MORTGAGE BANKERS ASSOCIATION

June 14, 2017

Via Electronic Submission

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

RE: Docket No. FR-6030-N-01, Reducing Regulatory Burden; Enforcing the Regulatory Reform Agenda Under Executive Order 13777

Dear Mr. Pereira:

The Mortgage Bankers Association[1] ("MBA") is writing in response to the U.S. Department of Housing and Urban Development's ("HUD" or "Department") request for comments to assist the Department in identifying existing regulations that may be outdated, ineffective, or excessively burdensome in connection with HUD's work in accordance with Executive Orders 13771, "Reducing Regulation and Controlling Regulatory Costs," and 13777, "Enforcing the Regulatory Reform Agenda" (the "Request"). We appreciate the opportunity to comment on this important topic for our members.

Below we provide a detailed discussion of the costs and burdens associated with complying with certain regulations governing the Federal Housing Administration ("FHA") single-family and multifamily loan programs, including the origination and servicing of such loans. We provide detailed suggestions regarding amendments to origination and servicing requirements to modernize and standardize HUD regulations to better align the Department's loan programs with other similar mortgage loan programs. Finally, we recommend revision of the Discriminatory Effects Rule to conform to the recent United States Supreme Court decision in this area.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

In addition to the important work of identifying and assessing the compliance costs and regulatory burden associated with specific regulations governing HUD programs, mortgage industry participants and borrowers are greatly impacted by the Department's implementation of guidelines and policies regarding the FHA and other mortgage programs, even if those guidelines are not directly tied to regulatory requirements. Such policy determinations have, in many instances, increased the compliance costs and operational risks associated with participating in HUD loan programs and, in certain instances, have caused mortgage participants to severely limit or decrease their participation in HUD loan programs. While many of these policies and implementing guidelines may be outside the scope of the Department's Request, we have provided a summary of these matters in Section II.C., below, to bring these important issues to the Department's attention as it embarks on this important and necessary review.

To accomplish many of the tasks necessary to modernize and streamline HUD programs, as well as manage HUD programs efficiently and effectively, FHA and Ginnie Mae need to be funded at their requested levels through the regular appropriations process. Current staffing levels need to be increased and technology systems require significant upgrades to operate effective risk management processes and maintain up-to-date program guidance to accommodate current loan volume. Funding is also necessary for FHA, in particular, to engage and retain high-quality contractors with the capability of working efficiently with the industry.

I. Executive Summary

As noted above, this letter sets forth recommendations for regulatory amendments in three areas of HUD programs. With regard to the single-family FHA insurance program, we address regulatory burdens impacting both the origination and servicing of FHA-insured mortgage loans. We also make recommendations regarding the Department's multifamily loan program, as well as the Discriminatory Effects rule.

First, as explained in detail below, the risks associated with originating FHA-insured loans have increased exponentially over the last few years with the Department of Justice's reliance on loan-level and annual certifications to pursue lenders for treble damages under the False Claims Act based upon loan-level defects in FHA loans. These certifications hold lenders to the unreasonable standard of perfection and result in a threat of liability that has caused many lenders to retreat from the FHA program. For these reasons, we recommend that HUD amend the regulation governing the loan-level origination certification and the certification language itself. We further recommend that HUD remove or amend the annual certification requirement and the certification language. We also recommend amendments to existing FHA origination guidelines and other policies regarding the Loan Review System and Defect Taxonomy, Property Assessed Clean Energy ("PACE") loans, the model mortgage document, and Ginnie Mae requirements.

Second, as discussed in detail below, servicing FHA-insured loans requires adherence to a unique and often outdated set of regulatory requirements that in many ways has not kept pace with the significant changes to mortgage loan servicing that have occurred in the past several years. Moreover, while mortgage loan servicers have had to adjust their systems and processes to ensure adherence to significant changes in the regulation of loan servicing by other federal and state agencies, including the Consumer Financial Protection Bureau ("CFPB"), HUD regulations governing servicing have remained largely stagnant. The resulting environment for servicers is one of increased costs for mortgagees to service FHA-insured loans differently than other loan portfolios, which results in a decreasing number of businesses willing to engage in servicing of FHA-insured loans. To address these concerns, below we provide the following recommendations to amend HUD servicing regulations:

- <u>Amend the FHA foreclosure timelines and debenture interest curtailment structure</u>, by either (i) amending the regulations to eliminate the separate foreclosure timelines and replace with one, overall foreclosure timeframe or (ii) amending the regulations to impose pro-rata curtailment to each missed foreclosure deadline with corresponding amendments to extend the first-legal and conveyance timelines to reflect the time necessary to comply.

- <u>Adopt a direct conveyance model and continue to increase the use of alternatives to conveyance claims</u>. Below, we set forth the significant benefits to a direct conveyance model for the Department, FHA borrowers, and the mortgage servicing industry. We also make several recommendations for amendments to the Single Family Loan Sale ("SFLS") program and the Claim Without Conveyance of Title ("CWCOT") process to expand the loans eligible for processing through these channels rather than a traditional conveyance claim.

- <u>Standardize the FHA loss mitigation program to benefit borrowers and reduce costs</u> by aligning toward other modification processes, such as the MBA's "One Mod" principles or the recently released GSE "Flex Mod" program, that streamline loss mitigation to focus on limited paperwork requirements and payment reduction.

- <u>Eliminate outdated regulatory requirements</u> that no longer reflect the realities of modern servicing standards, including the face-to-face interview requirement, reasonable rate provisions for lender-placed insurance, requirements regarding physical documentation, and flood insurance.

- <u>Amend the partial claim regulation to impose reasonable consequences for documentation delays</u>, in addition to crafting a process to document receipt of partial claim documentation in the future.

These recommendations would benefit the Department, FHA borrowers, and the mortgage servicing industry by modernizing and streamlining FHA servicing requirements to reflect current industry standards and reduce the costs associated with servicing delinquent FHA-insured loans.

Third, with regard the multifamily loan program, the FHA – Ginnie Mae Multifamily and Residential Healthcare programs financed through private sector lenders have been some of the longest running, and most successful public-private partnership programs. To preserve and enhance the continued success of these partnerships, MBA has identified several regulations and policies that HUD and other executive agencies should review, and eliminate or modify under the Executive Orders, to reduce the drag of regulatory burden on the prospects for continued successful performance of these public-private partnerships. These include: (i) improving the administration of the Davis-Bacon Act prevailing wage rate requirements; (ii) delaying the required use of the FHA multifamily capital needs assessment "e-Tool," unless it is proven to be more efficient than the current process; and (iii) addressing environmental barriers to the development of FHA-insured multifamily and residential healthcare projects.

Finally, we recommend revision of the Discriminatory Effects Rule to conform to the recent United States Supreme Court decision in this area.

II. FHA Single-Family Regulations

First, MBA applauds the Department on its hard work in consolidating hundreds of Mortgagee Letters and Handbooks into a comprehensive Handbook governing single-family mortgage loan origination and servicing. We look forward to continuing to partner with HUD to further refine and enhance that Handbook to ensure it reflects all guidance relevant to participation in the FHA single-family loan program and encourage continued engagement to provide clarification as necessary. While this comprehensive effort tackled HUD guidelines, much work still needs to be done to modernize and standardize the regulatory provisions governing the FHA single-family loan program. As discussed in detail below, MBA recommends that the Regulatory Task Force HUD is establishing to address the Executive Orders identified in the Request undertake a fulsome review of the regulations governing FHA origination and servicing to ensure that outdated provisions are eliminated and, as a whole, the regulations reflect modern processes and technologies. To this end, below we provide recommendations to amend HUD regulations and policies regarding single-family mortgage and mortgagee certifications, as well as several FHA servicing regulations governing, among other things, foreclosure timelines, debenture interest curtailment, property conveyance, and loss mitigation.

In addition to the specific regulatory provisions referenced below, mortgagees would greatly benefit from the opportunity to review and comment on any proposed changes to Departmental policy regarding mortgage loan origination and servicing, even if HUD announces such changes through Mortgagee Letter rather than regulatory amendment. Implementing such amendments takes considerable resources, as they necessitate updates to electronic systems, development of new procedures, employee training, and redeployment of personnel. Providing the mortgage industry with an opportunity to review and comment on proposed changes would alert the Department to the specific challenges an amendment to guidelines would create and would reduce the burden of complying with the changes by giving the industry notice of HUD's intentions. Once the Department announces final amendments to policy, through regulation or Mortgagee Letter, the MBA also requests that HUD provide lenders and servicers with sufficient time to implement the changes. The opportunity to comment on proposed changes and increased implementation time for final amendments are not prohibited by the current regulatory framework and would greatly reduce the burden of compliance with FHA single-family regulations and implementing guidelines.

A. Single-Family Mortgage and Mortgagee Certifications

The risks associated with originating FHA-insured loans have increased exponentially over the last few years with the Department of Justice's reliance on loan-level and annual certifications to pursue lenders for treble damages under the False Claims Act ("FCA") based upon loan-level defects in FHA loans. These certifications, however, hold lenders to the unreasonable standard of perfection and result in a threat of liability that has caused many lenders to retreat from the FHA program. In fact, of the top ten FHA lenders as recently as five years ago, only one remains the same. The leaders of many of these lenders have gone on record that they have backed away from the FHA specifically because of the potential for unbounded liability under the FCA. Loan origination is a human process, and even in cases of automated underwriting, data integrity depends on the often subjective determinations of experienced personnel in processing and underwriting the loan. Technical errors and mere human mistakes are inevitable and should not be a basis to demand treble damages on loans that become claims. There is a simple and direct way to fix this issue – revise or eliminate the provisions of the loan-level certifications that require an unreasonable standard of perfection. For lenders to return to the FHA program, revisions are needed to the loan-level and annual certifications to reflect the subjective realities of FHA lending and to assure lenders that they will be held accountable only for their knowing and material errors that directly impact the insurability of loans.

1. Amend the Regulation Governing the Loan-Level Origination Certification and the Certification Itself.

The National Housing Act does not require a mortgagee to make any specific certifications to the Department regarding the loan's eligibility for FHA insurance. The HUD regulations regarding insurance of FHA mortgages, however, require that two specific certifications be made upon submission of the loan for FHA insurance endorsement -- one by a representative of the lender and one by the underwriter for manually underwritten loans. Notably, Section 203.255(b) states, in applicable part:

> . . . [T]he mortgagee shall submit to the Secretary, within 60 days after the date of closing of the loan or such additional time as permitted by the Secretary, properly completed documentation and certifications as listed in this paragraph (b):

> (5) An underwriter certification, on a form prescribed by the Secretary, stating that the underwriter has personally reviewed the appraisal report and credit application (including the analysis performed on the worksheets) and that the proposed mortgage complies with HUD underwriting requirements,....
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> (11) A mortgage certification on a form prescribed by the Secretary, stating that the authorized representative of the mortgagee who is making the certification has personally reviewed the mortgage documents and the application for insurance endorsement, and certifying that the mortgage complies with the requirements of paragraph (b) of this section. . . .[2]

Relying on this authority from the regulation, HUD requires the following underwriter certifications on HUD Form 92900-A, which the Department amended in 2016 (emphasis added):

> . . .The undersigned representative of the mortgagee also certifies that all information entered into TOTAL Mortgage Scorecard is complete and accurately represents information obtained by the mortgagee, that the information was obtained by the mortgagee, pursuant to FHA requirements, and that there was no defect in connection with the approval of this mortgage such that the result reached in TOTAL should not have been relied upon and the mortgage should not have been approved in accordance with FHA requirements.
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> . . . [T]he undersigned Direct Endorsement Underwriter certifies that I have personally reviewed and underwritten the appraisal report (if applicable), credit application, and all associated documents used in underwriting this mortgage. I further certify that: . . . I have performed all Specific Underwriter Responsibilities for Underwriters and my underwriting of the borrower's Credit and Debt, Income, Qualifying Ratios and Compensating Factors, if any, and the borrower's DTI with Compensating Factors, if any, are within the parameters established by FHA and the borrower has assets to satisfy any required down payment and closing costs of this mortgage . . . . There was no defect in connection with my approval of this mortgage such that my Final Underwriting Decision should have changed and the mortgage should not have been approved in accordance with FHA requirements.

Quite simply, these certifications require underwriters to certify that underwriting decisions comply with ALL of the FHA guidelines – an absolute standard. The regulations and the certifications, however, do not recognize that underwriting entails subjective judgments as to which reasonable people could disagree. It is also impossible for the origination of a loan that is dependent on the human process to be perfectly compliant in every case, despite lenders striving for error-free originations as a business practice. The effect of this standard of perfection cannot

[2] 24 C.F.R. § 203.255(b) (emphasis added).

be overstated – it is the lynchpin of every FCA prosecution by the Department of Justice and the direct cause of lender retreat from the FHA program.

The good news is that this situation can be remedied with simple changes to the certifications that will not limit HUD's ability to protect the FHA Insurance Fund or the Department of Justice's ability to pursue true fraudulent schemes under the FCA. The MBA is developing specific proposed revisions to the loan level certification (Form 92900-A), which revisions will incorporate three basic tenets. First, the changes will limit the lender's certification to items that are material to the eligibility of the loan for FHA insurance and things it can control. This can be accomplished by inserting concepts of materiality where relevant and having the lender certify to information it gathered, rather than to perfection under the rules. Second, the changes would eliminate unacceptably broad language that the government could argue is a promise the loan complies with all rules regardless of materiality or the knowledge of the lender. Third, the changes would make additional revisions to ensure that the certifications work for industry participants and reflect how loans are underwritten and closed pursuant to present mortgage origination standards. MBA is eager to discuss these proposed changes to the certifications in Form 92900-A with the Department as it takes action in response to the Executive Order.

Making these common sense revisions will stem the tide of recent enforcement actions and investigations involving FHA-insured loans that have converted the certifications to a "gotcha" game. As a result of this environment, industry confidence in the integrity of the FHA Program has waned, and lenders are wary of making any FHA-insured loans that have any risk of default. In turn, this has negatively impacted access to credit through this important channel.

Certifications also have nothing to do with the absolute obligation of the lender and the underwriter to adhere to FHA requirements. Approved mortgagees are required to comply with FHA requirements irrespective of their provision of certifications, and the FHA has the full array of administrative remedies that it may utilize to address alleged violations of such requirements, even if no certification existed. Certifications should not serve as a guaranty or warranty of perfect compliance with FHA loan-level requirements or as an independent basis for administrative sanctions absent intentional and material fraud.

Accordingly, Section 203.255(b) should be amended to better balance the Department's desire to hold lenders accountable for the origination of insurable mortgage loans with the lenders' concern that draconian penalties could result from a literal application and interpretation of the loan-level certification regulation. These loan-level certifications should be expressly qualified in the regulation by the individual's knowledge and reflect that underwriting entails subjective judgments such that liability should only arise if the failure to comply with FHA requirements materially and adversely impacted the eligibility of the mortgage for FHA insurance. Unintentional mistakes or instances of non-compliance that do not affect the loan's insurability should not result in a risk of substantial legal penalties based on a regulatory-required certification when such mistakes would not otherwise carry the risk of HUD's imposition of administrative penalties for the underlying violation of FHA requirements.

2. Remove or Amend the Annual Certification Requirement.

In addition to the certifications required in connection with the origination of every FHA-insured loan, to maintain approval to originate and service FHA-insured loans, mortgagees annually certify as to their adherence to FHA requirements at the time of certification and at all times during the certification period. To receive initial FHA approval as a mortgagee, an entity must agree to comply with general approval requirements, which include eligibility criteria. Mortgagees must also complete a recertification process each year to maintain FHA approval. The regulations contain both general approval requirements and specific eligibility requirements dependent on an entity's organizational structure, which all FHA approved entities must meet, and continue to meet, to maintain FHA approval.[3] However, nothing in the National Housing Act requires a mortgagee to make any specific certifications to the Department regarding the mortgagee's eligibility to participate in the FHA program. Similarly, the regulations do not require that applicants and approved mortgagees certify to their compliance with all eligibility criteria.

HUD regulations require that the application for approval and each recertification must be made "on a form prescribed by the Secretary."[4] While the mortgagee must consent to comply with the general approval requirements set forth in Section 202 of the regulations as part of the application process, the regulations set forth only one specific requirement regarding the contents of the application and annual recertification forms. Specifically, Section 202.5(m) requires that, upon approval and with each annual certification, the mortgagee "must submit a certification that it has not been refused a license and has not been sanctioned by any state or states in which it will originate insured mortgages or Title I loans." We are not aware of any additional regulatory provision regarding initial approval or annual recertification that requires the approval or recertification form to include additional specific language or certifications.

The "Doing Business with FHA" section of HUD Handbook 4000.1, which became effective on September 14, 2015, contains additional guidance from HUD regarding the initial application and annual recertification processes for obtaining and maintaining FHA approval. Focusing on the recertification process for mortgagees to maintain FHA approval, a mortgagee must, unless otherwise noted, complete FHA's recertification process on an annual basis by submitting a recertification package within 90 days after the mortgagee's fiscal year end. The mortgagee, through a corporate officer, must complete a series of annual certification statements that address the mortgagee's compliance with FHA requirements over the certification period. If

[3] See 24 C.F.R. §§ 202.5 through 202.10.

[4] See 24 C.F.R. §§ 202.3(a), 202.5(m).

a mortgagee is unable to certify truthfully to one or more of the statements set forth in the online certification, the mortgagee must not make the particular certification. Instead, the mortgagee must submit an explanation for each certification that it is unable to complete. The mortgagee may submit supporting documentation with its explanation. FHA will review the mortgagee's explanation and communicate to the mortgagee any additional information or documentation needed to render a final decision regarding the mortgagee's ability to complete the annual recertification process.

The certification statements are based in large part on the ineligibility criteria found in the National Housing Act and its implementing regulations, but the statements also require the mortgagee to make broad certifications of compliance with FHA requirements. For instance, the seventh certification statement required in the annual recertification states:

> I certify that, to the best of my knowledge and after conducting a reasonable investigation, the Mortgagee does now, and did at all times throughout the Certification Period, comply with all HUD regulations and requirements necessary to maintain the Mortgagee's FHA approval as codified in 24 CFR § 202.5, HUD Handbook 4000.1 Sections I and V, as amended by Mortgagee Letter, and any agreements entered into between the Mortgagee and HUD, except for those instances of non-compliance, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.

While HUD has taken steps to amend the certifications over the years to address mortgagee concerns and narrow overbroad certifications of compliance, including "knowledge" and "reasonable investigation" qualifiers, this current certification continues to require a corporate officer of a mortgagee to certify to broad compliance with Section 202.5 of FHA regulations and Sections I and V of HUD Handbook 4000.1. Section 202.5(e) broadly requires a mortgagee to service FHA loans in accordance with subpart C of Part 203 of FHA regulations. Section I.A.6.c of HUD Handbook 4000.1 requires a mortgagee to "ensure that its operations are compliant with all applicable federal, state and local laws." Thus, despite the certification's reference to compliance with regulations and requirements necessary to maintain the mortgagee's FHA approval, mortgagees must certify broad compliance with all FHA servicing regulations, as well as applicable federal, state and local laws.

Given the breadth and detail of FHA's servicing requirements and federal, state, and local laws applicable to the origination and servicing of mortgage loans, no corporate officer can really know that a mortgagee has met all of these standards, even though HUD has qualified this certification with the signer's knowledge after a reasonable investigation. Moreover, as currently drafted, <u>any</u> instance of non-compliance with <u>any</u> FHA servicing requirement or other applicable federal, state, or local law would render this certification inaccurate, regardless of whether such non-compliance was material or resulted from mistake rather than intentional violation of FHA requirements.

In fact, during the annual FHA recertification process, rather than make the above-referenced certification, the current process of many mortgagees is to select "unable to certify" in HUD's recertification system and proceed to disclose instances of material non-compliance with HUD requirements and/or otherwise qualify the certification. Often these qualifiers take the form of referencing the mortgagee's quality control and risk management processes utilized to identify, resolve and, when required, report instances of non-compliance with FHA requirements. To the extent a mortgagee describes its general systems and processes for compliance in an "unable to certify" statement, HUD generally requests additional supporting information regarding instances of non-compliance. If the mortgagee cannot identify any specific instances of non-compliance, HUD will force the mortgagee to check the certification box in order to move through the recertification process, despite the mortgagee's attempt to avoid making a broad certification of compliance.

A mortgagee – large or small – simply cannot know if it is in 100% compliance with all FHA servicing regulations or other applicable federal, state or local laws. Indeed, it is unlikely that any company could certify that it is fully compliant with these FHA requirements, regardless of materiality. As a matter of corporate governance, mortgagees simply cannot sign certifications that it knows or should know may not be true and should not ask its officers and employees to do so either. It is not in HUD's or the lender's best interest to have a certification that no reasonable person can sign. Approved mortgagees are required to comply with these requirements regardless of whether the mortgagee certifies to such, and FHA may use its enforcement powers and administrative remedies to address alleged violations of FHA requirements.

For these reasons, FHA regulations should be amended to remove any requirements for certifications in connection with the annual recertification process. The current required certification regarding license refusals and state sanctions are business changes that HUD obligates a mortgagee to report to FHA within mere days of occurrence, and HUD actively enforces this reporting requirement. If mortgagees already are obligated to report these specific events to HUD, a certification regarding <u>the absence</u> of such events has little utility to the Department and should be removed from the regulations.

Moreover, if the Department retains some form of certification statements as a matter of policy in connection with the annual recertification process, rather than require a mortgagee's corporate officer to certify to perfect compliance with any portion of FHA regulations and requirements, the annual certification instead should be limited to <u>disclosure of known material violations identified after a reasonable investigation</u>. The certification also should include language regarding the <u>existence of policies and procedures that are reasonably designed to ensure material compliance</u>. Such a certification would drive a mortgagee to investigate and identify areas of material non-compliance and ensure that it maintains a robust risk management program such that a corporate officer would be able to sign the certification. Such a certification would provide HUD with a strong tool, along with the available administrative enforcement penalties, to take action against mortgagees that failed to report material non-compliance and/or maintain a robust quality control process in order to protect the FHA Insurance Fund.

B. FHA Servicing Regulations

As discussed in detail below, servicing FHA-insured loans requires adherence to a unique and often outdated set of regulatory requirements that in many ways has not kept pace with the significant changes to mortgage loan servicing that have occurred in the past several years. Moreover, while mortgage loan servicers have had to adjust their systems and processes to ensure adherence to significant changes in the regulation of loan servicing by other federal and state agencies, including the CFPB, HUD regulations governing servicing have remained largely stagnant and unaligned with other regulatory and industry standards. The resulting environment for servicers is one of increased costs for mortgagees to service FHA-insured loans differently than other loan portfolios. Notably, data from MBA's most recent Servicing Operations Study indicates that unreimbursed foreclosure and REO costs for FHA-insured loans are three times higher than conventional loans. This data evidences the unique challenges in servicing FHA-insured loans and the urgent need to modernize HUD servicing requirements to better reflect industry standards, increase certainty with regard to the application of HUD servicing requirements, and avoid the increased costs associated with complying with differing sets of servicing standards across loan portfolios. This environment of increased costs and lack of alignment has resulted in a decreasing number of businesses willing to engage in servicing of FHA-insured loans, which over time increases the cost of originating FHA-insured loans and reduces access to credit for otherwise qualified FHA borrowers.

To address these concerns, below we provide recommendations to amend HUD servicing regulations governing foreclosure timelines, debenture interest curtailment, property conveyance alternatives, and loss mitigation. Our recommendations would benefit the Department, FHA borrowers, and the mortgage servicing industry by modernizing and streamlining FHA servicing requirements to reflect current industry standards and reduce the costs associated with servicing delinquent FHA-insured loans.

1. Amend the Foreclosure Timelines and Debenture Interest Curtailment Structure.

Since 1998, FHA has required servicers to initiate foreclosure actions within 180 days of default, also known as the "first legal action" deadline.[5] FHA-approved servicers must also manage the process from the first legal action date through the foreclosure sale within "reasonable diligence" timelines established by regulation and set on a per-state basis through the issuance of Mortgagee Letters by HUD.[6] Once the servicer acquires good and marketable

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[5] See 24 C.F.R. § 203.355.

[6] See id. § 203.356(b); Mortgagee Letter 16-03.

title, it must transfer the property to the Department within 30 days of, among other things, filing the deed for recording or acquiring possession of the property that secured the mortgage loan.[7] As an initial matter, these multiple timelines for completing foreclosure actions stifle efficiency and create mandated property holding periods that increase costs. These timelines are unique to the FHA program and contribute to the increasing cost of FHA servicing that is resulting in some servicers choosing to exit the program and decreased liquidity for FHA-insured loans.

Such costs are exacerbated by the current regulatory structure regarding the curtailment of interest when a servicer misses any of the foreclosure timelines. Currently, Section 203.402(k) authorizes FHA-approved mortgagees to include debenture interest in a conveyance claim[8] for FHA insurance; however, if the mortgagee fails to meet one of the foreclosure timelines set forth in an enumerated list of regulatory provisions cited in Section 203.402(k)(1)(i), the mortgagee may only include in its FHA insurance claim interest to the date on which the required foreclosure-related action should have been taken, or to which it was extended.[9] These timelines include, among other deadlines, the following foreclosure deadlines: (i) the "first legal deadline" to commence foreclosure set forth in Section 203.355; (ii) the "reasonable diligence" deadline to prosecute the foreclosure set forth in Section 203.356(b); and (iii) the "conveyance deadline" set forth in Section 203.359. The restriction in Section 203.402 on the ability to collect debenture interest once a foreclosure deadline has been missed, often referred to as "self-curtailment," requires servicers to forgo all debenture interest that it would otherwise be able to collect if it misses any of these deadlines to the earliest missed deadline.

Such penalties for missing foreclosure-related deadlines are both excessive and inequitable. Under the current regulations, for example, a servicer who missed the first legal deadline by five days but makes up the difference once the foreclosure has begun will nevertheless face effective penalties in the amount of thousands of dollars of interest curtailment back to the missed first legal deadline, despite the fact that <u>HUD would have incurred no actual losses</u> related to the servicer's performance. For example, one of our large servicer members estimates that as many as forty-six percent (46%) of its FHA loans that ultimately went into foreclosure had a missed first legal deadline, but had a completed foreclosure within the reasonable diligence deadline. These curtailments can result in an extremely significant and unrecoverable losses early in the process, creating perverse incentives that may impact other FHA timelines or claim payments.

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[7] <u>See</u> 24 C.F.R. § 203.359.

[8] This regulatory provision also sets forth debenture interest authorization for claims without conveyance of title and pre-foreclosure sale claims. <u>See</u> 24 C.F.R. § 203.402(k)(2) and (3).

[9] <u>See</u> 24 C.F.R. § 203.402(k).

Additionally, the reasonable diligence timelines are updated infrequently and fail to recognize the impacts of litigation, court delays, and required mediation by certain jurisdictions. One member estimates that up to thirty-four percent (34%) of delinquent FHA loans have missed the reasonable diligence deadline in the past five years. Although FHA servicers can request extensions or rely on certain automatic extensions to these foreclosure deadlines, the process of relying on these extensions is time-consuming.[10] The extension process is very manual and time-consuming for both HUD and the servicing industry.[11] While many of the extensions are "automatic" – which demonstrates how unrealistic the existing timeframes can be in the current servicing environment – documenting the circumstances to support claiming an automatic extension are extensive. Moreover, if an extension is needed for any other reason, servicers are required to obtain approval of the extension from HUD through its the Extensions and Variances Automated Requests System ("EVARS") or other manual processes. This manual procedure often produces inconsistent results, with HUD staff approving certain extension requests while denying others based on similar circumstances. The uncertain and manual extension process further increases the cost of servicing delinquent FHA-insured loans. Ultimately, FHA's multiple performance deadlines not only result in punitive penalties for servicers, they reduce servicers' flexibility for managing the entire foreclosure timeline.

Overall, FHA's three-milestone foreclosure timeline is out of sync with the spirit of the CFPB regulations regarding servicing, which encourage borrower engagement and wait time on the front-end of the delinquency to ensure that the borrower receives available loss mitigation. The FHA process is based on regulations that have not been amended in over twenty years, well before the CFPB servicing regulations and state foreclosure protections were implemented. As a result of the costs and burdens associated with the foreclosure deadlines as currently set forth in FHA servicing regulations, MBA makes the following recommendations for modifications to the above-referenced provisions.

a. Amend the regulations to eliminate the separate foreclosure timelines and replace with one, overall foreclosure timeframe.

The Department should eliminate the separate timelines for the various foreclosure events outlined above and replace it with state-specific timelines for the overall foreclosure event. This new foreclosure timeline would replace the current separate timelines with a single standard governing the entire foreclosure process. Such a combined standard would hold the servicer accountable for its overall performance while bringing penalties more in line with the actual losses incurred by HUD as a result of that performance and would not result in penalties if the

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[10] See Mortgagee Letter 2016-04.

[11] We do appreciate that HUD has worked toward addressing some issues with automatic extensions in recent years by adding certain extensions to accommodate changes to other federal servicing requirements, including the CFPB's servicing regulations.

servicer's overall performance is reasonable. Moreover, any penalty imposed for missing the deadline should be reasonably related to the harm caused to the FHA Insurance Fund as a result of the delay. Finally, such a standard would align with the current foreclosure timelines used by the GSEs, resulting in greater systemic efficiencies and lower operational costs.

One timeline provides additional incentive for servicers to manage the overall foreclosure process to ensure timely initiation and prosecution of the foreclosure to avoid missing the deadline. By establishing one deadline, the servicer would have an even greater incentive to move the process forward to meet the single deadline. Each loan has specific circumstances that could cause delay along the way, with some delays lasting longer than others depending on the borrower's circumstances and the jurisdiction in which the property is located. One deadline would allow servicers to put time in the "bank" early in the foreclosure process, which would provide servicers with more time to manage any delays that occur later in the foreclosure process without requiring extensions of such deadlines to avoid curtailment. Also, a unified timeline would result in less need for extensions of the timelines, which currently involve a manual process that is costly and time-consuming for both HUD and the mortgagee. Rather than request and/or document the reasons necessary for three separate extensions, HUD and mortgagees could focus on any extension needed for one milestone, which would allow the Department to focus on the overall foreclosure process in determining whether delays were within or outside of the servicer's control.

We also note that, in past proposals to amend FHA servicing regulations to modernize the foreclosure timeline process, the Department considered establishing a deadline to file a claim for FHA insurance benefits and terminating the FHA insurance policy after that deadline has passed. We strongly disagree with this proposal and urge HUD not to pursue termination of insurance or other maximum FHA insurance claim deadline in any future efforts to amend the foreclosure timeline regulations. As noted by commenters to the prior proposal, [12] as well as an Urban Institute study,[13] HUD's authority to impose a claim deadline is unclear, given that the National Housing Act, which governs the FHA insurance program, expressly states that "insurance benefits shall be paid … and shall be equal to the original principal obligation of the mortgage (which such additions and deductions as the Secretary determines are appropriate),"[14]

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[12] See HUD-2015-0060-0015, Comments Submitted by Krista Cooley, K&L Gates LLP, on Proposed Rule FR-5742-P-01 Federal Housing Administration (FHA): Single Family Mortgage Insurance Maximum Time Period for Filing Insurance Claims, Curtailment of Interest and Disallowance of Operating Expenses Incurred Beyond Certain Established Timeframes, available at https://www.regulations.gov/document?D=HUD-2015-0060-0015. See also "HUD's Proposal to Terminate FHA Insurance Policies Could Terminate the FHA Program," by Krista Cooley and Kathryn Baugher, at http://www.jdsupra.com/legalnews/hud-s-proposal-to-terminate-fha-73669/.

[13] See "FHA's Proposed Servicing Reforms Need More Thought," by Laurie Goodman, Urban Institute available at http://www.urban.org/sites/default/files/publication/65646/2000349-FHAs-Proposed-Servicing-Reforms-Need-More-Thought.pdf.

[14] 12 U.S.C. § 1710(a)(5) (emphasis added).

and includes an incontestability clause expressly providing that any insurance contract executed by the Secretary "shall be conclusive evidence of the eligibility of the loan or mortgage for insurance, and the validity of any contract of insurance so executed shall be incontestable … except for fraud or misrepresentation."[15] Imposition of a maximum claim deadline would not account for delays outside of the mortgagee's control, which would require a robust, fair, and consistent extension process to ensure that insurance benefits were not unnecessarily cancelled. HUD's existing process for extension requests and approvals produces inconsistent results to requests for extensions of the current foreclosure deadlines and is already overburdened. Finally, a maximum claim deadline would call into question how HUD would continue to monitor and enforce ongoing servicing requirements in connection with loans that had exceeded the deadline, or whether the Department would continue to have jurisdiction over the loan to do so.

b. As an alternative, amend the regulations to impose pro-rata curtailment to each missed foreclosure deadline.

In the alternative, the Department should re-publish its proposed regulation to amend the "self-curtailment" provisions to permit only pro rata curtailment for each missed foreclosure-related deadline. Pro-rata curtailment provisions should be straightforward, setting forth exactly how to calculate any pro-rata curtailment, so they can be easily understood and implemented by mortgage industry participants, and clearly enforced by HUD staff. Precision with regard to the calculation of dates and curtailment amounts is imperative to ensure that both HUD representatives and industry participants agree on how the regulatory provisions must be applied at the loan-level. Equally as important, the curtailment penalty should be reasonably related to the actual harm caused by the missed deadline to the FHA Insurance Fund. In establishing curtailment deadlines, we strongly urge the Department to limit curtailments to debenture interest and forgo prior proposals to curtail for other expenses, including property preservation costs, real estate taxes, and insurance premiums. Payment of such costs in FHA insurance claims benefits the Department by ensuring that properties are maintained during the foreclosure process, protected by insurance policies to cover unforeseen events, and free from tax liens at the time of conveyance to HUD. Current regulations reflect the necessity of these three important goals and any regulatory changes in this regard should continue to do so.

c. Amend Existing Deadlines for the First-Legal and Conveyance Timelines to Reflect the Time Necessary to Comply.

If the Department decides to maintain separate deadlines for each foreclosure-related event, the MBA requests that the Department amend the regulations setting forth the deadlines to commence foreclosure and convey property to HUD once the mortgagee has acquired marketable title, 24 C.F.R. §§ 203.355 and 203.359, respectively, to extend the time provided to

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[15] Id. § 1709(e).

the mortgagee to take these actions. The current regulations governing these deadlines are unreasonably short.

With regard to the deadline to commence foreclosure, Section 203.355(a) requires the mortgagee to commence foreclosure within six months of the date of the loan default, unless the borrower receives a loss mitigation alternative pursuant to HUD requirements. To meet this deadline, the mortgagee must first contact the borrower, obtain information regarding the default event, and evaluate the borrower for loss mitigation alternatives to foreclosure. Servicers also must adhere simultaneously to other federal requirements, with the most recent being the CFPB's servicing regulations.[16] Ensuring adherence to all applicable requirements greatly depends on when and how cooperatively the borrower engages in this process, which often requires more time than currently provided in Section 203.355. In those circumstances, the servicer must document the reasons for the delay or, in certain cases, request an extension of the deadline from HUD through EVARS. Only certain EVARs requests receive automated approvals. Others require review by HUD staff, with uneven results, further increasing the uncertainty of servicing FHA-insured loans.

With regard to the conveyance deadline, as noted above, Section 203.359(b) requires the mortgagee to acquire good and marketable title and transfer the property to the Department within 30 days of, among other things, filing the deed for recording or acquiring possession of the property that secured the mortgage loan.[17] After obtaining title, however, the servicer must ensure that the property is in conveyance condition, which often requires repairs that take more than 30 days to complete. As a result, servicers are often required to document the reason for the delay and obtain extensions to this deadline. Such inefficient processes would be avoided by both HUD and mortgagees if the regulations provided additional time to meet the foreclosure commencement and conveyance deadlines.

2. <u>Adopt a Direct Conveyance Model and/or Continue to Increase the Use of Alternatives to Conveyance Claims.</u>

a. Adopt a Direct Conveyance Model.

While servicers generally foreclose in their own name, properties are conveyed to other entities that insure or invest in mortgages, such as the GSEs, within 24 hours of foreclosure sale or redemption. For FHA, as noted above, HUD regulations require servicers to convey the property within 30 days of the later of the foreclosure sale or the receipt of marketable title, <u>see</u> 24 C.F.R. § 203.359, and complete repairs required to ensure that the property is in "conveyable condition;" however, Section 203.358 of the existing regulations contains a provision authorizing

[16] 12 C.F.R. §§ 1024.30 <u>et seq</u>.

[17] FHA could eliminate some delay by removing the requirement that mortgagees obtain HOA or condo information unless there is a lien recorded on the title.

direct conveyance. In the past several years, FHA-approved servicers' conveyance inventories have increased significantly, as a result of the age, increased post-foreclosure regulatory requirements and physical condition of the properties securing the FHA mortgages. The Department ultimately bears these costs through reimbursement in the conveyance claim payment. Unclear standards of what constitutes "conveyable condition" complicate this process and ultimately add to the time to convey and the costs servicers bear to transfer title of the property and obtain the benefits of the FHA insurance policy covering the loan. Differing interpretations of the guidelines between HUD and servicers has also led to an increase in re-conveyances, which is extremely costly and time-consuming for both FHA and servicers. One MBA member servicer reports that its estimated re-conveyance costs over the last five years has exceeded $220 million, not including an additional $45 million in carrying costs incurred during the re-conveyance period. Uncertainties regarding the payment of claims because of title and condition issues and associated regulations, as well as the potential liability that accompanies such uncertainty, has further contributed to the increased the costs of servicing FHA-insured loans and the potential exposure to FHA servicers of not being able to recover foreclosure-related losses in connection with FHA-insured mortgages.

To alleviate these costs, MBA recommends that HUD adopt a direct conveyance model in which properties are transferred to HUD immediately following the foreclosure sale. This approach would allow the Department to move properties to REO more quickly, increase FHA's flexibility in selling a property in an "as-is" condition, apply consistent property preservation standards, and eliminate costly and time-consuming negotiations regarding "over-allowable" expenses. This model would eliminate servicers' need for the extensive infrastructure necessary to repair and bill the Department for costs associated with getting properties into "conveyance condition," and would greatly reduce the risk that local code violations and ensuing code enforcement penalties would occur. Such a model would also eliminate the need for reconveyance and acquisition claim infrastructure and is consistent with the approach taken by the GSEs.

Under a direct conveyance model, the Department could utilize its existing field servicer manager relationships for necessary maintenance, and could explore creative ways to utilize the REO portfolio to further HUD's mission of providing access to homeownership opportunities. Avoiding a lengthy conveyance process would increase HUD's ability to turn properties more quickly. Faster disposition of these properties would reduce blight and allow for a quicker return to productive uses, greatly benefiting communities and neighboring home values. To accomplish a change to a direct conveyance model, HUD could explore contracting with servicers, as the GSEs currently do, to perform certain post-conveyance functions. To avoid potential reputational risk associated with foreclosure, the Department could amend its requirements to allow the servicer to foreclose and simultaneously convey following the later of judgment or vacancy. Thus, any foreclosure litigation would be handled by the servicer. Coupled with an expansion of foreclosure alternatives, discussed in detail below, the number of properties that come to the Department through conveyance, direct or otherwise, will be greatly reduced, allowing HUD the flexibility to craft a direct conveyance model that benefits the Department, the mortgage servicing industry, and the neighborhoods in which conveyed properties are located.[18]

b. Expand the SFLS Program.

Additionally, HUD should continue to expand its use of alternatives to conveyance claims, including the Distressed Asset Stabilization Program ("DASP"), otherwise known as Single Family Loan Sales ("SFLS") program. As noted in the Department's most recent Annual Report to Congress on the financial status of the FHA Mutual Mortgage Insurance Fund, SFLS program sales have netted an estimated $2.4 billion over what would have been collected by HUD through the standard conveyance claim and REO execution process.[19] Continuing to reduce the amount of full conveyance claims HUD pays will continue to strengthen the FHA Insurance Fund. While the Department has made considerable efforts in the past several years to increase the use of this program, additional program changes would expand the distressed loans and properties that could be moved through this program, which would reduce the number of conveyance claims and greatly reduce the costs of foreclosure and property maintenance for both the Department and FHA servicers associated with conveyance claims.

With regard to the SFLS program, the eligibility criteria an FHA-insured loan must meet for inclusion in the SFLS program is currently unnecessarily narrow. Restrictive criteria has caused the population of saleable loans to decrease, lessening the number of loans that can be resolved through this program instead of more costly and burdensome conveyance claims. This increases costs for both HUD and the mortgage servicing industry. Eliminating certain barriers to entry into the SFLS program would significantly expand the population of loans eligible for the SFLS program and generate cost savings to the FHA Insurance Fund. To that end, we recommend that the Department eliminate the delinquency and vacancy minimums, as well as the minimum loan-to-value restrictions applicable to recent sales. Mortgage servicers should also be able to include additional loans in the SFLS program if the Department amended the criteria of eligible loans to include those loans secured by properties with surchargable damage, provided the damage is insurable or the FHA claim is reduced by the estimate to repair. Additionally, we support expanding the SFLS program to include loans secured by mobile homes. We recommend that HUD consider expanding SFLS eligibility criteria to include loans in bankruptcy, such as loans that are delinquent post-petition.

These expansions of SFLS eligibility criteria could more than double the number of FHA-insured loans eligible for the program, which would result in significant costs savings to

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[18] MBA also recommends that HUD accept indemnification agreements for title defects. Such indemnity letters are accepted at loan origination and should be acceptable at the time of conveyance, as well. See HUD Handbook HUD Handbook 4000.1 II.A.6.a.ii (last rev. Dec. 30, 2016); 24 C.F.R. § 203.389.

[19] Federal Housing Administration Annual Report to Congress, at https://portal.hud.gov/hudportal/documents/huddoc?id=2016fhaannualreport1.pdf (Nov. 15, 2016).

FHA in resolving claims in connection with these severely delinquent loans without having to reimburse foreclosure-related expenses in a conveyance claim. Such expansions would also allow more borrowers who are evaluated and determined to be ineligible for FHA loss mitigation options to obtain access to the expanded loss mitigation options offered by purchasers of loans through the SFLS program. Servicers would benefit from the increased certainty and dramatically reduced costs of servicing delinquent FHA loans that would not be subject to conveyance.

A more frequent and consistent SFLS sale schedule with longer lead-time to review and include loans in sales would also increase the number of loans resolved through this channel, as these changes would provide servicers with additional time to prepare loans and submit claims. Finally, our members report that when SFLS claims are reversed, they often experience delays in HUD's reinstatement of the FHA insurance policy on the loan, which increases their risk of liability in connection with continuing to service the loan. For this reason, we request standardization in the SFLS process to provide certainty to servicers regarding the reversal and insurance reinstatement processes associated with this claim option. We also urge the Department to consider updating the breach warranty period for first-lien position and title issues to avoid breaches on loans multiple years after the SFLS transaction is completed.

c. Expand the CWCOT Option.

Finally, HUD should continue to expand its use of the Claim Without Conveyance of Title ("CWCOT") option. This program is governed by the regulatory provisions set forth in 24 C.F.R. § 203.368. That regulation currently does not apply if the mortgaged property has been damaged by, among other things, natural disasters or the mortgagee's failure to take reasonable action to preserve and protect vacant properties.[20] MBA recommends that the Department amend this section of the CWCOT regulation to remove the restriction on inclusion of damaged properties in the CWCOT program, provided the damage is insured or the FHA claim is reduced by the estimate to repair. We also recommend amending the regulatory provisions to expand application of the CWCOT process to encompass loans that were not previously approved through CWCOT. The Department should also consider re-evaluating CWCOT policy guidance to allow faster adjustments to sale prices to reflect property values in real time. Examples of such changes include: (i) permitting servicers to conduct new appraisals when the occupancy of the property changes, both pre-and post-foreclosure sale; (ii) increase the frequency with which HUD updates the "haircut" applied to property sale value; (iii) permit neighborhood-level discount values; and (iv) establish a system to discount the sale price further during the "Second Chance" stage of the CWCOT option to increase the likelihood of sale and avoidance of a conveyance claim.

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[20] See 24 C.F.R. § 203.368(b).

These changes would provide HUD with additional flexibility in expanding the scope of the CWCOT option. Expanded use of the CWCOT option will help HUD avoid conveyance claims for additional FHA-insured loans, thus decreasing the financial costs to the FHA Insurance Fund, the Department, and servicers regarding full conveyance claims.

3. Standardize the FHA Loss Mitigation Program to Benefit Borrowers and Reduce Costs.

The MBA strongly supports a streamlined approach in which all government agencies administering loan programs, including the FHA program, and the government sponsored enterprises ("GSEs") align their loss mitigation standards based on the lessons learned from the most recent economic downturn and the data gained from the HAMP program. A cornerstone to such a streamlined approach is a loan modification waterfall that focuses on limited paperwork requirements and targets payment reduction. Unfortunately, despite widespread government and industry consensus, FHA's current loss mitigation process remains heavily focused on documentation, indeed adding more requirements in a recent Mortgagee Letter. Moreover, the current FHA loss mitigation structure relies on a debt-to-income analysis for loss mitigation qualification that we believe will result in greater borrower fallout and higher servicing costs without providing a benefit to consumers or the Fund. As an alternative to the current FHA loss mitigation waterfall, experience with loan modifications during the financial crisis suggests that payment reduction is the key driver of sustainable modifications that keep borrowers in their homes and reduce losses to investors and insurers.

For these reasons, we urge the Department to align toward the MBA's "One Mod" principles or the recently released GSE "Flex Mod" program and associated streamline modification. To do so, FHA should consider amendments to the partial claim regulation[21] to provide any necessary flexibility.[22] These streamlined programs seek to provide borrowers with sustainable modifications, which will result in more completed modifications than traditional modification programs, lower re-default rates and, ultimately, fewer claims paid by HUD and far less financial impact on the FHA Insurance Fund. The property disposition options included in these streamlined programs also return benefits to the Insurance Fund by (i) resulting in fewer full conveyance claims, and (ii) accelerating the conveyance process for those who do not qualify for alternatives, which will decrease holding costs included in ultimate conveyance claims. Borrowers will benefit from the easier process and deeper relief focused on payment reduction and communities will benefit from keeping more borrowers in their homes or a faster return to productive use of properties for those that qualify for disposition options. Mortgage

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[21] See 24 C.F.R. § 203.371.

[22] We note that, depending on how such changes are structured, the Department may need to pursue amendments to the National Housing Act provision governing partial claims, as well. See 12 U.S.C. § 1715u.

servicers will benefit from the standardization of loss mitigation processes across loan portfolios and the avoidance of the costly conveyance process discussed in detail above.

4. Eliminate Outdated Regulatory Requirements.

In most instances, the regulations governing the servicing of FHA-insured loans have not been amended or updated since the early 1990s. In the decades since that time, the mortgage servicing industry has undergone significant changes to its structure and operations, and the increased use of technology and digital innovation to assist with the servicing of mortgage loans has rendered several of the existing regulatory provisions obsolete or unduly burdensome in the modern servicing industry. For these reasons, as noted above, we recommend that the Regulatory Task Force HUD is establishing to address the Executive Orders identified in the Request undertake a fulsome review of the regulations governing FHA servicing to ensure that outdated provisions are eliminated and, as a whole, the regulations are updated to reflect modern servicing operations and technologies. To that end, below we recommend the elimination of, or amendment to, four regulatory provisions that add undue burden and costs to FHA servicing in light of current industry standards.

a. Repeal the Face-to-Face Interview Requirement.

MBA recommends that the Department eliminate the regulations governing the face-to-face requirement for delinquent FHA-insured single-family loans. This regulation, currently set forth in 24 C.F.R. § 203.604, requires servicers of delinquent FHA to make a "reasonable effort" to arrange a face-to-face interview with the borrower and defines the term "reasonable effort" to include, among other things, at least one visit to the mortgagor at the property securing the mortgage.[23] While the regulation sets forth certain exceptions, including an exception if the mortgaged property is not "within 200 miles of the mortgagee, its servicer, or a branch office of either," these exceptions are limited.[24] Moreover, several courts have determined that the "200 mile exception" does not apply if the entity servicing the mortgage has any office within a 200-mile radius of the mortgaged property, even if that office does not engage in loan servicing activities.[25]

The imposition of this requirement dates back to a time when borrowers were less likely to have access to information regarding available loss mitigation options and when mortgage origination and servicing activities were more likely to be conducted locally. In today's

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[23] See 24 C.F.R. § 203.604(d).

[24] See id. § 203.604(c)(2).

[25] Jose v. Wells Fargo Bank, N.A., 54 N.E.3d 1130, 1132-1135 (Mass. App. Ct. 2016) ("A reading of the plain language of the regulation reveals both that it is not ambiguous and that the quoted HUD response to the FAQ is inconsistent with the regulation.").

servicing environment, where many servicers of FHA-insured loans have a national presence, it is difficult, if not impossible in certain instances, to make such visits. Currently, a financially troubled borrower receives numerous telephone and written solicitations for loss mitigation assistance through an expanded list of channels, including call centers and websites. Servicers have expanded their outreach processes and are sensitive to the need to offer timely loss mitigation options; in fact, such processes are required by the CFPB servicing regulations, as well as FHA servicing guidelines and state laws in many jurisdictions.

As a result of these improved outreach processes, coupled with the borrower's ability to research options independently, any benefit from a face-to-face interview pales in comparison to the significant costs associated with this requirement, which can reach millions of dollars each year for large servicers. Unfortunately, these efforts are met with limited success in assisting borrowers with reinstating their loans and/or obtaining loss mitigation alternatives to foreclosure. In fact, data from our members demonstrates the incredibly limited utility of such face-to-face interview attempts. According to data from one servicer, the costs of complying with the face-to-face interview requirement in just one year amounted to $3.9 million; however, these efforts resulted in a successful loss mitigation document collection rate of only 5.8% for that same time period. Consequently, compliance with this requirement results in a serious commitment of resources by servicers that provides borrowers with no additional benefits or protections that those already required under other consumer protection servicing regulations.

The Department has publicly agreed that this regulation is overly burdensome. Over twenty years ago, in Mortgagee Letter 1996-65, the Department stated: "<u>HUD has agreed with the industry that the Department's existing policies need to be revised in light of current technology and business needs. These issues, force-placed hazard insurance and the requirement of a face-to-face conference between mortgagees and defaulting mortgagors, will require regulatory revision</u>." (Emphasis added.) HUD acknowledged that, even before electronic communications were as widely available to delinquent borrowers as they are today, regulatory revision of Section 203.604 was necessary. In that Mortgagee Letter, HUD indicated that it would take action "shortly" to revise the regulation regarding this requirement.[26] In 2007, in response to a proposed rule to amend Section 203.604, commenters called for a repeal of the face-to-face requirement.[27] In response, the Department stated that:

> HUD agrees with the commenters and has determined that amending the existing requirement is appropriate. As the Department has already relieved the industry from a requirement to conduct a face-to-face meeting as a requirement for loan

[26] <u>See</u> Mortgagee Letter 1996-65.

[27] <u>See</u> 72 F.R. 56,155.

> origination, it may also be time to make a similar change with respect to FHA's servicing requirements.[28]

To date, however, the Department has not revised this regulatory requirement.[29]

Given the incredible burden placed on servicers to adhere to this requirement and its limited utility in assisting borrowers to obtain loss mitigation, reestablish current mortgage payments, and avoid foreclosure, we respectfully request that the regulation be abolished.

b. Eliminate the "Reasonable Rate" Provisions Applicable to Lender-Placed Insurance.

As noted above, in Mortgagee Letter 1996-65, the Department stated: "HUD has agreed with the industry that the Department's existing policies need to be revised in light of current technology and business needs. These issues, force-placed hazard insurance and the requirement of a face-to-face conference between mortgagees and defaulting mortgagors, will require regulatory revision." (Emphasis added.) Thus, the Department, even twenty years ago, acknowledged that the HUD regulations regarding a "reasonable rate" of insurance for lender-placed insurance required revision. In that Mortgagee Letter, HUD indicated that it would take action "shortly" to revise the regulation regarding this requirement. See id. To date, however, the Department has not revised this regulatory requirement.

Specifically, the regulation still attempts to define "reasonable rate" as a rate not to exceed the rate set by a principal state-licensed rating organization or a FAIR Plan rate; if neither is available, mortgagees are directed to seek approval of the "reasonable rate" from a HUD Field Office. This complex and ambiguous "definition" has become even more outdated since Mortgagee Letter 1996-65 given ensuing federal and state regulatory developments. Those developments include Regulation X's lender-placed insurance rate restrictions,[30] GSE and other investor restrictions on lender-placed insurance,[31] and new state insurance rules and settlement agreements involving virtually every regulatory jurisdiction requiring, among other things, mandating periodic rate reviews and specific benchmarks for reducing lender-placed insurance

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[28] Id. at 56,159.

[29] We note that the Department has attempted to address this requirement through informal guidance in the form of answers to "Frequently Asked Questions" on its website; however, certain courts have determined such guidance to be nonbinding. Jose v. Wells Fargo Bank, N.A., 54 N.E.3d 1130, 1132-1135 (Mass. App. Ct. 2016). Such decisions further underscore the need for regulatory revision regarding this provision.

[30] See 12 C.F.R. §1024.37(h).

[31] See, e.g., FNMA Servicing Guide B-6-01.

rates if unsupported by losses, and prohibiting insurance commissions and other payments to licensed affiliates of mortgage servicers.

Therefore, as part of the Department's current effort to reduce regulatory burden, we recommend eliminating the "reasonable rate" provisions applicable to lender-placed insurance in 24 C.F.R. §§ 203.402(c), 203.379(a)(4), allowing the Department to manage lender-placed insurance directly with industry. Alternatively, if HUD concludes that lender-placed insurance premium reimbursements remain a necessary component of their revised regulations, we recommend a requirement whereby mortgage servicers may claim no more than the filed premium rate accepted from time to time by the applicable insurance regulatory agency in order to be consistent with the rules of other major investors and guarantors.

c. Repeal the Regulatory Requirement for Physical Documentation.

Section 203.365(c)(4) currently requires servicers of FHA-insured mortgages to "[w]ithin 24 hours of a request by the Secretary, … make available for review, or forward to the Secretary, hard copies of identified claim files." (Emphasis added.) This regulation was originally promulgated in an environment where servicing records were created and stored in paper form. Current servicing systems and standards have drastically changed, making this particular regulatory requirement, and any FHA guidelines drafted to implement this regulation, severely outdated. Presently, mortgage servicers utilize a broad array of technology and software functions to document servicing activities and store servicing records. As technology continues to improve, mortgage servicers and other industry participants will continue to move toward an electronic storage system for all servicing records, including promissory notes and mortgage documents, loss mitigation agreements, sales contracts, etc. The standards to which servicers are held to ensure security of borrower information, particularly non-public personal information such as Social Security Numbers, requires that services utilize digital technology to record and store servicing information.

While these technologies greatly increase the efficiency and security of recording servicing activities, this system of recordkeeping also means that information regarding a borrower's servicing account may be housed in several different places across a servicer's digital platform. Thus, when compiling a "claim file" or other servicing record, to be comprehensive, servicers need sufficient time to pull together all of the information relevant to the Department's review of the servicing of that particular file. The 24-hour timeframe set forth in Section 203.365 is not a sufficient time period in which to accomplish this task.

For these reasons, the MBA urges the Department to amend this regulatory requirement, and any other references in FHA requirements to hard copy documents and a 24-hour delivery requirement, to reflect more accurately the realities of the current and improving digital systems used to service FHA-insured mortgage loans and store servicing records. Amending this regulation would provide servicers with the flexibility to create and store servicing records in line with evolving technological improvements. Eliminating the 24-hour timeframe in favor of a more realistic and reasonable approach would provide servicers with the time necessary to pull documentation relevant to any Departmental review of a mortgagee's servicing activities and would create efficiencies for HUD's auditors in reviewing files for compliance with FHA servicing rules.

Finally, with regard to FHA claims audits, we appreciate that, under Section 203.365(d), HUD has the authority to "use statistical sampling in selecting claims to be reviewed and in determining the amount due the Secretary because of overpayment."[32] We request that the Department implement guidelines clearly defining what items can be extrapolated under this authority as part of a claims review, as well as clarity as to how FHA calculates the extrapolation it uses to determine the amount due because of overpayment.

d. Amend the Regulatory Requirements Regarding Flood Insurance.

The Biggert-Waters Act requires lender to accept private policies in satisfaction of the mandatory purchase requirement if the policy meets certain criteria. [33] Some lenders, however, have refused to accept private flood insurance on FHA-insured loans where the property is located in a Special Flood Hazard Area ("SFHA") because, currently, Section 203.16a of FHA regulations and implementing guidelines require flood insurance coverage in the form of a National Flood Insurance Program ("NFIP") policy.[34] We recommend that these provisions be amended to permit both NFIP and private insurance policies in connection with FHA-insured loans. We note that both Fannie Mae and Freddie Mac currently permit both such policies under their guidelines.

5. Amend the Partial Claim Regulation to Impose Reasonable Consequences for Documentation Delays.

The current regulation governing partial claims of FHA insurance proceeds authorizes the Department to pay FHA-insured mortgagees such partial claims to qualified delinquent borrowers if certain conditions are met.[35] To obtain this loss mitigation assistance option, the borrower must execute a mortgage in favor of HUD, and the servicer must provide the original credit instrument to the Department within 60 days of execution, and must provide the recorded security instrument to HUD within six months following the date of execution.[36] If the servicer

[32] 24 C.F.R. § 203.365(d).

[33] See 42 U.S.C. § 4012a(b)(1) and (2).

[34] See 24 C.F.R. § 203.16a; HUD Handbook 4000.1 II.A.1.b.iv.(A)(1).

[35] See 24 C.F.R. § 203.371.

[36] See id. § 203.371(c), (d).

does not provide the documentation within the deadlines prescribed in the existing regulation, the regulation states that "the mortgagee shall be required to reimburse the amount of the claim paid, including the incentive."[37]

The regulatory penalty is unduly burdensome for several reasons. First, because it is tied merely to the timing of delivery of documents to the Department, the penalty bears no rational relationship to any loss to the FHA Insurance Fund. For example, if the borrower, after receiving a partial claim, continues to perform on the loan and either pays off the entire loan balance or sells the property with proceeds sufficient to cover the original mortgage balance and the partial claim balance, the FHA Insurance Fund will experience no financial harm as a result of partial claim documentation delays or deficiencies. In fact, under these circumstances, if HUD had previously demanded a full refund of the partial claim from the servicer under the existing regulation, the Fund would receive a windfall of partial claim benefits from both the payoff of the partial claim and the previous refund of the claim from the servicer. Under the current regulations, HUD can, and does, require repayment of the partial claim as soon as the stated delivery deadlines are missed, rather than waiting to impose penalties until the FHA Insurance Fund in fact experiences a loss as a direct result of the partial claim documentation deficiency. Because of the regulatory imperative to refund the partial claim amount, HUD has been unwilling to accept indemnification of losses as a remedy for document delays, even though this remedy would directly relate a penalty to loss incurred as a result of any document deficiency.

These inequities with regard to the penalty of full partial claim reimbursement are exacerbated by the opaque and delayed process the Department's contractor currently has in place to manage partial claim documentation. Currently, the Department does not confirm receipt of either the note or mortgage document, causing servicers to have to comb through overnight delivery records to evidence compliance with the regulation. In many instances, HUD's contractor has misplaced the original promissory note and the Department has required servicers to issue lost note affidavits to avoid the penalty of partial claim reimbursement, even when the servicer's record demonstrates that it had possession of the note for the entire time up to delivery to HUD. Addressing partial claim demands regarding missing documentation from HUD's contractor over the last few years has resulted in our membership having to increase staffing and incur costs that range from $400,000 to over $2 million annually.

Documenting compliance with this regulatory requirement is also complicated by the fluidity of mortgage servicing rights. Often, the servicing responsibilities for pools of loans are transferred from one servicer to another in the midst of a partial claim option. In these circumstances, locating the responsible party and required documentation can be challenging for both HUD and mortgage servicers. Finally, when a servicer agrees to refund the partial claim, the Department must assign the partial claim documents back to the servicer so that it can

[37] Id. § 203.371(d).

attempt collection on the note and mortgage when and if the debt becomes due. Our members have encountered severe delays in that re-assignment process, resulting in instances in which the servicer has had to forgo collection of the partial claim amount when the loan is refinanced and/or the underlying property is sold. Continued management of partial claim documentation in light of HUD's inefficient process costs at least one of our members approximately $150,000 annually.

Accordingly, the MBA requests that the partial claim regulation at 203.371 be amended to provide for a more reasonable remedy for delays in partial claim documentation delivery that is rationally related to the risks to the FHA Insurance Fund related to such delays. At a minimum, we recommend that HUD consider allowing servicers an opportunity to cure any document deficiencies prior to imposing penalties, provide for indemnification of the loan rather than repayment of the entire partial claim if such deficiency cannot be cured, and/or wait to impose penalties until the FHA Insurance Fund in fact experiences a loss as a direct result of the partial claim documentation deficiency. HUD should also continue to evaluate opportunities to improve the whole partial claim documentation delivery process.

C. Additional Policy Changes for Consideration

In addition to regulatory changes that will alleviate significant burdens on lenders originating and servicing FHA-insured loans, we ask the Department to consider changes to a number of policy decisions and requirements that create challenges for lenders originating and servicing FHA-insured loans. While these changes do not impact explicit requirements contained in FHA regulations, modifications to current approaches and requirements would lessen the burden on FHA mortgagees, which, in turn, would benefit consumers needing access to this important source of credit. Below we summarize certain of these key FHA policies.

1. Loan Review System and Defect Taxonomy

We commend HUD on the development of its Loan Review System ("LRS") that is already providing substantial process improvements for both lenders and FHA. The implementation of LRS, which incorporates the Single Family Loan Quality Assessment Methodology ("Defect Taxonomy") as a common language for defect classification, seems to indicate FHA's willingness to provide greater certainty and clarity regarding the types of errors that can expose lenders to False Claims Act risk. But, as discussed above, in order to truly improve and expand access to credit for consumers under the current regulatory environment, HUD needs to take additional steps towards safeguarding lenders from excessive False Claims Act liability for minor mistakes. HUD's LRS incorporates the Defect Taxonomy as a common language for defect classification, but no additional enforcement clarity has been provided. Without formal Handbook guidance that defines: (1) specific remedies for each tier in the taxonomy; (2) which tiers will require indemnification; (3) which tiers will never require indemnification; and (4) what remedial actions will be necessary to resolve issues under each tier (i.e., monetary or non-monetary), participating lenders will not be able to lend with certainty under the FHA program.

It is critical that HUD take the necessary steps to limit the overly broad certification regime that can lead to subjective judgments of what constitutes a "material" false claim under the False Claims Act by completing the full implementation of the Defect Taxonomy through clear and formal Handbook guidance. The creation of a transparent defect classification and enforcement standard is critical to achieving a concrete definition to which lenders can point if the government asserts a False Claims action for an immaterial error. To this end, we recommend that the implementation of the Defect Taxonomy include publication of the Defect Taxonomy's parameters through formal guidance that includes specific tiers and remedies. Implementation should also take into consideration a borrower's timely payment history for a set length of time since origination, as a timely payment history indicates that a subsequent loan default was caused by something other than origination issues. A three-year "sunset" provision, for example, would continue to protect the FHA Insurance Fund from early delinquencies attributable to loan origination defects while creating additional certainty for FHA lenders, which would likely improve access to credit, as it has in other loan portfolios.

We also recommend that FHA allow lenders to provide a formal response for loan file deficiencies categorized under any defect tier should FHA plan to consider findings from every tier in the determination of its lender ratings. Under the final Defect Taxonomy, deficient loan findings that fall into tier 3 or tier 4 may not be formally refuted. However, if these findings will ultimately be factored into a lender's scorecard, lenders should be offered the opportunity to resolve and correct these deficiencies with FHA.

2. <u>Property Assessed Clean Energy ("PACE") Loans</u>

Residential PACE program structures vary by program, state and municipality, to providing financing for assorted energy improvement and water efficiency products – ranging from solar panels to energy efficient appliances and windows and more. Typically, private companies initiate PACE loans that are funded by proceeds raised through the issuance of municipal bonds and added to a borrower's property tax bill as a special assessment. Due to this characteristic structure, residential PACE programs present problematic lien priority issues as well as significant consumer protection concerns.

With FHA's July 2016 policy change to insure mortgage loans for properties encumbered with PACE assessments as long as "the PACE obligation is collected and secured by the creditor in the same manner as a special assessment against the property" and "[t]he property [is not] subject to an enforceable claim (i.e., lien) superior to the FHA-insured mortgage for the full outstanding PACE obligation at any time," it is important to underscore that "the property may…become subject to an enforceable claim (i.e., a lien) that is superior to the FHA-insured mortgage for delinquent regularly scheduled PACE special assessment payments."[38] By allowing delinquent PACE amounts to remain in a tax-lien position for foreclosed properties, this will impact the salability of the FHA-insured property. PACE loans can be placed on both FHA single-family and multifamily insured properties and multifamily FHA lenders have raised similar concerns to those identified here. And, in other cases, borrowers may find themselves underwater due to their PACE payments, precipitating a default and a claim on the FHA insurance fund. Moreover, in the event of a foreclosure, the presence of the outstanding PACE obligation – which runs with the property – can still result in the property being sold at a sizeable discount. Under all scenarios, the FHA Insurance Fund will ultimately shoulder the cost, impacting the government's collateral position. FHA did not solve PACE's lien priority issues by simply indicating that a PACE loan is a tax assessment.

In addition, FHA's policy change did not sufficiently address the serious consumer protection concerns which PACE loans present. The guidance alludes to the U.S. Department of Energy ("DOE") "updating its Best Practices Guidelines for Residential PACE Financing, which may be used by states and counties to align with their consumer protection goals"—but these now-released DOE Guidelines[39] are merely non-binding recommendations for states and municipalities. Notwithstanding limited disclosure requirements,[40] FHA's PACE policy does not require that enumerated consumer protections be present, in order for a particular jurisdiction's PACE program to be deemed satisfactory. In other words, FHA policy leaves what is appropriate consumer protections for countless others to determine with no consistency from state-to-state, municipality-to-municipality.

Nationwide protections are needed for PACE, to streamline the "patchwork" of consumer standards that exist (or have yet to develop) – ensuring that consumers are treated fairly and consistently wherever they happen to live. More specifically, MBA believes that a comprehensive assessment of a borrower's income, credit history, outstanding credit obligations, expected monthly payments, and more should be conducted for all loans originated – including PACE loans. Instead, PACE financing today is often based on a borrower's equity in their property and their mortgage and property tax payment history, rather than on their true ability to repay their financial debt.

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[38] Mortgagee Letter 2016-11, available at https://portal.hud.gov/hudportal/documents/huddoc?id=16-11ml.pdf.

[39] DOE Best Practice Guidelines for Residential PACE Financing Programs (November 18, 2016), *available at* https://energy.gov/sites/prod/files/2016/11/f34/best-practice-guidelines-RPACE.pdf.

[40] E.g., ML 2016-11, page 3: "the existence of a PACE obligation on a property [must be] readily apparent to mortgagees, appraisers, borrowers and other parties to an FHA-insured mortgage transaction in the public records and must show the obligation amount, the expiration date and cause of the expiration of the assessment, and in no case may default accelerate the expiration date."

It is vital to highlight that PACE loans are not currently subject to the federal mortgage financing rules of the CFPB – including "Ability-to-Repay," the Truth in Lending Act (containing the Home Ownership and Equity Protection Act), "Know Before You Owe," etc. This is because PACE financing has been conveniently classified as a tax assessment rather than a loan. MBA believes that PACE loans are consumer loans secured by real property and therefore should be subject to federal mortgage financing rules, not dependent on a patchwork of state/municipal consumer protections that do not adequately protect borrowers. Given the existing consumer issues, MBA urges FHA to join us in our efforts to secure the CFPB's supervision of PACE.

Furthermore, FHA has not provided appraisal guidance or standards for the evaluation of energy efficient home improvements under PACE, yet appraisers are required to analyze and report the impact of PACE energy improvements on the value of the property. This poses a risk that improvements or cost savings may be overvalued, as benefits are often difficult to quantify. In fact, generally acceptable industry-wide standards for such valuation do not exist. Of further concern, lenders also are responsible for determining if a PACE program is compliant with FHA's guidelines. Therefore, PACE program eligibility is structured as a lender warranty, circumscribed by general requirements and standards that PACE programs must meet to be eligible for FHA financing. This framework could expose lenders to both indemnification and False Claims Act risk due to the lack of standardization that exists among current (and future) PACE programs in state and municipalities across the country.

Given all of our aforementioned concerns, we ask that FHA follow the lead of the Federal Housing Finance Agency – on behalf of Fannie Mae and Freddie Mac – as it relates to PACE loans and discontinue the allowance of FHA insurance for transactions where a borrower's property is encumbered by <u>any</u> first lien (i.e., generally a tax-lien) PACE loan amount. FHA should permit financing of PACE-encumbered properties <u>only if</u> the PACE lien is definitively subordinated to the FHA loan and national, standardized consumer protections are in place.

3. <u>Model Mortgage Document</u>

With the issuance of HUD Handbook 4000.1 to streamline FHA origination and servicing guidelines, the Department introduced a revised mortgage document in an effort to permit mortgagees to use security instrument documents more closely aligned with standard Fannie Mae/Freddie Mac uniform security instruments, while continuing to incorporate unique FHA requirements. November 2016, however, HUD published a formal Notice of Proposed Information Collection to request comment from interested parties regarding proposed revisions to the model mortgage document. We believe the model mortgage document originally made part of HUD Handbook 4000.1 struck the right balance between uniformity with security instrument documents in conventional transactions and the incorporation of unique FHA regulatory requirements into the mortgage contract, and we ask that HUD decline to make the proposed changes to the model mortgage document.

4. Ginnie Mae Requirements

In addition to the amendments to the FHA regulations discussed in detail above, the MBA urges the Department to consider changes to program and policy guidance regarding the Government National Mortgage Association ("GNMA" or "Ginnie Mae"). As an initial matter, MBA recommends that Ginne Mae modernize its platform to support loan-level, rather than pool-level, capabilities to align with the industry standards of other securitizers and for Ginnie Mae. Loan-level management would create significant flexibility for mortgage industry participants. We also support continued improvements to the Acknowledgement Agreement to better synchronize with the GSE forms, including use of multiple Acknowledgment Agreements for discrete mortgage pools, expanded cure rights in respect of issuer defaults and right to excess net sales proceeds following involuntary termination of issuer and sale by GNMA of the related mortgage servicing rights. Also, for issuers under certain volume thresholds, mandatory field reviews on an annual basis are excessive and unnecessary.

As you know, given that more than 90% of FHA-insured loans are included in Ginnie Mae securitizations, it is imperative for the Department to ensure alignment of FHA and Ginnie Mae requirements to create and sustain a secondary market for FHA-insured loans. To that end, we recommend that Ginnie Mae and FHA work together to align requirements regarding modifications for divorced borrowers with FHA-insured loans to ensure that adherence with FHA requirements will be sufficient to adhere to Ginnie Mae requirements for re-pooling modified loans in such circumstances. We also request that Ginnie Mae refrain from making retroactive changes to custodial requirements, such as those recently made regarding unrecorded modifications in the document custodian guidelines. Finally, we recommend that Ginnie Mae consider updating its guidance on title insurance for modified loans to conform to industry standards.

III. FHA Multifamily and Residential Healthcare Program Regulations

The FHA – Ginnie Mae Multifamily and Residential Healthcare programs financed through private sector lenders have been some of the longest running, and most successful public-private partnership programs. The programs have performed incredibly well, achieving HUD's housing mission of providing much needed affordable rental housing and residential healthcare facilities for low- and moderate-income families and for workforce housing, while experiencing extremely low delinquencies and generating significant revenue for the federal government. To preserve and enhance the continued success of these partnerships, MBA has identified several regulations and policies that HUD and other executive agencies should review, and eliminate or modify under the Executive Orders, to reduce the drag of regulatory burden on the prospects for continued successful performance of these public-private partnerships.

A. Improve Administration of Davis-Bacon Prevailing Wage Rate Requirements

The National Housing Act (§ 212) requires Davis-Bacon Act compliance on multifamily and residential healthcare projects assisted with FHA mortgage insurance under §§ 221, 232 and 241. Davis-Bacon requires developers to pay wages to construction workers at the rates that prevail in the locality on projects of a character similar, for the same work performed under direct federal contracts.

1. Split-Wage Rate Determinations

For purposes of wage rate determination under Davis-Bacon, there are four categories of construction work:

- Residential,
- Building (Commercial),
- Heavy and
- Highway.

HUD and the Department of Labor have historically applied the following definition of residential work:

> Residential construction is defined as projects involving the construction, alteration, or repair of single family houses or apartment buildings of no more than four stories in height. This includes all incidental items such as site work, parking areas, utilities, streets and sidewalks. The primary component, which determines the character of work, is the housing. Elements such as site work, parking areas, etc., are incidental items and are included within the definition of residential construction. Generally, any housing development (four stories or less) is classified as "residential." This classification is not altered by the cost of incidental items, even if such costs reach the threshold guides (above) for "substantial." Except in the most extraordinary circumstances, such as where local industry practice clearly demonstrates otherwise, only residential wage decisions shall be assigned for housing development projects of four stories or less. [41]

This definition covers a broad range of activities normally associated with residential construction. Consistent with a reasonable interpretation and application of that broad definition, HUD has dependably assigned only a single Davis-Bacon residential wage decision (i.e., a single

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[41] HUD Handbook 1344.1, Rev 2 (3-6(C)); See also Labor Relations Letter LR-96-03.

schedule of wage rates setting the hourly wages and benefits for the project) to most residential construction projects for decades.

HUD's Office of Field Policy and Management/Davis-Bacon Labor Standards staff, however, recently departed from that interpretation and application. Specifically, developers of individual residential rental projects (of four stories or less) – projects that historically would have been required to use only a single schedule of wages under the definition above – are now required to use as many as four different wage rate decisions, each containing a different wage schedule.

In our view, this new and unnecessary increase in regulatory complexity is not needed to ensure that developers of residential FHA project pay appropriate wages, and so is both <u>unnecessary and ineffective</u> within the meaning of the Executive Orders.

In addition, this change in interpretation and application adds substantial and unnecessary costs to the construction of projects, <u>imposing costs that exceed the benefits of the change</u>. For example, the complexities of tracking every construction worker as to their precise location vis-à-vis the boundaries of four separate wage decisions, alone, are practically and financially prohibitive. Even in the best of circumstances, imposing multiple wage decisions adds enormous administrative burden to every participant in the endeavor: the lender, the developer, the owner, the prime contractor and its subcontractors. Ironically, it adds equally enormous administrative burden to HUD.

To prevent the unwarranted costs that result from this ineffective and unnecessary change in interpretation and application, HUD should take whatever steps are necessary to ensure that staff consistently comply with its long-standing interpretation and application of Davis-Bacon. Specifically, residential construction projects, including all incidental items such as site work, parking areas, utilities, streets and sidewalks, should consistently be assigned a single, residential Davis-Bacon wage rate decision, absent a proven established local area practice to the contrary.

2. <u>"Locking-In" Wage Rates Earlier</u>

The interaction between regulations specifying when a project "locks in" applicable Davis-Bacon wage rates and the effective date of updates to Davis-Bacon wage rates can have an <u>adverse impact on job creation, eliminate jobs and impair the effectiveness of FHA in fulfilling its housing mission.</u>

The terms of each FHA mortgage transaction are set at the time of FHA issues a firm commitment. However, despite the fact that the terms of the mortgage are set at that time, the project remains vulnerable to changes in applicable Davis-Bacon wage rates. That is, under Department of Labor regulations (29 CFR 1.6) wage rates are not locked in until the time FHA issues the initial endorsement (when the wage rates are locked in, so long as construction begins within 90 days[42]), a time that happens sometime after the time of the commitment. The impact of such a change on a project after the time the mortgage terms are already set can be profound in that the increases can be up 100 to 400 percent, which can cause increases in costs not warranted by any public policy benefit, delays or even cancellation of projects, which can inhibit job creation or eliminate jobs.

The problem arises from the regulatory standards establishing timing as to when a change in Davis-Bacon wage rates becomes effective. The Department of Labor modifies Davis-Bacon wage rates for each locality from time to time to keep them current. The modified rates become effective when issued. That is, there is no transition period granted to incorporate updated wage rates into projects that have not yet "locked-in" their applicable Davis-Bacon wage rates, nor are developers permitted to include additional construction cost contingencies in their budgets to cover unanticipated increases in Davis-Bacon wage rates that occur between firm commitment and initial endorsement.

This problem and its adverse impacts on costs and housing mission is entirely preventable. To mitigate the disruptive impact of potential late changes to applicable Davis-Bacon wage rates, HUD should modify applicable regulations and procedures to lock in the applicable Davis-Bacon wage rates at the time of the firm commitment. This would be similar to the procedures typically in place for competitive bidding. As an interim measure, until pertinent regulations or directives can be revised, HUD should establish a hardship waiver process for the projects affected by a late-breaking wage rate change to effectively provide an early lock-in of wage rates to minimize the negative impacts on financing, cost and jobs.

3. Residential Healthcare Facilities are "Residential"

As the housing needs of our population have evolved, residential healthcare facilities have become more prevalent. These facilities offer living units with support services for its residents. Some facilities are developed with fully equipped units with full bathrooms and kitchens, whereas some units in a property, such as an Alzheimer's floor, are developed without full kitchens and/or baths to better serve and protect the special needs of those residents.

HUD, following informal/undocumented DOL guidance, assigns Residential Davis-Bacon wage rates to new construction and substantial rehabilitation housing projects – only if every unit contains a full kitchen and bathroom. Otherwise, the project is assigned a Building (commercial) Davis-Bacon wage decision, which typically carries wage rates many times higher than residential rates. This regulatory interpretation fails to take into account the practical realities of how residential healthcare facilities operate to serve the needs of their residents and, in the process, imposes unnecessary costs to projects, which are ultimately born by the residents.

[42] In FHA processing, the issuance of a Firm Commitment by HUD is an important step in loan production which is followed by Initial Endorsement.

This interpretation is outdated in that, except for the lack of a cooking appliance, for example, nothing is materially different in the construction or composition of these units. In addition, this wage designation ignores the conclusion of the DOL Wage Appeals Board that the absence of full-scale kitchens or separate bathrooms does not preclude a determination that the character of the work is residential in nature.[43]

To update regulatory requirements consistent with changes in residential healthcare facilities, to cease imposing costs not warranted by corresponding benefits, HUD and DOL should discard the concept that any housing unit lacking a full-scale kitchen and bathroom precludes a determination that the project is "residential" in character.

B. Delay the required use of the FHA Multifamily Capital Needs Assessment "e-Tool" unless it is proven to be more efficient than the current process

The Capital Needs Assessment (CNA) e-Tool is a grouping of several electronic templates being developed by HUD's Office of Multifamily Housing Programs in an effort to establish a data standard and framework for streamlining and automating the preparation, submission, and analysis of CNAs. CNAs are due diligence reports commonly used to examine current physical conditions at properties, specify repairs and replacements needed immediately, and budget for long-term capital repair and replacement. Currently, CNAs are submitted along with the property's appraisal package.

On April 19, 2017, HUD published Mortgagee Letter 2017-09 – Implementation of the CNA e-Tool – Delayed Implementation, which delayed the mandated usage date for the e-Tool until October 1, 2017. While MBA appreciates the extension, we also believe that HUD should not mandate usage of the entire e-Tool on October 1, immediately following the end of US Government Fiscal Year 2017 which traditionally has been a peak volume time of the year. Such an implementation date will have costs in the form of disruption that will outweigh the benefits of the new reporting. There will be a substantial rush of both submissions and questions that will be asked of HUD in late-September, when the end-of-year business is most pressing and all FHA MAP lenders would have to use the e-Tool.

While MBA applauds and supports HUD's desire to streamline and automate these processes, the results of early user acceptance testing (a.k.a. "beta" testing) by stakeholders, including lenders and due diligence vendors, demonstrates that there are numerous system "bugs" to fix in the validation and submission parts of the tool. Additionally, MBA is concerned that HUD Multifamily has indicated it does not plan to automate a "front-end" upload feature to

[43] See WAB Case No. 90-29, Dutch Hotel Single-room Occupancy ("Housing unit requirements. Each housing unit must be fully and independently functional; each housing unit must have its own kitchen and bathroom. A building wage decision is applicable if the project design fails to meet these criteria. For example, certain assisted living facilities may not meet these criteria. Note: Single room occupancy (SRO) projects are exempt from these criteria. SRO projects are not required to have a kitchen and bath in each housing unit.").

load the CNA data from a due diligence vendor into the electronic template. The consequence of not automating this feature is that many lenders will have the added cost of hiring vendors to help with the uploading of this data or they must assume a significant cost to undertake this in-house. Some vendors will be able to create an automated front-end feature from their systems and therefore offer a "streamlined" CNA process, which some stakeholders have estimated may cost the lender an additional $2,000 per loan.

Overall, MBA supports HUD's desire to streamline and automate the CNA process, but maintains that for this process improvement to be time and cost effective, implementation and usage should be required only when bugs have been fixed, all aspects of the e-Tool have been automated, and trainings have been offered. Specifically, HUD should extend the effective date until the CNA e-Tool is ready for all production upon its mandated use. In addition, MBA believes that HUD should not mandate usage of the e-Tool until a front-end automation is available to all stakeholders to avoid these additional costs, the possibility of submission mistakes, and a delay in FHA's production process. MBA suggests an interim step of allowing lenders to use the CNA e-Tool on an optional basis, which could include loading the third-party due diligence reports.

Finally, MBA also notes that the CNA e-Tool information manual is currently 195 pages, and the Frequently Asked Questions documents is an additional 35 pages long, which demonstrates the complexity of both the electronic templates, as well as their submission process. These are in addition to the almost 500 page Multifamily Accelerated Processing Guide[44]. Therefore, MBA further recommends that when the CNA e-Tool is complete and ready to launch, HUD offer an adequate number of trainings and information sessions as possible in order to prepare stakeholders for the change to mandated use in the future and release an updated and streamlined CNA e-Tool manual. MBA also urges HUD to issue guidance on other unknown aspects of the e-Tool, such as what the post-closing usage will be (e.g. 10-year Property Capital Needs Assessments, etc.).

C. Environmental Barriers to the Development of FHA-Insured Multifamily and Residential Healthcare Projects

1. Information Collection: Energy Benchmarking

On October 4, 2016, HUD published its Notice of Proposed Information Collection requirements[45] for energy and water utility usages. HUD developed the requirements to carry

[44] FHA Multifamily business guidance for FHA-approved multifamily lenders is primarily conducted in accordance with the 2016 MAP Guide.

[45] 60-Day Notice of Proposed Information Collection: Energy Benchmarking, 81 FR 68446 (Oct. 4, 2016 ("Notice").

out President Obama's 2013 Climate Action Plan.[46] Since that time, President Trump has rescinded the Climate Action Plan in his Executive Order on Promoting Energy Independence and Economic Growth[47]. As a result, this proposed date collection requirements fall into the category of actions that "derive from or implement Executive Orders or other Presidential directives that have been subsequently rescinded or substantially modified." As such, this requirement should be rescinded.

In addition, the proposed requirements impose costs that exceed benefits. The information collection process requires the collection of utility usage data from municipalities or utility companies and is likely to be a time-consuming process that can take two months or more to complete. Along with the collection of this data and its potential costs, the submission process will take considerably more than the estimated 30 minutes of regulatory burden that HUD relied upon to develop its proposal.[48] In addition, utility companies are commonly reluctant, unwilling or simply do not have the technical capability to provide resident energy consumption data for a whole building. Therefore, the requirement would create an uneven playing field, where different property owners in certain localities are compelled to bear substantial costs to comply with onerous requirements, depending on their local utility's willingness to provide this data readily and inexpensively, in furtherance of target policy benefits that are no longer in effect. Therefore, MBA also strongly urges HUD to withdraw the requirements described in the information collection because the compliance costs would exceed benefits in areas that remain in scope.

2. Federal Flood Risk Management Standards

Historically, the Federal Emergency Management Agency's Flood Insurance Rate Maps clearly depicted the 100-year floodplains across the nation, which has been helpful and accessible to all parties. However, the previous Administration, under Executive Order 13690[49], provided a new methodology for establishing floodplains under the Federal Flood Risk Management Standards ("FFRMS"). This approach allows federal agencies to select among three approaches for establishing base flood elevations and hazard area sitings, designs and construction standards.

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[46] The Report of the Executive Office of the President of June 2013

[47] Executive Order on Promoting Energy Independence and Economic Growth (March 28, 2017)

[48] 81 FR 68450, (Oct. 4, 2016) ("Notice").

[49] E.O. 13690 "Establishing a Federal Flood Risk Management Standard" was published in the Federal Register on February 4, 2015 (80 FR 6425)

Consistent with that new approach, on October 28, 2016, HUD's Office of Community Planning and Development published a Proposed Rule[50] that redefined building standards for structures within the 100-year floodplain as described below:

> This proposed rule would require that noncritical actions be elevated 2 feet above the base flood elevation. In addition, the rule would require that critical actions[51] be elevated above the greater of the 500-year floodplain or 3 feet above the base flood elevation. For structures subject to HUD's floodplain regulation, this proposed rule also would enlarge the horizontal area of interest commensurate with the vertical increase, but the rule does not change the scope of actions to which the floodplain review process or elevation requirements in the floodplains regulations apply.

A key problem with the proposal is that one cannot reasonably comment on the proposal without <u>information that is not publicly available</u>. To be able to assess the scope of an impact of the proposed new rule, the public will need to view the resulting new maps that depict the 100-year floodplains, based upon the base flood elevations and hazard areas, under the methodology specified in the Proposed Rule. However, these updated maps have not been created or published to reflect the FFRMS approach to floodplain mapping. Stakeholders have not been given the facts necessary to fully assess the scope and impact of the proposed rule, particularly areas for land that could be subject to the 500-year floodplain standard.

In light of the requirements under the General Government Appropriations Act (2001), which was cited in HUD's Notice on Reducing Regulatory Burden, <u>to maximize, among other things, the integrity of information they disseminate</u>,[52] MBA urges HUD to delay implementation of the proposed rule until the horizontal floodplain maps have been published, and then to re-release the Proposed Rule for comment only after the needed information is public, as the new maps are critical gauging the scope of impact of the proposed rule. In addition, HUD should consider adding language to "grandfather" all FHA pipelines (single-family, multifamily, and residential healthcare properties) to avoid issues with development planning and design, and new construction financing. We also encourage proper training for HUD staff in order to ensure consistency in their evaluation of proposed developments.

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[50] Docket No. FR-5717-P-01 "Floodplain Management and Protection of Wetlands; Minimum Property Standards for Flood Hazard Exposure; Building to the Federal Flood Risk Management Standard"

[51] Critical actions (as defined in 24 CFR 55.2(b)(3)(iii)) are projects where even a slight chance of flooding is too great for reasons such as loss of life, injury, or irreparable damage. Non-critical actions are any actions that are not critical actions. (Footnote in original.)

[52] 44 U.S.C. 3516(b)(2)(B)

IV. Discriminatory Effects Rule

Finally, MBA requests that HUD revise the Discriminatory Effects rule issued on February 15, 2013 (24 C.F.R. Part 100, Subpart G (78 Fed. Reg. 11,460) (found at http://portal.hud.gov/hudportal/documents/huddoc?id=discriminatoryeffectrule.pdf) (the "Discriminatory Effects Rule" or "Rule"). The Rule conflicts with, the Supreme Court's June 2015 decision in Texas Dept. of Community Affairs, et al vs. The Inclusive Communities Project, Inc., 576 U.S. ___ (2015) (Inclusive Communities), which details how these claims are brought.

At the time HUD issued the Discriminatory Effects Rule, there was a split among the federal circuit courts of appeal regarding whether the disparate impact theory of liability was cognizable under the Fair Housing Act (42 U.S.C. 3601, et. seq.). This split of authority created uncertainty for both government and industry regarding the parameters of the statute. HUD issued its Discriminatory Effects Rule in large part to eliminate this uncertainty. In the Rule's preamble, HUD explained that the Rule formalized HUD's "longstanding interpretation of the Fair Housing Act to include discriminatory effects liability and [established] a uniform standard of liability for facially neutral practices that have a discriminatory effect." 78 Fed. Reg.11,460, 11,479. Inclusive Communities eliminated the need for a regulation declaring that the Fair Housing Act provides for disparate impact liability, because that was the key holding of the case: "The Court holds that disparate-impact claims are cognizable under the Fair Housing Act . . . ." Inclusive Communities at 23.

Inclusive Communities also articulated important limitations on how the disparate impact theory must be applied, and HUD's Discriminatory Effects Rule contradicts these limitations in a number of respects. For instance, while the Court asserted that the Fair Housing Act requires a "robust" causal connection between a specific policy or policies and the alleged impact, the Rule appears to allow claims challenging disparities arising out of "multiple acts or policies." Compare 576 U.S. ___, at 20 with 78 Fed. Reg. 11,469. Further, whereas Inclusive Communities requires a plaintiff to prove that there is an "available alternative" that serves the defendant's "legitimate needs," the Discriminatory Effects Rule provides that a plaintiff need only show that the defendant's business interest "could be served by another practice that has a less discriminatory effect." Compare 576 U.S. ___, at 10 with 24 C.F.R. 100.50 (c)(3). These and other inconsistencies between Inclusive Communities and the Rule are the subject of currently pending litigation challenging the Rule on the grounds that it contradicts applicable Supreme Court precedent. Am. Ins. Assoc. v. U.S. Dep't of Hous. & Urban Dev., No. 13-966 (D.D.C. 2013). MBA urges HUD to revise the Discriminatory Effects Rule so that the Fair Housing Act can be properly construed in accordance with Supreme Court precedent. In the meantime, we respectfully urge HUD to work to ensure that the Government articulates the position in pending litigation that the rule is inconsistent with Inclusive Communities and what those inconsistencies include.

V. Conclusion

We would welcome the opportunity to meet with HUD representatives to discuss these recommendations in more detail. If you have any questions regarding our single family recommendations please feel free to contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement at (202) 557-2878 or PMills@mba.org. For questions regarding our multifamily recommendations, please contact Tom Kim, Senior Vice President of Commercial/Multifamily at (202) 557-2745 or at TKim@mba.org.

Thank you for your consideration.

Sincerely,

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Tom Kim
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