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U.S. Department of Housing and Urban Development



**"H.R. 5679, The Foreclosure Prevention and
Sound Mortgage Servicing Act of 2008"**

**Subcommittee on Housing and Community Opportunity
Committee on Financial Services**

U.S. House of Representatives

April 16, 2008

Chairwoman Waters, members of the subcommittee, on behalf of Secretary Jackson and Commissioner Montgomery, thank you for allowing the Federal Housing Administration to participate in this hearing and to discuss the critical difference that sound servicing practices can make in preventing mortgage foreclosures. While a mortgage servicer is rarely the cause of a default, timely and comprehensive servicing actions can and do enable many delinquent borrowers to avoid foreclosure and retain homeownership.

This dynamic is well illustrated by looking at the highly successful FHA Loss Mitigation Program, which encompasses a series of flexible workout options for managing seriously delinquent loans – defined as those that are more than 90 days delinquent – in the FHA portfolio. These workout options are administered not by government staff, but by FHA servicers. FHA provides monetary incentives to encourage servicers to help borrowers recover from serious default and provides additional incentives to those servicers with an exemplary record of working with borrowers and mitigating claim costs to the FHA insurance funds.

Mandatory Participation

It is important to stress that although loan servicers have delegated authority to execute individual loss mitigation actions, participation in the FHA Loss Mitigation Program is not optional.

- Within 45 days of default, every delinquent borrower must be provided comprehensive written information about workout options, including contact information for HUD-approved housing counseling agencies.
- Each borrower must be evaluated for loss mitigation by the 90th day of default.
- No servicer may initiate foreclosure until their senior management committee has reviewed the loss mitigation analysis and determined that the borrower does not qualify for any option.
- Servicers must offer loss mitigation throughout the foreclosure process any time the borrower requests such consideration or the servicer becomes aware that the borrower's financial situation may have improved and assistance is now an option.
- And finally, these activities must be reported to FHA monthly and documented in the loan file.

To ensure compliance, FHA has developed a sophisticated tiered ranking system to both monitor and rate each servicer's commitment to loss mitigation. Top ranked servicers – those who reported some type of loan work action for at least 80 percent of their seriously delinquent loans – are eligible to earn increased incentives. In the most recent round of tier ranking published in January 2008, 89 servicers ranked in Tier One and only five servicers ranked in Tier Four. Servicing lenders that do not take loss mitigation seriously are in jeopardy of paying to FHA a fine equal to triple the cost of their foreclosure claim and can also be held accountable with other sanctions.

Focus on Home Retention

The vast majority of delinquent loans are reinstated through simple repayment plans executed in the first or second month of delinquency. FHA's home retention options are targeted at seriously delinquent borrowers who demonstrate an ongoing commitment to keep their homes but who require more than just a short-term repayment plan to help them regain their financial footing. These options include:

Special Forbearance – A long-term repayment plan that provides one or more special repayment provisions, such as a reduction or suspension of payments for a period of time while the borrower recovers from the cause of the default.

Mortgage Modification – A permanent change to one or more of the mortgage terms including capitalization of delinquent payments, re-amortization of the payments or a change in the interest rate that will fully reinstate the loan and potentially result in a lower monthly payment.

Partial Claim – A loan provided by FHA in an amount necessary to reinstate the delinquent mortgage. The loan is interest free and is not due and payable until the first mortgage is paid off. This option provides up to 12 months of mortgage payment assistance to borrowers who have the ability to resume making full payments but do not have funds to bring their loan current. Until recently, this option was only available through FHA, but recently Fannie Mae introduced a HomeSaver Advance workout patterned on the FHA model.

Disposition Options

For borrowers who are financially unable or no longer wish to retain homeownership, perhaps because of a death or divorce, FHA provides pre-foreclosure sale and deed-in-lieu of foreclosure options. In these "disposition" options, FHA provides the borrower with compensation of up to \$2,000 to ease the transition to more affordable housing.

A **Pre-Foreclosure Sale** allows a borrower to sell the house on the private market and use the proceeds of the sale to fully satisfy the mortgage debt, even if the proceeds are less than the amount owed.

The **Deed-In-Lieu** option allows a borrower who has been unable to sell his or her home, the ability to deed the property to FHA in full satisfaction of the debt rather than be subjected to a foreclosure action.

While these disposition options provide needed relief to borrowers whose financial situation has changed to the extent that they cannot resume making payments, FHA's commitment to home retention is evident in use patterns. In FY 2007, for example, 95 percent of all loss mitigation workouts resulted in the borrower keeping the home, while less than 5 percent of borrowers received loss mitigation through a pre-foreclosure sale or a deed-in-lieu.

Program Flexibility

One of the significant strengths of the FHA Loss Mitigation Program is its flexibility. FHA is continually monitoring market conditions and making changes to its loss mitigation options in response to economic or other trends. For example, following the terrorist attacks of September 11th, FHA added a new home retention tool, “Special Forbearance for the Unemployed Borrower,” to address the specific needs of borrowers who were temporarily un- or under-employed but had a strong employment history and no prior defaults. After a series of hurricanes struck the Gulf Coast region in 2005, FHA created a special Mortgage Assistance option to advance up to 12 months’ worth of mortgage payments to borrowers who were in the process of rebuilding their homes but could not rebuild and make monthly mortgage payments at the same time. Currently we are working on potential policy improvements that will eliminate some of the impediments to the mortgage modification and preforeclosure sale options to assist more borrowers who have negative equity while remaining actuarially sound.

Loss Mitigation Results

The dual goals of the FHA Loss Mitigation Program are to help FHA insured borrowers avoid foreclosure and to minimize losses to our Insurance Funds. The program is successfully achieving both of these goals.

Use of loss mitigation tools to prevent foreclosure has increased exponentially since the program was first introduced in 1997. In that year, only 773 families received help keeping their homes, while 64,000 properties were acquired through foreclosure. That dynamic has shifted dramatically in the ensuing years. In five of the past six years, loss mitigation use exceeded the number of foreclosures. Last year alone, FHA helped 86,500 seriously delinquent borrowers retain home ownership.

As loss mitigation use has increased over time, there has been a corresponding reduction in foreclosure claims. Contrary to the incorrect report in last Sunday’s *Washington Post*, the percentage of FHA insured loans that terminated in foreclosure has decreased every year for the past three years, from 1.64 percent of all FHA loans in fiscal year 2004 to 1.42 percent in 2007. It is equally important to note that these workouts are not a temporary fix. While it is unrealistic to expect that every loss mitigation action will be a success, 87 percent of borrowers who received home retention workouts in 2005 still had active loans in 2007. And, in terms of preserving the financial integrity of the insurance funds, the \$158 million paid in home retention claims last year had a net benefit of \$2 billion in loss avoidance.

The FHA Loss Mitigation program is comprehensive, dynamic and successful at both reducing financial losses and helping ever increasing numbers of FHA borrowers retain homeownership. It is also a central reason that FHA is considered a safe and affordable loan product. Many subprime borrowers would have benefited from an FHA loan. Going for the quick close, many mortgage originators and borrowers ignored the warning signs that these products were not economically viable in the long term.

Fortunately, many borrowers now stuck in uneconomic subprime ARMs have the option of refinancing through *FHASecure*. This program, introduced by President Bush in September 2007, gave the Department greater flexibility to allow borrowers who became delinquent as the result of an interest rate reset the option to refinance to FHA. As of April 10, 2008, 155,000 borrowers had closed on a fixed rate, *FHASecure* loan. Just last week, in this hearing room, Commissioner Montgomery announced additional mortgage assistance for subprime borrowers by giving FHA the ability to insure loans for borrowers who are a few payments late or who have received a voluntary mortgage principal write-down. *FHASecure* is now expected to assist 500,000 at risk borrowers by the end of December 2008.

However, *FHASecure* may not be the most appropriate workout solution for every borrower. We strongly encourage servicers to consider all available loss mitigation strategies.

In closing, I would like to again thank the Subcommittee for its thoughtful consideration of loss mitigation. The Administration is committed not only to helping American families achieve homeownership but also to helping them preserve it.