

March 27, 2024

Julia R. Gordon  
Assistant Secretary for Housing - FHA Commissioner  
U.S. Department of Housing and Urban Development  
Office of Housing  
451 Seventh Street, SW  
Washington, DC 20410

RE: Permanent Loss Mitigation Waterfall

Dear Commissioner Gordon:

The National Consumer Law Center, on behalf of its low-income clients, and the Center for Responsible Lending write with recommendations on how FHA should shape its post-COVID loss mitigation waterfall. As the market turns from a response to COVID-19 to identifying permanent policies informed by lessons learned from the pandemic, FHA has an opportunity to strengthen the options it makes available to homeowners facing hardship. FHA has shown leadership in developing innovative foreclosure alternatives that provide relief in any market condition. We believe FHA should build its long-term loss mitigation waterfall from the innovative options it has already created.

FHA should integrate its current loss mitigation options into a comprehensive, consolidated system. In addition to the highlights we have included below, we have also attached a detailed proposal for the waterfall, and we would appreciate the opportunity to discuss this with you. In developing this plan, we have focused primarily on the mechanics of providing relief to borrowers and not on other important issues, such as borrower outreach, appeals, and notices.

**1. Streamlined options should play a primary role in FHA's loss mitigation waterfall.**

FHA should continue to make streamlined loss mitigation reviews the primary means for assessing eligibility under its loss mitigation waterfall. There are significant benefits to borrowers and to the Mortgage Mutual Insurance Fund (MMIF) from minimizing the submission of financial documents.

The burden of collecting income documentation has not been well managed by servicers. Because of the economics of mortgage servicing, servicers do not generally maintain staffing levels that enable them to handle full-documentation loss mitigation applications effectively. Borrowers sometimes give up and fail to complete the process, especially if they are being asked to submit the same documents over and over again. Some borrowers may see their foreclosure proceed to conclusion as they try to complete their application to the servicer's standards. Finally, the collection of financial documents is not necessary to provide borrowers with effective relief. Research has shown that targeting a reduction in monthly payment, which

does not require a comprehensive evaluation of the borrower's financial situation, is more effective at reducing redefaults than meeting an income-based affordability target.

Moreover, there is little evidence of homeowners who obtained streamlined loss mitigation relief of borrowers taking advantage of the process to gain a lower payment without a true financial hardship. Because missed mortgage payments result in considerable negative consequences for the borrower's credit score, any incentive a borrower might have to purposely miss payments just to receive a payment reduction would be small, thereby eliminating the need for collecting hardship documentation from borrowers.

We urge FHA to retain its current streamlined evaluation process as the primary mode of evaluating borrowers for relief. **Servicers should review borrowers who have fallen behind on their mortgage for an Advanced Loan Modification, a Standalone Partial Claim, a targeted payment reduction modification modeled on the COVID-19 Recovery Modification, and the Payment Supplement before collecting any financial documentation.** The streamlined COVID programs have been very successful in minimizing unnecessary foreclosures for FHA, and FHA should retain them.

We recognize that FHA may still want a test for determining if borrowers can afford the loss mitigation option offered. If so, for streamlined loss mitigation options, we suggest that FHA rely on trial plans for assessing affordability instead of requiring the collection of borrower financial information. The test for determining affordability with a trial plan is simple - if the borrower makes the trial plan payments, it is reasonable to conclude that it is affordable. A test based on the borrower's circumstances is more complicated as it involves assessing and interpreting non-uniform financial information against a uniform affordability target. Moreover, the logistics involved with trial plans are simpler. The trial plans only require the delivery and acceptance of a plan instead of the gathering and submission of the numerous financial documents needed to provide a clear picture of a borrower's situation.

**In order to help borrowers who need deeper payment relief than the streamlined options provide, FHA should retain FHA-HAMP, with amendments as suggested in the attached memo, because it may provide deeper payment reductions depending on the borrower's financial situation.** Once borrowers have been given the opportunity to obtain low-barrier, streamlined relief and still decide more help is necessary, collecting documentation is reasonable since it is optional and needed to ensure that additional relief is both warranted and sufficient to avoid redefault.

## **2. FHA should remove barriers to accessing forbearance consistent with the Government Sponsored Enterprises (GSEs)**

FHA should apply the lessons learned from the response to the pandemic and eliminate unnecessary barriers to accessing forbearance. During the pandemic, federally-backed borrowers facing financial hardship, including FHA-insured borrowers, had access to twelve

months of forbearance without having to submit financial documentation. Servicers approved forbearance plans based on a phone conversation with a borrower who asked for help.

This was a great success. In fact, increased access to streamlined forbearance during the pandemic has largely been credited with avoiding somewhere between hundreds of thousands and millions of foreclosures.<sup>1</sup>

**With the success of streamlined forbearance, FHA should revise its forbearance policies in Handbook 4000.1 to remove the requirement that borrowers submit financial documents if they seek up to twelve months of forbearance. In addition, FHA should broaden the scope of hardships that justify forbearance.** Under FHA Handbook 4000.1, borrowers seeking Special Forbearance, which is the current program for providing twelve months of relief, must establish that they are unemployed. This is an overly restrictive requirement for forbearance as borrowers may face other hardships that prevent them from meeting their payment obligations.

These changes would bring FHA forbearance policy into alignment with the Government Sponsored Enterprises (GSEs). Both Fannie Mae and Freddie Mac allow borrowers to access forbearance for up to twelve months without a financial package and allow for a broad scope of financial hardships to qualify for forbearance. There is no regulatory barrier to these changes. The regulation governing Special Forbearance, 24 C.F.R. § 203.471, does not require submission of financial documentation and instead gives FHA broad discretion to determine eligibility requirements.

### **3. FHA should permit borrowers to receive one modification every 12 months.**

The FHA-insured loan program was created to provide housing stability to low- to moderate-income borrowers, and those borrowers may face multiple or continuing financial hardships during the terms of their mortgages. FHA's rules should account for the unpredictable and challenging nature of financial hardships. If FHA believes some limit on modifications is necessary, requiring twelve months to elapse between loan modifications would be reasonable.

The reason usually cited to limit repeat loan modifications is to prevent the improper use of loss mitigation as a way to unreasonably delay foreclosure. **Permitting one modification every 12 months would enable borrowers to obtain loss mitigation when appropriate after defaulting on a previously modified or reinstated FHA-insured loan, but would be too long a schedule to be usable as a way to stall a foreclosure.**

In determining where to set the limit, it is important to note that the structure of loss mitigation naturally limits how much payment relief a borrower can receive in a subsequent modification. The use of partial claim, whether in a modification or as a means for reinstatement, is capped by statute at 30% of the borrower's unpaid principal balance at the time of the first partial claim.

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<sup>1</sup> Sources: [How Many Mortgage Foreclosures Is Forbearance Preventing? | St. Louis Fed \(stlouisfed.org\)](#) and [U.S. Foreclosure Activity Drops To An All-Time Low In 2021 | ATTOM \(attomdata.com\)](#).

Moreover, the extension of the borrower's repayment term often has a large impact on payment relief in an initial modification, but then becomes much less effective in providing relief when there is a short period between modifications. Therefore, borrowers have limited ability to gain further payment relief through multiple modifications.

FHA must clarify, however, that Standalone Partial Claims and Payment Supplement partial claims should not factor into the twelve-month modification window. Partial claims already have a lifetime statutory cap, which significantly limits any improper use of the standalone partial claims. Moreover, it is crucially important to allow borrowers to access a modification after a standalone partial claim to help borrowers who thought they could resume their pre-hardship payments, but who in fact need a payment reduction. Moreover, partial claims may be needed shortly after modifications to address the short-term hardships that can follow the resolution of a longer-term hardship that modifications address.

Finally, servicers should be directed to disregard the twelve-month limitation if the prior loan modification did not comply with the FHA waterfall. Borrowers who were given the incorrect loan modification (e.g., one that did not reach the target 25% payment reduction even though it was possible to achieve that reduction) through servicer error should be able to get the correct modification without delay.

#### **4. FHA should improve borrower protections in partial claim collections.**

We applaud FHA's use of its partial claim authority in developing innovative loss mitigation options like the Payment Supplement. With the increased reliance on partial claims in FHA's loss mitigation system, **we urge FHA to reconsider its system for collecting on partial claims once they become due and payable.** We have recently heard case examples from legal aid attorneys representing clients who have paid off their FHA-insured loans and who nevertheless face aggressive collection. In those cases, collection moved quickly from FHA to the Department of Treasury, and once at Treasury, the homeowners were informed that tens of thousands of dollars in collection fees and costs would be added to their accounts.

We welcome a dialogue with FHA on how to help homeowners avoid financial hardship while also protecting the health of the MMIF. **FHA should work with mortgage servicers to develop a method for including any partial claim amounts on the borrower's monthly mortgage statement to help borrowers better understand what is owed.** Additionally, the attached memorandum includes a detailed proposal for a Partial Claim Repayment Plan (PCRP) that would help the borrowers who have due and payable partial claims at the maturity of their first mortgage. **For borrowers who cannot resolve their partial claim through a PCRP, FHA must develop additional criteria for determining whether to pause any collection if the borrower retains the home and for determining whether a hardship exemption is appropriate.**

We would appreciate the opportunity to meet with you about these recommendations. If you are able to meet with us, please contact Steve Sharpe, Senior Attorney at National Consumer Law Center, at [ssharpe@nclc.org](mailto:ssharpe@nclc.org) or Kanav Bhagat, consultant to the Center for Responsible Lending, at [kbhagat@housingrpa.com](mailto:kbhagat@housingrpa.com).

Sincerely,

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