December 15, 2022

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

Payment Supplement Account Recommendation

Dear Commissioner Gordon:

The Housing Policy Council[1] and our member companies thank you for your leadership and willingness to discuss the limitations of the existing FHA loss mitigation options, which are less effective in a rising interest rate environment. We appreciate that you and your team participated in the policy roundtable that we hosted in November; it was our objective to provide a forum for various stakeholders to assess the situation and review a programmatic concept. While that discussion highlighted for HPC that it will be difficult for all parties to implement a payment supplement loss mitigation program, there is also consensus about the need for a permanent solution to address market conditions where note rates for mortgages in Ginnie Mae pools are well below the prevailing market interest rates. That said, HPC members have continued the dialogue and developed a set of recommendations for your consideration.

The Payment Supplement Account proposal that we're addressing with this letter is similar to the concept that we presented and discussed during the November roundtable. To retain the note rate on existing mortgages and allow loans to remain in Ginnie Mae pools, FHA would authorize the use of partial claim funds to supplement a reduced monthly payment from the borrower; combined, the two sources of funds would equal the full pass-through remittance owed to the bondholder. The partial claim amount would be placed in a specialized Payment Supplement Account (PSA) and funds from this account would subsidize the reduced monthly payment from the borrower. The servicer would follow existing FHA policy to establish and record a subordinate lien for the amount of the partial claim, to be serviced by FHA's vendor. The servicer would access the account each month, when the borrower makes the agreed-upon reduced payment, remitting the full scheduled payment to the Ginnie Mae MBS bondholder. Program features that we recommend are highlighted below.

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[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.

Alternative Approaches for Consideration:

Before presenting our recommendations on the Payment Supplement program, we want to be clear that the implementation of a program of this nature will be challenging and protracted. Therefore, we continue to believe that it is in the interests of FHA and consumers to continue to consider other policy ideas that have been identified and discussed. For example, one of the simplest ways to address the payment affordability calculation would be for FHA to permit utilization of the FHA partial claim up to the full statutorily authorized cap of 30 percent. Further, FHA could reduce or eliminate the annual mortgage insurance premium on seriously delinquent loans. Both of these ideas were proposed previously, but continue to warrant exploration, given the need for an immediate solution.

Two additional ideas floated in the roundtable are oriented towards Ginnie Mae. The first of these is a future change to the Ginnie Mae prospectus to permit recasting of loans in Ginnie Mae MBS. This would be a prospective change to the legal agreements, that would allow a partial claim to be used to pay down some portion of the principal balance and the loan to be reamortized. The second is the immediate creation of a Ginnie Mae pooling option into which servicers could deliver below-market modified loans. It is possible that an appropriate government entity could purchase these Ginnie Mae MBS and hold to maturity or resell in the future without any or only minimal economic loss.

Finally, most recently, HPC members have been discussing the use of a partial payment forbearance as a more immediate vehicle to reduce borrower payments for a temporary period. Such an agreement would specify the amount of the borrower's monthly partial payment and term. Depending on the program structure, the servicer may need to address any pre-existing delinquency or forbearance prior to the partial payment forbearance period to bring the borrower current, then offer servicer corporate advances for the full forbearance period to make up the difference between the borrower paid partial payment and the full, contractual payment due to the MBS bondholder.

While HPC believes that some of these ideas have merit, we don't want to miss the opportunity to weigh in on the payment supplement account concept, as we think it too has promise, but also poses significant risks if implemented poorly. However, if your team is receptive to discussion on any of these alternative proposals, HPC stands ready to provide feedback and technical assistance.

Principles to Facilitate Program Implementation:

We'd also like to request that the FHA adopt a set of principles that would facilitate and ease the transition to a new program. We ask that FHA strive to keep the program as simple as possible, with features and terms that are generally consistent with existing programs and that rely on the current operational processes and practices in use. For example, we ask that any new program be placed within the existing COVID loss mitigation waterfall, where streamlined loss mitigation solutions are offered to borrowers with a simple attestation of financial hardship

and need for assistance, rather than submission of extensive financial information for evaluation. We also ask that FHA consider extending the COVID solutions for at least another year and then consider making the Payment Supplement program and streamlined approaches permanent.

Due to the expected operational and technological challenges of implementing a payment supplement solution, we also request that FHA provide ample implementation time, with a transition period of at least 12 months from the announcement date before the program becomes mandatory. FHA could permit early adoption. This would allow individual servicers to offer the new program prior to the mandatory date, yet give each company sufficient time for required implementation activities, including but not limited to: updating technology platforms; reconfiguring internal processes and practices; developing new disclosures, notifications, and monthly statements for consumers; training customer service, loss mitigation, and back-office staff; producing consumer-facing educational information and materials; performing standard development and testing of the new procedures; and establishing rigorous compliance controls. Finally, given the significant number of changes to policy and procedures, we ask that FHA engage with the industry throughout the development and implementation phases. For this, we recommend that FHA utilize the Office of Single Family Housing Drafting Table and other communications tools to distribute and receive feedback from stakeholders.

Finally, given the substantial amount of work that will be done to reconfigure servicer infrastructure to offer this program – technology, human resources, and processes – we ask that FHA provide servicers with financial recompense in the form of incentive payments. Additionally, for the partial payment forbearance, servicers will be obligated to finance the cost of the advances, which warrants additional remuneration for the increased cost of executing the program. Such payments were authorized by Congress[2] and offered during the great financial crisis and are also available from Fannie Mae and Freddie Mac. The additional funds will help to offset the costs associated with the execution of numerous COVID-related recovery programs as well as any new programs.

Payment Supplement Program Recommendations:

In terms of the program features, we'd like to propose that FHA consider the following, all of which are designed to be consistent with the current COVID recovery loss mitigation programs:

- *Streamlined Borrower Eligibility*: No financial information collected from borrower; attestation of borrower hardship and need[3], in lieu of an evaluation to determine affordability or eligibility.
- *Payment Reduction*: Funds from the partial claim calculated to provide a reduction equivalent to 25 percent of principal and interest (P&I); the payment supplement would

[2] 12 USC §1710 (a)(2): Payment for Loss Mitigation: The Secretary may pay insurance benefits to the mortgagee to recompense the mortgagee for all or part of any costs of the mortgagee for taking loss mitigation actions that provide an alternative to foreclosure of a mortgage that is in default or faces imminent default, as defined by the Secretary. . .

[3] We recommend making this assistance available to all seriously delinquent borrowers, not just those who have experienced a COVID hardship.

cover only principal, but the reduction would be for an amount equal to 25 percent P&I, similar to that offered under the COVID recovery programs; if a 25 percent reduction could not be achieved, a smaller payment reduction would be offered over the term of the supplement.

- *Term for supplement:* The length of the payment supplement would be five years, similar to the initial fixed rate period of step rate modifications offered under the Home Affordable Modification Program (HAMP) from the financial crisis. There would be no extensions beyond five years, and there would be no early termination of the payment supplement, as both an extension and early termination would greatly increase the operational complexity.
- *Fixed Supplemental Payments*: For ease of execution and deference to lessons learned from HAMP, we propose no graduated increase in payments over the five-year term, to return the borrower to the previous payment. The payment supplement and the borrower's required monthly P&I payment would remain the same over the entire five-year term when the PSA is in effect. The escrow portion of the payment will fluctuate to account for changes in property taxes and insurance.
- *Placement of Payment Supplement at Bottom of Waterfall* (Streamlined Waterfall): Similar to the COVID recovery modification, we propose that this new option be located at the bottom of the hierarchy to maximize the outcomes for the borrower and FHA:
  - If a 25 percent P&I payment reduction is achievable via modification, servicer offers modification
  - If 25 percent P&I payment reduction is achievable via Payment Supplement, servicer offers Payment Supplement
  - If neither modification nor Payment Supplement achieves a 25 percent P&I reduction, servicer offers the program that results in deepest payment reduction for the borrower
  - If the payment reduction from the modification and Payment Supplement are essentially equal, the servicer would offer the program with the lowest partial claim utilization, to preserve these funds for future hardships.
- *Non-Interest-Bearing PSA*: The PSA should not be subject to interest accrual, which would require extensive accounting and risk management controls, a complication that would further delay execution of an already-complex program.

One of the most significant concerns for HPC members is borrower redefault, an unfortunate event that historically is more prevalent for customers with prior delinquencies. Given the critically important and vulnerable population that FHA serves, we recommend that FHA require a servicer to collect financial information from borrowers who redefault, to assess the best means to help them successfully reperform. Further, if a PSA is active at the time of the redefault, we recommend a prohibition on establishing a second/new PSA as it would be very difficult to set up and manage a second account of this nature. All aspects of a dual PSA

arrangement, from basic accounting to borrower monthly statements, would be operationally complex and cumbersome.

Instead, FHA should allow for the redefautling borrower to be evaluated under the existing loss mitigation waterfall. If a borrower could afford the reduced monthly payment allowed under the active PSA agreement, a servicer would offer a new stand-alone partial claim/subordinate lien arrangement to pay off arrearages and allow the borrower to resume the reduced monthly payment. For borrowers who need an additional payment reduction, we propose that FHA permit a new modification, under which it may be possible for a new partial claim (if applicable) combined with application of the funds in the PSA to pay off arrearages and reduce the loan balance, to achieve a lower monthly payment. If neither of these arrangements permit the borrower to reinstate and reperform, property disposition options would be pursued.

We thank you in advance for consideration of our recommendations and request that the FHA leadership team continue to engage with the industry and other stakeholders as you develop and implement any new loss mitigation programs. We recognize the need for a solution to address the challenging market conditions that are likely to persist for the foreseeable future, with market rates exceeding note rates on mortgages in Ginnie Mae pools. Yet, we also know that executing a new programmatic solution is complicated and ask that FHA work closely with the industry and other stakeholders to assess the impact of various features and options on servicer operations and customer experience. Should you have any immediate questions regarding this set of recommendations, please do not hesitate to contact us.

Yours truly,

Edward J. DeMarco
President
Housing Policy Council