NCSHA

National Council *of* State Housing Agencies

October 29, 2021

Ms. Lopa Kolluri, Principal Deputy Assistant Secretary for Housing
Ms. Julienne Joseph, Deputy Assistant Secretary for Single Family Housing
Office of Housing / Federal Housing Administration
Department of Housing and Urban Development
451 7th Street SW
Washington, D.C. 20410-8000

Re.: 40-Year Loan Modification COVID-19 Recovery Loss Mitigation Options

Ms. Kolluri and Ms. Joseph:

The National Council of State Housing Agencies (NCSHA)[1] and our state Housing Finance Agency (HFA) members appreciate the opportunity to comment on the Department of Housing and Urban Development's (HUD's) DRAFT Mortgagee Letter (ML) dated September 27, 2021.

We recognize that the Biden-Harris Administration has worked hard to evolve the options available to homeowners with a Federal Housing Administration (FHA)-insured mortgage so that more homeowners are able to retain homeownership and the wealth they had accumulated before being impacted by COVID-19. However, we believe that HUD's proposed ML goes a step too far by requiring that all servicers offer a 40-year loan modification + partial claim (40yrLM) to homeowners for whom a 30-year loan mod + partial claim is not sufficient to retain homeownership. This proposed change will adversely impact the mortgage revenue bond (MRB) programs that have formed the backbone of state HFA affordable mortgage programs for over 50 years because it will disrupt what is now a highly efficient market, cause investors to demand higher interest rates, and make it more difficult for state HFAs to assist future homeowners with affordable home mortgage loans.

We urge the Department to exempt state HFAs from being required to provide a 40yrLM, or, at a minimum, provide state HFAs (upon their request) with a waiver from this proposed obligation just as it did in 2009. At that time, the Department provided variances to the requirements of ML 2009-35 when a state HFA reviewed a mortgage loan for the Loan Modification/FHA-HAMP Options under HUD's then-Loss Mitigation Program. (See **Exhibit 1**)

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[1] NCSHA is a nonprofit, nonpartisan organization. None of NCSHA's activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.

As further support for the Department providing our requested exemption, it also can look to the example set by the Consumer Financial Protection Bureau (CFPB), which recognizes HFAs as "small servicers"[2] and has generally exempted small servicers from the requirements of its Protections for Borrowers Affected by the COVID-19 Emergency Under the Real Estate Settlement Procedures Act (RESPA), Regulation X Final Rule.[3]

To help you better understand why a waiver for state HFAs and their MRB loan programs is so necessary, we describe below how MRB programs work and are structured. We then discuss how the 40yrLM creates a mismatch in the structured amortization of MRBs and the negative implications this has for MRB programs and the ability of state HFAs to help future homebuyers who could not afford a market-rate mortgage loan to make their home purchase, or to assist struggling homeowners with other types of mortgage loans.

MRB Programs Are Unique and By Definition Serve Lower Income Homebuyers

MRB programs are unique to state and local housing finance agencies, and their structure differs significantly from the mortgage-backed securities (MBS) typically used by the for-profit mortgage lenders. MRBs have made first-time homeownership possible for over 3.36 million lower-income families, and historically, state HFAs have issued more than $331.67 billion in MRBs.[4]

State and local HFAs have authority under the Internal Revenue Code to issue federally tax-exempt housing bonds to support affordable housing activities in their states. Issuing bonds is a way for HFAs to access private capital markets to help support affordable housing activities. HFAs sell the tax-exempt bonds to individual and corporate investors who are willing to purchase bonds paying lower than market interest rates because of the bonds' tax-exempt status.

State HFAs, as MRB issuers, pass the interest savings to homebuyers through below-market interest rate mortgage loans (and often with substantial down payment assistance) that lower the costs of homeownership, enabling individuals and families who could not otherwise afford a market-rate mortgage loan to purchase a home and begin accumulating wealth.

Congress has placed limits on the use of MRB proceeds, which underscore the targeted purpose of this limited resource. Mortgage loans financed by MRB proceeds are restricted to first-time homebuyers who earn no more than the area median income (AMI). Larger families can earn up to 115% of AMI. Additionally, the price of a home purchased with an MRB-funded mortgage loan is limited to 90% of the average area purchase price (which itself is a percentage of the FHA mortgage limits). In 2020, state HFA MRB programs issued $9.122 billion in MRBs and

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[2] Per 12 C.F.R. 1026.41(e)(4)(ii)(B), HFAs are considered to be "small servicers."

[3] 86 FR 34848 published June 30, 2021 and became effective August 31, 2021.

[4] Ever-to-date, through December 31, 2020 (estimated).

financed 45,556 in new home mortgages. Generally, MRB borrowers earn less income and buy homes costing less than the MRB program limits allow.

In 2020, 13% of MRB borrowers earned less than 50% of the applicable median income (the greater of statewide or AMI). Twenty-eight percent earned 60% or less of AMI, and 51% of all MRB borrowers earned 80% or less of AMI. The national median income among MRB borrowers in 2020 was $52,493 -- two-thirds of the national median family income of $78,500 published by HUD for FY2020.

MRBs finance modestly-priced homes for borrowers who otherwise could not afford a market-rate mortgage loan. The national average price of an MRB-financed home was $183,611 in 2020, whereas the FHA loan limit in that year was $331,760, highlighting further the importance of state HFA homeownership programs in reaching lower income homebuyers.

The Structure of MRBs

MRBs are debt securities with specified, fixed maturities or required sinking fund redemptions (usually semi-annual). Unlike MBS, MRBs <u>are not</u> structured as pass-through securities. Instead, state HFAs owe scheduled principal and interest payments to MRB investors, whether or not mortgage loan principal and/or interest was received from homeowners. Furthermore, MRB bond indentures conform to municipal bond industry standards, which include 10-year lockouts on redeeming or calling a bond, except in the limited circumstance of when an underlying mortgage loan prepays. Hence, an HFA would owe investors the scheduled principal and interest that was promised, whether or not an asset-liability mismatch develops from underlying mortgage loans being modified.

The structuring of MRBs is conceptually simple: the scheduled monthly payments on the pool of loans to be financed are put into a spreadsheet, and then the scheduled principal components of those loans are grouped into semiannual amounts. Then semi-annual MRB bond maturities (or mandatory sinking fund redemptions, which are legally the same as maturities) are set to roughly equal those semi-annual amounts of loan principal payments. Typically, the longest bond maturities are no more than 32 years, and even less if all the loans are already originated by lenders and bought by the HFA with MRB proceeds. The interest rates on the MRB proceeds-financed mortgage loans are slightly higher than the bond interest rates, and the mortgage loan interest payments are used to pay the semi-annual MRB bond interest payments (the slight amount of loan interest not so used pays the HFA loan servicer fees and the HFA's administrative costs, such as the bond trustee and HFA program staff expenses).

MRBs are either backed by whole loans or by Ginnie Mae securities formed by loans funded from MRB proceeds. The proposed 40yrLM would adversely affect HFAs that use MRBs to finance whole loans as well as those that back their MRB with Ginnie Mae securities.

The Negative Impacts of the 40yrLM on HFA Whole Loan Programs

The proposed 40yrLM would reduce the principal payments (and very possibly the interest payments, depending on how the required 25% reduction in principal and interest payments was achieved) on the mortgage loans and stretch the principal payments out from 30 years to 40 years. This would result in less loan principal being available to pay the required principal on outstanding MRBs, and may even result in less loan interest available to pay interest on the MRBs, either of which could result in defaults on the HFA's MRBs *unless the HFA uses other funding to make up the shortfall because of the mismatch created in the structured amortization of the bonds.* Because HUD is requiring a 40yrLM to follow the 30yrLM in its loss mit waterfall, even if the desired 25% reduction in principal and interest is not achievable, it is artificially deepening the asset-liability mismatch that will occur from loan modifications.

If the HFA has other funds available (most HFA MRB indentures have some excess collateral, which is required by the rating agencies to get a rating on the MRBs), the HFA may be able to absorb the shortfall and avoid defaults on its MRBs, although one result could be a downgrade of the ratings of the MRBs (and thus a higher interest rate in the future on the MRBs and hence, future homebuyers). This clearly depends on the number of loans that would be modified under the proposed 40yrLM, which is unknown. Even though state HFAs are generally well-capitalized, to the extent that the 40yrLM causes the HFA to have to use its other general funds to make up shortfalls created from a mismatch in an MRB's structured amortization, those general funds will not available for the HFA's other affordable housing programs or to help future homeowners.

Additionally, and just as importantly, the 40yrLM, if finalized as proposed, may cause some state HFAs to be out of compliance with the terms of their bond indentures, potentially triggering a non-monetary or technical default. Although most HFA enabling state-level statutes do not limit the maturity of loans that the HFA can finance, in some cases the bond indentures that secure the MRBs do limit the maturities. Modifications of loans into 40-year term loans most likely were not disclosed in bond documents so they would cause disclosure-related issues if investors deemed the extended loan modification terms to be "material" and in violation of the bond indenture, thereby creating a technical default. Finally, all HFA MRB indentures contain a financial covenant which requires the HFA to follow sound banking practices, and extensive modifications may violate that covenant, especially if the modifications create cash flow issues for the HFA.

Impact of the 40yrLM on MRBs Secured by Ginnie Mae Securities

If an HFA issues MRBs which are collateralized by Ginnie Mae securities (whose underlying loans are MRB-qualified loans), the structuring is the same as described above, but it is based on the expected Ginnie Mae payments (which reflect the underlying loans). Because modification of a mortgage loan results in a requirement that the Ginnie Mae seller/servicer buy the loan out of the Ginnie Mae pool, the buyout constitutes a Ginnie Mae prepayment, which is a legitimate reason for the HFA to redeem/refinance a like amount of MRBs. (Note – this is in contrast to the whole loan structure discussed above, where a loan modification does not create a prepayment of the loan or right to redeem/refi the related MRBs.)

However, for those state HFAs that are Ginnie Mae seller/servicers or use a sub-servicer for their loans, the HFA has to have the liquidity outside the MRB indenture to buy out the modified loans (as is the case with loans modified into a 30-year loan mod, too). While the MRBs are protected because Ginnie Mae guarantees the Ginnie Mae payments which secure (and are used to pay) the MRBs, because HUD's loss mitigation waterfall requires a 40yrLM to be offered to a homeowner even if the target interest reduction is not achieved, loan modifications will undoubtedly be higher in number than otherwise anticipated and HFAs will have increased needs to use their general funds to buy out the loans from the Ginnie Mae pools.

[We also wish to note that some HFAs serve as a master servicer on behalf of other state HFAs, so are even more concerned that the required 40yrLM will result in larger buyouts from Ginnie Mae pools and strain the ability of those HFAs to fund other affordable housing programs.]

Lack of Liquidity for a 40-Year Security

While the Department has already provided for the creation of 40-year Ginnie Mae pools, 40-year Ginnie Maes are not liquid securities and issuing them will result in financial losses for the issuer. Who does HUD believe will invest in 40-year Ginnie Mae securities at competitive rates?

There currently is no market for 40-year Ginnie Mae securities. It also is not clear who the investors in such a security would be, or how much an investor in the 40-year pools will demand for purchasing the securities. These uncertainties are exacerbated by several important market considerations. First, there are no 40-year FHA mortgage loans originated to homebuyers. Hence, a 40-year Ginnie Mae pool will be 100% composed of previously defaulted mortgage loans, making the life of the security much less predictable and less fungible (due to the limited size of the market), and thus, priced much higher. In the absence of any market performance data to analyze, investors will assume the worst case scenario in terms of performance and prepayment speeds, further impacting pricing. Investors are likely to assume that the automatically modified mortgage loans will have higher re-default rates, too. [The preceding sentence is true about making the expected life of the Ginnie Mae's more difficult to determine, but it isn't true about MBS losses since Ginnie Mae guarantees the Ginnie Mae MBS payments.] Hence, our members anticipate significant losses when selling 40-year pools.

In Conclusion

In summary, adding a 40-year loan modification to COVID-19 Recovery Loss Mitigation Options will have a significant negative effect on HFAs and their ability to provide mortgage financing to first-time homebuyers now and into the future. State HFAs issue MRBs to finance their homeownership programs that are collateralized by FHA-insured whole loans or MBS guaranteed by Ginnie Mae. These bonds are structured and sold to investors assuming principal payments based on a structured, fixed 30-year amortization schedule. If FHA-insured loan terms are extended by 10 years, then a mismatch in expected loan principal receipts versus bond debt service will occur. If enough 40-year loan modifications were to be executed – and at this point it is impossible to know how many that could be -- there would be a shortfall in bond debt service which could lead to rating downgrades to state HFA bond programs. Highly rated state HFA bond programs are key to access capital at low rates to pass along to the nation's first-time homebuyers.

While HUD created a similar potential problem for state HFAs 10 years ago with its HAMP program, it also provided HFAs the right to opt out of the HAMP program if participating could possibly cause cash flow problems for the HFA's MRBs. Please consider extending the same flexibilities to state HFAs now, too, or preferably, exempting state HFAs from being required to provide a 40yrLM.

We welcome the opportunity to discuss this matter with you in greater detail at your convenience.

Respectfully,

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives

Exhibit 1

U.S. Department of Housing and Urban Development
National Servicing Center, HUFM
301 NW 6th Street, Room 200
Oklahoma City, OK 73102
http://www.hud.gov/offices/hsg/sfh/nsc/nschome.cfm

November 24, 2009

Mr. Brent Adney
Director Homeownership Programs
South Dakota Housing Development Authority
P. O. Box 1237
Pierre, SD 57501

RECEIVED NOV 30 2009

Dear Mr. Adney:

SUBJECT: Variance Request to Mortgagee Letter 2009-35
- Loan Modification/FHA-HAMP Options

The purpose of this letter is to provide guidance to your letter of November 9, 2009; whereas, South Dakota Housing Development Authority (SDHDA) is requesting a Variance to the requirements of Mortgagee Letter 2009-35 when reviewing for the Loan Modification/FHA-HAMP Options under HUD's Loss Mitigation Program.

SDHDA has stated that funding for single family homeownership mortgages are acquired through the sale of Mortgage Revenue Bonds and that due to the requirements of these funds that SDHDA cannot extend the term of a mortgage beyond the original 30 years and the interest rate cannot be reduced; therefore, SDHDA cannot utilize HUD's Loan Modification/FHA-HAMP Options.

Based upon SDHDA's letter, the National Servicing Center (NSC) approves SDHDA's Variance Request. NSC does recommend complete documentation within the Servicing File for each delinquent asset; whereas, HUD's Loan Modification/FHA-HAMP Options could not be utilized.

Should you have any questions, please don't hesitate to contact Debra Beacham at (405) 609-8452 or Debbie.K.Beacham@hud.gov.

Sincerely,

Acting for
Sharon A. Lundstrom
Director, National Servicing Center

Cc: Karen Baker – QAD Director – Denver