WRITTEN STATEMENT OF VANCE T. MORRIS

Director for Single Family Asset Management
U.S. Department of Housing and Urban Development

Hearing before the Subcommittee on Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives

"Loan Modifications: Are Mortgage Servicers Assisting Borrowers with Unaffordable Mortgages"

February 24, 2009

Madam Chair, Ranking Member Capito and members of the committee, on behalf of the Department of Housing and Urban Development I'd like to thank you for the opportunity to speak about FHA's loss mitigation practices and, in particular, loan modifications. I am Vance Morris, the Director for FHA's Office of Single Family Asset Management, and I am responsible for managing the Government's interest in FHA-insured mortgages including servicing and loss mitigation, as well as Real Estate Owned (REO) activities. My Office's responsibilities include establishing and updating general servicing guidelines for FHA lenders, helping homeowners retain homeownership while overcoming the financial difficulties that lead to the mortgage defaults, monitoring lenders for compliance with servicing and loss mitigation requirements, and managing and selling properties acquired by FHA. These activities are instrumental to maintaining the strength of FHA's insurance funds and its $534 billion portfolio.

I have been with the U.S. Department of Housing and Urban Development (HUD) for 12 years, and prior to serving in my present capacity, I served as the Director of Single Family Program Development where I developed credit and valuation policy. I also worked in the lender approval and quality assurance areas. Therefore, I am keenly aware of the need to ensure that FHA loans remain safe and affordable options for homeowners.

In 1996, HUD completed a study titled "Providing Alternatives to Mortgage Foreclosure: A Report to Congress", which formed the basis of HUD's Single Family Loss Mitigation Program. During the same year, the Department implemented its Loss Mitigation Program with the primary objectives of (1) maximizing the opportunity for borrowers to retain home ownership and cure delinquencies on their mortgages; (2) mitigating losses that would result from foreclosure by using alternatives to foreclosure; (3) providing lenders with performance-based incentives, and (4) minimizing paperwork and empowering lenders to work directly with homeowners to determine the most appropriate loss mitigation tool. It is important that lenders actively engage in loss mitigation solutions with borrowers, before four full monthly installments are due and unpaid as required by regulation. Lenders must evaluate each defaulted loan, consider all loss mitigation options, and determine for which of these (if any) the borrower may be eligible. In addition to loan modifications, FHA has the following home retention loss mitigation tools:

Special Forbearance is a payment plan that allows the mortgage company to accept less than the total delinquency due, which provides for an extension of time to bring the mortgage current beyond when foreclosure would otherwise be initiated. Instances where mortgagees might opt for this loss mitigation tool are (1) the borrower has recently experienced involuntary but temporary reduction in income, and (2) the borrower now has a reasonable ability to pay the arrearage under the terms of a repayment plan. To initiate a special forbearance payment plan, the mortgagee must execute the plan no earlier than 3 missed payments and no later than 12 missed payments. Special forbearances can be used in conjunction with Loan Modifications and Partial Claims. In Fiscal Year 2009, HUD projects a seventeen percent increase in Special Forbearance actions over FY 2008, where there were 22,144 such actions.

For Partial Claims, FHA will advance funds to the lender on behalf of the borrower to cure a default if the loan is at least four months due and unpaid and not more than twelve months due and unpaid. The amount of the partial claim must cure the delinquency and may also include legal fees from canceled foreclosures. In a partial claim, FHA effectively creates a subordinate mortgage from the borrower that is due when the borrower sells the property or at the time that the first mortgage is paid in full. Partial Claims may not be utilized when there are more than 12 months of full mortgage payments that are due and unpaid. In Fiscal Year 2009, HUD projects a 48 percent increase in Partial Claims actions over FY 2008, where there were 16,416 Partial Claims actions.

The most utilized loss mitigation tool is loan modification. Loan modifications account for nearly 60 percent of FHA's loss mitigation actions, annually. Loan modifications are intended to eliminate the past due amounts on the loan for the borrower who has recovered from financial distress. Lenders may re-amortize the loan up to 30 years, change the interest rate (up or down) within established ranges, and add the delinquency into the loan modification to bring the loan current. It is our understanding that the interest rate increase is to bring the loan up to a market rate in order to securitize the loan. Generally, the lender changes the term of the loan and maintains the same interest rate. It is also our understanding that lowering the interest rate affects the lender's profitability and is rare. Over the past 12 years, through January 31, 2009, FHA insured lenders have completed over 324,000 loan modifications. The number of loan modifications varies each year. In Fiscal Year 2008, over 57,900 loan modifications were completed or over 4,800 per month. HUD estimates that in FY 2009 loan modifications will increase by nearly 12 percent over FY2008 to nearly 65,000 loan modifications.

HUD measures the effectiveness of a loss mitigation action by determining if the loan ended in foreclosure 24 months following that action. By that measure, loan modifications are an effective tool because, historically, over 85 percent of the loans modified were not foreclosed in the 24 months following the action. This is not to say that the loans do not re-default. The modified loans have a re-default rate of 35%.

FHA delinquent borrowers are contacted in a variety of ways. Borrowers are sent a "How to Avoid Foreclosure" pamphlet that explains FHA's loss mitigation options and encourages borrowers to contact their lender. In addition, FHA supports housing counseling agencies that provide delinquency and loss mitigation counseling in their communities. FHA's National Servicing Center provides training to servicers in the Loss Mitigation Program and operates a help desk for FHA borrowers who need help making contact with their lenders. HUD also has on its website information for consumers on its Loss Mitigation Program.

Lenders are required to evaluate each defaulted FHA loan to determine which, if any, loss mitigation tools will help the borrower avoid foreclosure. Violation of this requirement can result in a penalty 3 times the amount FHA paid in a foreclosure claim to reimburse the lender.

The process to modify a loan is as follows:

> Under HUD's Loss Mitigation Program, the lender is required to review the borrower for loss mitigation qualification prior to the fourth full monthly installment due on the mortgage becoming unpaid (assuming the borrower cooperates). This process begins with the borrower providing financial information for the lender to perform a financial analysis of the borrower's financial condition and independently verify the information. If the lender determines from the financial analysis and title evaluation the borrower will qualify/benefit from a loan modification it then sets the terms of the proposed modification which may include a reduction in interest rate, capitalization of delinquent payments and if applicable legal fees from a canceled foreclosure, re-amortization or recast to extend the term back out to 360 months. The lender would draft the documents and send them to the borrower with new payment and term information, for execution and return, the modification is filed on record and the loan is brought current.

Costs to the servicers that FHA will reimburse for modifying the loans are title work and document preparation, HUD provides an incentive payment to lenders of $750 plus up to $250 for title work. If the lender has to foreclose the cost ranges from $2,500 up to $5,000 depending on the state the property is in. HUD reimburses the lenders up to 75 percent of the foreclosure costs. We understand that servicers could also lose or gain money when re-pooling these mortgages with interest rate changes, but FHA does not have analyses on these costs.

If a borrower does not qualify for any FHA loss mitigation home-retention tools (special forbearance, loan modifications or partial claims), the borrower would be evaluated for the non-home retention loss mitigation options of pre-foreclosure sale and deed in lieu of foreclosure.

Under a pre-foreclosure sale (PFS), which is a short sale, a borrower, under certain conditions, may sell their house for less than the outstanding debt. The lender preauthorizes the terms of the sale and the minimum sales price in accordance with FHA guidelines. For Fiscal Year 2009, HUD projects approximately 5,000 pre-foreclosure sales, an amount which represents no significant change from each of the prior three years.

Deed-in-Lieu of Foreclosure is a type of conveyance that occurs when the borrowers voluntarily transfer the property to the mortgagee. This loss mitigation tool should only be considered when the borrower is in default and does not qualify for any other loss mitigation options or upon failure of a pre-foreclosure sale. For Fiscal Year 2009, HUD projects less than 1,000 deeds-in-lieu, an amount which represents no significant change from each of the prior three years.

The charts below summarize FHA's loss mitigation actions and re-default and claim rates associated with the loss mitigation actions.

Loss Mitigation Data FY2006 – FY2009 as of January 31, 2009			
	Total Retention Tools	**Total Non Home Retention Tools**	**Total Loss Mitigation**
FYTD 09	38,704	2,027	40,731
FY 08	96,482	4,685	101,167
FY 07	86,527	4,480	91,007
FY 06	75,528	5,244	80,772

Source: US Dept of HUD Claims Branch reports.

FHA Single-Family Insurance FY2004 – FY2006 Re-Default and Claim Rates After Loss Mitigation Loan Workouts			
Year of Initial 90-day Defaults Subsequently Cured with FHA Loss Mitigation Tools	Re-Default Rate Within One Year	Claims Within One Year of Cure	Claims Within Two Years of Cure
2004	32.8%	9.3%	14.1%
2005	31.4%	7.8%	12.6%
2006	32.4%	6.2%	9.6%

Source: US Dept of HUD; Defaults are defined as 90-day delinquencies; Re-defaults are new 90-day delinquencies reported within 12 months after curing the initial default; Cures involve use of FHA loss mitigation tools by loan servicers; Insurance claims arise primarily from foreclosure actions. Data as of September 30, 2008

HUD is requesting new authority to enhance its partial claim program to enable FHA to buydown mortgage balances. The Administration is developing changes to the authority that will allow FHA to assist homeowners experiencing reductions in income that are more than just temporary in nature while considering the impact to program costs.

Again, I want to thank you for the opportunity to explain FHA's loan modification and other loss mitigation options. I am prepared to answer your questions.