December 23, 2024

Commissioner Julia Gordon
Federal Housing Administration (FHA)
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Permanent Waterfall Recommendations

Dear Commissioner Gordon:

The Housing Policy Council[1] and the National Mortgage Servicing Association[2] appreciate your leadership in pursuing a loss mitigation program that effectively assists homeowners who are struggling to pay their mortgages. We also believe it is timely and important to make permanent changes to the loss mitigation system that embrace the lessons learned from providing assistance to borrowers during the COVID-19 pandemic.

Your recent proposal, in the Draft Single Family Handbook Policy Handbook (Draft Handbook), embraces the best parts of the COVID loss mitigation system, while making key changes that will further enhance its effectiveness. Although we think there are a number of changes that must be made to the draft policy, the framework you are proposing is sensible, and should be finalized.

Specifically, we support FHA's plan to incorporate three successful elements of pandemic-related loss mitigation into the draft handbook:

I. **Streamlining documentation requirements benefits all parties.** Reducing unnecessary obstacles, including paperwork requirements, has proven to be better for borrowers, servicers, and FHA. It helps to resolve delinquencies faster, transitioning borrowers into sustainable solutions quicker to reduce avoidable foreclosures. Thus, we agree that FHA should establish a permanent streamlined process for loss mitigation reviews, as reflected in the proposed handbook, and eliminate the previous, ineffective system of collecting unnecessary documents from borrowers.

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org.

[2] With membership comprising more than 90 percent of the mortgage servicing market, the National Mortgage Servicing Association (NMSA) is a nonpartisan organization driven by senior executive representation from the nation's leading mortgage servicing organizations, formed for the purpose of effecting progress and change on the key challenges that face the mortgage servicing industry. By bringing together decision making executives from across the nation, the NMSA drives the conversation on shaping the American housing industry for the benefit of homeowners.

II. **Targeted payment reduction works.** Historical research, and recent FHA experience, demonstrate that targeting a reduction in monthly payment, which does not require a comprehensive evaluation of the borrower's financial situation, is more effective at reducing redefaults than meeting an income-based affordability target. Additionally, this improvement aligns with the Government Sponsored Enterprise (GSE) Flex Modification, which makes implementation easier for servicers and aligns treatment of FHA and GSE borrowers. Thus, we support FHA's decision to incorporate targeted payment reductions into the permanent waterfall.

III. **Treating struggling borrowers the same increases program effectiveness.** Creating a single set of programs, to be delivered in accordance with a uniform set of rules and standard hierarchy to provide relief for any type of hardship is a best practice. Having one waterfall eases servicer implementation and improves borrower understanding, without unnecessarily limiting the options borrowers can access to address their unique circumstances. Thus, we support the use of one loss mitigation waterfall of permanent loss mitigation options, which includes access to standalone partial claims, loan modifications, and payment supplements[3] for all hardships, including natural disasters.

Another strength of the Draft Handbook is that it is responsive to a foundational lesson learned from the pandemic programs, that using trial payment plans is an effective tool for demonstrating payment affordability and reducing redefault rates. As servicers have learned from the GSE Flex Modification Program, using trial payment plans to measure affordability is significantly more effective than requiring full documentation. However, we acknowledge that one of the challenges with the FHA pandemic programs, was the high borrower redefault rate in the first three months of the loss mitigation solution. To address this, it is prudent to require a borrower to successfully complete a trial payment plan that provides direct evidence of the affordability of the permanent solution. Thus, we support the Draft Handbook's use of trial payment plans for all permanent loss mitigation options.[4]

As positive as these foundational elements of the Draft Handbook are, there are a handful of issues that we view as critical to modify in the final guidance. The remainder of this letter sets forth the 7 most significant policy concerns that we have identified with the Draft Handbook. Additionally, we have provided comprehensive feedback through the Draft ML Feedback Response Worksheet that highlights 74 comments that we believe need to be addressed in the final Handbook.

[3] We strongly advocate that the Payment Supplement Program be made a permanent loss mitigation option and are concerned that is currently scheduled to expire at the end of April 2025.

[4] Currently the Draft Handbook does not require a trial payment plan for the "Outside of the Waterfall Loan Modification." We believe that this was potentially a drafting error and not a policy choice. Regardless, we strongly believe that this option for borrowers who are not in contact with their servicer should be required to complete a trial payment plan.

Permanent Waterfall Significant Recommendations

- **Provide a Realistic and Appropriate Implementation Date:** Due to the significant operational, technological, and political risks of implementing the permanent waterfall, we urge FHA to extend the current COVID loss mitigation waterfall to February 1, 2026, and correspondingly set February 1, 2026 as the implementation deadline for the final Handbook. Because the Draft Handbook covers a broad range of topics and includes new program options, a substantial implementation timeframe is necessary to allow the new Administration time to review the policy and ratify it before servicers dedicate resources to the various activities (system updates, process changes, staff training, etc.) required to execute and comply. If a new administration temporarily suspends the policy for review, there must be clear public communication. Additionally, if the new administration makes substantive changes, FHA must post the new policy to the Drafting Table for additional stakeholder feedback.

- **Eliminate remaining hardship documentation requirements.** As stated above, we support FHA's proposal to eliminate the collection and review of borrower financial documentation to prove eligibility for loss mitigation options. Unfortunately, the Draft Handbook retains "Required Hardship Documentation" for certain borrowers. We believe that the inclusion of these requirements was intended to align the FHA policy with the GSE Uniform Borrower Application Form (UBAF). However, there are various elements of the UBAF that are problematic and HPC plans to approach the GSEs to recommend changes to update the form. Therefore, we request that FHA remove the additional documentation requirements, which introduce inconsistency in the treatment of FHA borrowers based on their hardship *and* conflicts with FHA's overarching objective to permit all borrowers the opportunity to pursue assistance in a simple and streamlined way.

- **Eliminate Operationally Infeasible and Legally Problematic Elements-** The handbook introduces a host of new policies and procedures, the vast majority of which are workable, but there are three of them that are facially unworkable and should be eliminated. Specifically, the following provisions should be eliminated from the final proposal:
    - Requiring a mortgagee employee to sign and date a verbal verification based on a Borrower Affordability Attestation (BAA).[5] A servicer's system of record will already indicate whether or not a customer provided the verbal BAA. Requiring a servicing employee to sign a "verification" of this activity would not provide any further

[5] Draft Handbook page 64, lines 7-9.

meaningful assurance that the borrower had verbally provided the BAA but will be operationally cumbersome and will significantly increase servicers costs and complexity.

- Requiring servicers to provide a lost note affidavit must be limited to circumstances where a servicer does not have proof of delivery to HUD.[6] Servicers cannot lawfully execute an affidavit stating that HUD was unable to locate documents delivered to it or that HUD made any particular efforts to locate those documents. Only HUD would be able to execute an affidavit stating that HUD was unable to locate documents delivered to it or that HUD made efforts to locate those documents.
- The provision indicating that HUD may release a lien if a servicer fails to timely record an assignment of the mortgage must be revised to correct an error.[7] We recommend the following text: "I*f the security instrument has been recorded, the Mortgagee must provide HUD with a legal instrument that, upon execution by HUD, will assign the security instrument from HUD to the Mortgagee. HUD will execute the assignment and endorse the underlying note to the Mortgagee. After a Mortgagee receives an executed assignment from HUD, the Mortgagee must submit it for recordation within 15 business days."* This change will make it clear that once HUD assigns the security instruments to the Mortgagee, the Mortgagee will hold exclusive rights, and HUD cannot release the lien.

- **Prevent Abusive Practices-** We do not support the Draft policy regarding "reconsideration for permanent home retention options after [Trial Payment Plan (TPP)] failure." The Draft Handbook policy is too broad and will likely lead to borrower abuse. Since the waterfall does not allow for borrower choice on what loss mitigation option they receive, but it does require communication about all options that may be available, some borrowers could become aware that if they simply fail to make their first TPP payment, they will be reviewed for all options and given the one "that provides the greatest payment reduction." This approach conflicts with the integrity of the loss mitigation waterfall, adds complexity for servicers, and introduces misaligned incentives for borrowers and FHA. A more rational policy would be to limit this "2nd chance" to those borrowers who receive a loss mitigation option with minimal payment reduction, like a standalone partial claim or a standalone loan modification. These programs are higher in the waterfall and, because they are offered prior to other options, a borrower may mistakenly believe that they can make payments at a higher level than they can actually sustain. If a borrower makes a mistake and chooses one of these two options that don't offer significant payment relief, and then fails the TPP, it is reasonable to allow them to re-enter the waterfall to see if a payment reduction option is available to

[6] Draft Handbook page 73, line 3-16.
[7] Draft Handbook page 74, line 6-21.

cure the delinquency. In other words, a TPP failure should lead to the next step on the waterfall, not a review for the “greatest payment reduction.”

- **The Equity Saver Sale (“ESS”) program should be reproposed-** The ESS is an interesting concept that should be explored further in the future, but the draft guidelines are so ambiguous they are materially flawed. The most critical ambiguity is what constitutes “sufficient equity,” as there is no operationally workable definition provided. Is it sufficient equity to provide the borrower a "profit" that covers all typical real estate closing expenses? The current vague definition doesn’t seem to contemplate closing expenses in any way, let alone that these will vary from market to market. FHA should repropose ESS in a future mortgagee letter with a specific and operationally feasible definition that will prevent multiple interpretations, calculation errors, and different processes across servicers.

Conclusion

We thank you in advance for consideration of our recommendations and respectfully request that the FHA leadership team continue to engage with the industry and other stakeholders as you develop and finalize your permanent loss mitigation programs. From a process standpoint, we commend your decision to post the Draft Handbook to the Drafting Table; this iterative approach and partnership with industry participants is truly a best practice that contributes to more efficient and effective policy making. Should the new FHA leadership team decide to make substantive changes to the permanent waterfall, we adamantly request that FHA post the new policy to the Drafting Table for additional stakeholder feedback.

Should you have any immediate questions regarding this set of recommendations, please do not hesitate to contact us.

Yours truly,

Housing Policy Council
National Mortgage Servicing Association