July 30, 2014

Kathleen Zadareky
Deputy Assistant Secretary for Single Family Housing
US Department of Housing and Urban Development
451 7th Street S.W.
Washington, DC 20410

Dear Kathleen:

MBA greatly appreciates the outreach and efforts on the part of FHA to meet with our members to discuss how certain policy changes could result in increased access to credit for borrowers. We have been engaged with FHA in discussions on multiple such issues and remain committed to working with you and your staff. We are writing today to respond to your request that the recommendations of the MBA task force on the FHA foreclosure and conveyance process be submitted to your office by the end of the month for possible inclusion in the upcoming servicing handbook.

Continued weakness in the housing market has raised concerns about the costs and availability of mortgage credit, particularly for borrowers with imperfect credit profiles. While there has been some improvement in recent months, credit conditions are considerably more restrictive than they were in the early 2000s, and the majority of lenders continue to operate well within FHA’s established “credit box.”

FHA has already taken a number of important steps designed to reduce the incidence of credit overlays, including developing a detailed quality control taxonomy and preparing a comprehensive underwriting and servicing handbook. We applaud the Department for these efforts and believe a comprehensive set of initiatives, once enacted, will lead to significant improvements in credit access. However, we also believe that HUD’s efforts will be more effective if several key servicing issues are also addressed.

Please note that the recommendations we are presenting in this letter are high priority items that we believe would represent a “quick fix” for addressing some of the problems currently associated with FHA’s foreclosure and conveyance processes. As such, they are not intended to be comprehensive or to preclude further discussions with HUD on these and other servicing issues. We have also included potential longer-term solutions which require regulatory changes or changes in FHA’s operating model. We would welcome the opportunity to work with FHA on these longer-term initiatives in the upcoming months.

The task force has identified key issues associated with the FHA foreclosure and conveyance process that increase both the costs and uncertainty of servicing loans to borrowers with imperfect credit profiles. These include:

- Foreclosure timelines that do not account for new regulations and borrower outreach requirements
- Large and inequitable penalties associated with failure to meet these guidelines
• Conveyance standards that are open to differing interpretations and have led to re-conveyances
• Property preservation and relocation allowances that are often insufficient to meet existing needs

In developing our recommendations, the task force tried to distinguish between longer-term solutions that require regulatory and/or significant process changes and shorter-term solutions that are within the Commissioner’s authorities and could presumably be implemented through the handbook or other operational changes. A summary of our recommendations is provided below:

○ **Short-Term Recommendations**
  ○ Expand automatic extensions to the First Legal Action deadline to incorporate new federally-mandated loss mitigation requirements and streamline the costly loan-by-loan exception process
  ○ Establish Reasonable Diligence timelines that penalize servicers for poor performance but do not result if a servicer’s performance is reasonable
  ○ Increase allowable repair and relocation expenses to reflect market costs
  ○ Give servicers greater flexibility in managing the nature and timing of property repair expenses
  ○ Expand the Claims Without Conveyance of Title (CWCOT) and the Second Chance Programs
  ○ Eliminate servicer’s responsibility for property preservation once the property has been conveyed

○ **Longer-Term Recommendations**
  ○ Pursue regulatory changes that replace separate milestones for First Legal Action and Reasonable Diligence with a single standard governing the entire foreclosure process
  ○ Move to a direct conveyance model

The remainder of this letter provides greater detail on our recommendations, as well as our rationale for proposing these changes.

### 1.0 Foreclosure Timelines

Since 1998, FHA has required servicers to initiate foreclosure actions within 180 days of default (the “First Legal Action Date”). Servicers are also required to manage the process from the first legal action date to foreclosure sale within “Reasonable Diligence” timelines established for every state. This “dual milestone approach” differs from that of other entities (GSEs, VA, private), who generally hold servicers accountable for the length of the *entire* foreclosure process.

New federal and state requirements designed to ensure that borrowers are evaluated for a broad range of loss mitigation options have made FHA’s standard for first legal action extremely difficult to achieve. Under penalty of law, servicers are now required to provide borrowers with a reasonable amount of time to make a loss mitigation application complete, allow time for borrowers to appeal loss mitigation decisions, and delay the initiation of foreclosure actions until loss mitigations requirements have been met (i.e., no dual tracking). However, First Legal Action regulations were established prior to the enactment of these consumer protection laws.

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1 A nine-month deadline applied from 1992 to 1998, and a one-year deadline applied prior to 1992.
In many instances, compliance with CFPB Servicing Standards (Regulation X) can make it impossible to achieve FHA’s timeline for first legal action. In fact, according to CoreLogic data, over 60% of all FHA foreclosures completed between 2011 and 2013 missed the deadline for first legal action, and an additional 23% met the first legal date but failed to meet the due diligence timeframe. In short, failure to meet FHA existing timeframes has become the rule, and not the exception.

While HUD provides for certain “automatic” extensions in certain circumstances, these extensions are often insufficient to address the issues that servicers face and requirements with which servicers must now comply. Moreover, while HUD permits servicers to request extensions to timelines through the EVARS system, the process is time-consuming and expensive for both FHA and servicers, and can lead to inconsistencies in the circumstances under which HUD representatives grant such extension requests. The uncertainty inherent in HUD’s “exceptions policy” is contributing to credit overlays.

1.1 Key Issues Associated with Foreclosure Timelines

The working group has identified several key issues associated with FHA first legal and due diligence timelines. They include:

- **Penalties for missing the first legal action date are both excessive and inequitable.** Missing the first legal action date results in curtailment of debenture interest until the property is conveyed to HUD, whether the date was missed by one or 100 days. The consequences of missing this date are also significantly higher in judicial states where foreclosure timelines are considerably longer. For example, HUD allows 3 months to complete a foreclosure in Texas compared to 19 months in New York. Under these timelines, the costs of failing to meet the first legal action date on a $170,000 mortgage would be about $5,600 higher in New York than in Texas, assuming a 2.5% debenture rate.

- **Reasonable diligence timelines are updated only infrequently and fail to recognize the impacts of litigation, court delays and required mediation.** Fifty percent of recent FHA foreclosures failed to meet reasonable diligence standards, exposing even the best servicers to large and uncertain servicing costs.

- **While servicers can request extensions to established timeframes, the process is time-consuming and expensive and results in inconsistent outcomes due to the nature of the review.** In addition, uncertainty regarding the granting of exceptions exposes servicers to potentially large and unknown costs, thereby contributing to credit overlays.

- **FHA’s Dual performance standards not only result in punitive penalties for servicers, but reduce their flexibility/accountability for managing the entire foreclosure timeline.** Currently, a servicer who missed the first legal standard by 5 days, but makes up the difference once foreclosure has been initiated, will face penalties amounting to thousands of dollars in interest curtailments despite the fact that HUD incurred no actual losses that were directly related to the servicer’s performance.
1.2 Potential Solutions

In the long-term, the working group believes that FHA should pursue regulatory changes that eliminate the separate timeline for first legal action and replace it with state-specific timelines for the overall foreclosure. 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.

However, recognizing that regulatory changes are likely to take some time, FHA should consider taking immediate steps to expand, extend and streamline “automatic extensions” to the first legal deadline in order to incorporate new federal loss mitigation requirements. In particular:

- **Replace the current process of requesting extensions through EVARS with automatic extensions based on monthly SFDMS status reports.** While this may require additional codes, including those suggested below, leveraging the SFDMS system and its documentation requirements would reduce uncertainty and greatly streamline the exceptions process.

- **Expand the list of allowable extensions such as:**
  - **Incomplete Documents:** Provide a 60 day automatic extension for the borrower to respond to notice of incomplete documents and provide the servicer time to review any additional documentation, consistent with CFPB Servicing Standards (Regulation X) and the National Mortgage Settlement (NMS).
  - **Documents Complete/In Active Loss Mitigation Review:** Provide a 60 day automatic extension from the date at which a complete application is submitted.
  - **Denial:** Provide a 90 day automatic extension once a borrower has been denied loss mitigation, which would provide time to obtain and address any borrower appeals of the loss mitigation decision in accordance with CFPB Servicing Standards (Regulation X).

- **Increase the extension periods currently allowed for certain events and/or allow for multiple extensions, including:**
  - **Loss Mitigation Failure:** Increase the current extension period from 90 to 120 days to allow servicers sufficient time to re-evaluate borrowers who failed a loss mitigation option for other loss mitigation solutions.
  - **Bankruptcy:** Provide multiple automatic 90 day extensions for bankruptcy through SFDMS if the time provided by a single extension is not sufficient. The current 90 day automatic extension is adequate in some cases, but often is insufficient depending on bankruptcy timelines in local jurisdictions.
  - **Re-evaluate standing:** Provide an automatic extension of 30 days for delays in addressing title issues, with the ability to request additional extensions if required. Courts are applying greater scrutiny to loan documentation to ensure that the “right party” is bringing a foreclosure action. While in the past, issues with title could be addressed after the first legal action, this is no longer possible in all cases. Servicers frequently require more time to ensure clear title before the first legal action can be taken.
In addition to these changes, FHA should work with the industry to establish reasonable diligence timelines that can actually be achieved by servicers with reasonable performance. Only performance outliers should be penalized—reasonable performance should not. The GSEs currently set their standards so that roughly 70% of all loans will fail. We do not believe that the GSE standards are appropriate ones.

2.0 Property Preservation and Conveyance

While servicers generally foreclose in their own name, properties are conveyed to other entities that insure or invest in mortgages (GSEs, VA, private) within 24 hours of foreclosure sale or redemption (the direct conveyance model). For FHA, servicers must convey the property within 30 days of the later of the foreclosure sale or the receipt of marketable title, and complete repairs required to ensure that the property is in “conveyable condition.” Currently, FHA is holding servicers responsible for maintaining the property until the claim is paid by HUD, rather than the date on which the claim is filed and title is conveyed to the Department. Exceptions, however, can significantly delay claim payments, extending the servicer’s costs associated with vandalism and/or continued deterioration of the property for one or two additional months even though title has been conveyed to HUD.

Despite the recent slowdown in foreclosure sales, conveyance inventories and timelines have increased significantly. For example, two large servicers reported that their average conveyance inventories increased by more than 50% from the third quarter of 2013 to the first quarter of 2014, while their average conveyance timelines increased from 104 to 160 days. Extended timelines primarily reflect the age and physical condition of properties entering the conveyance process. According to CoreLogic, the average “age” of foreclosed properties (measured by number of months delinquent) increased from 20.1 months in 2011 to 25.5 months in 2013, an increase of 27%. In Florida and New York, the average age at foreclosure completion was 41.0 and 36.6 months, respectively, in 2013.

The condition of property at intake to the conveyance inventory has also deteriorated, as evidenced by the level of required repairs. While HUD has a total repair allowance of $2,500, two large servicers reported that they are currently spending an average of $3,500 to $4,000 in post-foreclosure repairs.

Finally, while properties must be vacant prior to conveyance, three large servicers reported that between 20% and 35% of their conveyance inventory was occupied in March 2014. This further complicates the conveyance process, which must conform to complex and varied state eviction laws. It also increases the likelihood of vandalism and further degradation of the property that often accompanies forced evictions. Two servicers reported that roughly half of all occupied properties require a forced eviction.

2.1 Key Issues Associated with Property Preservation and Conveyance

The working group has identified the following key issues associated with the property preservation and conveyance process:

- FHA’s total allowance for repairs is inadequate, given the aging of the foreclosure inventory, deferred maintenance, and the complexity of required repairs. While some large servicers may be willing to
absorb such losses in order to minimize reputational risk, others may elect to take severely aged properties into their own REO, forgoing FHA insurance, to allow for sale in "as-is" condition.

- Line-item caps for specific types of repairs (e.g., roof) further contribute to these problems and often lead to superficial repairs that are not in the long-term interests of HUD. While servicers can submit requests for exceeding the allowance for a particular line item, the negotiation process is time-consuming and the outcomes, highly uncertain. According to one servicer, requests to exceed allowance were required for nearly 50% of conveyed properties in March 2014, and nearly half of these requests were ultimately denied. Another servicer reported that the average amount denied was roughly $4,000.

- Standards of "conveyable condition" are also unclear. While the guidelines require that hazardous conditions be addressed and that the property is "broom swept," they are often enforced to a standard of "marketable condition." Differing interpretations of the guidelines between HUD and servicers has also led to an increase in re-conveyances — an extremely costly result for both FHA and servicers.

- In all too many cases, extended timeframes between conveyance and payment have increased the servicer’s liability for properties that have already been conveyed to HUD. Uncertainty regarding the payment of claims—and the liabilities that accompany that uncertainty—have further contributed to the uncertainties regarding the servicer’s potential exposure to foreclosure-related losses.

2.2 Potential Solutions

In the long-term, the working group believes that FHA should adopt a direct conveyance model in which properties are transferred to HUD immediately following the foreclosure sale. This approach would allow FHA 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 through FHA’s own vendor network, and eliminate costly and time-consuming negotiations over allowable expenses and expense overages.

However, recognizing that in-sourcing the conveyance process would require significant time to design and implement, we believe that HUD should consider implementing the following short-term changes:

- **Increase and expand the scope of the Claims without Conveyance of Title (CWCOT) programs, including the Second Chance program, to allow for more third party sales through auction or direct retail sales.** In addition, HUD should consider expanding the number of outlets and the level of discounts for both programs to facilitate the sale of foreclosed properties, and adjusting Fair Market Values to consider property condition and MSA (vs. state) property values.

- **Increase the allowance for preservation expenses to $5,000 while retaining the servicer’s ability to request additional funds.** Increasing the property preservation allowance to a more realistic level will make the process more efficient by reducing the number of required "exceptions." At the same time, preserving the servicer’s right to request additional funds if needed is critical to property preservation efforts in high cost states such as New York.
• Delegate authority to servicers to manage a total pool of expenses within the allowance. This would eliminate the time consuming process of requesting/approving line-item exceptions. It would also allow the servicer to consider local market conditions and to avoid more costly post-foreclosure solutions by spending more on pre-foreclosure repairs.

• Increase relocation allowances to $3,000 (consistent with FNMA standards) to incent occupants to vacate the property and reduce the level of lengthy eviction proceedings. This would benefit the MMI Fund by shortening conveyance timelines and reducing the costs of property preservation.

• Accelerate the timing of the inspection by FHA’s Field Service Manager (FSM), and require the FSM to certify that the property is in conveyable condition. This review would mitigate servicer risk of subsequent vandalism/required repairs and the risk of re-conveyances.

3.0 Summary and Next Steps

We appreciate the Department’s efforts to improve the administration of the FHA program in a way that benefits lenders, borrowers and the MMI Fund. While much will be gained from HUD's quality assurance and handbook initiatives, we believe that the additional steps we are suggesting will make those efforts more successful.

In the long term, we believe that FHA can best achieve its objectives by eliminating its separate requirements for first legal action and reasonable diligence and moving to a direct conveyance model. In the short term, however, we believe that the particular changes we are suggesting will help to reduce the uncertainty currently associated with the FHA foreclosure and conveyance process, which should ultimately help to reduce the incidence of credit overlays. We are therefore asking that HUD consider incorporating these recommendations in its upcoming servicing handbook.

We would welcome the opportunity to meet with your staff to discuss these recommendations in more detail. If you have any questions, please feel free to contact us.

Regards

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