Reforming FHA Servicing

Servicing Federal Housing Administration (FHA)-insured loans requires adherence to a unique and often outdated set of regulatory requirements that in many ways has not kept pace with the significant changes to mortgage loan servicing that have occurred in the past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. These requirements contribute to the increasing cost of FHA servicing that is resulting in some servicers choosing to exit the program. Comprehensive reform of FHA servicing standards and processes is a critical factor in ensuring broad industry participation in the FHA program and a deep and liquid market for FHA/Ginnie Mae servicing rights.

OVERVIEW

- FHA's foreclosure process includes multiple timelines for completing actions that stifle efficiency and create mandated property holding periods that increase costs. These costs are exacerbated by the requirement that servicers curtail interest if any of the foreclosure timelines are missed. Such penalties for missing foreclosure-related deadlines are both excessive and inequitable. 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 penalties in the amount of thousands of dollars of interest curtailment back to the missed first legal deadline, despite the fact that Department of Housing and Urban Development (HUD) would have incurred no actual losses related to the servicer's performance. These timelines are unique to the FHA program and contribute to the increasing cost of FHA servicing, which results in some servicers choosing to exit the program.

- Unlike the GSEs or the Department of Veterans Affairs (VA), FHA does not take direct conveyance of a property after foreclosure. Rather, they require the servicer to bring the property into "conveyable condition" within 30 days of taking control of the property. 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 have also led to an increase in re-conveyances, which is extremely costly and time-consuming for both FHA and servicers.

- 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. Despite widespread government and industry consensus, FHA's current loss mitigation process remains focused on documentation and relies on a debt-to-income analysis for loss mitigation qualification—despite most research showing DTI is not a relevant metric for modification performance.

IMPACT

- 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 for conventional loans. These data evidence 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. Over time this migration from the program increases the cost of originating FHA-insured loans and reduces access to credit for otherwise qualified FHA borrowers.

MBA'S POSITION / NEXT STEPS

- Amend the FHA foreclosure timelines and debenture interest curtailment structure, by either (i) amending the regulations to eliminate the separate foreclosure timelines and replace them 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.

- Adopt a direct conveyance model and continue to increase the use of alternatives to conveyance claims such as the Claims Without Conveyance of Title process and the Single Family Loan Sale program.

- Standardize the FHA loss mitigation program to benefit borrowers and reduce costs by aligning with other modification processes, such as the recently released GSE "Flex Mod" program, that streamline loss mitigation to focus on limited paperwork requirements and payment reduction.