Strengthening the Federal Housing Administration's Homeownership Programs

The Federal Housing Administration (FHA) plays an indispensable role in helping low-income families and other traditionally under-served populations achieve the dream of homeownership. FHA's support for sustainable low down payment lending dovetails perfectly with HFAs' affordable homeownership missions.

In recent years, nearly three-quarters of HFA loans were insured by FHA. As government entities, HFAs are authorized to provide down payment assistance in connection with FHA mortgages. This is crucial because one of the biggest impediments to purchasing a home for otherwise responsible borrowers is the cost of affording a heavy down payment.

NCSHA recommends that HUD consider the following changes to FHA policies and guidelines to improve FHA's ability to support affordable homeownership.

<u>Origination/Underwriting</u>

Examine FHA Premiums

Given the strong financial standing of the Mutual Mortgage Insurance Fund's (MMIF), NCSHA believes the time has come for HUD to take a fresh look at whether FHA should reduce its premiums to make homeownership more affordable.

NCSHA recognizes that the MMIF experienced significant losses in the wake of the housing crisis, prompting HUD to enact five separate premiums increases and reenact the life of loan policy. In recent years, however, the MMIF has regained its financial footing and is continuing to grow. FHA's capital ratio has also returned to its statutory minimum level and is projected to continue improving in the near future. FHA loan performance has also improved considerably in recent years—its serious delinquency rate has declined 50 percent since the crisis began and is near a ten-year low.

Despite HUD reducing annual mortgage insurance premiums for most single-family loans by 50 basis points in 2014, FHA premiums remain elevated by historical standards. This results in increased costs for homeowners and prices responsible working families out of the home purchase market altogether. The may also steer higher-quality borrowers away from FHA loans in favor of alterative options, depriving the MMIF of a vital source of income.

FHA's decision in 2013 to once again apply annual insurance premiums throughout the life of the entire loan, instead of canceling them after the outstanding principal balance reaches 78 percent of the original balance, has likewise made FHA-insurance a less accessible options for working families. As with the higher premiums, this policy also hinders the strength FHA's book of business because many higher-quality borrowers refinance out of FHA-insured loans to avoid paying the premiums.

Amending FHA Underwriting of Mortgage Credit Certificates to Maximize Borrower Benefit

Federal tax law allows HFAs to use their tax exempt single family mortgage revenue bond authority to provide low- and moderate-income borrowers with Mortgage Credit Certificates (MCCs). MCCs allow borrowers to claim a federal tax credit for a portion of the mortgage interest they pay each year. Specifically, borrowers may claim a credit on up to 30 percent of their mortgage interest costs (50 percent for new construction loans) up to $2,000 each year.

MCCs have proven to be a valuable tool for HFAs in supporting affordable homeownership opportunities. However, FHA's underwriting guidelines currently reduce the value of a borrower's MCC benefit by not allowing the benefit to be considered when calculating their mortgage payment-to-effective income ratio (PTI) and their total debt-to-income ratio (DTI).

Specifically, page 178, Sec.4 a.iii.(A)(1)) of FHA's Single Family Policy Handbook (hereafter referred to as the "FHA Handbook") states that, when calculating a borrower's monthly mortgage payment for the purpose of calculating their PTI and DTI, mortgagees "may deduct the amount of the Mortgage Credit Certificate or Section 8 Homeownership Voucher if it is paid directly to the Servicer." MCC benefits are not paid to the servicer but rather directly claimed by the borrower when filing his or her federal taxes, so this provision effectively prevents MCC benefits from being deducted from a borrower's mortgage payment. This is turn increases the borrower's PTI and DTI ratios and makes it less likely that they will be approved for an FHA loans.

NCSHA requests that HUD amend the FHA Handbook so that the tax savings a borrower realized from their MCC can be fully incorporated into the FHA underwriting process.

<u>Servicing/Loss Mitigation Policies</u>

As public-mission driven entities, HFAs are deeply committed to helping struggling borrowers remain in their homes. However, many of HUD's serving and loss-mitigation standards have proven to be burdensome and unworkable. NCSHA asks that HUD make several crucial adjustments to FHA's pre-foreclosure requirements that will reduce unnecessary compliance burdens and allow mortgage lenders and servicers to more efficiently operate their loan modification and assistance efforts

Rescind FHA Face-to-Face Meeting Requirement

FHA regulations (24 CFR Section 203.604) require all mortgagees to have a face-to-face meeting with the borrower, or make a reasonable effort to do so, before the borrower is seriously delinquent. "Reasonable effort" consists of at least one letter sent to the borrower by certified mail and at least one in-person visit to the borrower in his or her home. In addition to the regulation, FHA's Single Family Policy Handbook ("The FHA Handbook") (paragraph III.A.2.h.xxi.(A)3, page 595) requires that the individual conducting the in-person visit have the ability to negotiate repayment plans with the borrower.

While this requirement is certainly well-intentioned, in practice it has proven costly and difficult to meet. What's more, it often provides little benefit to borrowers. In order to fully comply with the regulations and Handbook as currently written, mortgagees have to either engage a third party vendor or hire and train representatives who have the capability to negotiate loan modifications or divert previously trained staff to the task of traveling to contact borrowers at their homes. Hiring and training staff with such credentials can be prohibitively expensive, particularly for public mission-driven mortgagees such as HFAs. In addition, despite mortgagees' good faith efforts to set up face-to-face meetings, home visits are often not successful.

The requirement is also unnecessary in today's housing market. It was instituted during a time when most mortgage servicing and origination was performed locally, and when borrowers were less likely to know of the mortgage modification options available to them. Today, most servicers must follow the Consumer Financial Protection Bureau's mortgage servicing rule, as well as various state laws, which require servicers to make a variety of contacts to delinquent borrowers to make them aware of their options for loss mitigation. HUD itself found that the Face-to-Face requirement to be "obsolete" in 2007.

NCSHA strongly recommends that FHA rescind the face-to-face meeting requirement to allow HFAs and other servicers to shift their resources to more effective loss mitigation efforts.

Allow Longer Timelines for Repayment Plans

When delinquent borrowers with FHA-insured loans are ineligible for FHA's Home Affordable Modification Program (either because they have already completed HAMP, their loan was funded through tax-exempt mortgage revenue bonds, or the loan has not yet seasoned), HFAs that service loans in-house will offer borrowers forbearance plans to help them keep their homes. Under FHA's Handbook (paragraph III.A.2.k.ii.(A), page 611), such plans cannot exceed six months in duration.

Six months is often an inadequate amount of time to structure a forbearance plan that will meet the borrower's needs. That is especially true for the low- and moderate-income borrowers HFAs serve, many of whom lack substantial cash reserves and often fall behind on their mortgage payments due to adverse circumstances such as deaths in the family, divorce, or unexpected unemployment. While servicers can request variances for longer repayment plans, the process for applying and securing such variances is cumbersome and servicers have to apply for them on an individual basis.

Given HFAs' public missions and the underserved borrowers they serve, NCSHA suggests that HUD amend the Handbook to allow HFAs to offer longer forbearance plans to struggling borrowers.

Clarify Timing for Providing Borrowers with Loan Modification Agreements

Effective March 1, FHA's Single Family Handbook (paragraph III.A.2.K.vi.(F)(5)(A), page 633), requires that servicers provide borrowers with their FHA-HAMP modification agreement at 30 days before the permanent FHA-HAMP modification goes into effect. Permanent FHA-HAMP modifications go into effect on the first day of the second month after the month following the month when borrowers make their third monthly-payment during the Trial Payment Period (TPP).

This requirement is straightforward and simple to comply with in those instances in which a borrower makes their third and final trial modification payment at the beginning of the month. However, when borrowers make their third monthly trial payment near then end of the month, servicers have to scramble to get the loan modification agreement to borrowers by the 30-day advance deadline. This compressed timeline creates needless administrative difficulties for HFAs and other servicers.

Some HFAs have told us that, in order to ensure they comply with the 30-day advanced notice, they send borrowers the FHA-HAMP documents after the borrowers pay their *second* trial payment. They are concerned that this could confuse borrowers, who may think they have already been approved for a permanent modification despite still having to make one more trial payment.

NCSHA asks HUD to publish guidance explaining how HFAs and other servicers can comply with the 30-day advanced notice timeframe without having to send borrowers such documents before they have completed their trial modifications.

Address Property Preservation Costs for Rural Areas

In the unfortunate cases where an HFA or other servicer must foreclosure upon a home, the servicer is responsible for arranging for a number of property preservation and protection activities, such as snow removal and changing locks, until the property is conveyed to FHA. FHA typically reimburses servicers for the costs associated with such activities after conveyance.

In rural areas of the country, it is often expensive to hire contractors to perform such activities because there are so few contractors available and they need to travel long distances. The reimbursements FHA offers for such servicers do not account for these increased costs, and are often insufficient to cover the servicer's expenses. In such instances, the servicer effectively pays the difference out of pocket.

As public entities, HFAs cannot afford to consistently realize loses for required property protection and preservation activities without it significantly hampering their affordable homeownership programs. NCSHA recommends that FHA examine its reimbursement rates for property preservation and protection activities to take into account the increased costs of ordering such services for properties in rural areas.

Rescind Proposed Floodplain Standards for FHA-insured Properties

On October 28, HUD published a proposed rule (FR–5717–P–01) that would adopt more stringent floodplain requirements for housing funded, endorsed, or insured through HUD single-family and multifamily programs. Specifically, the proposed rule adopts higher elevation standards for all properties prospectively assisted by HUD programs, requiring that they be built at least two feet above the 100-year flood level. The standards are increased to three feet for certain "critical" properties.

NCSHA appreciates HUD's desire to update its floodplain standards to better reflect current risk levels. However, we are deeply concerned that the proposed standards would hinder the development and rehabilitation of needed affordable housing by substantially increasing costs. We are particularly concerned about the impact the proposed rule could have on development in disadvantaged markets, including many struggling industrial cities that have traditionally been based around bodies of water, rural areas, and those parts of the country where there is a limited amount of developable space.

Before HUD takes any further action on this issue, we ask that it thoroughly examine how new floodplain standards will impact the development and availability of affordable housing and take steps to mitigate the cost associated with compliance.

NCSHA's comments on the proposed rule, which were submitted in December, are attached.