHA standard modifications.[147] The FHA standard modification applied a cookie-cutter formula unrelated to affordability. While Treasury HAMP modifications were reducing borrower payments by over one-third, FHA standard modifications reduced payments on average by about 11%, a percentage unlikely to prevent re-default.[148]

In early 2012, the U.S. Government Accountability Office (GAO) examined the performance of FHA loss mitigation compared to all other major loss mitigation programs, including those for conventional, GSE, and other government-insured loans. FHA came out worst in the comparison, behind all other industry players. [149] When compared to all other categories of home loans, FHA loans had the highest post-modification re-default rates.

To its credit, FHA substantially revised its loss mitigation protocols during 2012-13. FHA came out with a new design for FHA-HAMP and an entirely revamped set of loss mitigation guidelines for evaluating borrowers. The new formulas permitted modifications with substantial payment reduction, allowing payments as low as 25% of the borrower's income.

The new FHA loss mitigation guidelines had the potential to benefit homeowners and the insurance fund in substantial ways. Unfortunately, the rules were complicated. Servicers needed robust oversight from HUD if they were going to implement the guidelines properly. At the same time, servicer delays had created a huge backlog of mortgages in default. Many of these loans had been in default for years with little attention from servicers. These were the circumstances under which HUD decided to ramp up its DASP program, a program that allowed servicers to shortcut state foreclosure procedures, terminate FHA insurance early, sidestep FHA loss mitigation reviews, and cut off homeowner access to all FHA options.

By rolling out DASP, FHA undermined implementation of its own improved loss mitigation program. At the time, hundreds of thousands of loans in default desperately needed reviews under FHA's new guidelines. Instead, FHA offered servicers an option to receive immediate payment of insurance claims without sufficient oversight to ensure loss mitigation had been exhausted. Not surprisingly, the largest mortgage servicers, the ones who had caused and perpetuated the foreclosure delays, were quick to respond. Servicers, such as Bank of America, Wells Fargo, and JP Morgan Chase, chose most of the loans to be sold through DASP sales.[150]

As the examples from the Philadelphia mediation program show, HUD has allowed DASP sales to proceed without effective oversight of servicers' loss mitigation activities. Selling off an FHA loan when the default could have been cured and an insurance claim avoided clearly harms the insurance fund. Without a meaningful analysis of the critical relation between loss mitigation and sound management of the insurance fund, HUD was not in a position to assess the real cost of DASP as an impediment to FHA's loss mitigation program, and consequently as a drain on the insurance fund.

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In its 2012 report on government agencies' loss mitigation performance, the GAO repeatedly cited FHA's long-standing failure to assess the beneficial impact of loss mitigation on protecting the insurance fund. Significantly, the GAO noted that HUD had not evaluated the cost-effectiveness of specific loss mitigation options in relation to particular loan and borrower characteristics, such as borrower income and loan-to-value ratio.[151] Because of these deficiencies, the GAO found that FHA and HUD had "a limited understanding of the ultimate costs of their loss mitigation programs."[152] Without this understanding HUD could not appropriately balance the tradeoffs "between assisting borrowers to keep their homes and helping ensure the lowest cost to the taxpayer." [153] Comparing FHA's assessments of its loss mitigation programs with those by the Treasury Department (for HAMP) and the GSEs, the GAO concluded that FHA lacked adequate data to evaluate the costs and benefits of loss mitigation as it pertained to both borrowers and taxpayers.[154]

I. HUD's Loan Sale Program During the 1990s Showed that HUD Can Set Standards for Distressed Loan Buyers

DASP was not HUD's first program to involve sales of tens of thousands of single-family home mortgages. Until 1996, HUD operated a program under which HUD itself took assignments of defaulted FHA insured loans ("the HUD Assignment Program"). After taking ownership of the loans, HUD staff would oversee loss mitigation for them. In the early 1990s, HUD held 110,000 mortgages under the Assignment Program. From 1994 through 1997, as part of the phase-out of the Assignment Program, HUD auctioned off nearly 100,000 HUD-owned loans to private investors.

There were significant differences between the procedures HUD used for the 1990s loan sales and the structure it set up for DASP sales. Most significantly, in the 1990s HUD required that buyers continue to service the loans under the same guidelines that HUD staff were using while HUD owned the loans.[155] The 1990s sales did not cut off the loss mitigation options that applied to the loans before the sales. In addition, after the sales HUD continued to monitor the new servicers directly to verify compliance with HUD's servicing standards. HUD provided a complaint mechanism through which borrowers could notify HUD if a new servicer was not complying with HUD's rules. HUD staff would be available to mediate between the borrower and the new servicer.

HUD now takes the position that a DASP sale cuts off the loan's participation in the FHA program, including any obligation to follow FHA servicing guidelines. With the exception of the small portion of loans sold under "Neighborhood Stabilization" pools, HUD has not set clear, enforceable standards for loss mitigation once the loans are sold.[156] Homeowners are not told in advance that their loans will be sold. Once the sale has taken place, homeowners have no effective recourse to HUD to correct abusive practices of the new servicers.

After the 1990s loan sales, HUD had a research firm evaluate the status of the loans sold under the program. According to the firm's review of data two years after the sales, the new servicers resolved nearly all loan accounts within six months of purchase, and 61% of the loans were performing. [157] This resolution rate contrasts starkly with the DASP program. For example, for the sale of 27,580 loans in large national pools conducted in June and September 2014 (SFLS 2014-2), HUD described about one-half as "unresolved" as of January 2016. Only 11.7% were considered performing.[158]

HUD would not need to reinstitute the old assignment program in order to exercise effective control over buyers of distressed loans. HUD controlled buyers in the 1990s sales through the terms of auction bidder contracts. HUD could include enhanced provisions in the bidding agreements for future loan sales and develop appropriate enforcement mechanisms to make sure the purchasers complied with the terms.

The Government Sponsored Enterprises (GSEs), Freddie Mac and Fannie Mae, have shown a greater willingness to include homeowner protections in the contract terms for sales of their non-performing loans. Beginning in 2015, Fannie Mae has required that buyers have the ability to review borrowers for HAMP modifications. In April 2016, the conservator for the GSEs announced three new requirements for purchasers of non-performing GSE loans.[159] These included a requirement that purchasers review certain underwater loans for principal reduction modifications and implement these modifications if appropriate under a net present value test. The new GSE guidelines also limit the rate at which interest rates may be increased under post-sale modifications. Finally, the GSEs will bar loan purchasers from unilaterally releasing liens to abandon vacant properties. These new GSE requirements are narrow, and it remains to be seen how they will be enforced. HUD could certainly develop more rigorous standards based on its published guidelines for FHA servicers.

IV. ASSESSING DASP'S IMPACT ON HOMEOWNERS

A. The Evidence Does Not Show that DASP Helps Homeowners

When HUD announced the ramped-up loan sale program in mid-2012, it emphasized the potential benefits for homeowners. In June 2012, then-HUD Secretary Donovan described HUD's plan to increase note sales tenfold as a "program to give more homeowners with seriously delinquent loans the chance to avoid foreclosure."[160] HUD took the position that while a loan remained insured by FHA the servicer could not reduce the principal balance as part of a modification. According to HUD, removing the obligation to comply with FHA rules would allow a new servicer to modify loans by reducing the principal balances owed. HUD's view presumed that market incentives would drive the new servicers to exercise greater flexibility to accommodate borrowers. According to HUD, "[b]ecause the loans are generally sold for less than what the borrower currently owes, the purchaser has the ability to reduce or modify the loan terms while still making a return on the initial investment."[161] This would provide "the opportunity for the borrowers to potentially stay in their home under a new sustainable mortgage or other meaningful help."[162]

This did not materialize. There is little evidence that the private investors purchasing HUD loans are approving loss mitigation options with more favorable terms than would have been available under FHA's guidelines. For-profit investors have purchased 98% of the loans sold under DASP.[163] In reports about DASP, HUD has sought to describe the outcomes in a positive manner. However, the numbers do not support such a view.[164] HUD's reports rely on vague terminology and give little specific information about what actually happened to loans after DASP sales. For example, HUD's report covering data for loan sales from 2010 to January 2016 indicated that 35.5% of 89,000 loans sold were still "Not Yet Resolved."[165] This meant that the servicer was still reporting the loan as in "delinquent servicing" – a final resolution of the default had not been reached.[166] Loans sold through DASP were on average 29 months delinquent before the sales.[167] If modifications with principal reduction had been a naturally attractive option, one would think that buyers would have acted quickly to put these modifications in place. The fact that such a large portion of these long-term delinquent loans remained in "black hole" status long after the note sales is troubling.

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For the 65% of loans that HUD labeled as "resolved" after a DASP sale, the vagueness of reported outcomes raises similar concerns. HUD pointed out that for 43% of the "resolved" loans foreclosures were "avoided."[168] However, under the rubric of "foreclosure avoided" HUD included all instances where the borrower gave up the property through a deed-in-lieu of foreclosure or short sale. The category also included cases where the borrower paid off the loan or was merely in a short-term forbearance period.[169]

As of January 2016, HUD reported about 16.8% of the "resolved" loans as "re-performing."[170] HUD further divided the "re-performing" resolved loans between those that were "re-performing with loan modification" (15.3% of resolved loans) and those that were "re-performing – other" (1.5% of resolved loans). The 16.8% figure for re-performing loans shrinks in the larger context. Roughly one-third the loans sold under DASP remained "unresolved." In addition, HUD did not provide data on another 15% of the loans sold because DASP purchasers had already sold them to other buyers.[171] Therefore, the 16.8% of "resolved" loans that HUD could identify as re-performing did not comprise more than about 10% of the loans sold under the program.

What was really going on with the 10% of DASP loans that were supposedly "re-performing?" HUD defined a "modification" as either a trial or permanent modification, but did not report anything about the structure of these agreements.[172] We do not know whether HUD simply accepted servicers' characterizations of certain resolutions as modifications even though they did not permanently change loan terms. The more specific examples discussed next call into question the loan buyers' labeling practices. Nor do we know the extent to which the modifications targeted affordable payments based on the borrowers' income. Most significantly, we do not know whether the modifications were better or worse than a modification the borrower could have received under FHA's current guidelines if a DASP sale had not taken place.

HUD has the ability to collect useful and reliable data about loss mitigation outcomes after DASP sales. The Office of the Comptroller of the Currency, for example, publishes quarterly reports with detailed breakdowns of loan modification characteristics for millions of conventional mortgage loans.[173] The Treasury Department has published monthly summaries of hundreds of thousands of modifications under the HAMP program, including details of how loan terms changed and how the changes affected affordability.[174] As HUD was beginning the large-scale DASP sales in 2012, HUD declined to establish such requirements. HUD could easily have required the buyers to report this information on a regular basis. The data would show whether DASP sales actually do benefit homeowners by providing flexible, sustainable loss mitigation, as HUD had announced at the program's inception.

The evidence of the actual loss mitigation offers that DASP buyers are giving borrowers substantiates the concerns raised about the program. The evidence does not support the theoretical analysis behind HUD's pro-borrower spin. Some major servicers of DASP loans are presenting borrowers with options that include long-term payment plans that are labeled as loan modifications, but are not true modifications that permanently change loan terms. Other servicers for the buyers offer "trial modifications" coupled with vague offers to consider the borrower for a modification at some distant time in the future. The offers often do not refer to the terms of a permanent modification or to any established program for calculating the terms. Caliber, a servicer acting for one of the largest purchasers at DASP sales, offers five-year "interest only" payment plans. These plans lull borrowers with a teaser payment that will eventually convert to a level at least as high as the previously unaffordable payment and include a huge balloon payment due for all earlier unpaid amounts. Calling these types of offers "modifications" of the mortgage is deceptive. Still other servicers require substantial lump-sum payments as the initial step in any loan modification.

HUD's reporting terminology puts a favorable gloss over many of these questionable practices. A homeowner making payments under one of these "modifications" has likely not been offered a long-term solution. These types of offers, combined with the trend of homeowners who have their loans sold before they have exhausted FHA loss mitigation, belie any claim that DASP tends to provide better solutions to homeowners. At the same time, DASP allows the new owners to bide their time, collect payments, re-sell the loans as "performing," or foreclose whenever they choose.

HUD's data regarding performance of loans after note sales must be viewed in the light of these practices. For example, Lone Star Funds purchased 16,686 loans from the national pools sold in Loan Sale Number 2014-2 (June, September 2014). Lone Star's purchases represented 61% of the loans sold in that sale. HUD's status report from January 2016 indicates that 50% of the loans from this sale were "resolved" and 20% of these resolved loans were "Re-Performing with Loan Modification."[175] We happen to know something about the terms of the offers that Lone Star has called "modifications." During the latter part of 2014 and in early 2015, many homeowners received documents containing offers from Caliber Home Loans, Loan Star's servicer. Caliber informed the homeowners: "Your request for a loan modification has been approved" and the mailing included a document captioned "Modification

Agreement – Limited Term."[176] Caliber's standard agreement contained the following language:

> *Summary of Modification: We will reduce the balance on which interest is accruing and we may lower the interest rate for a period of time called the Reduction Period. During the Reduction Period you will make monthly "interest only" payments (plus escrow and Ancillary payments). Certain amounts are deferred, meaning that you still owe them, but they will be collected by the Servicer at a later date. On the Reduction Period End Date, your Loan and interest rate will revert to the terms of the operative loan documents and your payment may increase. Deferred amounts will remain deferred.*[177]

It is hard to see how these terms create a loan modification. The agreement does not reduce the debt the homeowner must repay. Instead, it capitalizes arrearages to increase the interest-bearing principal. The agreement does not specify a maturity date for repayment, so it is not possible to tell whether there will be a balloon payment due at maturity and how large that balloon payment will be. Most importantly, the interest rate reverts back to the original loan terms when the reduction period ends. Because the principal balance has increased, the monthly payment for principal and interest will likely end up significantly higher than the pre-modification payment, the payment that led the homeowner into default. There is no long-term benefit to the borrower from these terms. The homeowner pays for five years and never reduces the debt. There is a benefit for Lone Star, however. The loan "performs" for five years and Lone Star can sell the loan at any time if it can make a profit off the deal.

Under current bidder agreements, purchasers of DASP loans must wait twelve months before they can foreclose. Before 2015, the waiting period was only six months. While the six-month period applied, servicers for DASP buyers were structuring modification agreements to last for six months. Two servicers of DASP loans, Selene Finance and Rushmore Loan Management, offered homeowners these six-month agreements, labeled trial modification plans, without providing details as to what the repayment terms would be after six months.[178] Selene's offer required that the homeowner make an initial payment of $10,000 to start off the trial plan, while Rushmore's offer demanded a $6,000 initial payment. Under these agreements the servicer could allow the loan to "perform" for six months, but be under no obligation to keep the terms affordable thereafter. Bayview, the largest buyer of DASP loans, placed homeowners in particularly precarious modification agreements. Bayview's form modification agreement provided that if the homeowner defaulted on a payment, the homeowner must give up the property immediately through a deed in lieu of foreclosure or short sale.[179]

B. The Changes to DASP HUD Announced in 2015 Contain No Specific Resolutions to Long-Standing Problems with the Program

In April 2015, HUD issued a press release announcing several technical changes to the DASP program. These changes were to be effective with an auction to be held later that year.[180] One of the changes announced was that future purchasers of loans through DASP will be required to delay foreclosure for twelve months instead of six months after they acquire the mortgages. The extension may help borrowers in a few situations. However, investors with a legitimate interest in preserving the existing mortgages could easily have approved a modification or similar option within six months.

HUD also began requiring future buyers of loans through DASP to evaluate all borrowers for some form of HAMP modification. HUD never established any guidelines on what this "HAMP-like" modification should be or how it intends to enforce this requirement. The Treasury Department's HAMP program is ending at the end of 2016 and there is no indication yet regarding what type of requirement will replace it.[181] FHA's version of HAMP (FHA-HAMP) works within a comprehensive "waterfall" protocol that guides the servicer in a review for a series of FHA loss mitigation options. HUD did not suggest that it is making the entire FHA loss mitigation program binding on DASP buyers. Over the past year, HUD has not provided a clear explanation of how it will enforce this unique FHA servicing option on non-FHA servicers. Similarly, it has not explained how it will require the private equity firms and hedge funds that buy the loans to honor this requirement when they re-sell the loans. Without transparent standards and a rigorous enforcement structure, asking servicers to modify loams has little value.

HUD also indicated that it was imposing more reporting requirements on buyers of DASP loans. HUD did not describe how detailed these reporting requirements will be or when they will be made public. Finally, HUD stated that it was enhancing pre-sale screening of loans entering into DASP pools. Here again, HUD did not release any details about this screening procedure. These changes do not go far enough to resolve the problems with the DASP program.

C. Most FHA Loans are Sold By the Servicers Who Caused Major Foreclosure Delays

HUD allows mortgage servicers to select the loans that it sells through DASP. In its reports HUD identifies the servicers that supplied most of the loans for the sales. HUD's disclosures show that a few very large mortgage servicers supplied the majority of loans that passed through DASP.

> DASP could be called "The Bank of America" loan sale program, as 44,501 DASP loans were sold in pools made up exclusively of Bank of America loans. Another 16,830 were sold in pools that consisted of Bank of America loans mixed with loans from another servicer, typically JP Morgan Chase.

Wells Fargo, JP Morgan Chase, and Bank of America were the three largest servicers of residential mortgages throughout the foreclosure crisis. They are also the largest servicers of FHA mortgages.[182] Of the 101,254 loans that HUD sold up to August 2015, 67,059 came from these three servicers. DASP could be called "The Bank of America" loan sale program, as 44,501 DASP loans were sold in pools made up exclusively of Bank of America loans. Another 16,830 were sold in pools that consisted of Bank of America loans mixed with loans from another servicer, typically JP Morgan Chase.

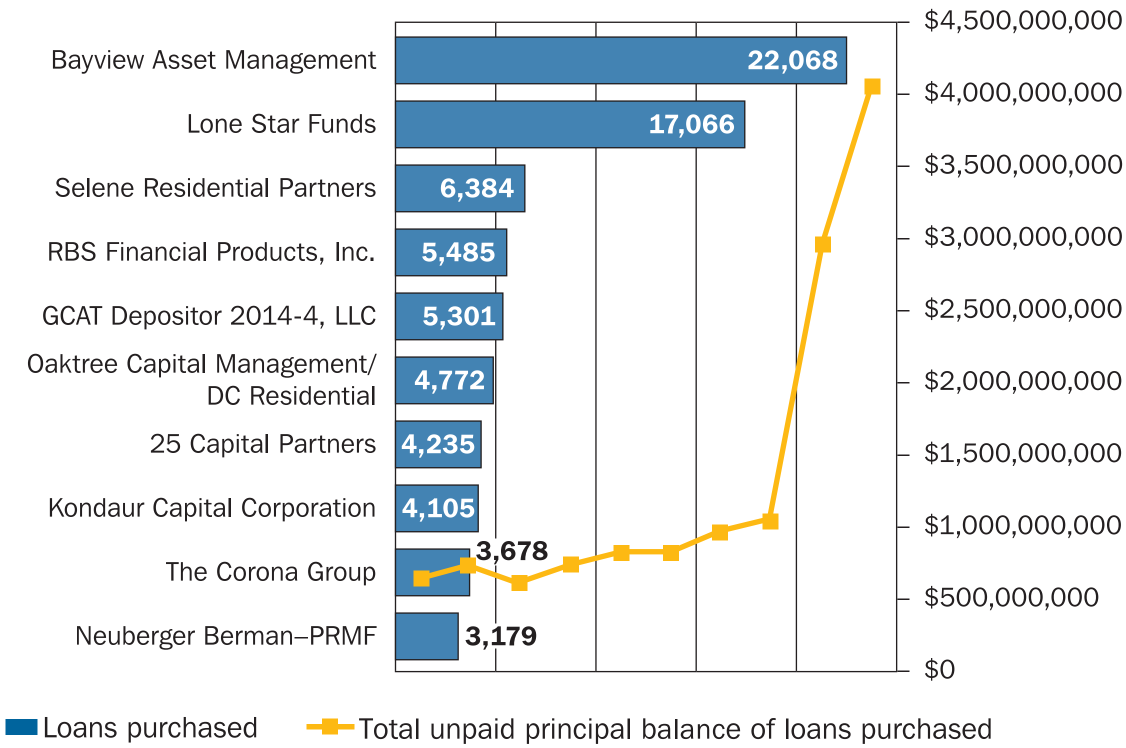
Roughly two-thirds of the billions of dollars in FHA insurance claims paid out under DASP went to Bank of America, Wells Fargo, and JP Morgan Chase. Notably, these were three of the five servicers targeted by the 49 state attorney generals' investigations during 2010-12. The involvement of these particular servicers goes a long way to explaining the extensive delays, averaging two and one-half years of delinquency, for the loans sold through DASP. It also explains the concentration of loans from judicial foreclosure states. These were the servicers most under scrutiny from courts and government agencies, a scrutiny that turned out to be well-founded.

D. Most DASP Purchasers are Private Equity Firms and Hedge Funds

The winners of DASP auctions have been almost exclusively large private equity firms and hedge funds.[183] These are firms that specialize in buying up distressed assets. They may tinker marginally with the assets they buy, but their goal is eventually to sell them to someone else for a profit. The recycling periods may last two, three, or more years, but the firms' ultimate objective remains to resell the assets for substantially more than they paid for them.[184]

CHART 2

Top 10 Loan Buyers of FHA Defaulted DASP Loans



Source: RealtyTrac, February 2016.

Two private equity firms, Bayview Asset Management and Lone Star Funds, have bought the largest shares of DASP loans.[185] Neither firm has a credible track record for building stable communities. The Blackstone Group owns the controlling interest in Bayview. Blackstone is the largest buyer of non-performing loans in the country, and the largest private equity firm generally. Blackstone is the leading funder behind the conversion of former single-family-owned homes into rental properties.[186] This trend has spawned a new generation of mega-landlords that own small empires of single-family rental homes.[187] As this trend develops, absentee landlords replace homeowners and former homeowners face higher housing costs as renters.

Lone Star Fund's role as the major purchaser of DASP loans raises concerns as well. Lone Star services mortgages through its subsidiary, Caliber Home Loans. Caliber's chairman and CEO, Joe Anderson, previously led Countrywide Mortgage's marketing division. Countrywide was a prime driver of the bad lending practices that led to the foreclosure crisis.[188] The third largest DASP purchaser is Selene Residential Partners. Selene is a division of Ranieri Partners, whose Chairman and Founding Partner Lewis Ranieri was a key promoter of mortgage-backed securities during the subprime boom.[189] Overall, the cast of characters buying the bulk of FHA loans has not demonstrated a commitment to distressed homeowners and neighborhoods.

HUD has not produced evidence that Bayview, Lone Star, and the other private equity firms purchasing DASP loans are agreeing to reduce principal balances as part of modifications on any regular basis.[190] Overwhelmingly, the speculative buyers have not modified loans at all. They foreclose much more frequently than they modify loans. For example, for the second large DASP National Pool auction during 2013, the buyers reported that they had modified 9.1% of the loans while they foreclosed on 56.8% of them.[191] In addition, many of the loans not foreclosed were disposed of through short sales or deeds in lieu of foreclosure rather than preserved through home retention options.[192] As previously discussed, even the modifications offered are often not sustainable.

Arguably, some private equity firms and hedge funds have an interest in converting "non-performing" loans into "performing" loans. Performing loans can fetch more money upon resale than non-performing loans. However, to label a loan "performing" the firms do not have to modify it. They certainly do not have to reduce the principal balance. There are easier ways to designate a loan as "performing." As described previously, when Caliber offers a "loan modification," it is routinely a five-year interest-only payment plan. The agreement does not permanently restructure the loan terms, as occurs when a loan is modified. Instead, the borrower remains liable for the full loan balance and faces reversion to the old loan terms – to the payment obligation that the borrower could not afford before the DASP sale. These steps may help Caliber and Lone Star maximize the amount of money they make when they sell the loan (or the empty house) in a few years to someone else, but they do not help the borrower remain a homeowner for the long term.

Financial speculators are the primary source of funds for bailing out the insurance fund through DASP sales because they are willing and able to pay the most money for the loans. Lone Star describes its investment approach as to capitalize on market conditions in which "[f]inancial institutions' balance sheets are under pressure and there is a need to dispose of high volumes of assets to manage capital, deleverage and build liquidity."[193] This accurately described HUD's position with respect to the FHA insurance fund in 2012. Private equity firms could appear to be natural partners for institutions in HUD's position at the time. The equity firms borrow heavily from pension funds, wealthy investors, and other public and private institutions. They securitize the income flows from their holdings, attracting capital at advantageous rates. With their access to these resources the large speculative investors can pay higher prices and squeeze out smaller community-focused bidders.

Taking the fire sale approach and welcoming high-paying financial speculators might be an acceptable alternative if HUD's only obligation under federal law was to manage an insurance fund. Congress, however, directed HUD to fulfill another purpose as well. This was

Taking the fire sale approach and welcoming high-paying financial speculators might be an acceptable alternative if HUD's only obligation under federal law was to manage an insurance fund. Congress, however, directed HUD to fulfill another purpose as well. This was to preserve homeownership for families who would otherwise not have this opportunity.

to preserve homeownership for families who would otherwise not have this opportunity. This second purpose must always guide HUD's exercise of discretion in implementing the FHA housing program.

The equity funds' business model is focused on asset recycling. This model does not align with HUD's obligation to preserve homeownership, as directed by Congress, whenever feasible. Speculative investors can easily maximize payouts from distressed loans without doing the work of formally modifying the loans.

The incentives of the servicers who manage loans on behalf of DASP investors are similarly not aligned with the goal of homeownership. Mortgage servicers get paid based on the terms of their contracts with the investors who own the loans. These compensation structures often discourage modifications. Thus, servicers' own financial incentives often lead them to foreclose rather than modify mortgage loans.[194]

V. RECOMMENDATIONS

HUD must not conduct further loan sales unless and until it has put in place a strong and effective system for enforcement of its loss mitigation requirements and consistent, fair post-sale requirements that promote homeownership. We recommend the following:

1. Enhance loss mitigation compliance.

- **Require servicers to document and certify compliance with each step of FHA's sequential loss mitigation review, including documentation of the grounds for denial of foreclosure alternatives, before HUD pays a claim.** FHA-insured loans are routinely processed through foreclosure by mortgage servicers who fail to comply with FHA loss mitigation guidelines. DASP currently rewards those servicers and loan owners by paying off their claims early, saving them the time and expense of completing foreclosures in compliance with FHA rules. Yet, FHA guidelines are tailored 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.
- **Create a review and appeal procedure for loss mitigation decisions using neutral decision makers.** The National Servicing Center now receives homeowner complaints but generally does not provide a de novo review of a servicer's response to a homeowner's request for loss mitigation. The NSC should offer appeals from FHA servicer denials or reviews of FHA loss mitigation problems that engage in fact-finding and require the servicer to follow procedures where the servicer has not adhered to requirements. Homeowners routinely face servicer non-compliance and generally have little recourse without seeking legal assistance. Such a procedure ideally would be implemented by a new neutral hearing–officer structure, although it could be established within the current structure.

- **Impose penalties on servicers who delay processing loss mitigation requests or systemically circumvent FHA loss mitigation requirements.** Delays in processing loss mitigation requests undermine home retention and impose significant costs on the FHA insurance fund by increasing the chances of foreclosure and inflating amounts due under a loan. HUD must use its statutory authority to impose penalties on repeat players who abuse the system, harm homeownership, and undermine FHA's program goals.
- **Require servicers to provide notice to homeowners.** Such notice would accurately inform homeowners about the sale process, servicer obligations before and after sales, and homeowners' rights under these note sale transactions, including the status and results of any loss mitigation outreach and review. The notice should be provided prior to the inclusion of a loan in a DASP pool and provide a homeowner with adequate opportunity to finish the loss mitigation process if it is still underway. Notice is needed because homeowners are routinely learning that their loans were sold while they are still seeking to complete the loss mitigation review process. Moreover, homeowners generally are unaware of the sales and the effect they have on homeowner rights.
- **Develop transparent and fair guidelines for determining which defaulted loans are sold.** HUD should develop objective guidelines for determination of which defaulted loans are sold. These guidelines should ensure that servicers are not using the process to avoid compliance with more protective state foreclosure laws.
- **Promote compliance with state and local laws, including mediation requirements.** State and municipal mediation programs create a forum for engagement between servicers and homeowners facing hardship and produce better home retention results. As a result, mediation programs support better compliance with FHA loss mitigation guidelines. HUD should include in its oversight measures to ensure and promote compliance with mediation programs.

2. Improve buyer oversight.

- **Implement a detailed loss mitigation protocol that provides top-tier loss mitigation protections to homeowners.** The GSEs have required purchasers at its non-performing note sales to apply some basic standards in reviewing borrowers for loss mitigation. In 2015, Fannie Mae began to require that buyers contract with HAMP servicers and provide HAMP reviews for all homeowners whose loans have been subject to a note sale. In April 2016, the Federal Housing Finance Agency (FHFA) set some minimal requirements for consideration of principal reduction and restricted interest rate hikes in post-sale modifications. HUD's requirements are less specific and therefore less protective. As a minimum standard, HUD should require actual FHA-HAMP reviews, rather than settling for "substantially similar" offerings. Proprietary modifications generally are not as affordable for homeowners and do not provide the same level of long-term performance. Because HAMP modifications, including FHA-HAMP, are offered within the context of a larger loss mitigation protocol, HUD should require evaluations for FHA-HAMP within a comprehensive set of loss mitigation options. These options should be at least as supportive of sustained homeownership as FHA's current loss mitigation guidelines. The options should include review for principal reduction because that is the major benefit for homeowners HUD announced in launching the loan sale program.

- **Require that purchasers of distressed loans disclose their loss mitigation protocols.** As long as loans are FHA-insured, a set of defined, publicly available loss mitigation guidelines apply to them. Homeowners and housing counselors can look at these rules and know what the available options are. This transparency evaporates when servicers for buyers of FHA loans take over. The new servicers act arbitrarily. To the extent that they follow any system, their protocols are secret. These servicers sometimes deny that they offer any form of loss mitigation at all. Attorneys for homeowners have had to pursue litigation aggressively just to get the servicers to disclose what options they offer. HUD should require a transparent disclosure of available loss mitigation options as an essential element of the contracts to bid at distressed loan auctions. These protocols should be disclosed to the public as well as to HUD.
- **Implement an effective system for homeowner appeals of servicer loss mitigation decisions.** As previously described in connection with the need to enhance loss mitigation oversight generally, the National Servicing Center (NSC) currently takes borrower complaints and often works with the borrower and servicer to solve loss mitigation problems. We have suggested ways in which the NSC's role can be strengthened. Homeowners facing problems with loss mitigation after loan sales need access to the same type of effective dispute resolution process.
- **Establish an effective system of monitoring and enforcing loss mitigation requirements for new owners and servicers.** Servicers and new loan owners should be required to document compliance with post-sale requirements for a time certain following a note sale. Although HUD has begun to set some minimal requirements for loan buyers, such as the review for a modification similar to a HAMP modification, HUD has not disclosed what the consequences will be if the buyer ignores the requirement. Nor has HUD disclosed what remedies it will provide for homeowners harmed by the buyer's non-compliance. HUD needs to articulate clear consequences, enforce them, and ensure that homeowners are made whole if a buyer or its assignee ignores HUD requirements.
- **Bar from future auctions buyers who have purchased FHA loans in the past but systemically violated loss mitigation standards and other program requirements.** Investors with a record of violating post-sale FHA requirements should not be able to continue to profit from the sales without complying with rules intended to ensure that the program meets it goals.
- **Require reporting for post-sale loss mitigation activities, including data to show the levels and nature of payment changes, and old and new borrower debt-to-income ratios.** HUD's rationale for the note sale program in part is the potential for better outcomes for homeowners. It is essential to better track the sustainability of outcomes.
- **Mandate post-sale reporting of demographic and geographic data about homeowners, loss mitigation, and loan performance.** The foreclosure crisis hit hardest in communities of color. It is crucial to ensure that sales and outcomes are monitored so that policies are implemented fairly and without disparate impact.
- **Report data on subsequent sales and rentals involving the properties.** Any assessment of the utility of the DASP sales, especially in light of the loss of access to FHA loss mitigation options, must be evaluated in light of the ultimate disposition of the properties involved.

- **Establish a clear rule that post-sale reporting requirements are binding on subsequent buyers of the loans.** Investors should not be able to "launder" the notes by selling them again. The importance of post-sale measures is not diminished simply because a loan has been sold again.
- **Assess meaningful financial penalties for substantial noncompliance with reporting requirements and bidding contract terms.** Oversight of the DASP sales only can be done well where there is adequate information about the sale outcomes and adherence to program guidelines. The availability of penalties for substantial problems with reporting or contract compliance will improve investor performance post-sale. Because bidding contract terms include loss mitigation requirements, where applicable, enforcement of such rules is an essential part of enhancing sustainable outcomes.
- **Direct the immediate public release of all post-sale management reports and supporting documentation.** HUD has developed reporting standards for DASP buyers. The public should know what HUD asks in these reports and how frequently buyers must submit them. So far, the public does not have access to HUD's post-sale reviews. These provide essential insights into the agency's stewardship of its mission and the efficacy of the DASP sales as a tool for meeting our national housing goals. These reports and related documentation must be made available to ensure public accountability and transparency for the program.
- **Establish procedures to promote participation by non-profits and mission-driven entities.** Auctions should be set up to facilitate participation by non-profits and other mission-driven entities by creating some smaller loan sale pools and allowing direct sales of individual defaulted loans to non-profits and government entities. These organizations share HUD's mission of sustainable homeownership and can promote better DASP outcomes. As an additional protection for communities facing blight, HUD should bar loan purchasers and their assigns from releasing liens on vacant properties and walking away from them. The Federal Housing Finance Agency (FHFA) announced a similar requirement for GSE non-performing loan sales in April 2016.

FHA loans are the primary means for African-American and Hispanic families to achieve ownership. The unnecessary loss of FHA homeownership forces these households into the rental market. Families often pay 50% or more of income for rental housing, while losing out on accruing wealth through homeownership. In many cases, these outcomes are avoidable.

VI. CONCLUSION

HUD's heavy reliance on note sales to cut losses from the insurance fund, minimizing more basic measures such as enforcing loss mitigation requirements, detracts from the achievement of important national housing goals. The American homeownership rate is at a 20-year low.[195] The ongoing erosion of homeownership from low-income families is likely to be of long duration, and for some families will be permanent. Low- and moderate-income communities have been substantially altered by mass foreclosures. In recent decades, FHA loans have been the primary means for African-American and Hispanic families to achieve homeownership.[196] The unnecessary loss of FHA homeownership forces these households into the rental market. As rents around the country rise, the families pay increasingly high percentages of their income for housing, often 50% or more,[197] while losing out on accruing wealth through homeownership. Instead of being pillars of stable communities, former homeowners must flee to wherever they can temporarily afford the rent. In a substantial number of cases, these outcomes are avoidable.

> Vigorous enforcement of HUD's loss mitigation rules would preserve homeownership and stabilize communities better than essentially unrestricted sales of the loans, often to financial speculators.

Vigorous enforcement of HUD's loss mitigation rules would preserve homeownership and stabilize communities better than essentially unrestricted sales of the loans, often to financial speculators. To date, however, HUD has not held its major servicers accountable for their non-compliance with HUD's own servicing rules. In the end, the mortgage servicers who caused the crisis for the FHA insurance fund walk away the winners. HUD pays the servicers' inflated claims and the servicers often evade state laws meant to promote sustainable homeownership. The note sale program should continue only if it can be transformed to benefit homeowners, communities, and the Fund while preventing FHA servicers from escaping their obligations under FHA's rules and avoiding accountability under state law for their conduct.

ENDNOTES

1. 42 U.S.C. 1441.
2. U. S. Dept. of HUD: "The Federal Housing Administration (FHA), Official HUD website http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory.
3. U.S. Dept. of HUD Federal Housing Admin. *Annual Report to Congress The Financial Status of the FHA Mutual Mortgage Insurance Fund* Fiscal Year 2015 (Nov. 16, 2015) p. 14.
4. *Id.* U.S. Dept. of HUD Federal Housing Admin. *Annual Report to Congress The Financial Status of the FHA Mutual Mortgage Insurance Fund* Fiscal Year 2015 (Nov. 16, 2015) p. 14.
5. FHA Status of the Mutual Ins. Fund FY 2015 p.6.
6. FHA Status of the Mutual Ins. Fund FY 2015 p.6
7. U.S. Dept. of HUD Federal Housing Admin. *Annual Report to Congress The Financial Status of the FHA Mutual Mortgage Insurance Fund* Fiscal Year 2015 (Nov. 16, 2015) p. 14.
8. 12 USC 1708(a)(7).
9. Kate Berry, "Banks Cede Market Share to (Gulp) Thinly-Capitalized Non-Banks", *National Mortgage News* (Apr. 6, 2015), *available at* http://www.nationalmortgagenews.com/news/origination/banks-cede-fha-market-share-to-gulp-thinly-capitalized-nonbanks-1048041-1.html.
10. *Id.* p. 21
11. 12 U.S.C. § 1715u.
12. HUD Handbook 4000.1 at p. 591 (pdf version March 2016) (effective March 14, 2016). *See also* HUD Mortgagee Letter 2013-32 (Sept. 30, 2013).
13. HUD Mortgagee Letter 2012-22 (Nov. 16, 2012); HUD Mortgagee Letter 2013-32 (Sept. 30, 2013)
14. 24 C.F.R. § 203.605(a); 24 C.F.R. § 203.606.
15. *See* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2013-39 (Oct. 28, 2013); HUD Handbook 4000.1 p. 569 (pdf version March 2016) Part III A.2.
16. *HUD Mortgagee Letter 2013-39* at 3.
17. 24 C.F.R. § 203.605.
18. *See* U.S. Dep't of Hous. & Urban Dev., Mortgagee Letter 2013-40 (Nov. 1, 2013); HUD Handbook 4000.1 p. 584 (pdf version March 2016), Part III.A.2.i.
19. *See, e.g.*, Mathews v. PHH Mortg. Corp., 724 S.E. 2d 196 (Va. 2012); Pfeifer v Countrywide Home Loans, 21 Cal. App. 4th 1250 (2012); Lacy-McKinney v. Taylor Bean & Whitaker Mortg. Corp., 937 N.E. 2d 853 (Ind. Ct. App. 2010); U.S. Bank v. Detweiler, 946 N.E. 2d 777 (Ohio Ct. App. 2010).
20. Legislation enacted as part of HUD's 1999 appropriations authorized HUD to make advance payment of FHA insurance claims to lenders in connection with future loan sales. 12 U.S.C. § 1710(a)(1)(A). The legislation authorizes HUD to pay the claims upon assignment of the mortgage from the lender when at least three full monthly installments are due on the loan.
21. HUD program description *available at* http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2012/HUDNo.12-116.
22. HUD publishes summaries of results of DASP auctions at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/comp/asset/sfam/sfls.
23. *See e.g.* U.S. Dept. of HUD Single Family Loan Sale 2012-3 Conveyance, Assignment and Assumption Agreement at http://portal.hud.gov/hudportal/documents/huddoc?id=3caafinal.pdf.
24. Neighborhood Stabilization Outcome Target Pool Mortgage Loan Rider at http://portal.hud.gov/hudportal/documents/huddoc?id=targetpool.pdf; http://portal.hud.gov/hudportal/documents/huddoc?id=sopoolqua.pdf.
25. HUD summarizes results of DASP auctions, including number of loans sold, at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/comp/asset/sfam/sfls.
26. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale*

Program (January 22, 2016) p. 6 available at: http://portal.hud.gov/hudportal/documents/huddoc?id=resultsummary.pdf.

27. *Id*.
28. Auction results for the DASP loan sales conducted since 2010 are summarized at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/comp/asset/sfam/sfls.
29. *Id*.
30. For example, HUD requires that its servicers give borrowers a form of notice at a fixed time after a default. 24 C.F.R. § 203.602.
31. The Reinvestment Fund, *Philadelphia Residential Mortgage Foreclosure Diversion Program: Initial Report and Findings* (June 2011), available at https://www.reinvestment.com/wp-content/uploads/2015/12/Foreclosure_Diversion_Initial_Report-Report_2011.pdf.
32. *Id*. at 9.
33. *Id*.
34. *Id*. at 9–10.
35. *Id*. at 12.
36. *Id*. at 13–14.
37. *Id*. at 15.
38. Mr. Cruz tells his own story in the Univision Spanish language news report available at http://www.univision.com/philadelphia/wuvp/noticias/vivienda/venta-de-viviendas-deja-a-familias-de-filadelfia-en-la-calle-video.
39. Philadelphia City Council Resolution No. 160106 (February 11, 2016).
40. These programs are described in detail in the 2012 Report prepared by the National Consumer Law Center, *Rebuilding America How States Can Save Millions of Homes Through Foreclosure Mediation* (Feb. 2012) available at https://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-foreclosure-mediation.pdf .
41. State of Connecticut Judicial Branch, *Foreclosure Mediation Program,* Report to the General Assembly, Connecticut Foreclosure Mediation Program (March 1, 2016) App. E. p. 53.
42. The New York courts publish annual summaries of data on the New York foreclosure conferences, State of New York Unified Court System, Report of the Chief Administrator of the Courts 2010-2015 available at http://www.nycourts.gov/publications/pdfs/2015ForeclosureReport.pdf
43. National Consumer Law Center, *Rebuilding America How States Can Save Millions of Homes Through Foreclosure Mediation* (Feb. 2012).
44. Lorenzo Morrison is unrelated to Paulette Morrison, the New York homeowner described in the previous example.
45. 12 U.S.C. § 1715u.
46. 24 C.F.R. §§ 203.35(a)(10), 203.35(c), 203.605(c), 203.500.
47. 24 C.F.R. § 203.356(b).
48. The schedules are published in HUD Mortgagee Letter ("ML's") and were revised in 1990, 2001, 2005, 2013, and 2015. *See* ML 90-4 (August 14, 1990); ML 2001-19 (August 24, 2001); ML 2005-30 (July 12, 2005); ML 2013-38 (October 28, 2013). In HUD Mortgagee Letter 2016-03 (Feb. 5, 2016) (effective Jan. 1, 2016) HUD substantially increased the foreclosure time frames that had been in effect for several decades. Few, if any, of the newly extended time frames reflect changes in state laws.
49. ML 2016-03 (Feb. 5, 2016) p. 2.
50. HUD Mortgagee Letter 2013-38 (October 28, 2013).
51. HUD Mortgagee Letter 2016-03 (Feb. 5, 2016) (effective Jan. 1, 2016).
52. *See e.g.* Homeward Residential Inc. v. Gregor, 122 A. 3d 947, 952 (Maine 2015) (responding to servicer's argument that state foreclosure laws had become too complicated to follow: "[t]he law, the rules of evidence, and court processes have not become more complicated in these matters. Applying established law, however, has become more problematic as courts address the problems

the financial industry has created for itself"). The state laws that servicers found challenging often addressed authority to foreclose. These state laws uphold standards of transparency for records of ownership of property and basic contract rights. *See* Deutsche Bank v. Johnston, — P.3d. – 2016 WL 852521 * 8-9 (N.M. Mar. 3, 2016) (the rules for strict compliance for standing to foreclose are "vital because the securitization of mortgages has given rise to a pervasive failure among mortgage holders to comply with the technical requirements underlying the transfer of promissory notes, and more generally the recording of interests in property."); U.S. Bank N.A. v. Ibanez, 941 N.E. 2d 40, 55 (Mass. 2011) ("what is surprising about these cases is not the statement of principles articulated by the court regarding tittle law and the law of foreclosure in Massachusetts, but rather the utter carelessness with which the plaintiff banks documented the titles to their assets." (Cordy, J. concurring).

53. U.S. Dept. of HUD, Federal Housing Admin., *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 7.
54. 24 C.F.R. §§ 203.35(a)(10), 203.35(c), 203.605(c), 203.500.
55. U.S. Dept. of HUD, *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 4
56. ML 2013-38. The states were Florida, Iowa, Maine, New Jersey, New York, and Vermont.
57. 24 C.F.R. §203.602.
58. 24 C.F.R. § 203.604.
59. 24 C.F.R. §203.605.
60. 24 C.F.R. § 203.606.
61. *New York Times,* October 2, 2010, "Company Stops Insuring Title in Chase Foreclosures" http://www.nytimes.com/2010/10/03/business/economy/03foreclose.html
62. April 2011 Interagency Review of Foreclosure Policies and Practices http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf (Inadequate procedures policies and control over all aspects of foreclosure process).
63. The investigation targeted Bank of America, JP Morgan Chase and Co., Wells Fargo & Co., Citigroup Inc., and Ally Financial, Inc. (GMAC).
64. The New York courts issued a rule requiring that attorneys who filed foreclosure cases to certify that they had taken reasonable steps to verify the accuracy of documents they filed in courts. Servicers' attorneys had to file this certification whenever they requested court action to move a case toward a foreclosure sale. State of New York Unified Court System, The 2012 Report of the Chief Administrator of the Courts, p. 2 https://www.nycourts.gov/publications/pdfs/2012ReportOfChiefAdministratorOfTheCourts.pdf
65. New Jersey Administrative Order No. 01-2010 (Jan. 31, 2011) N.J. Court Rule 4:64-1(a) (2), 4:64-2(d). Lender's attorney must attach to complaint a certification that the attorney communicated with the appropriate employee of the entity claiming the right to foreclose. These employees must have personally reviewed the relevant documents and certifying attorneys must provide the names of and state the job responsibility of the employees with whom they communicated. The implementation of the rule coincided with long-term investigations by the state courts into the foreclosure practices of mortgage servicers. New Jersey Courts Press Release Dec. 20, 2010. http://www.judiciary.state.nj.us/superior/press_release.htm
66. *New York Times*, October 2, 2010, "Company Stops Insuring Title in Chase Foreclosures" http://www.nytimes.com/2010/10/03/business/economy/03foreclose.html
67. Foreclosure Activity at 40-Month Low, RealtyTrac May 10, 2011 http://www.realtytrac.com/content/foreclosure-market-report/realtytrac-april-2011-foreclosure-activity-report-6578
68. *Newark Star Ledger*, June 27, 2011, "After Ruling Halted N.J. Foreclosures, Experts Fear Deluge of Filings," http://www.nj.com/news/index.ssf/2011/06/after_ruling_halted_nj_foreclo.html
69. LPS Mortgage Monitor Performance Observations April 2012 pp. 14, 18. http://www.bkfs.com/CorporateInformation/NewsRoom/MortgageMonitor/201204MortgageMonitor/MortgageMonitorApril2012.pdf; LPS Mortgage Monitor Performance Observations October 2012 p. 14;

http://www.bkfs.com/CorporateInformation/NewsRoom/MortgageMonitor/201209Mortgage Monitor/Oct2012.pdf

70. *Id*.
71. RealtyTrac, Exclusive Report Quarter 1 2013 Foreclosure Inventory Update p. 1
72. RealtyTrac, U.S. Foreclosure Market Report for August 2014. (September 9, 2011) http://www.realtytrac.com/content/foreclosure-market-report/august-2014-us-foreclosure-market-report-8137. (showing first annual increase in foreclosure auctions for 44 consecutive months).
73. State of New York Unified Court System, The 2012 Report of the Chief Administrator of the Courts, p. 2 https://www.nycourts.gov/publications/pdfs/2012ReportOfChiefAdministratorOfTheCourts..pdf 2013 Report https://www.nycourts.gov/publications/pdfs/2013ForeclosureReport.pdf 2014 Report https://www.nycourts.gov/publications/pdfs/2014-Foreclosure-Report-ofthe-CAJ.pdf
74. State of New York Unified Court System, the 2014 Report of the Chief Administrator of the Courts, p. 3.
75. *Id*.
76. *Id*.
77. State of New York Unified Court System, The 2013 Report of the Chief Administrator of the Courts, pp. 4–5.
78. *Id*.
79. *Id*.
80. Cole *et al*. v. Baum, No. CV-11-3779 (E.D.N.Y. 2011).
81. *Stalled Settlement Conferences, Banks Frustrate New York Foreclosure Settlement Conferences: A Report on Residential Foreclosure Settlement Conferences in New York City* April 2014 http://www.mfy.org/wp-content/uploads/Stalled-Settlement-Conferences.pdf (tracking compliance in 252 mediation cases).
82. RealtyTrac, Foreclosure Activity on Slow Burn (Oct. 11, 2011) listing the ten states with the longest foreclosure time frames as: New York (986 days), New Jersey (974 days).
83. *See* US Bank v. Guillaume, 38 A.3d 570 (N.J. 2012).
84. Fannie Mae Announcement SVC-2011-15 (September 1, 2011) directs all new foreclosures in Hawaii to be judicial and stop all non-judicial foreclosures.
85. *Washington Times* ,Feb. 18, 2013 , "Foreclosure Delays, D.C., Maryland Keeping Homes but Losing Values" http://www.washingtontimes.com/news/2013/feb/18/foreclosure-delays-come-at-high-cost/?page=all
86. D.C. Code §42-815.02, Saving D.C. Homes from Foreclosure Act of 2010 in Nov. 2010, amended 2013; Hawaii Rev. Stat. §667-1 (2011, amended 2013).
87. *Center for Public Integrity,* (September 2014, updated January 2015) Alison Fitzgerald, "Homeowners Steamrolled as Florida Courts Clear Foreclosure Backlog," available at http://www.publicintegrity.org/2014/09/10/15463/homeowners-steamrolled-florida-courts-clear-foreclosure-backlog
88. The National Mortgage Settlement concluded the investigation commenced in 2010 by the attorneys generals of 49 states and various federal agencies, including the Department of Justice and HUD.
89. *Id*.
90. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2010 Q4 (Nov. 4, 2010) pp. 11–12.
91. *Id*.
92. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2010 Q4 (Nov. 4, 2010) p.13, FY 2011 Q1 (Mar. 17, 2011) p. 17.
93. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2010 Q4 (Nov. 4, 2010) pp. 10-11.
94. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2011 Q1 (Mar. 17, 2011) p. 10-11.

95. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2011 Financial Status of the FHA Mutual Mortgage Insurance Fund (Nov. 15, 2011) p. 29.
96. There were 8.7 to 8.8 million FHA-insured mortgages outstanding during the years 2010 – 2013. The seriously delinquent rate for these mortgages was 8.5% as of September 2010, 9% as of September 2011, 9.8% as of September 2012, and 8.2% as of September 2013. Seriously delinquent includes loans at least 90 days in default and in foreclosure or bankruptcy. U.S. Dept. of HUD, *FHA Single Family Loan Performance Trends Credit Risk Management Reports*, 2013-14; U.S. Dept. of HUD *FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress*, 2011-2014; U.S. Dept. of HUD *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund*, fiscal years 2010-2014. According to these sources, the number of loans first becoming seriously delinquent held to a steady rate during 2009, 2010, and 2011, with about 500,000 new serious delinquencies occurring each year. The annual totals for new delinquencies dropped slightly during 2012 (to about 460,000) and remained well over 400,000 in 2013.
97. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2011 Q2 (June 27, 2011) pp. 11–12.
98. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2011 Financial Status of the FHA Mutual Mortgage Insurance Fund (Nov. 15, 2011) p. 36.
99. *Id.*
100. Since 2008, conference and mediation programs appeared in over twenty states. These programs were created under state statutes or court rules. The programs are described in National Consumer Law Center, Rebuilding America How States Can Save Millions of Homes Through Foreclosure Mediation (Feb. 2012) available at https://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-foreclosure-mediation.pdf
101. See National Consumer Law Center, Rebuilding America How States Can Save Millions of Homes Through Foreclosure Mediation (Feb. 2012). Part VIII.
102. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2011 Financial Status of the FHA Mutual Mortgage Insurance Fund (Nov. 15, 2011) p. 36.
103. Id.
104. Id at p. 37.
105. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2011 Q4 (Jan. 31, 2012) p. 9.
106. Id.
107. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2012 Q3 (Sept. 7, 2012) p. 8; U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2013 Q4 (April 24, 2013) p. 8.
108. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2012 Q1 (Mar. 26, 2012) p. 8, 12 ("We anticipate the recent settlement will accelerate foreclosure activity, perhaps within the next two quarters. . . . It is possible that the recent settlement may spark a breaking of the foreclosure back-log that has been affecting the entire mortgage industry since the start of FY 2011.").
109. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2012 Q4 (April 24, 2013) p. 8.
110. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2013 Financial Status of the FHA Mutual Mortgage Insurance Fund (December 13, 2013) p. 27.
111. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2013 Financial Status of the FHA Mutual Mortgage Insurance Fund (December 13, 2013) p. 26.
112. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2013 Q1 (May 15, 2013) p.9. *See also Id* FY 2013 Q2 p. 9 (July 11, 2013); *Id.* FY 2013 Q3 p. 9 (Aug. 23, 2013).

113. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2014 Q1 (March 31, 2014) p. 12.
114. *Id*.
115. *Id*. p. 12.
116. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2013 Financial Status of the FHA Mutual Mortgage Insurance Fund (December 13, 2013) p. 52.
117. *Id*. at pp. 24-26.
118. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2012 Financial Status of the FHA Mutual Mortgage Insurance Fund (November 16, 2012) p. 53.
119. *Id*.
120. *Id*. at pp. 52-53.
121. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2013 Financial Status of the FHA Mutual Mortgage Insurance Fund (December 13, 2013) p. 25.
122. *Id*.
123. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2015 Q4 (Dec. 4, 2015) p. 23 (Exhibit A-7).
124. U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2013 Financial Status of the FHA Mutual Mortgage Insurance Fund (December 13, 2013) p. 25.
125. U.S. Dept. of Housing and Urban Develop. , FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2015 Q4 (Dec. 4, 2015) p. 23 (Exhibit A-7).
126. The 2013 DASP note sales averaged a loss severity of 64% measured against the unpaid principal balances due on the loans. The traditional REO sales during 2013 produced loss severities averaging 61%.U.S. Dept. of HUD Annual Report to Congress Fiscal Year 2013 Financial Status of the FHA Mutual Mortgage Insurance Fund (December 13, 2013) p. 52.
127. *Id*.
128. *Id*.
129. *Id*. p. 26.
130. *Id*. p. 52.
131. U.S. Dept. of HUD *Annual Report to Congress Fiscal Year 2015 Financial Status of the FHA Mutual Mortgage Insurance Fund* (Nov. 16, 2015) p. 73.
132. Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications*, 41 Conn. L. Rev. 1107, 1119 (2009).
133. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 2.
134. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (data as of August 3, 2015) p. 1.
135. Matthew Goldstein, *New York Times,* April 30, 2014, "Funds for Troubled Mortgages are on the Rise,"; John Gittlesohn and Heather Perlberg, *Bloomberg News*, "Hedge Funds Boost Bad-Loan Prices as U.S. Sales Increase," August 11, 2014; John Gittlesohn and Clea Benson, *Bloomberg News*, Dec. 18, 2012, Blackstone, Ranieri Building on Bad FHA Loans; Heather Perlberg, *Bloomberg News* , May 8, 2015., "House Flippers are Back Together with Wall Street – What Could Possibly Go Wrong?"
136. U.S. Dept. of HUD. , *FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2015 Q4* (Dec. 2, 2015) p. 23. HUD's losses on post-foreclosure REO sales were 71.7% of the unpaid balance on loans in 2011. In 2105 the average losses were 56.65 percent of the unpaid balances.
137. U.S. Dept. of HUD, *FHA Single-Family Mutual Mortgage Insurance Fund Programs Quarterly Report to Congress FY 2015 Q4* (Dec. 2, 2015) p. 23.
138. *Id*.
139. GAO *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis* (GAO Report 12-296 (June 2012) p. 15.

140. U.S. Dept. of Treasury, *Making Home Affordable Program Performance Report Through Fourth Quarter of 2015* p. 8.
141. Office of the Comptroller of the Currency *Mortgage Metrics Report (Disclosures of National Bank Mortgage Loan Data Third Quarter 2015* (Dec. 2015) p. 36.
142. GAO *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis* (GAO Report 12-296 (June 2012) p. 58.
143. HUD Mortgagee Letter 2009-23 (July 30, 2009).
144. U.S. Dept. of HUD *Annual Report to Congress Fiscal Year 2015 Financial Status of the FHA Mutual Mortgage Insurance Fund* (Nov. 16, 2015) p. 73
145. GAO *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis* (GAO Report 12-296 (June 2012) p. 48.
146. *Id*. at p. 10
147. U.S. Dept. of HUD *Annual Report to Congress Fiscal Year 2011 Financial Status of the FHA Mutual Mortgage Insurance Fund* (Nov. 15, 2011) pp. 25–27.
148. GAO *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis* (GAO Report 12-296 (June 2012) p. 55–56; Office of the Comptroller of the Currency *Mortgage Metrics Report (Disclosures of National Bank Mortgage Loan Data Third Quarter 2015* (Dec. 2015) p. 37.
149. GAO *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis* (GAO Report 12-296 (June 2012) p. 55–56.
150. *See e.g.* U.S. Dept. of HUD Sale Results Summaries: Single Family Loan Sale 2014-2 Part 2 (Sept. 2014) p. 2; Single Family Loan Sale 2014-1 Part 2 (Dec. 2103) p. 2.
151. GAO *Foreclosure Mitigation: Agencies Could Improve Effectiveness of Federal Efforts with Additional Data Collection and Analysis* (GAO Report 12-296 (June 2012) pp. 58–62.
152. *Id*. pp. 61-62.
153. *Id*.
154. *Id*. p. 70.
155. Abt Associates, *FHA Asset Sales Study – Final Report* (October 1998) p. 47 n. 32. available at http://www.abtassociates.com/reports/D19981269.pdf (this was a HUD-commissioned study).
156. In April 2015, HUD announced that it was going to require buyers of loans at future DASP sales to review borrowers for a "HAMP-like" modification. To date, HUD has not released any details about what this vague term means. HUD has not disclosed any mechanism for enforcing such a standard. *See* HUD Press Room: "HUD Announces Changes to Distressed Asset Stabilization Program" Press Release April 24, 2015.
157. Abt Associates, *FHA Asset Sales Study – Final Report, supra,* pp. 47–48, 52.
158. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 44 (HUD did not include status data for approximately 10% of the loans from this sale that DASP purchasers had already sold to new buyers).
159. Federal Housing Finance Agency, *FHFA's Analysis of a Principal Reduction Modification Program and Enhanced Non-Performing Loan Sales Requirements* (April 14, 2016) at http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-PRM-Program-and-Further-Enhancements-to-NPL-Sales-Reqts.aspx
160. Prepared Remarks of Secretary Shaun Donovan at Press Conference Announcing Distressed Asset Stabilization Program June 8, 2012. (HUD Press Room Speech 06082012)
161. HUD Public Affairs Press Release No. 12-116 July 18, 2012 *HUD Accepting Applications for Entities to Purchase Troubled Mortgages, Offer Chance to Avoid Costly Foreclosures and Stabilize Neighborhoods.*
162. *Id*.
163. U.S. Dept. of HUD Federal Housing Admin. *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 8.

164. U.S. Dept. of HUD Federal Housing Admin. *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (data from August 3, 2015 and January 22, 2016); U.S. Dept. of HUD Federal Housing Admin. *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (data as of February 6, 2015); U.S. Dept. of HUD Federal Housing Admin. Quarterly Report on FHA Single Family Loan Sales (data as of May 30, 2014).
165. U.S. Dept. of HUD Federal Housing Admin. *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 11. An additional 15,000 loans had been sold by DASP buyers to new owners. HUD did not report information on the status of these loans. *Id.*
166. *Id.* p. 54
167. *Id.* p. 4.
168. *Id.* p. 11
169. *Id*.
170. *Id*.
171. *Id*. 9
172. *Id*. p. 54.
173. *See e.g.* Office of the Comptroller of the Currency, *OCC Mortgage Metrics Report* (Third Quarter 2015, December 2015) pp. 17-29, at http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics/mortgage-metrics-q3-2015.pdf.
174. Archive of Making Home Affordable Performance Reports available from U.S. Treasury at https://www.hmpadmin.com/portal/news/press_archives.jsp
175. U.S. Dept. of HUD, *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program*, data as of January 22, 2016, p. 44. The same entry indicates that of the total of 27,580 loans sold in this sale approximately 3,000 had already been transferred by the initial buyers. HUD did not provide any data about the status of these loans.
176. Caliber Modification Agreement – Five Year Limited Term Interest Only, available at http://www.nclc.org/issues/opportunity-denied.html.
177. *Id*. ¶ 3.
178. Selene Finance Trial Modification Plan ; Rushmore Loan Management Services, LLC Trial Modification Agreement, both at http://www.nclc.org/issues/opportunity-denied.html.
179. Bayview "Loan Adjustment Agreement" ¶ 11. Available at http://www.nclc.org/issues/opportunity-denied.html.
180. U.S. Dep't of Hous. & Urban Dev., HUD Press Room, "HUD Announces Changes to Distressed Asset Stabilization Program," No. 15-048 (April 24, 2015)
181. In contrast with HUD's post-sale requirement, note sales of Fannie Mae conducted through the Federal Housing Finance Agency have an explicit HAMP review requirement. *See* Fannie Mae, *Fannie Mae NPL Sales Auction Process; Bidder Qualification Request, Servicer Eligibility* (June 25, 2015) *available at* http://www.fanniemae.com/resources/file/npl/npl-training-presentation.pdf.
182. HUD's Neighborhood Watch site gives detailed breakdowns of servicer portfolio size for FHA loans. https://entp.hud.gov/sfnw/public/. As of early 2016, the largest FHA services were: Wells Fargo, JP Morgan Chase, U.S. Bank, and Bank of America. Bank of America ranked higher in past years, but recently sold off significant portions of its FHA portfolio, as described in this Report.
183. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2015) p. 8.
184. *See e.g.* Lone Star Funds, Fund Investment Periods as of Sept. 30, 2015 reported at Lone Star Funds website: http://www.lonestarfunds.com/funds-raised/. Referenced in Connie M. Razza, *Vulture Capitalism Hits Home* Center for Popular Democracy (2015). *See also* Jared Bennett, "The Government is Selling Thousands of Homes to Hedge Funds Without their Owners' Knowledge" The Atlantic Sept. 23, 2015; Matthew Goldstein, "As Banks Retreat , Private Equity Rushes to Buy Troubled Home Mortgages" New York Times Sept. 28, 2015 (referencing confidential Lone Star delinquent mortgage offering document).

185. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 8. *See also* Sarah Edelman, *et al, Is the FHA Distressed Asset Stabilization Program Meeting its Goals?* Center for American Progress (September 2014) pp. 7–9.
186. Heather Perlberg, *Bloomberg Business News* Aug. 24, 2015, "BlackRock Said to Start Financing Rental-Home Investors"; Heather Perlberg, *Bloomberg Business* Feb. 26, 2015 "Cerberus Joins the Wall Street landlord Club"; John Gittlesohn and Clea Benson, *Bloomberg Business News*, Dec. 18, 2012, "Blackstone, Ranieri Betting on Bad FHA Loans"
187. Sarah Edelman, *et al, Is the FHA Distressed Asset Stabilization Program Meeting its Goals?* Center for American Progress (September 2014) pp. 7–9, *available at* https://cdn.americanprogress.org/wp-content/uploads/2014/09/Edelman-DASP-report.pdf; Matthew Goldstein, "Equity Firms are Lending to Landlords, Signaling a Shift" New York Times March 3, 2015.
188. Tom Schoenberg, et al., *BofA to pay $16.7 Billion to End U.S. Mortgage Probes*, Bloomberg.com (Aug. 21, 2014), *available at* http://www.bloomberg.com/news/articles/2014-08-21/bofa-agrees-to-pay-16-65-billion-to-end-u-s-mortgage-probes, ("Countrywide has been blamed by lawmakers and regulators for using lax underwriting standards and predatory lending that fueled its ascent to the biggest U.S. mortgage lender before its collapse and $2.5 billion sale to Bank of America.")
189. William D. Cohan, *The Atlantic* (October 2013) "Why Wall Street Loves Houses Again,;" John Gittlesohn and Clea Benson, *Bloomberg Business News* , Dec., 18, 2012, "Blackstone, Ranieri Betting on Bad FHA Loans"
190. Matthew Goldstein, *New York Times* Sept. 28, 2015, "As Banks Retreat , Private Equity Rushes to Buy Troubled Home Mortgages." ("In the first half of 2015, Fitch ratings said of the loans it had reviewed Caliber had not completed any modifications that included permanent principal reductions.")
191. U.S. Dept. of HUD *Report to the Commissioner on Post-Sale Reporting FHA Single Family Loan Sale Program* (January 22, 2016) p. 34 (describing SFLS 2013-2 National Pools Sale June 26, 2013 consisting of 13,149 loans. These figures pertain to the 79% of the loans that the new servicers reported as "resolved" since the June 2013 DASP sale date.
192. *Id.*
193. Lone Star Investment Funds website: About Lone Star Investment Approach http://www.lonestarfunds.com/about-us/our-business/ Referenced in Connie M. Razza, *Vulture Capitalism Hits Home* Center for Popular Democracy (2015).
194. Diane E. Thompson, *Foreclosing Modifications: How Servicers Incentives Discourage Loan Modifications*, 86 Wash. L. Rev. 755 (Dec. 2011); Adam J. Levitin and Tara Twomey, *Mortgage Servicing,* 28 Yale J. on Reg. 1 (2011) *available at* http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/mortgage_servicing_levitin_and_twomey_win2011.pdf.
195. *The State of the Nation's Housing 2015* Joint Center for Housing Studies of Harvard Univ. (2015) p. 19.
196. In fiscal year 2015 82 percent of FHA purchase loans were for first-time homebuyers. In calendar year 2014, FHA provided financing for 43 percent of all African-American borrowers, and 44 percent of all Hispanic borrowers. U. S. Dept. of HUD Federal Housing Admin. *Annual Report to Congress The Financial Status of the FHA Mutual Mortgage Insurance Fund* Fiscal Year 2015 (Nov. 16, 2015) p. 14.
197. *The State of the Nation's Housing 2015* Joint Center for Housing Studies of Harvard Univ. (2015) p. 5 "In 2013, almost half of all renters had housing cost burdens, including more than a quarter with severe burdens (paying more than 50 percent of income for housing)."

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EXHIBIT 2

February 4, 2015

FHA Commissioner Biniam Gebre
U.S. Department of Housing and Urban Development
451 Seventh Street, SW
Washington, DC 20410

Dear Commissioner Gebre:

We know that you have received many recommendations, from various organizations, regarding ways to improve the Distressed Asset Stabilization Program (DASP). In order to assist your office as you work on improvements, and to streamline our communication with FHA, our organizations have arrived at a set of core reforms that we all agree are key in order for DASP to maximize its potential. These consensus reforms are outlined in the attached one page document.

As you will recognize, many of the organizations below are coalitions, networks or associations, comprised of numerous local community groups, housing development groups, and other non-profits across the country. We work in and/or represent many communities where these loans are concentrated and the borrowers whose loans go into the pools.

We welcome the opportunity to discuss these issues further, and in more detail, with you and/or your staff.

Sincerely,

Right to the City (RTTC)
Center for Popular Democracy (CPD)
Americans for Financial Reform (AFR)
Center for American Progress (CAP)
National Consumer Law Center (NCLC) (on behalf of its low-income clients)
National Community Reinvestment Coalition (NCRC)
National Council of La Raza (NCLR)
National Association for Latino Community Asset Builders (NALCAB)
National Fair Housing Alliance (NFHA)
Leadership Conference on Civil and Human Rights
California Reinvestment Coalition (CRC)
Greenlining Institute

Improving the Distressed Asset Stabilization Program

PROTECT THE RIGHTS OF HOMEOWNERS THROUGHOUT THE PROCESS

- Prior to placing a loan in a sale pool and paying the claim, require servicers to document and certify compliance with each step of FHA's sequential loss mitigation review, including documentation of the grounds for denial of foreclosure alternatives.
- Prior to the inclusion of a loan in a DASP sale, require servicers to provide homeowners with notice that accurately informs them about the sale process, the servicer obligations before and after sales, and the homeowner's rights under these transactions.
- Develop an effective HUD review system to handle homeowner complaints about post-sale conduct of servicers and owners.

PRIORITIZE NONPROFIT PARTICIPATION, MORTGAGE MODIFICATIONS & AFFORDABILITY

- Require all buyers and their servicers to participate in MHA, including HAMP-PRA. All loans must go through MHA waterfall at least once after they are sold through DASP, and this must be documented.
- Ensure greater percentage of purchases by non-profits and buyers committed to home retention and affordability. Mechanisms to ensure this greater participation include, but are not limited to: 1) either a "first look" or "last look" for qualified buyers, 2) weighting of enhanced outcomes in the auction process, 3) expansion of NSO pools to at least 50% of total FHA auctions, and 4) direct sales of NSO loans for competitive bids limited to non-profit bidders.
- Facilitate participation by non-profits and other mission driven entities by creating some smaller pools.

EXPAND AND IMPROVE NEIGHBORHOOD STABILIZATION OUTCOME AUCTIONS

- Significantly scale up the number of mortgages being sold through NSO pools.
- Require that some percentage of any REO be sold to an owner occupant, donated to a non-profit or local government or converted into an affordable rental unit.

STRENGTHEN MONITORING & REPORTING TO ENSURE EFFECTIVE OVERSIGHT & ENFORCEMENT

- Require detailed quarterly reporting, including:
    - Terms of loan modifications; demographic and geographic information about homeowners.
    - Disposition results including whether home is held as a long-term rental and, if so, monthly rent charged; and whether the home was sold to an owner-occupant, non-profit or investor.
- Require reporting requirements to travel with the loan if it is re-sold and include traceability back to original buyer.
- Make aggregate information available to the public in a timely way.
- Bar from future auctions buyers who have purchased FHA mortgages in the past but have failed to meet required objectives.

EXHIBIT 3

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FHA's Distressed Asset Sale Program Should Strengthen Home Retention Goals

Dec. 26, 2012

HUD already has completed the first round of its expanded auction sale program for defaulted FHA-insured single family home loans. Due to widespread noncompliance with FHA loss mitigation requirements, homes likely are being included in the bulk sale program without adequate home retention efforts. Crucial information about the immediate and long-term effects of the sales must be available to the public. Homeowners affected by the process must have better access to remedial action for abuses. Moreover, post-sale requirements fail to provide reasonable measures to avoid unnecessary foreclosures. Protections for FHA homeowners can be strengthened while still providing needed revenue for the FHA insurance fund.

Problem # 1: The selection process for loans to be sold rewards poor mortgage servicing practices. We routinely see evidence of servicers' non-compliance with HUD's loss mitigation rules. These rules require that servicers consider homeowners for specific alternatives to foreclosure before proceeding to foreclosure sales. For example, HUD rules require a thorough review for loss mitigation at ninety-days' delinquency and monthly thereafter. Right now, many thousands of FHA-insured loans have been in foreclosure for years, without completion of these basic reviews. The FHA loan sales reward servicers who fail to conduct appropriate loss mitigation reviews. Servicers facing delays and court scrutiny in judicial foreclosure states are contributing the overwhelming majority of loans to these sales. FHA is paying off the full insurance claim in each case.

Solution # 1: The process for selection of loans for inclusion in all sale pools (both Neighborhood Stabilization Pools and unrestricted national pools) must require rigorous scrutiny of the servicer's loss mitigation reviews. This scrutiny will provide enormous savings for the FHA insurance fund.

- Servicers should be required to document compliance with each step of FHA's sequential loss mitigation review, including documentation of the grounds for each decision to deny an option, before securing permission to sell loans and before receiving FHA insurance benefits.

- Servicers who have delayed loss mitigation reviews beyond the time frames allowed under FHA rules must not be permitted to sell those loans, and payment of insurance benefits must be conditioned upon taking appropriate actions to remedy the delays.

- FHA must develop a screening tool that requires servicers to document loss mitigation reviews, and this screening tool must be developed with public input and be publicly available.

- Before a loan is referred to a loan sale or an insurance payment is made, the homeowner must receive a copy of the screening tool showing the loss mitigation review history, the options considered, and the reasons for any denials.

- FHA must develop a procedure for a homeowner who disagrees with the servicer's loss mitigation allegations to obtain review of the decisions.

Problem #2: Inadequate information is available to the public regarding the auction results and the long-term results of the sales. To date, FHA has released only aggregate data on completed loan sales. The premise of the loan sale program is that the purchasers will consider and implement home retention options that will preserve long-term homeownership for borrowers who would otherwise lose their homes. Thus far, the data provides no information about the nature of post-sale loan modifications, whether they involved principal reduction, and how affordable they are for the individual borrowers. In addition, FHA has not provided data indicating the impact of these sales on borrowers of color and other groups protected by civil rights laws.

Solution #2: Monitoring and reporting should ensure effective oversight and enforcement.

- For all loans sales, both Neighborhood Stabilization Pools and unrestricted national pools, HUD should require detailed reporting and make this reporting available to the public. The data collected must go beyond what is asked on the Ex. B-1 form to the quarterly reports now required for Neighborhood Stabilization Program pool sales completed to date. For the sales involving these pools, FHA requires quarterly post-sale self-reporting. The self-reporting should be subject to spot reviews by FHA and the data reported should include details about the quality of the loss mitigation option implemented. For example, the forms should include details about principal reduction, degree of payment changes, and long term affordability prospects for the borrower.

- HUD should assess financial penalties for substantial noncompliance with reporting requirements and contract terms.

- HUD should provide immediate public release of all post-sale management reports and supporting documentation. It is not clear to what extent HUD will make even the limited post-sale self-reporting documents available to the public. These must be made public, as should the more detailed information described above.

Problem # 3: FHA's loan sale program excludes the homeowners from all decisions made in the transactions that most affect them. Homeowners whose loans are being sold have paid substantial amounts up front at their closings in order to participate in the FHA insured loan program. They continued to make payments to the insurance fund after their closings. As it is structured now, the loan sale program abruptly cuts off insurance benefits to these borrowers while their loans remain outstanding. The decision to sell loans is made without notice to or input from the homeowners. Aside from the basic unfairness of this process, the exclusion of homeowners cuts off the one likely source of outside information related to the servicer's true performance of its loss mitigation duties before the sales. After the loan sales, the homeowner is again left without recourse when faced with abusive servicer conduct.

Solution # 3: HUD should do homeowner outreach both directly and through use of outside advocacy groups and housing counselors to document borrower complaints and to seek redress where appropriate.

- HUD should implement a system of notices to homeowners that accurately informs them about the sale process, the servicer obligations before and after sales, and what their rights are as the parties most affected by these transactions.

- HUD should develop an effective review system consistent with due process to handle homeowner complaints about conduct of post-sale servicers and owners.

Problem #4: Under the current Neighborhood Stabilization Program rules, post-sale requirements are vague and hide abuses. Among the outcomes that will count toward satisfaction of a purchaser's Neighborhood Stabilization Program obligations, purchasers will often choose sale of the property to a purported owner-occupant and collection of payments from an existing borrower for six months. According to the Neighborhood Stabilization guidelines, the credit for sale to an owner-occupant goes to any transaction involving a buyer who states he or she will live in the home for one year, without ensuring longer-term owner occupants are involved. This vague provision invites abuse and manipulation by investors and speculators. Credit for maintaining a loan in current pay status goes to any payment arrangement that produces six monthly payments, regardless of how those payments were achieved or what happens after those six months. Purchasers are not required to screen homeowners for any specific type of loan modification, despite general industry standards that determine how to modify a loan to achieve affordable payments. The post-sale guidelines do not ensure that sustainable loss mitigation will be provided to struggling homeowners. The guidelines also provide no remedies for borrowers who are abused or misled by servicers of the acquired loans.

Solution #4: Post-sale requirements for Neighborhood Stabilization pools must be revised to ensure transparency and accountability.

- Homes should be sold to genuine owner-occupants and oversight and reporting should be used to ensure such outcomes. The criterion for owner-occupancy should require occupancy either by the pre-sale owner or by a new purchaser for the entire four-year reporting period.

- The criteria for loan modification must be tied to a percentage of income payment level and a one year record of successful payments.

- Purchasers should be required to make affordable loan modifications where consistent with investor interests. Servicers who mislead homeowners or otherwise engage in abuses should be subject to explicit administrative enforcement measures including effective monetary penalties, and should be directly accountable to the homeowners.

Problem # 5: The overwhelming majority of loans sold thus far have gone to private for-profit investors. When it announced the expansion of its loan sales program in June 2012, HUD extolled the benefit of involvement by community-based non-profits. According to HUD, the non-profits would buy loans and work with homeowners to provide sustainable options. The results from the September 2012 sales of loans in all categories indicate that about 400 loans were sold to community-based non- profits, while about 9,000 were sold to for-profit investors. Non-profits are most likely to work with homeowners to best explore home retention options. Entities holding the loans in portfolio are also more likely to seek sustainable homeownership outcomes than trusts managing securitized debt.

Solution # 5: For all categories of loan sales, promote non-profit purchases and require private investors to seek sustainable outcomes and provide detailed reporting.

- HUD should prioritize bids from buyers who will hold the loans in portfolio rather than securitize them.

- HUD should require that a higher percentage of bidders be community-based non-profit entities.

- To the extent that sales to private investors go forward, the private investors should be subject to the same outcome goals and reporting requirements as the neighborhood stabilization buyers.

Comments of:

Atlanta Legal Aid Society, Inc., Bay Area Legal Aid,

Bronx Legal Services, Brooklyn Legal Services,

Central Virginia Legal Aid Society, Community Legal Aid Services, Inc.,

Community Legal Services of Philadelphia, Inc. (on behalf of its low-income clients),

Connecticut Fair Housing Center, Florida Legal Services, Inc.,

Housing and Economic Rights Advocates (HERA), Indiana Legal Services, Inc.,

The Legal Aid Society of Cleveland, The Legal Aid Society of Columbus,

Legal Aid Society of the District of Columbia, Legal Aid Society of Southwest Ohio, LLC,

Legal Services NYC, MFY Legal Services, Inc.,

Michigan Poverty Law Program, Mississippi Center for Justice,

Mountain State Justice, Inc.,

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

National Fair Housing Alliance, North Carolina Justice Center,

Northwest Justice Project, Queens Legal Services,

Philadelphia Legal Assistance, Public Justice Center,

Southeastern Ohio Legal Services, Staten Island Legal Services,

Vermont Legal Aid, Inc., Westchester Residential Opportunities Inc.

On

United States Department of Housing and Urban Development, Office of the Assistant Secretary for Housing—Federal Housing Commissioner

60-Day Notice of Proposed Information Collection: FHA Single Family Model Mortgage Documents, 81 Fed. Reg. 85997

Docket Number: No. FR-5913-C-34; HUD-2016-0134
January 30, 2017

On behalf of the clients, communities, and neighborhoods we represent, we write in support of HUD's decision to restore language to the FHA-insured form mortgage that prevents unnecessary payment of insurance claims and improper foreclosures.[1] Our comments are informed by the substantial experience of the legal aid practitioners, housing counselors, and community groups who helped in drafting these comments and who assist individual homeowners who face unnecessary foreclosures.

Restoring this language will not only help homeowners get loan modifications and keep their homes but also will save taxpayer funds by holding counterparties accountable for non-compliance with a narrow set of FHA regulations targeted to ensure that a full loss mitigation evaluation occurs prior to foreclosure of loans. The overwhelming majority of these disputes settle without prolonged litigation. The restored language facilitates settlement by providing a legal mechanism to prevent foreclosure if the lender does not follow the mandatory regulations. By facilitating loss mitigation options, the restored language helps to avoid claims and saves taxpayer money. As a result and in response to the first question posed in the Federal Register Notice, the restored language clearly has practical utility for HUD's operations and is truly necessary for the agency's proper functioning. [2]

Background

These comments address HUD's multiple changes to the form mortgage but will focus on HUD's decision to restore important language to the form. The language at issue is found in Paragraph 22 of the proposed updated mortgage and states: "[n]otwithstanding any other provision in this Security Instrument, other than for any default under Section 17, Lender may not initiate foreclosure for a monetary default unless permitted by regulations of the Secretary." We will refer to this language in these comments as the "compliance language."

The compliance language explicitly incorporates HUD-issued regulations, found at 24 C.F.R. Part 203, that require lenders to take specific actions when homeowners default to ensure that

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[1] These comments are submitted by the non-profit organizations listed on the cover page. The primary drafters of the comments are Steven Sharpe from the Legal Aid Society of Southwest Ohio, LLC, and Alys Cohen and Geoff Walsh from the National Consumer Law Center. The Legal Aid Society of Southwest Ohio, LLC provides a full range of civil legal services to low-income residents of seven counties in southwest Ohio – Brown, Butler, Clermont, Clinton, Hamilton, Highland, and Warren. 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.

[2] With respect to this proposal, the first of the four inquiries is the most relevant and our analysis of it demonstrates the significant value of the proposed form. As such, our comments will focus on the first inquiry; however, as explained below, the form will also clarify the rights of the parties, which is relevant to the third inquiry.

loss mitigation is exhausted.[3] As explained in detail below, in order to protect the FHA insurance fund and avoid unnecessary foreclosure, HUD has implemented its loss mitigation protocol with enough flexibility to address a wide range of issues. The regulations require the loss mitigation evaluation to occur in a timely manner as means of preserving taxpayer money, holding HUD counterparties accountable, and furthering FHA's mission of promoting homeownership.

Similar language had been a stable feature of the FHA form documents, in former paragraph 6 of the note and former paragraph 9 of the mortgage, for around 25 years.[4] During those 25 years, homeowners faced with non-compliant lenders have used this language to stop needless foreclosures and insurance claim payouts while protecting taxpayer funds and promoting FHA's purpose of promoting homeownership.

HUD removed the original compliance language in September 2014 without providing any notice of the change, any explanation for the change, or any opportunity for stakeholders to comment. Because the language was added through a Federal Register notice and comment process but removed without any notice, HUD's initial decision violated the Administrative Procedure Act (APA). HUD's decision to restore the language will ameliorate the substantive impact of HUD's previously improper action.

Simply put, the restoration of compliance language to the form mortgage saves money for the insurance fund and holds HUD servicers accountable while also saving homes and alleviating procedural problems with the earlier removal. The language's role in protecting taxpayer funds is especially important given the structure of HUD's current compliance system, which, as described further below, only applies after HUD pays an insurance claim.

With respect to the first question posted in the Federal Register Notice,[5] as a result of the benefit to the taxpayer, we strongly believe that the inclusion of the compliance language promotes the

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[3] For example, the regulation at 24 C.F.R. § 203.602 requires the lender to send a specific notice, the regulation at 24 C.F.R. § 203.604 addresses when a lender must arrange a face-to-face meeting regarding loss mitigation options, and the regulation at 24 C.F.R.§ 203.605 states that the lender must "evaluate on a monthly basis all of the loss mitigation techniques provided at § 203.501 to determine which is appropriate." The above regulations specify time windows in which all of these steps must occur to ensure an early evaluation of foreclosure alternatives.

[4] Paragraph 9(d) if the previous form mortgage stated: "In many circumstances regulations issued by the Secretary [of HUD] will limit Lender's rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary." U.S. Department of Housing and Urban Development, Lender's Guide to the Single Family Mortgage Insurance Process, Handbook 4155.2, Chapter 12-A (March 24, 2011). The form note included similar language.

[5] The four questions posed in the Federal Register Notice are: (1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) The accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Ways to enhance the quality, utility, and clarity of the information to be collected; and (4) Ways to minimize the burden of the collection of information on those who are to respond; including through the use of appropriate

proper performance of the functions of HUD and has significant practical utility. Regarding the third question, by clarifying the legal standards that apply to these loans, the inclusion of the compliance language enhances the quality, utility, and clarity of the form mortgage. Our discussion below provides additional detail regarding the agency's questions. We have no position on the second question, which involves the accuracy of the agency's estimate of the burden from the information collection, or the fourth question, which involves whether there are processes to minimize the burden of the information collection. These questions do not impact the decision to reinstate the compliance language.

1. **HUD implemented the original compliance language through a formal process that recognized the importance of the language.**

HUD first proposed the compliance language in Paragraph 9 of the mortgage in a July 6, 1988 Notice of Proposed Policy.[6] The language specifically incorporated requirements from federal regulations that set out mandatory actions that lenders must take prior to foreclosure. In releasing the language, HUD recognized that the regulations already made these steps mandatory. However, HUD stated:

> Uniform mortgage provision 9 contains an incorporation by reference of the regulations that will usually restrict a mortgagee's ability to accelerate and foreclose immediately upon default by the mortgagor. The regulations would restrict a mortgagee regardless of the mortgage language, but HUD believes that the regulation represent[s] a **major policy of the insurance programs and, therefore, should be incorporated**.[7]

In this statement of policy, HUD clearly recognized the importance of the regulations and the usefulness in having them incorporated into the contracts between borrowers and lenders. By putting the requirements in the contracts, HUD improved compliance incentives and counterparty accountability.

Even after receiving critical comments regarding the proposed language, HUD adopted the policy and finalized the language in 1989. HUD addressed claims that the language was counterproductive and would drive up costs of litigation.[8] According to HUD, lenders that comply with regulations would not be harmed and would be able to proceed to a foreclosure judgment:

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automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

[6] Requirements for Single Family Mortgage Instruments, 53 Fed. Reg. 25434-01 (July 6, 1988)

[7] Id. at 25435 (emphasis added).

[8] Requirements for Single Family Mortgage Instruments, 54 Fed. Reg. 27596-01, 27599 (June 29, 1989).

> We rejected the commenter's suggestions that the references to regulations by the Secretary will impair the lender's ability to successfully defend a suit. HUD does not intend to create a conflict between the mortgage language and regulations, and there should be no adverse impact of informing the borrower that some regulations procedures exist which limit a lender's rights to foreclose.[9]

HUD understood that not all regulations were incorporated into the contract – it only incorporated loss mitigation regulations.

> [The language] simply prevents acceleration and foreclosure on the basis of the mortgage language when foreclosure would not be permitted by HUD regulations. For example, 24 CFR 203.606 specifically prohibits a mortgagee from foreclosing unless three full monthly payments due on the mortgage are unpaid. As long as this requirement remains in the regulations, we do not expect mortgagees to violate it even though the mortgage fails to repeat the requirement, and we believe that a borrower could appropriately raise the regulatory violation in his or her defense. If a mortgagee has violated parts of the servicing regulations which do not specifically state prerequisites to acceleration or foreclosure, however, the reference to regulations in the mortgage would not be applicable. HUD retains the general position recited in 24 CFR 203.500, that whether a mortgagee's refusal or failure to comply with servicing regulations is a legal defense is a matter to be determined by the courts.[10]

HUD saw a clear benefit in adding the language to the form contracts. It also noted that the changes applied to a narrow band of regulations that provide prerequisites to foreclosure. In doing so, it saw that this change would have limited cost and scope while improving compliance.

On October 2, 1989, HUD issued a follow-up Notice through the Federal Register with a correction and to add an effective date of March 1, 1990 for the use of the forms.[11]

HUD incorporated the compliance language in paragraph 6(b) of the note and paragraph 9(d) of the mortgage in Handbook 4155.2, Lender's Guide to the Single Family Mortgage Insurance Process.[12] Lenders of FHA-insured mortgages included the language in the notes and mortgage.

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[9] Id.
[10] Id.
[11] *See* Requirements for Single Family Mortgage Instruments; Announcement of Mandatory Date for New Requirements; and Corrections, 54 Fed. Reg. 40529-02 (October 2, 1989); *see also* U.S. Department of Housing and Urban Development, Mortgagee Letter 91-08, Attachment (February 11, 1991); U.S. Department of Housing and Urban Development, Mortgagee Letter 89-23 (October 11, 1989).
[12] As set forth in the handbook, paragraph 9(d) of the previous form mortgage stated: "In many circumstances regulations issued by the Secretary [of HUD] will limit Lender's rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary." U.S. Department of Housing and Urban Development,

Since HUD's adoption of the compliance language, courts have focused on this language in halting foreclosures in cases of counterparty non-compliance with FHA servicing requirements.[13] The language has had a critical role in preserving taxpayer funds and avoiding unnecessary claim payouts.

2. **By supporting a homeowner's ability to challenge unnecessary foreclosures, the previous form mortgage language provided a means for avoiding HUD payment of claims that does not exist in HUD's current system for compliance**.

The language that HUD added to the note and mortgage supported its major policy of promoting compliance with FHA loss mitigation regulations. By incorporating the language into the homeowners' contracts, the form note and mortgage provide a means for individual homeowners to address regulatory non-compliance prior to foreclosure and prior to claim payment, thus saving taxpayer funds. HUD's own compliance mechanism only evaluates cases after the money has 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 mortgage**e. 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

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.

Lender's Guide to the Single Family Mortgage Insurance Process, Handbook 4155.2, Chapter 12-A (March 24, 2011). The form note included similar language.

[13] *See, e.g.,* Covarrubias v. CitiMortgage, 623 Fed.Appx. 592 (4th Cir. 2015); Mullins v. GMAC Mortgage, LLC, 2011 WL 1298777, at *2 (S.D.W. Va. 2011); Pfeifer v. Countrywide Home Loans, Inc., 211 Cal. App. 4th 1250, 1266, 150 Cal. Rptr. 3d 673, 686 (2012); Fonteno v. Wells Fargo Bank, N.A., 228 Cal. App. 4th 1358, 1370, 176 Cal. Rptr. 3d 676, 686 (2014) ("To be clear, we are being asked to permit enforcement of a contract, not a statute."); ABN AMRO Mortg. Grp v. Tullar, 770 N.W.2d 851, *3 (Iowa Ct. App. 2009); BAC Home Loans Servicing, LP v. Taylor, 986 N.E.2d 1028, 1034 (Ohio Ct. App. 2013); Wells Fargo v. Phillabaum, 950 N.E.2d 245, 246 (Ohio Ct. App. 2011); Mathews v. PHH Mortgage Corp., 283 Va. 723, 733, 724 S.E.2d 196, 200 (2012).

As a result, the compliance language plays a critical role. It gives homeowners a clear avenue to raise non-compliance before the claim has been paid and before the homeowner has lost the home.

3. **Non-compliance with FHA requirements is a significant problem that can be addressed by the proposed language**.

The restoration of the language is critically important because servicer non-compliance with FHA regulations is an ongoing problem. The language is a key to counterparty accountability. As explained in a recent HUD Office of Inspector General (OIG) report, lenders are not consistently complying with FHA regulatory requirements.[14] In its October 2016 Report, OIG described how it reviewed a sample of FHA insurance claims paid out over a five-year period. OIG found that HUD paid $141.9 million for servicers' claims for interest improperly charged after the servicers had missed HUD deadlines for prosecution of foreclosures. It is important to note that HUD guidelines build in ample time for considering alternatives to foreclosure, and, as a result, any non-compliance is attributable to servicer delays.

HUD incurred $2.09 billion for servicers' claims for unreasonable and unnecessary holding costs (legal fees, property maintenance charges, tax advances) incurred after the servicers missed deadlines set out in HUD guidelines. What was particularly disturbing about the OIG's findings was the frequency with which servicers misrepresented their actions when filing insurance claims with HUD. According to the OIG's survey sample, in approximately 45% of the cases in which the servicers should have reduced their claim amounts due to their non-compliance with HUD guidelines, they failed to do so. Instead, they asked for and received full insurance claims as if they had complied with the guidelines.[15]

The OIG found that HUD was not effectively monitoring servicers' claims while processing them in order to ensure compliance with HUD regulations. HUD monitored only a small number of claims. The automated reviews were not effective, and the agency did not dedicate adequate staffing resources to conduct hands-on reviews.

Based on this Report, it is incumbent upon HUD to augment oversight of servicers who are foreclosing on FHA mortgages. The decision to remove an important oversight tool by taking away the compliance language was clearly a step in the wrong direction. Restoration of the compliance language is one step toward better oversight.

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[14] U.S. Department of Housing and Urban Development , Office of Inspector General, Federal Housing Administration, Washington, DC, Single-Family Mortgage Insurance Claims (October 14, 2016), https://www.hudoig.gov/sites/default/files/documents/2017-KC-0001.pdf
[15] Id. at p. 7.

The OIG report outlining lender non-compliance confirms the experience that homeowners face across the nation, as we describe below. As explained below, homeowners benefit from the prompt and timely application of loss mitigation standards prior to foreclosure. In fact, some foreclosure options become difficult, if not impossible, to obtain later in the process. Servicers continue to fail to take required steps to evaluate homeowners for FHA loss mitigation and fail to correctly apply the loss mitigation waterfall. The compliance language provides an avenue for avoiding the payment of claims to these non-compliant servicers.

4. **Reinstatement of the compliance language would ameliorate the substantive impact of the Administrative Procedure Act violation HUD caused when it improperly removed the language**.

HUD's decision to reinstate language that is similar to the language it removed from the form mortgage significantly lessens the Administrative Procedure Act problem that HUD caused in removing the language. The proposed language is substantially similar and, if adopted in its current form, will provide similar benefits. HUD should take steps to address the problem for people who received forms without the language so that compliance on those loans also can be addressed, but this is outside the scope of these comments.[16]

HUD removed the language from the form note and mortgage in connection with the final draft of the Origination through Post-Closing Endorsement section of Single Family Handbook without any notice to stakeholders or opportunity to comment and notwithstanding the established nature of the compliance language and its benefits to the taxpayer and the FHA insurance fund.

The initial draft of the section was released on HUD's website on October 29, 2013 and was originally titled Application through Endorsement.[17] It was amended less than a week later on November 5, 2013 and renamed Origination through Post-Closing/Endorsement; the documents were not published in the Federal Register. The draft included a section on the requirements for the form note and mortgage provisions, in addition to around 300 pages of additional rules. In the subsection of the November 5, 2013 draft, HUD included an empty box with the notation: "REMAINDER OF SECTION i Mortgage and Note PENDING – UNDER CONSTRUCTION."[18] HUD provided no indication that removal of the compliance language was under consideration.

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[16] We would be happy to work with FHA staff on such a process.
[17] *See* U.S. Department of Housing and Urban Development, FHA INFO #13-68 (October 29, 2013), https://portal.hud.gov/hudportal/documents/huddoc?id=SFH_FHA_INFO_13-68.pdf.
[18] *See* U.S. Department of Housing and Urban Development, November 5, 2013 Draft, Handbook 4000.1, Sec. I.B.1.d.1.i ("Mortgage and Note"), p. 184 (Nov. 5, 2013). Unfortunately, it appears that the draft versions of the handbook are no longer available on-line.

Even though HUD may have contemplated some unspecified changes to the mortgage provisions, HUD did not release any updated drafts of the Origination through Post-Closing/Endorsement section with proposed changes to the mortgage provisions until the final version was released. Consumer advocates and other stakeholders provided extensive comments to the Origination through Post-Closing/Endorsement section of Handbook 4000.1 but had no reason to believe that HUD was removing the compliance language from the form note and mortgage.

On September 30, 2014, HUD released on its website the final version of the section including the form mortgage and note provisions.[19] Again, this release was not published in the Federal Register. Even the final text of Handbook 4000.1 failed to reveal changes to the mortgage form. It included no text regarding any mandatory provisions of the FHA-insured note and mortgage, and it provided no discussion of the form mortgage language or why the compliance language had been removed.

Instead of incorporating the specific mandatory language for the form note and mortgage, which HUD had done in previous handbooks, Handbook 4000.1 includes links to HUD websites that have the form note and mortgage posted on them. Handbook 4000.1 states: "The Mortgagee must develop or obtain a separate Mortgage and Note that conforms generally to the Freddie Mac and Fannie Mae forms in both form and content, but that included the specific modification required by FHA set forth in the applicable Model Note and Mortgage."[20] This quote in the pdf version of the handbook ends with a hyperlink that directs users to a HUD website entitled "The Single Family Housing Policy Handbook (SF Handbook; HUD Handbook 4000.1) Supplemental Documents."[21] The Supplemental Documents website includes a separate link for Model Documents, entitled "Single Family Mortgages Model Documents."[22] The Model Documents link includes a link to a form forward note and a form forward mortgage. And it is this form forward note and mortgage, reachable after a long chain of links from the Handbook, that deleted the compliance language that HUD instituted through its June 1989 Notice of Policy. The model mortgage document also includes a new paragraph 20 that discusses third-party beneficiaries (which HUD has also positively amended in its current proposal). Like the handbook, the model documents were not published in the Federal Register. The drafts of the Origination through Post-Closing/Endorsement section of the Handbook that HUD released in October and November 2013 provided no link to the Model Documents website, and it made no indication that HUD was removing the compliance language.

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[19] *See* U.S. Department of Housing and Urban Development, FHA Info #14-59 (September 30, 2014).
[20] *See* U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook, Handbook 4000.1, pg. 346 (December 30, 2016), available at https://portal.hud.gov/hudportal/documents/huddoc?id=40001HSGH.pdf.
[21] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/handbook_references
[22] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/model_documents

In fact, HUD made no public announcement at any time of its plans to remove the compliance language from the model note and mortgage provisions. It issued no press release or FHA INFO announcement mentioning the removal in connection with the issuance of the handbook. Because the model documents are simply included as links to Handbook 4000.1, it is unclear when in the drafting cycle HUD made its change. The removal of the language is not part of the text of Handbook 4000.1.

In removing the compliance language without any notice to the public through the Federal Register and without an opportunity for public comment, HUD violated the Administrative Procedure Act, 5 U.S.C. § 553.[23] The language was first added in 1989 after a public process in the Federal Register that considered comments. It conferred substantive rights on borrowers and imposed contractual obligations on lenders vis-à-vis borrowers. Stakeholders had no chance to make any comments on HUD's decision to remove the language before HUD removed it.

5. The FHA loss mitigation program saves taxpayer money.

Improving compliance with loss mitigation regulations saves money for HUD and taxpayers because FHA's loss mitigation program is effective. The program includes a menu of options to help a homeowner avoid foreclosure and a set of steps, including a face-to-face meeting, to ensure that the lender has fully reviewed the homeowner for all options before foreclosure. The compliance language helps to ensure that servicers follow this cost-reduction program.

FHA has improved its loss mitigation program considerably over the past few years by providing multiple options to fit the individual needs of homeowners.[24] Through FHA's framework, a lender considers a homeowner's specific financial situation when deciding the appropriate tool. The homeowner may need a temporary reduction in payment or a payment plan while looking for work. In some cases, the homeowners' interest rate and payment are affordable with their current income, but they need help catching up from a former loss of income and cannot manage a repayment plan. In that case, a partial claim payment from HUD will catch up the loan and avoid the full claim payment that would occur with a foreclosure. Because the partial claim is a loan from HUD to the homeowner, HUD has the ability to recover this claim payment. Finally, many homeowners require a modification of their loan terms because of a financial hardship. Loan modifications result in a stream of loan payments and avoid a full insurance claim payout.

HUD's menu is detailed and depends on financial information from homeowners. As HUD has recognized, homeowners have different communication needs and limitations. This is especially

[23] Mendoza v. Perez, 754 F.3d 1002 (D.C. Cir. 2014).
[24] *See* U.S. Department of Housing and Urban Development, Mortgagee Letter 2013-32 (September 20, 2013), https://portal.hud.gov/hudportal/documents/huddoc?id=13-32ml.pdf.

true since FHA-insured loans serve low- to moderate-income communities. The challenge is especially great for homeowners with disabilities.

HUD's outreach requirements, which are set out in regulations, help ensure meaningful communication with homeowners. The face-to-face meeting requirement is included in the regulations and is a key component.[25] It requires lenders 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.

A recent homeowner case out of Atlanta demonstrates the need for face-to-face meeting compliance:

> After years of making mortgage payments, Ms. and Mr. B fell behind due to unanticipated hardships. Mr. B's stepdaughter died on January 28, 2014, and the Bs took in and cared for her son. That April, Mrs. B fell and broke her hip. She had to stay in the hospital for a month, and spend even more time in rehabilitation. She became bedridden and could hardly walk. Prior to all of this, Mr. B had two heart attacks.
>
> Inundated with new expenses and without Ms. B being able to manage the household finances, the Bs fell behind. The Bs were eligible for an FHA-HAMP loan modification, but understandably failed to research and pursue their mortgage options amid the tide of adversity.
>
> Given the medical issues and the Bs' unique challenges, the Bs would have benefited from a face-to-face meeting about their options, including FHA-HAMP. Despite this, Bank of America and Carrington failed to offer a face-to-face meeting. The Bs' situation was exactly the type of scenario that the face-to-face meeting was designed for – the honest but overwhelmed and unfortunate borrower.
>
> The Bs lost their home to foreclosure on September 6, 2016. After the foreclosure sale, the Bs contacted an Atlanta Legal Aid attorney who listened to the Bs' story and determined that the Bs would have been eligible for an FHA-HAMP loan modification if they had applied. Atlanta Legal Aid sent a letter to Bank of America and Carrington regarding their failure to conduct a fact-to-face meeting to help the Bs determine their options prior to foreclosing. While Carrington did not admit any wrongdoing, it agreed to rescind the foreclosure sale and offered an FHA-HAMP modification to the Bs. The Bs are still in their longtime home and able to afford their mortgage payments again.

[25] 24 C.F.R. § 203.604.

This story demonstrates the power of the face-to-face meeting and the need for a mechanism to enforce it. It required no litigation, but saved a home and prevented an unnecessary claim payment.

6. **Use of the compliance language has helped HUD avoid unnecessary claim payments, enhance compliance, and preserve homeownership.**

Most FHA homeowners who face challenges getting help from their servicer do so without assistance (as we discuss further below). For those who find assistance, their cases demonstrate how use of the compliance language has reversed servicer non-compliance and opened up access to intended solutions under FHA's existing regulations. Homeowners continue to see lender non-compliance with several aspects of FHA loan servicing that unnecessarily hold up money-saving loss mitigation options. The facts of these cases make clear that the contract language is saving money by preventing unnecessary foreclosure and insurance claim payouts, usually without any published court decisions. We have highlighted cases that do not involve full published decisions and that illustrate specific issues with FHA servicing and how homeowners resolved these cases.

- *Servicers continue to issue unnecessary and duplicative document requests*.

Prior to retaining a legal services attorney through the Northwest Justice Project, DL, a disabled senior veteran, applied for a loan modification with Bank of America. He should have received assistance; however, Bank of America failed to correctly apply the FHA rules and denied him. Even after Northwest Justice Project became involved, Bank of America continued to put up hurdles in the process, including asking for an IRS form 4506-T on *fifteen* separate occasions. DL and his lawyers continued to advocate and through their efforts, DL received the modification he should have received months earlier.

Multiple unnecessary document requests were especially problematic for JF from Springfield, MA since English is his second language. JF, a self-employed tailor who fell behind around the time of the economic downturn, attempted several times to reach an agreement with PNC Bank and had to resubmit documents on multiple occasions. PNC did not promptly review the documents and unnecessarily rejected items. JF tried to have phone conversations with PNC, but his language barrier made talking on the phone difficult. In this case, a face-to-face meeting clearly would have helped PNC and JF communicate, but the bank failed to provide one. JF finally reached Community Legal Aid in Springfield, MA, which became involved in the case and negotiated a loan modification. JF became current on his loan and helped avoid another claim payment by HUD.

BC and WC from Middletown, Ohio also endured confusing communications from their lender, unnecessarily strict requirements, and the need to re-submit documents. After completing a twelve-month forbearance plan to address unemployment, U.S. Bank initially told them that they were eligible for a loan modification and that documents were coming. U.S. Bank then changed its position and told them that they had to submit financial material. The Cs agreed and tried to meet U.S. Bank's demands. The bank at first required them to submit a document that did not exist and then required unnecessarily detailed employment information. The Cs tried to give U.S. Bank what it wanted, but the bank was not satisfied. U.S. Bank finally sued and the Cs retained the Legal Aid Society of Southwest Ohio. Soon after the lawsuit, the Cs reached a trial plan agreement with U.S. Bank, which they are finalizing at this time.

- *Servicers struggle to honor workout options from previous loan servicers*.

After suffering from a work injury, Mr. H from Mount Claire, West Virginia reached a forbearance agreement with his lender in June of 2014 to bring the loan that he shares with his wife current in three months. Before the end of the forbearance agreement, the Hs were notified that their loan was transferred to Selene Finance. Instead of honoring the agreement, Selene demanded a new loss mitigation application. When the Hs complied with this request, Selene took no action on the application and instead proceeded to foreclosure. The Hs retained Mountain State Justice and reached an agreement with the bank that brought the loan current and allowed the Hs to continue to make payments.

Similarly, FO from Manchester, Connecticut struggled in the transfer of his loan between Bank of America and PennyMac. Bank of America offered FO a three-month trial plan prior to a modification, and FO made all the payments. Before making his third payment, Bank of America informed FO that it never received a written trial plan payment arrangement. FO had not received one but was happy to provide it, and he faxed it into Bank of America and made his third payment, which Bank of America accepted. However, Bank of America would not honor the modification and instead transferred servicing to PennyMac in November of 2016. FO then obtained help through the Connecticut Fair Housing Center. Finally, in January of 2017, FO received a final FHA-HAMP modification.

- *Servicers struggle to properly evaluate borrowers under the FHA waterfall*.

JK from Putnam, Connecticut worked with Wells Fargo for 18 months on a loan modification application that was delayed due to Wells Fargo's inability to correctly apply FHA rules. Although FHA has no debt-to-income ratio floor in its rules for a modification, Wells Fargo claimed there was such a floor and denied his application. JK reapplied and then was denied because Wells Fargo claimed he needed too much of a partial claim even though no partial claim was required. JK worked with the Connecticut Fair Housing Center, through those advocates, he eventually was approved for a standard FHA modification, without a partial claim, after an 18-month long application process.

YL from Martinsburg, West Virginia worked for years to get Flagstar to properly review him for a foreclosure alternative without any luck. After supplying financial information, Flagstar held up his application because YL did not have a bank account and, therefore, could not provide the required bank statements. Even after YL put this in writing at Flagstar's instruction, Flagstar denied his application for failure to provide bank statements. Flagstar never had a face-to-face meeting with YL and instead denied him for failure to provide documents that he had, in fact, provided. Knowing from YL's documents that he was unemployed, a special forbearance would have fit his situation, but one never came. Fearing foreclosure, YL asked for a reinstatement figure. Having not received a clear amount, YL determined that he should pay around $9,500 to Flagstar to avoid foreclosure. Flagstar put the money in suspense and scheduled a foreclosure sale. Right before the sale, YL called Flagstar for an update and was told no sale was scheduled and that it could not provide a reinstatement update. Soon after that, YL received another billing statement and he paid the difference of around $2,400 to Flagstar. One day prior to the sale, Flagstar generated a reinstatement quote, but YL did not receive it. The home was then sold at a sheriff sale. YL later called Flagstar and was told he was short by around $700, which he found out only after the sale occurred. Flagstar told YL that nothing could be done. YL then retained Mountain State Justice in response to an eviction action, and he reached an agreement with Flagstar that kept him, his wife, and his six children in their home.

- *Servicers continue to fail to evaluate for loss mitigation in instances of subsequent defaults*.

In recognition of the fact that low to moderate income families may have multiple financial hardships over the life of a loan, HUD has wisely decided to require servicers to evaluate loss mitigation options for borrowers who default on previous workout options, subject to rules. This rule protects taxpayer funds better than requiring foreclosure where a loan can become reperforming. The following case from Philadelphia reflects this problem and the others discussed above.

> KR fell behind in her mortgage in 2014 after her husband left and stopped contributing to the household expenses. CitiMortgage sent her a pre-foreclosure notice directing her to apply for Pennsylvania state assistance program that is not available to FHA borrowers. KR applied for the state assistance and was turned down because she was ineligible. Meanwhile CitiMortgage filed foreclosure against her. With the help of a housing counselor, KR submitted an application for a loan modification and continued to supply requested documents until April 2015, when CitiMortgage sent a letter denying her loan modification request because she was more than 12 months delinquent, which is not a valid reason for denial under the FHA rules, and because she had the "same hardship" as in a previous application. This was also untrue. KR attended four mediation conferences with her housing counselor and was unable to get assistance from CitiMortgage. At that point Community

Legal Services of Philadelphia (CLS) began working with KR, filed an answer to the foreclosure raising FHA servicing defenses, and helped her reapply for a loan modification in October 2015. KR and CLS submitted additional requested documents in November 2015. No decision on that application was ever received. In December 2015, CitiMortgage's attorney claimed in an email that the application had been denied because unspecified documents had not been received, and the attorney asked KR to submit an entirely new application. CitiMortgage then filed for summary judgment in the foreclosure, which CLS responded to with evidence that CitiMortgage had not reviewed KR for a loan modification as it is required to under FHA servicing rules. The court denied the motion. CLS helped KR reapply again in early 2016 and this time she was approved for an FHA-HAMP trial modification beginning June 2016 which she should have qualified for all along. KR received a permanent modification in October 2016 and the foreclosure case was marked settled.

The published court decisions have primarily focused on the face-to-face meeting requirement because it is one of the specific regulations that lenders must follow. As described above, the face-to-face meeting is a critical part of loss mitigation evaluations. Moreover, as the *Lacy-McKinney* case below demonstrates, the cases have at their core the full loss mitigation principles and not just the face-to-face meeting requirement.

The borrower's situation in *Taylor, Bean, & Whitaker v. Lacy-McKinn*ey demonstrates exactly the type of non-compliance the contract language will help to avoid.[26] Ms. Lacy-McKinney submitted a loss mitigation package early in her default in order to avoid foreclosure. She kept in contact with her lender and faxed requested information, but she was told several times that the information needed to be resubmitted. Despite the confusion and the need for further documents, the lender never held a face-to-face meeting. Instead, it filed a foreclosure lawsuit. The Indiana Court of Appeals reversed the trial court's initial decision to grant foreclosure and held that the borrower could raise these issues.

The contract language allows borrowers to address such clear non-compliance. In *U.S. Bank v. Detweiler*,[27] the court rejected a lender's foreclosure request due to the lack of compliance. "[W]e find that it is clear that appellee made no attempt to establish that it complied with the regulation that it have a face-to-face interview with the mortgagor, or made a reasonable effort to arrange the interview, before bringing the foreclosure action."[28] The Fifth District Court of Appeals in Florida echoed this conclusion in a recent case, and stated that the "Bank wholly failed to meet its burden, providing no evidence that it engaged in a face-to-face interview before filing its foreclosure complaint."[29]

[26] 937 N.E.2d 853 (Ind. Ct. App. 2010).
[27] 946 N.E.2d 777 (Ohio Ct. App. 2010).
[28] Id. at 784.
[29] Palma v. JPMorgan Chase Bank, 2016 WL 7176754, at *2 (Fla. Dist. Ct. App. Dec. 2, 2016).

In *Wells Fargo Bank v. Aey* the court directly addressed a lender filing foreclosure without having completed a modification evaluation or holding a face-to-face meeting. Ms. Aey fell behind when she had to take family medical leave. She started the modification process, but her lender filed foreclosure before the process was complete. Noting that both the note and mortgage incorporated by reference HUD regulations, the court held that the lender could not foreclose without complying with the loss mitigation and face-to-face meeting requirements.[30]

These reported cases are exceptions to the general pattern, in that the overwhelming majority of cases do not involve so much litigation that there is a reported decision. The compliance language, which is in place for the vast majority of outstanding FHA contracts, facilitates the parties reaching an agreement to avoid foreclosure. The purpose of the language is to improve compliance and provide more efficient resolutions.

7. **The compliance language saves taxpayer funds by promoting compliance without creating significant cost.**

When HUD initially put the compliance language in the form mortgage in 1989 through the Federal Register, it stated that "there should be no adverse impact of informing the borrower that some regulations procedures exist which limit a lender's rights to foreclose."[31] At least one commenter raised the argument that the language would involve additional cost from borrowers litigating non-compliance. HUD dismissed this argument. It recognized that the language would help compliance and it rejected the idea that the language would be costly.

That conclusion has been borne out. An exceptionally small number of homeowners obtain attorneys in foreclosure cases. In judicial and non-judicial foreclosure states, the vast majority of foreclosure cases occur by default without any legal intervention. According to the Mortgage Bankers Association, in the second quarter of 2016, there were 273,838 FHA loans serviced in Ohio and 5.41% were seriously delinquent (or 14,814 loans).[32] During the second quarter of 2016 (April through June), there were three cases reported to Westlaw that cite to the face-to-face meeting regulation (and one of them did not even involve a mortgage).[33] This shows how vanishingly sparse this litigation is when compared to foreclosure activity in general. The nationwide numbers amplify this point. Across the United States, there were approximately 6.26 million FHA loans that were serviced during the second quarter of 2016 and 4.43% of the loans were seriously delinquent (or 277,588 loans).[34] For the country, during this same period, there were only **five** cases reported to Westlaw citing to the face-to-face meeting regulation, including the three from Ohio. Moreover, as explained above, the overwhelming majority of these

[30] Wells Fargo Bank, N.A. v. Aey, 2013 WL 6500133 (Ohio Ct. App. 2013).
[31] Requirements for Single Family Mortgage Instruments, 54 Fed. Reg. 27596-01, 27599 (June 29, 1989).
[32] Mortgage Bankers Association, National Delinquency Survey Q2 2016 (August 2016).
[33] The face-to-face meeting regulation is found at 24 C.F.R. § 203.604.
[34] Mortgage Bankers Association, National Delinquency Survey Q2 2016 (August 2016).

disputes settle without prolonged litigation. The compliance language facilitates settlement by providing a legal mechanism to prevent foreclosure if the lender does not follow the mandatory regulations.

When HUD removed the language in 2014, it acted without publically releasing any data or evidence to establish that its previous conclusion was incorrect. NCLC, MFY Legal Services of New York, and the Legal Aid Society of Southwest Ohio made a Freedom of Information Act ("FOIA") request to determine if there were any internal explanations or assessments by HUD of the impact of removing the form note language. These organizations have received no documents in response to this FOIA request. Without any data to support its conclusion, HUD had no grounds for reversing its former conclusion that there should be "no adverse impact" from having the compliance language in the form mortgage. Its decision to restore the language is in line with its previous conclusion.

In fact, the data show that the FHA form language has not caused problems with the market. As explained above, the compliance language was a stable feature of the FHA mortgage for around 25 years. HUD's market share report shows that loan originations have fluctuated through that time in a way that appears independent of this language. [35] In fact, the market share of FHA-insured loans was at a relatively high point at the time before HUD removed the language.

Moreover, the Mutual Mortgage Insurance (MMI) fund continues to become more stable even though the vast majority of outstanding FHA loans include the compliance language. If such language caused such dramatic cost to the system, it would be currently revealing this in the MMI fund. To the contrary, the contract language helps the MMI fund and is contributing to its current strength.[36]

The evidence from both reported and unreported cases is that the compliance language has worked as HUD expected. HUD should maintain its former position and restore the language into the model mortgage as it plans to do.

8. **In addition to including the compliance language, HUD should clarify certain additional matters from the Federal Register release**.

A) The term "initiate foreclosure" should be clarified if HUD retains that language over the former compliance language, which is preferable.

[35] U.S. Department of Housing and Urban Development, FHA Single Family Market Share, Table 1 (September 9, 2016), https://portal.hud.gov/hudportal/documents/huddoc?id=FHA_SF_MarketShare_2016Q1.pdf.
[36] *See* Federal Housing Administration, Annual Report to Congress, The Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2016 (November 15, 2016).

As discussed above, we support HUD's inclusion of the compliance language. However, the new language is slightly changed from the language HUD previously used.

The proposed language in Paragraph 22 states: "Notwithstanding any other provision in this Security Instrument, other than for any default under Section 17, Lender **may not initiate foreclosure** for a monetary default unless permitted by regulations of the Secretary."

The inserted compliance language is a change from the removed language in 9(D), which stated "[t]his Security Instrument **does not authorize acceleration or foreclosure** if not permitted by regulations of the Secretary."

Because the previous language worked well to avoid unnecessary foreclosure, we prefer it to the slightly amended language. If HUD chooses to keep the proposed language as amended, which is far preferable to total removal, we seek clarification on the language HUD has chosen. We specifically want to know how "initiating foreclosure" differs from "acceleration or foreclosure."

This language appears to refer to HUD's own previous guidance on the issue. In Handbook 4000.1, HUD included a chart of first initial actions to institute foreclosure. The chart provides a state-by-state guide for what constitutes the first action to initiate foreclosure.[37] This chart closely tracks the Consumer Financial Protection Bureau's definition of "initiating foreclosure" provided in its regulations. We suggest that HUD clarify this in the final rule if the slightly amended language is favored over the original version.

B) HUD's amended language on third party beneficiaries has improved but is still unnecessary and confusing for judges.

HUD's new draft clearly improves Paragraph 20 of the mortgage. This paragraph, which HUD added in 2014, addresses a borrower's standing as a third party beneficiary. In general, efforts to obtain FHA loss mitigation do not rely on this theory and thus such language is still unnecessary.

Paragraph 20 of HUD's proposed mortgage states: "Mortgage Insurance reimburses Lender (or any entity that purchases the Note) for certain losses it may incur if Borrower does not repay the Loan as agreed. Borrower acknowledges and agrees that the Borrower is not a third party beneficiary to the contract of insurance between the Secretary and Lender." This language was first included in the revised form mortgage that HUD released around September of 2014 in connection with the release of the Single Family Housing Policy Handbook. This addition was in the same document that removed the compliance language.

[37] *See* U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook, Handbook 4000.1, Appendix 5.0 - First Legal Actions to Initiate Foreclosure and Reasonable Diligence Timeframes (Applies to Servicing Only).

Importantly, HUD's new version omits a confusing sentence that was at the end of the quoted language – "nor is Borrower entitled to enforce any agreement between Lender and Secretary, unless explicitly authorized to do so by Applicable Law." We support the removal of this sentence, which is irrelevant because such borrowers do not rely on any agreements between lenders and HUD. Instead, borrowers focus on the regulations and contracts that incorporate them.

Even with the improvement, however, the third party beneficiary language is still unnecessary, and it may also confuse courts in evaluating cases between borrowers and lenders.

C) It is important to ensure that the role of new notice language is clear and does not preclude challenges to unnecessary foreclosures.

In paragraph 22 of the revised form mortgage, HUD states:

> Neither Borrower nor Lender may commence, join, or be joined to any judicial action (as either an individual litigant or the member of a class) that arises from the other party's actions pursuant to this Security Instrument or that alleges that the other party has breached any provision of, or any duty owed by reason of, this Security Instrument, until such Borrower or Lender has notified the other party (with such notice given in compliance with the requirements of Section 14) of such alleged breach and afforded the other party hereto a reasonable period after the giving of such notice to take corrective action. If Applicable Law provides a time period which must elapse before certain action can be taken, that time period will be deemed to be reasonable for purposes of this paragraph. The notice of acceleration and opportunity to cure given to Borrower pursuant to Section 22 and the notice of acceleration given to Borrower pursuant to Section 17 shall be deemed to satisfy the notice and opportunity to take corrective action provisions of this Section

We realize that this language comes from Fannie Mae and Freddie Mac form instruments and that this is in line with HUD's policy of aligning with Fannie and Freddie.

This policy should not prevent homeowners from raising non-compliance. HUD should clarify that this language should not act to preclude homeowners from raising issues that are otherwise allowed by state law.

D) HUD should include the compliance language in the note as well as the mortgage.

When HUD originally instituted the contract language it was included in both the note and the mortgage. For some reason, HUD has only reinstituted the language in the mortgage and not the note. While including the language in the mortgage should work to prevent unnecessary foreclosures, we believe the language should also be reinstituted in the note. It is consistent with previous policy and does not involve any significant costs.

9. Conclusion

We applaud HUD for its decision to reinstate the compliance language into the form mortgage. For around 25 years, this language was critical in helping HUD avoid unnecessary foreclosures due to lender non-compliance. Unfortunately, lender non-compliance remains a problem, as indicated in the recent OIG report, which makes the language as important as ever. Without this language, homeowners' ability to stop unnecessary claim payments and foreclosures is undermined. As explained above and as HUD has already recognized, the decision to reinstate the compliance language will not add undue costs, and it will ameliorate the substantive impact of HUD's violation of the Administrative Procedure Act that occurred when HUD originally removed the language. We ask you to finalize your proposal for the sake of the Fund, homeowners, and communities.

Thank you for considering these comments.

EXHIBIT 5

NCLC®

NATIONAL CONSUMER LAW CENTER®

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February 28, 2013

C. Brian Faux
Senior Advisor
U.S. Dept. of HUD
Office of the Assistant Secretary for Housing
Federal Housing Commissioner
451 7th Street, SW, Room 9110
Washington, DC 20410

Dear Brian:

We appreciate your time and interest in discussing the FHA single family loan sales with us last month. We look forward to ongoing dialogue with you about this program. In particular, we will value your sharing information with us about this important program that affects tens of thousands of homeowners. In our last call, you and your colleagues addressed some of our questions. We hope that some further clarification from you will shed light on some of our remaining concerns.

We have a number of questions regarding the data describing what happened to formerly insured loans that were sold through the distressed asset sales program. HUD's assumption has been that private investors who purchase these loans for prices well under the market value of the secured properties will act upon their own financial incentives to modify the loans and take other steps to keep homeowners in the homes. You have indicated that data from sales completed thus far bears out this assumption.

One basic concern we have is that HUD has still not released any data that describes concretely the status of loans after investors purchased them. This is true even for the sales completed during 2010 and 2011.

With regard to the data on completed sales, these are some questions we have:

1. What are the reporting requirements for purchasers of loans in non-NSO pools? We have seen the reporting requirements for NSO pool loans, but nothing that describes either the specific data items that non-NSO purchasers must report or the frequency with which reports must be submitted. For the NSO pools the reporting requirements are set forth in section c of the NSO Outcome Pool Mortgage Loan Rider (Exhibit B-1-NSO to the Post-Sale Reporting Requirements attached to the Rider). If there is a non-NSO equivalent to this rider, it would be very helpful to see that.

2. If there are no reporting requirements for non-NSO pools, what metrics does HUD use to survey the post-sale status of the non-NSO loans? What outcomes have you tracked, and how do they apply across pools and purchasers?

3. In our January 25, 2012 call, you mentioned that HUD is implementing a more detailed system of tracking the post-sale status of formerly insured loans. This will include data on the structure of loan modifications, payment-to-income ratios, and the extent of principal reduction. Could you please describe this data in more detail, in particular:

   - When was this enhanced data review begun, or when will it begin?
   - Will HUD be collecting this data retroactively, for the sales since 2010?
   - Is this data being collected for NSO and non-NSO pools?
   - With what regularity will this data be made available to the public?
   - Can we obtain regional breakdowns of this data now?
   - For a loan modification, does the data include total payment reduction, percentage payment reduction, amount of principal reduction, and percentage principal reduction? Does the data include pre- and post-modification payment levels, pre- and post-modification debt-to-income rations, , and pre- and post-modification principal balance?

4. What information is in the FHA files on borrower demographics (race, gender, ethnicity, income level) and does the FHA loan identifier number let you gain access to that information?

   Finally, for the outcomes from SFLS 2012-3 (September 2012), available now on the HUD website, we can see breakdowns of the loan pools sold, including the identity of each institution that purchased a pool. It is not clear from the names of purchasers which ones were non-profits and which were for-profit investors. We would appreciate your clarifying for us which ones were non-profit buyers.

It would greatly help us to understand the details of HUD's loan sale program if you could respond with answers to these questions. Please feel free to contact us if any of the questions are not clear.

My contact information is below. I have also added Debby Goldberg's contact information. It would be best to direct questions about the Fair Housing and demographic tracking issues to her.

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Debby Golderg
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Sincerely,

Geoff Walsh
Staff Attorney

EXHIBIT 6

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April 29, 2019

VIA E-MAIL

U.S. Department of Housing and Urban Development
Freedom of Information Act Office
451 7th Street, SW, Room 10139
Washington, DC 20410-3000

Re*: FOIA Request*

Dear HUD FOIA Officer:

This is a request under the Freedom of Information Act (FOIA), 5 U.S.C. § 552.

FOIA Request

This FOIA requests the following:

1) Any and all reports, analyses, or other documents produced as a result of data assembly related to the HUD Single Family Loan Sales (SFLS) or the Distressed Asset Stabilization Program (DASP) created since January 1, 2016. This includes, but is not limited to, the following items (whether prepared by HUD or submitted to HUD by other sources):

    a. Any and all reports or data analyses regarding post-sale loss mitigation activities of DASP purchasers.

    b. Any and all reports or data analyses regarding purchaser disposition of loans sold through DASP.

    c. Any and all reports or data analyses addressing post-sale compliance with Neighborhood Stabilization Outcome (NSO) pool requirements.

    d. Any and all reports or data analyses addressing pre-DASP sale loss mitigation performance by servicers that have transferred loans into DASP pools.

2) Any and all documents reflecting the scheduling of any and all DASP or SFLS sales from the date of this letter forward, including communications with vendors and mortgagees regarding scheduling.

We request HUD's response in electronic format if possible. This request does not seek any personal identifying information of individual borrowers.

Fee Waiver Request

I request a fee waiver under FOIA, 5 U.S.C. § 552(a)(4)(A)(iii). I am an attorney at the National Consumer Law Center, and since 1969, the nonprofit National Consumer Law Center® (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 U.S.

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 exploitative practices, help financially stressed families build and retain wealth, and advance economic fairness.

NCLC has a significant record of seeking public records and then issuing reports and analysis based on those records to further the public's understanding of lending programs. NCLC has written extensively on the FHA insured mortgage program. Specifically with respect to the SFLS and DASP Programs, NCLC has engaged in extensive policy analysis, which includes a May 2016 comprehensive report regarding DASP and whether it has been effective.

It will not be used for NCLC's commercial interests.

If Fees Are Not Waived

If fees are not waived, I would like to know the cost of providing the requested material before it is produced. At this time, NCLC agrees to pay $25.00 for the applicable and reasonable costs permitted by statute.

If you have any questions about processing this request, you may contact me during business hours at (513) 331-1074 or reach me via email at ssharpe@nclc.org.

Sincerely,

/s/ Steven R. Sharpe

Steven R. Sharpe
Tel: (513) 331-1074
Email: ssharpe@nclc.org