National Council *of*
State Housing Agencies

April 10, 2024

Ms. Ingrid Ripley
Executive Director
Single-Family Housing Guaranteed Loan Program
Rural Housing Service
U.S. Department of Agriculture
1400 Independence Avenue, SW
Washington, DC 20250-0701

**RE: Proposed Changes to Chapters 17, 18 and 19 to Rural Development Single-Family Housing Guaranteed Loan Program, Handbook 1-3555**

Dear Ms. Ripley:

The National Council of State Housing Agencies (NCSHA),[1] on behalf of its state Housing Finance Agency (HFA) members, submits our below comments on RD's proposed revisions to Chapters 17, 18 and 19 of Handbook 1-3555.

We applaud Rural Development (RD) for creating its "Policy Desk" as a way of obtaining feedback on changes it is considering to its policies. Being able to provide actionable feedback before chapters on program handbooks become permanent is a useful way to ensure that once proposed changes are finalized, mortgage lender and servicer concerns have been taken into consideration.

We are generally supportive of the changes RD has made, as the proposed changes give mortgage loan servicers the flexibility to work with homeowners and provide loss mitigation options that enable them to stay in their homes. For example, RD uses "may" quite often when describing options under the Streamline Option. We also appreciate that RD updated various fee schedules to reflect more current costs.

As currently drafted, RD's Streamlined Option language and the detail contained in the Chapter 18 Appendix appear to accommodate the intricacies of state HFA tax-exempt mortgage

[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.

revenue bond (MRB) mortgage loan programs, which generally offer below-market interest rates to first-time, lower-income homebuyers. However, as we explain below, should RD's final draft incorporate language that requires an increase in loan term, there could be significant negative consequences for state MRB programs unless RD provides a carve-out for MRB programs similar to that provided by the U.S. Department of Housing and Urban Development (HUD).

**Background on State HFAs**

NCSHA is a nonprofit, nonpartisan organization created to advance, through advocacy and education, the efforts of the nation's state HFAs and their partners to provide affordable housing to those who need it.

In 2022, on average, five percent of state HFA program mortgage loans were guaranteed by RD programs, although in some rural states, the percentage of Single-Family Housing Guaranteed Loan Program (SFHGLP) loans was significantly higher. For example, in Maine, 48 percent of MaineHousing's single-family loans are USDA program loans, while in Vermont, 27 percent are and in South Dakota, 16 percent are.

As you know, state HFAs either purchase loans from their lender partners and sell them to a "master servicer," or they retain the ownership of the loan. Sixteen state HFAs service their own mortgage loans, fourteen of which offer USDA RD mortgage loans through their homeownership programs; three service USDA RD mortgage loans on behalf of other state HFAs, either as a "master servicer" or a sub-servicer.

**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 to fund mortgage loans. MRBs have made first-time homeownership possible for over 3.47 million lower-income families. Cumulatively, state HFAs have issued more than $354.4 billion in MRBs.[2]

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. The interest rate differential between a mortgage loan funded from an MRB and one from a taxable funding source varies depending on when the issuance used to fund the mortgage loan goes to market and the prevailing interest rate at the time a borrower seeks a mortgage loan. However, HFAs generally report a 50 basis point to 200 basis point rate advantage.

[2] Ever-to-date, through December 31, 2022 (estimated).

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 percent of AMI. Additionally, the price of a home purchased with an MRB-funded mortgage loan is limited to 90 percent of the average area purchase price (which itself is a percentage of the FHA mortgage limits). In 2022, state HFA MRB programs issued $12.257 billion in MRBs and financed 56,802 new home mortgages.

Generally, MRB borrowers earn less income and buy homes costing less than the MRB program limits allow. In 2022, 14 percent of MRB borrowers earned less than 50 percent of the applicable median income (the greater of statewide or AMI). Twenty-six percent earned 60 percent or less of AMI, and 53 percent of all MRB borrowers earned 80 percent or less of AMI. The national median income among MRB borrowers in 2022 was $59,465 – two-thirds of the national median family income of $90,000 published by HUD for FY2022.

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 $203,585 in 2022, whereas the FHA loan limit in that year was $420,680, 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. Extending loan modifications out for up to 480 months would adversely affect HFAs that use MRBs to finance whole loans as well as those that back their MRB with Ginnie Mae securities. For example, by stretching borrower principal payments out beyond 30 years to up to 40 years, less loan principal will be made available to pay the required principal on outstanding MRBs. This may even result in less loan interest available to pay interest on the MRBs. Either of these scenarios 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.

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 with an extended term, which is unknown. Even though state HFAs are generally well-capitalized, to the extent that loan term extensions cause 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 be available for the HFA's other affordable housing programs or to help future homeowners.

Additionally, and just as importantly, a mandatory, up-to-40-year loan modification 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 the HFA can finance, in some cases the bond indentures that secure the MRBs do limit the maturities. Modifications of loans into greater than 30-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.

**Concerns with the Proposed Changes**

**Chapter 18: Servicing Non-Performing Loans – Accounts with Repayment Problems**

**Section 18.9A: Final Offer (Streamline Option)**

NCSHA thanks RD for providing servicers with the flexibility to offer a Streamline Option should the borrower meet its list of criteria. We also thank the RD for not making mandatory

either interest rate modifications or the up-to-40-year loan modification, which as phrased, accommodates the constraints of MRB-funded mortgage loans (*emphasis* added):

- "The interest rate *may* be modified."
- "The loan repayment period *may* be extended in one month increments to the maximum term allowable, not to exceed 480 months."

Additionally, in Attachment 18-A: The Loss Mitigation Guide, Section I. Modification Options, RD again includes flexibilities that accommodate state HFA programs in Item 4: "The Servicer may establish lower rate and/or term allowable costs based on contractual restrictions," which provides state HFAs with the flexibility they need to provide loss mitigation solutions to homebuyers while staying in compliance with their bond disclosure documents.

We urge RD, as it finalizes its changes to this Chapter, to both retain these flexibilities and provide a clear statement that exempts mortgages funded by tax-exempt MRB programs from both of these requirements just as HUD has done. The extension of existing loan terms create unique complications for loans funded through MRB programs that have formed the backbone of state HFA affordable mortgage programs for over 50 years. In short, it will disrupt what is now a highly efficient market, cause investors to demand higher interest rates thereby blunting the effect of the tax-exempt interest rate advantage of the product and make it more difficult for state HFAs to assist future homeowners with affordable mortgage loans.

For reference, here are examples of HUD's exemption language from two sections of its loss mitigation waterfall:

> a. Exemption from COVID-19 Recovery Modification[3]
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> Mortgagees that service Mortgages funded in connection with mortgage revenue bonds that are restricted by the Internal Revenue Code are exempt from the COVID-19 Recovery Modification if they cannot extend the term of a Mortgage beyond the original 30 years or the interest rate cannot be modified.
>
> b. Exemption for FHA-HAMP[4]
>
> Mortgagees that service Mortgages funded in connection with mortgage revenue bonds that are restricted by the IRC are exempt from the FHA-HAMP Standalone Modification or FHA-HAMP Combination Loan Modification and Partial Claim if they cannot extend the term of a Mortgage beyond the original 30 years or the interest rate cannot be modified.

[3] HUD Handbook 4000.1 dated 10/31/2023, page 1279.
[4] Ibid., page 1222.

**Additional Comments**

**Chapter 18: Servicing Non-Performing Loans – Accounts with Repayment Problems**

**Section 18.9A: Final Offer (Streamline Option)**

The Streamline Option language requires that "Once the trial is complete the borrower must execute a final modification within 60 days of the last trial payment that includes a hardship affidavit attesting that they occupy the property as a principal residence and have suffered a financial hardship that created an involuntary inability to afford the current mortgage payment. This agreement can be sent after two trial payments are received." This is very late in the process to be asking a borrower for an attestation, particularly as it is a requirement for receiving a Streamline Option. We recommend that the hardship affidavit be obtained as part of the initial trial offer because if the borrower does not or is not able to attest that "they occupy the property as a principal residence and have suffered a financial hardship that created an involuntary inability to afford the current mortgage payment" up-front, they would not qualify for the Streamline Option at all. It is better to know whether the homeowner meets this requirement at the beginning so to better manage borrower expectations and their loss mitigation options.

Additionally, Section 18.9(A) appears to provide the servicer with the option to place the foreclosure on hold if the borrower responds with the initial trial payment. We are concerned this may be in conflict with Consumer Financial Protection Bureau requirements which state that if a borrower is in active loss mitigation, foreclosure must be put on hold.

**Section 18.11A: Acceptable Foreclosure Time Frames**

Regarding Prompt Referrals, RD's edit that "the servicer's loss claim documentation must demonstrate the case was promptly referred to the foreclosure attorney after bankruptcy filing"…should be edited back to say "…after bankruptcy release."

**Section 18.15B: COVID-19 Public Health Emergency**

NCSHA appreciates RD encouraging servicers to recommend financial counseling and assistance programs to borrowers and for mentioning the Homeowner Assistance Fund (HAF). However, we recommend RD also add mention of the HAF program's expiration: funding may not be made available after September 30, 2025. As of April 8, 2024, 30 state programs are closed and two more are putting HAF applicants on a wait list or have suspended their program.

**Chapter 17: Regular Servicing – Performing Loans**

**Section 17.2E: Required Servicing Actions**

RD's proposed language is unworkable, in large part because Legacy mortgage recovery advances (MRAs) are secured notes between RD and the homeowner and are serviced by RD. Hence, mortgage loan servicers do not have the knowledge about whether a homeowner has paid off their Legacy MRA, nor do servicers have the ability to release the lien – it must be done by USDA. Additionally, if a homeowner pays off their first mortgage, we do not believe a servicer

can legally deny the homeowner settlement of the first mortgage. In contrast, the "new" MRA is part of the first mortgage lien and can be collected by the closing agent if the property is sold.

We also recommend that RD break this section into two sub-sections to more clearly separate out what will be two categories of MRAs, as defined by the changes RD proposes to Chapter 18, Attachment 18-A: "All new MRAs will remain a part of the servicer's first lien and will not be secured with a note/mortgage in favor of the Agency. Prior MRAs will be referred to as "Legacy MRAs"." The difference is important because of the different ways in which RD is requiring that they be handled. RD also should consider defining "Legacy MRAs" in Chapter 17.

**Section 17.8B2: Closing a Transfer with an Assumption of the Outstanding Debt**

The newly-added text requires that the servicer "must process the assumption on a form approved by Fannie Mae, Freddie Mac, HUD, or VA …" RD should add the name and number (if applicable) of any form that any of these entities has created to make clear which forms are acceptable. This would enable servicers to readily identify forms that are acceptable for performing loans, the chapter in which RD has inserted this language.

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NCSHA appreciates the opportunity to offer these comments and welcomes any questions you may have.

Sincerely,

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives