Comments of:

Atlanta Legal Aid Society, Inc., Bay Area Legal Aid,

Bronx Legal Services, Brooklyn Legal Services,

Central Virginia Legal Aid Society, Community Legal Aid Services, Inc.,

Community Legal Services of Philadelphia, Inc. (on behalf of its low-income clients),

Connecticut Fair Housing Center, Florida Legal Services, Inc.,

Housing and Economic Rights Advocates (HERA), Indiana Legal Services, Inc.,

The Legal Aid Society of Cleveland, The Legal Aid Society of Columbus,

Legal Aid Society of the District of Columbia, Legal Aid Society of Southwest Ohio, LLC,

Legal Services NYC, MFY Legal Services, Inc.,

Michigan Poverty Law Program, Mississippi Center for Justice,

Mountain State Justice, Inc.,

National Consumer Law Center (on behalf of its low-income clients),

National Fair Housing Alliance, North Carolina Justice Center,

Northwest Justice Project, Queens Legal Services,

Philadelphia Legal Assistance, Public Justice Center,

Southeastern Ohio Legal Services, Staten Island Legal Services,

Vermont Legal Aid, Inc., Westchester Residential Opportunities Inc.

On

United States Department of Housing and Urban Development, Office of the Assistant Secretary for Housing—Federal Housing Commissioner

60-Day Notice of Proposed Information Collection: FHA Single Family Model Mortgage Documents, 81 Fed. Reg. 85997

Docket Number: No. FR-5913-C-34; HUD-2016-0134
January 30, 2017

On behalf of the clients, communities, and neighborhoods we represent, we write in support of HUD's decision to restore language to the FHA-insured form mortgage that prevents unnecessary payment of insurance claims and improper foreclosures.[1] Our comments are informed by the substantial experience of the legal aid practitioners, housing counselors, and community groups who helped in drafting these comments and who assist individual homeowners who face unnecessary foreclosures.

Restoring this language will not only help homeowners get loan modifications and keep their homes but also will save taxpayer funds by holding counterparties accountable for non-compliance with a narrow set of FHA regulations targeted to ensure that a full loss mitigation evaluation occurs prior to foreclosure of loans. The overwhelming majority of these disputes settle without prolonged litigation. The restored language facilitates settlement by providing a legal mechanism to prevent foreclosure if the lender does not follow the mandatory regulations. By facilitating loss mitigation options, the restored language helps to avoid claims and saves taxpayer money. As a result and in response to the first question posed in the Federal Register Notice, the restored language clearly has practical utility for HUD's operations and is truly necessary for the agency's proper functioning.[2]

Background

These comments address HUD's multiple changes to the form mortgage but will focus on HUD's decision to restore important language to the form. The language at issue is found in Paragraph 22 of the proposed updated mortgage and states: "[n]otwithstanding any other provision in this Security Instrument, other than for any default under Section 17, Lender may not initiate foreclosure for a monetary default unless permitted by regulations of the Secretary." We will refer to this language in these comments as the "compliance language."

The compliance language explicitly incorporates HUD-issued regulations, found at 24 C.F.R. Part 203, that require lenders to take specific actions when homeowners default to ensure that

[1] These comments are submitted by the non-profit organizations listed on the cover page. The primary drafters of the comments are Steven Sharpe from the Legal Aid Society of Southwest Ohio, LLC, and Alys Cohen and Geoff Walsh from the National Consumer Law Center. The Legal Aid Society of Southwest Ohio, LLC provides a full range of civil legal services to low-income residents of seven counties in southwest Ohio – Brown, Butler, Clermont, Clinton, Hamilton, Highland, and Warren. The National Consumer Law Center® (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States.

[2] With respect to this proposal, the first of the four inquiries is the most relevant and our analysis of it demonstrates the significant value of the proposed form. As such, our comments will focus on the first inquiry; however, as explained below, the form will also clarify the rights of the parties, which is relevant to the third inquiry.

loss mitigation is exhausted.[3] As explained in detail below, in order to protect the FHA insurance fund and avoid unnecessary foreclosure, HUD has implemented its loss mitigation protocol with enough flexibility to address a wide range of issues. The regulations require the loss mitigation evaluation to occur in a timely manner as means of preserving taxpayer money, holding HUD counterparties accountable, and furthering FHA's mission of promoting homeownership.

Similar language had been a stable feature of the FHA form documents, in former paragraph 6 of the note and former paragraph 9 of the mortgage, for around 25 years.[4] During those 25 years, homeowners faced with non-compliant lenders have used this language to stop needless foreclosures and insurance claim payouts while protecting taxpayer funds and promoting FHA's purpose of promoting homeownership.

HUD removed the original compliance language in September 2014 without providing any notice of the change, any explanation for the change, or any opportunity for stakeholders to comment. Because the language was added through a Federal Register notice and comment process but removed without any notice, HUD's initial decision violated the Administrative Procedure Act (APA). HUD's decision to restore the language will ameliorate the substantive impact of HUD's previously improper action.

Simply put, the restoration of compliance language to the form mortgage saves money for the insurance fund and holds HUD servicers accountable while also saving homes and alleviating procedural problems with the earlier removal. The language's role in protecting taxpayer funds is especially important given the structure of HUD's current compliance system, which, as described further below, only applies after HUD pays an insurance claim.

With respect to the first question posted in the Federal Register Notice,[5] as a result of the benefit to the taxpayer, we strongly believe that the inclusion of the compliance language promotes the

[3] For example, the regulation at 24 C.F.R. § 203.602 requires the lender to send a specific notice, the regulation at 24 C.F.R. § 203.604 addresses when a lender must arrange a face-to-face meeting regarding loss mitigation options, and the regulation at 24 C.F.R.§ 203.605 states that the lender must "evaluate on a monthly basis all of the loss mitigation techniques provided at § 203.501 to determine which is appropriate." The above regulations specify time windows in which all of these steps must occur to ensure an early evaluation of foreclosure alternatives.

[4] Paragraph 9(d) if the previous form mortgage stated: "In many circumstances regulations issued by the Secretary [of HUD] will limit Lender's rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary." U.S. Department of Housing and Urban Development, Lender's Guide to the Single Family Mortgage Insurance Process, Handbook 4155.2, Chapter 12-A (March 24, 2011). The form note included similar language.

[5] The four questions posed in the Federal Register Notice are: (1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) The accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Ways to enhance the quality, utility, and clarity of the information to be collected; and (4) Ways to minimize the burden of the collection of information on those who are to respond; including through the use of appropriate

proper performance of the functions of HUD and has significant practical utility. Regarding the third question, by clarifying the legal standards that apply to these loans, the inclusion of the compliance language enhances the quality, utility, and clarity of the form mortgage. Our discussion below provides additional detail regarding the agency's questions. We have no position on the second question, which involves the accuracy of the agency's estimate of the burden from the information collection, or the fourth question, which involves whether there are processes to minimize the burden of the information collection. These questions do not impact the decision to reinstate the compliance language.

1. **HUD implemented the original compliance language through a formal process that recognized the importance of the language.**

HUD first proposed the compliance language in Paragraph 9 of the mortgage in a July 6, 1988 Notice of Proposed Policy.[6] The language specifically incorporated requirements from federal regulations that set out mandatory actions that lenders must take prior to foreclosure. In releasing the language, HUD recognized that the regulations already made these steps mandatory. However, HUD stated:

> Uniform mortgage provision 9 contains an incorporation by reference of the regulations that will usually restrict a mortgagee's ability to accelerate and foreclose immediately upon default by the mortgagor. The regulations would restrict a mortgagee regardless of the mortgage language, but HUD believes that the regulation represent[s] a **major policy of the insurance programs and, therefore, should be incorporated**.[7]

In this statement of policy, HUD clearly recognized the importance of the regulations and the usefulness in having them incorporated into the contracts between borrowers and lenders. By putting the requirements in the contracts, HUD improved compliance incentives and counterparty accountability.

Even after receiving critical comments regarding the proposed language, HUD adopted the policy and finalized the language in 1989. HUD addressed claims that the language was counterproductive and would drive up costs of litigation.[8] According to HUD, lenders that comply with regulations would not be harmed and would be able to proceed to a foreclosure judgment:

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automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

[6] Requirements for Single Family Mortgage Instruments, 53 Fed. Reg. 25434-01 (July 6, 1988)

[7] Id. at 25435 (emphasis added).

[8] Requirements for Single Family Mortgage Instruments, 54 Fed. Reg. 27596-01, 27599 (June 29, 1989).

> We rejected the commenter's suggestions that the references to regulations by the Secretary will impair the lender's ability to successfully defend a suit. HUD does not intend to create a conflict between the mortgage language and regulations, and there should be no adverse impact of informing the borrower that some regulations procedures exist which limit a lender's rights to foreclose.[9]

HUD understood that not all regulations were incorporated into the contract – it only incorporated loss mitigation regulations.

> [The language] simply prevents acceleration and foreclosure on the basis of the mortgage language when foreclosure would not be permitted by HUD regulations. For example, 24 CFR 203.606 specifically prohibits a mortgagee from foreclosing unless three full monthly payments due on the mortgage are unpaid. As long as this requirement remains in the regulations, we do not expect mortgagees to violate it even though the mortgage fails to repeat the requirement, and we believe that a borrower could appropriately raise the regulatory violation in his or her defense. If a mortgagee has violated parts of the servicing regulations which do not specifically state prerequisites to acceleration or foreclosure, however, the reference to regulations in the mortgage would not be applicable. HUD retains the general position recited in 24 CFR 203.500, that whether a mortgagee's refusal or failure to comply with servicing regulations is a legal defense is a matter to be determined by the courts.[10]

HUD saw a clear benefit in adding the language to the form contracts. It also noted that the changes applied to a narrow band of regulations that provide prerequisites to foreclosure. In doing so, it saw that this change would have limited cost and scope while improving compliance.

On October 2, 1989, HUD issued a follow-up Notice through the Federal Register with a correction and to add an effective date of March 1, 1990 for the use of the forms.[11]

HUD incorporated the compliance language in paragraph 6(b) of the note and paragraph 9(d) of the mortgage in Handbook 4155.2, Lender's Guide to the Single Family Mortgage Insurance Process.[12] Lenders of FHA-insured mortgages included the language in the notes and mortgage.

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[9] Id.
[10] Id.
[11] *See* Requirements for Single Family Mortgage Instruments; Announcement of Mandatory Date for New Requirements; and Corrections, 54 Fed. Reg. 40529-02 (October 2, 1989); *see also* U.S. Department of Housing and Urban Development, Mortgagee Letter 91-08, Attachment (February 11, 1991); U.S. Department of Housing and Urban Development, Mortgagee Letter 89-23 (October 11, 1989).
[12] As set forth in the handbook, paragraph 9(d) of the previous form mortgage stated: "In many circumstances regulations issued by the Secretary [of HUD] will limit Lender's rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary." U.S. Department of Housing and Urban Development,

Since HUD's adoption of the compliance language, courts have focused on this language in halting foreclosures in cases of counterparty non-compliance with FHA servicing requirements.[13] The language has had a critical role in preserving taxpayer funds and avoiding unnecessary claim payouts.

2. By supporting a homeowner's ability to challenge unnecessary foreclosures, the previous form mortgage language provided a means for avoiding HUD payment of claims that does not exist in HUD's current system for compliance.

The language that HUD added to the note and mortgage supported its major policy of promoting compliance with FHA loss mitigation regulations. By incorporating the language into the homeowners' contracts, the form note and mortgage provide a means for individual homeowners to address regulatory non-compliance prior to foreclosure and prior to claim payment, thus saving taxpayer funds. HUD's own compliance mechanism only evaluates cases after the money has already has been paid.

In 24 C.F.R. § 203.500, HUD explains its system for monitoring compliance with loss mitigation regulation.

> This subpart identifies servicing practices of lending institutions that HUD considers acceptable for mortgages insured by HUD. **Failure to comply with this subpart shall not be a basis for denial of insurance benefits, but failure to comply will be cause for imposition of a civil money penalty, including a penalty under § 30.35(c)(2), or withdrawal of HUD's approval of a mortgage**e. It is the intent of the Department that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed

As the highlighted language demonstrates, HUD will not deny an insurance claim payment for loss mitigation failure. Rather, HUD will only assess a penalty when the money has already been paid. This not only allows for payment of unnecessary claims, but the penalty process as a general matter only applies when the homeowner has already lost the home in foreclosure.

Lender's Guide to the Single Family Mortgage Insurance Process, Handbook 4155.2, Chapter 12-A (March 24, 2011). The form note included similar language.

[13] *See*, *e.g.*, Covarrubias v. CitiMortgage, 623 Fed.Appx. 592 (4th Cir. 2015); Mullins v. GMAC Mortgage, LLC, 2011 WL 1298777, at *2 (S.D.W. Va. 2011); Pfeifer v. Countrywide Home Loans, Inc., 211 Cal. App. 4th 1250, 1266, 150 Cal. Rptr. 3d 673, 686 (2012); Fonteno v. Wells Fargo Bank, N.A., 228 Cal. App. 4th 1358, 1370, 176 Cal. Rptr. 3d 676, 686 (2014) ("To be clear, we are being asked to permit enforcement of a contract, not a statute."); ABN AMRO Mortg. Grp v. Tullar, 770 N.W.2d 851, *3 (Iowa Ct. App. 2009); BAC Home Loans Servicing, LP v. Taylor, 986 N.E.2d 1028, 1034 (Ohio Ct. App. 2013); Wells Fargo v. Phillabaum, 950 N.E.2d 245, 246 (Ohio Ct. App. 2011); Mathews v. PHH Mortgage Corp., 283 Va. 723, 733, 724 S.E.2d 196, 200 (2012).

As a result, the compliance language plays a critical role. It gives homeowners a clear avenue to raise non-compliance before the claim has been paid and before the homeowner has lost the home.

3. **Non-compliance with FHA requirements is a significant problem that can be addressed by the proposed language**.

The restoration of the language is critically important because servicer non-compliance with FHA regulations is an ongoing problem. The language is a key to counterparty accountability. As explained in a recent HUD Office of Inspector General (OIG) report, lenders are not consistently complying with FHA regulatory requirements.[14] In its October 2016 Report, OIG described how it reviewed a sample of FHA insurance claims paid out over a five-year period. OIG found that HUD paid $141.9 million for servicers' claims for interest improperly charged after the servicers had missed HUD deadlines for prosecution of foreclosures. It is important to note that HUD guidelines build in ample time for considering alternatives to foreclosure, and, as a result, any non-compliance is attributable to servicer delays.

HUD incurred $2.09 billion for servicers' claims for unreasonable and unnecessary holding costs (legal fees, property maintenance charges, tax advances) incurred after the servicers missed deadlines set out in HUD guidelines. What was particularly disturbing about the OIG's findings was the frequency with which servicers misrepresented their actions when filing insurance claims with HUD. According to the OIG's survey sample, in approximately 45% of the cases in which the servicers should have reduced their claim amounts due to their non-compliance with HUD guidelines, they failed to do so. Instead, they asked for and received full insurance claims as if they had complied with the guidelines.[15]

The OIG found that HUD was not effectively monitoring servicers' claims while processing them in order to ensure compliance with HUD regulations. HUD monitored only a small number of claims. The automated reviews were not effective, and the agency did not dedicate adequate staffing resources to conduct hands-on reviews.

Based on this Report, it is incumbent upon HUD to augment oversight of servicers who are foreclosing on FHA mortgages. The decision to remove an important oversight tool by taking away the compliance language was clearly a step in the wrong direction. Restoration of the compliance language is one step toward better oversight.

[14] U.S. Department of Housing and Urban Development , Office of Inspector General, Federal Housing Administration, Washington, DC, Single-Family Mortgage Insurance Claims (October 14, 2016), https://www.hudoig.gov/sites/default/files/documents/2017-KC-0001.pdf
[15] Id. at p. 7.

The OIG report outlining lender non-compliance confirms the experience that homeowners face across the nation, as we describe below. As explained below, homeowners benefit from the prompt and timely application of loss mitigation standards prior to foreclosure. In fact, some foreclosure options become difficult, if not impossible, to obtain later in the process. Servicers continue to fail to take required steps to evaluate homeowners for FHA loss mitigation and fail to correctly apply the loss mitigation waterfall. The compliance language provides an avenue for avoiding the payment of claims to these non-compliant servicers.

4. **Reinstatement of the compliance language would ameliorate the substantive impact of the Administrative Procedure Act violation HUD caused when it improperly removed the language**.

HUD's decision to reinstate language that is similar to the language it removed from the form mortgage significantly lessens the Administrative Procedure Act problem that HUD caused in removing the language. The proposed language is substantially similar and, if adopted in its current form, will provide similar benefits. HUD should take steps to address the problem for people who received forms without the language so that compliance on those loans also can be addressed, but this is outside the scope of these comments.[16]

HUD removed the language from the form note and mortgage in connection with the final draft of the Origination through Post-Closing Endorsement section of Single Family Handbook without any notice to stakeholders or opportunity to comment and notwithstanding the established nature of the compliance language and its benefits to the taxpayer and the FHA insurance fund.

The initial draft of the section was released on HUD's website on October 29, 2013 and was originally titled Application through Endorsement.[17] It was amended less than a week later on November 5, 2013 and renamed Origination through Post-Closing/Endorsement; the documents were not published in the Federal Register. The draft included a section on the requirements for the form note and mortgage provisions, in addition to around 300 pages of additional rules. In the subsection of the November 5, 2013 draft, HUD included an empty box with the notation: "REMAINDER OF SECTION i Mortgage and Note PENDING – UNDER CONSTRUCTION."[18] HUD provided no indication that removal of the compliance language was under consideration.

[16] We would be happy to work with FHA staff on such a process.
[17] *See* U.S. Department of Housing and Urban Development, FHA INFO #13-68 (October 29, 2013), https://portal.hud.gov/hudportal/documents/huddoc?id=SFH_FHA_INFO_13-68.pdf.
[18] *See* U.S. Department of Housing and Urban Development, November 5, 2013 Draft, Handbook 4000.1, Sec. I.B.1.d.1.i ("Mortgage and Note"), p. 184 (Nov. 5, 2013). Unfortunately, it appears that the draft versions of the handbook are no longer available on-line.

Even though HUD may have contemplated some unspecified changes to the mortgage provisions, HUD did not release any updated drafts of the Origination through Post-Closing/Endorsement section with proposed changes to the mortgage provisions until the final version was released. Consumer advocates and other stakeholders provided extensive comments to the Origination through Post-Closing/Endorsement section of Handbook 4000.1 but had no reason to believe that HUD was removing the compliance language from the form note and mortgage.

On September 30, 2014, HUD released on its website the final version of the section including the form mortgage and note provisions.[19] Again, this release was not published in the Federal Register. Even the final text of Handbook 4000.1 failed to reveal changes to the mortgage form. It included no text regarding any mandatory provisions of the FHA-insured note and mortgage, and it provided no discussion of the form mortgage language or why the compliance language had been removed.

Instead of incorporating the specific mandatory language for the form note and mortgage, which HUD had done in previous handbooks, Handbook 4000.1 includes links to HUD websites that have the form note and mortgage posted on them. Handbook 4000.1 states: "The Mortgagee must develop or obtain a separate Mortgage and Note that conforms generally to the Freddie Mac and Fannie Mae forms in both form and content, but that included the specific modification required by FHA set forth in the applicable Model Note and Mortgage."[20] This quote in the pdf version of the handbook ends with a hyperlink that directs users to a HUD website entitled "The Single Family Housing Policy Handbook (SF Handbook; HUD Handbook 4000.1) Supplemental Documents."[21] The Supplemental Documents website includes a separate link for Model Documents, entitled "Single Family Mortgages Model Documents."[22] The Model Documents link includes a link to a form forward note and a form forward mortgage. And it is this form forward note and mortgage, reachable after a long chain of links from the Handbook, that deleted the compliance language that HUD instituted through its June 1989 Notice of Policy. The model mortgage document also includes a new paragraph 20 that discusses third-party beneficiaries (which HUD has also positively amended in its current proposal). Like the handbook, the model documents were not published in the Federal Register. The drafts of the Origination through Post-Closing/Endorsement section of the Handbook that HUD released in October and November 2013 provided no link to the Model Documents website, and it made no indication that HUD was removing the compliance language.

[19] *See* U.S. Department of Housing and Urban Development, FHA Info #14-59 (September 30, 2014).
[20] *See* U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook, Handbook 4000.1, pg. 346 (December 30, 2016), available at https://portal.hud.gov/hudportal/documents/huddoc?id=40001HSGH.pdf.
[21] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/handbook_references
[22] http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/model_documents

In fact, HUD made no public announcement at any time of its plans to remove the compliance language from the model note and mortgage provisions. It issued no press release or FHA INFO announcement mentioning the removal in connection with the issuance of the handbook. Because the model documents are simply included as links to Handbook 4000.1, it is unclear when in the drafting cycle HUD made its change. The removal of the language is not part of the text of Handbook 4000.1.

In removing the compliance language without any notice to the public through the Federal Register and without an opportunity for public comment, HUD violated the Administrative Procedure Act, 5 U.S.C. § 553.[23] The language was first added in 1989 after a public process in the Federal Register that considered comments. It conferred substantive rights on borrowers and imposed contractual obligations on lenders vis-à-vis borrowers. Stakeholders had no chance to make any comments on HUD's decision to remove the language before HUD removed it.

5. The FHA loss mitigation program saves taxpayer money.

Improving compliance with loss mitigation regulations saves money for HUD and taxpayers because FHA's loss mitigation program is effective. The program includes a menu of options to help a homeowner avoid foreclosure and a set of steps, including a face-to-face meeting, to ensure that the lender has fully reviewed the homeowner for all options before foreclosure. The compliance language helps to ensure that servicers follow this cost-reduction program.

FHA has improved its loss mitigation program considerably over the past few years by providing multiple options to fit the individual needs of homeowners.[24] Through FHA's framework, a lender considers a homeowner's specific financial situation when deciding the appropriate tool. The homeowner may need a temporary reduction in payment or a payment plan while looking for work. In some cases, the homeowners' interest rate and payment are affordable with their current income, but they need help catching up from a former loss of income and cannot manage a repayment plan. In that case, a partial claim payment from HUD will catch up the loan and avoid the full claim payment that would occur with a foreclosure. Because the partial claim is a loan from HUD to the homeowner, HUD has the ability to recover this claim payment. Finally, many homeowners require a modification of their loan terms because of a financial hardship. Loan modifications result in a stream of loan payments and avoid a full insurance claim payout.

HUD's menu is detailed and depends on financial information from homeowners. As HUD has recognized, homeowners have different communication needs and limitations. This is especially

[23] Mendoza v. Perez, 754 F.3d 1002 (D.C. Cir. 2014).
[24] *See* U.S. Department of Housing and Urban Development, Mortgagee Letter 2013-32 (September 20, 2013), https://portal.hud.gov/hudportal/documents/huddoc?id=13-32ml.pdf.

true since FHA-insured loans serve low- to moderate-income communities. The challenge is especially great for homeowners with disabilities.

HUD's outreach requirements, which are set out in regulations, help ensure meaningful communication with homeowners. The face-to-face meeting requirement is included in the regulations and is a key component.[25] It requires lenders with offices near their borrowers to have or make a reasonable effort to have an in person meeting with the borrower in default. For homeowners with communication challenges or with limited transportation, these meetings are critical.

A recent homeowner case out of Atlanta demonstrates the need for face-to-face meeting compliance:

> After years of making mortgage payments, Ms. and Mr. B fell behind due to unanticipated hardships. Mr. B's stepdaughter died on January 28, 2014, and the Bs took in and cared for her son. That April, Mrs. B fell and broke her hip. She had to stay in the hospital for a month, and spend even more time in rehabilitation. She became bedridden and could hardly walk. Prior to all of this, Mr. B had two heart attacks.
>
> Inundated with new expenses and without Ms. B being able to manage the household finances, the Bs fell behind. The Bs were eligible for an FHA-HAMP loan modification, but understandably failed to research and pursue their mortgage options amid the tide of adversity.
>
> Given the medical issues and the Bs' unique challenges, the Bs would have benefited from a face-to-face meeting about their options, including FHA-HAMP. Despite this, Bank of America and Carrington failed to offer a face-to-face meeting. The Bs' situation was exactly the type of scenario that the face-to-face meeting was designed for – the honest but overwhelmed and unfortunate borrower.
>
> The Bs lost their home to foreclosure on September 6, 2016. After the foreclosure sale, the Bs contacted an Atlanta Legal Aid attorney who listened to the Bs' story and determined that the Bs would have been eligible for an FHA-HAMP loan modification if they had applied. Atlanta Legal Aid sent a letter to Bank of America and Carrington regarding their failure to conduct a fact-to-face meeting to help the Bs determine their options prior to foreclosing. While Carrington did not admit any wrongdoing, it agreed to rescind the foreclosure sale and offered an FHA-HAMP modification to the Bs. The Bs are still in their longtime home and able to afford their mortgage payments again.

[25] 24 C.F.R. § 203.604.

This story demonstrates the power of the face-to-face meeting and the need for a mechanism to enforce it. It required no litigation, but saved a home and prevented an unnecessary claim payment.

6. Use of the compliance language has helped HUD avoid unnecessary claim payments, enhance compliance, and preserve homeownership.

Most FHA homeowners who face challenges getting help from their servicer do so without assistance (as we discuss further below). For those who find assistance, their cases demonstrate how use of the compliance language has reversed servicer non-compliance and opened up access to intended solutions under FHA's existing regulations. Homeowners continue to see lender non-compliance with several aspects of FHA loan servicing that unnecessarily hold up money-saving loss mitigation options. The facts of these cases make clear that the contract language is saving money by preventing unnecessary foreclosure and insurance claim payouts, usually without any published court decisions. We have highlighted cases that do not involve full published decisions and that illustrate specific issues with FHA servicing and how homeowners resolved these cases.

- *Servicers continue to issue unnecessary and duplicative document requests*.

Prior to retaining a legal services attorney through the Northwest Justice Project, DL, a disabled senior veteran, applied for a loan modification with Bank of America. He should have received assistance; however, Bank of America failed to correctly apply the FHA rules and denied him. Even after Northwest Justice Project became involved, Bank of America continued to put up hurdles in the process, including asking for an IRS form 4506-T on *fifteen* separate occasions. DL and his lawyers continued to advocate and through their efforts, DL received the modification he should have received months earlier.

Multiple unnecessary document requests were especially problematic for JF from Springfield, MA since English is his second language. JF, a self-employed tailor who fell behind around the time of the economic downturn, attempted several times to reach an agreement with PNC Bank and had to resubmit documents on multiple occasions. PNC did not promptly review the documents and unnecessarily rejected items. JF tried to have phone conversations with PNC, but his language barrier made talking on the phone difficult. In this case, a face-to-face meeting clearly would have helped PNC and JF communicate, but the bank failed to provide one. JF finally reached Community Legal Aid in Springfield, MA, which became involved in the case and negotiated a loan modification. JF became current on his loan and helped avoid another claim payment by HUD.

BC and WC from Middletown, Ohio also endured confusing communications from their lender, unnecessarily strict requirements, and the need to re-submit documents. After completing a

twelve-month forbearance plan to address unemployment, U.S. Bank initially told them that they were eligible for a loan modification and that documents were coming. U.S. Bank then changed its position and told them that they had to submit financial material. The Cs agreed and tried to meet U.S. Bank's demands. The bank at first required them to submit a document that did not exist and then required unnecessarily detailed employment information. The Cs tried to give U.S. Bank what it wanted, but the bank was not satisfied. U.S. Bank finally sued and the Cs retained the Legal Aid Society of Southwest Ohio. Soon after the lawsuit, the Cs reached a trial plan agreement with U.S. Bank, which they are finalizing at this time.

- *Servicers struggle to honor workout options from previous loan servicers*.

After suffering from a work injury, Mr. H from Mount Claire, West Virginia reached a forbearance agreement with his lender in June of 2014 to bring the loan that he shares with his wife current in three months. Before the end of the forbearance agreement, the Hs were notified that their loan was transferred to Selene Finance. Instead of honoring the agreement, Selene demanded a new loss mitigation application. When the Hs complied with this request, Selene took no action on the application and instead proceeded to foreclosure. The Hs retained Mountain State Justice and reached an agreement with the bank that brought the loan current and allowed the Hs to continue to make payments.

Similarly, FO from Manchester, Connecticut struggled in the transfer of his loan between Bank of America and PennyMac. Bank of America offered FO a three-month trial plan prior to a modification, and FO made all the payments. Before making his third payment, Bank of America informed FO that it never received a written trial plan payment arrangement. FO had not received one but was happy to provide it, and he faxed it into Bank of America and made his third payment, which Bank of America accepted. However, Bank of America would not honor the modification and instead transferred servicing to PennyMac in November of 2016. FO then obtained help through the Connecticut Fair Housing Center. Finally, in January of 2017, FO received a final FHA-HAMP modification.

- *Servicers struggle to properly evaluate borrowers under the FHA waterfall*.

JK from Putnam, Connecticut worked with Wells Fargo for 18 months on a loan modification application that was delayed due to Wells Fargo's inability to correctly apply FHA rules. Although FHA has no debt-to-income ratio floor in its rules for a modification, Wells Fargo claimed there was such a floor and denied his application. JK reapplied and then was denied because Wells Fargo claimed he needed too much of a partial claim even though no partial claim was required. JK worked with the Connecticut Fair Housing Center, through those advocates, he eventually was approved for a standard FHA modification, without a partial claim, after an 18-month long application process.

YL from Martinsburg, West Virginia worked for years to get Flagstar to properly review him for a foreclosure alternative without any luck. After supplying financial information, Flagstar held up his application because YL did not have a bank account and, therefore, could not provide the required bank statements. Even after YL put this in writing at Flagstar's instruction, Flagstar denied his application for failure to provide bank statements. Flagstar never had a face-to-face meeting with YL and instead denied him for failure to provide documents that he had, in fact, provided. Knowing from YL's documents that he was unemployed, a special forbearance would have fit his situation, but one never came. Fearing foreclosure, YL asked for a reinstatement figure. Having not received a clear amount, YL determined that he should pay around $9,500 to Flagstar to avoid foreclosure. Flagstar put the money in suspense and scheduled a foreclosure sale. Right before the sale, YL called Flagstar for an update and was told no sale was scheduled and that it could not provide a reinstatement update. Soon after that, YL received another billing statement and he paid the difference of around $2,400 to Flagstar. One day prior to the sale, Flagstar generated a reinstatement quote, but YL did not receive it. The home was then sold at a sheriff sale. YL later called Flagstar and was told he was short by around $700, which he found out only after the sale occurred. Flagstar told YL that nothing could be done. YL then retained Mountain State Justice in response to an eviction action, and he reached an agreement with Flagstar that kept him, his wife, and his six children in their home.

- *Servicers continue to fail to evaluate for loss mitigation in instances of subsequent defaults*.

In recognition of the fact that low to moderate income families may have multiple financial hardships over the life of a loan, HUD has wisely decided to require servicers to evaluate loss mitigation options for borrowers who default on previous workout options, subject to rules. This rule protects taxpayer funds better than requiring foreclosure where a loan can become reperforming. The following case from Philadelphia reflects this problem and the others discussed above.

> KR fell behind in her mortgage in 2014 after her husband left and stopped contributing to the household expenses. CitiMortgage sent her a pre-foreclosure notice directing her to apply for Pennsylvania state assistance program that is not available to FHA borrowers. KR applied for the state assistance and was turned down because she was ineligible. Meanwhile CitiMortgage filed foreclosure against her. With the help of a housing counselor, KR submitted an application for a loan modification and continued to supply requested documents until April 2015, when CitiMortgage sent a letter denying her loan modification request because she was more than 12 months delinquent, which is not a valid reason for denial under the FHA rules, and because she had the "same hardship" as in a previous application. This was also untrue. KR attended four mediation conferences with her housing counselor and was unable to get assistance from CitiMortgage. At that point Community

Legal Services of Philadelphia (CLS) began working with KR, filed an answer to the foreclosure raising FHA servicing defenses, and helped her reapply for a loan modification in October 2015. KR and CLS submitted additional requested documents in November 2015. No decision on that application was ever received. In December 2015, CitiMortgage's attorney claimed in an email that the application had been denied because unspecified documents had not been received, and the attorney asked KR to submit an entirely new application. CitiMortgage then filed for summary judgment in the foreclosure, which CLS responded to with evidence that CitiMortgage had not reviewed KR for a loan modification as it is required to under FHA servicing rules. The court denied the motion. CLS helped KR reapply again in early 2016 and this time she was approved for an FHA-HAMP trial modification beginning June 2016 which she should have qualified for all along. KR received a permanent modification in October 2016 and the foreclosure case was marked settled.

The published court decisions have primarily focused on the face-to-face meeting requirement because it is one of the specific regulations that lenders must follow. As described above, the face-to-face meeting is a critical part of loss mitigation evaluations. Moreover, as the *Lacy-McKinney* case below demonstrates, the cases have at their core the full loss mitigation principles and not just the face-to-face meeting requirement.

The borrower's situation in *Taylor, Bean, & Whitaker v. Lacy-McKinn*ey demonstrates exactly the type of non-compliance the contract language will help to avoid.[26] Ms. Lacy-McKinney submitted a loss mitigation package early in her default in order to avoid foreclosure. She kept in contact with her lender and faxed requested information, but she was told several times that the information needed to be resubmitted. Despite the confusion and the need for further documents, the lender never held a face-to-face meeting. Instead, it filed a foreclosure lawsuit. The Indiana Court of Appeals reversed the trial court's initial decision to grant foreclosure and held that the borrower could raise these issues.

The contract language allows borrowers to address such clear non-compliance. In *U.S. Bank v. Detweiler*,[27] the court rejected a lender's foreclosure request due to the lack of compliance. "[W]e find that it is clear that appellee made no attempt to establish that it complied with the regulation that it have a face-to-face interview with the mortgagor, or made a reasonable effort to arrange the interview, before bringing the foreclosure action."[28] The Fifth District Court of Appeals in Florida echoed this conclusion in a recent case, and stated that the "Bank wholly failed to meet its burden, providing no evidence that it engaged in a face-to-face interview before filing its foreclosure complaint."[29]

[26] 937 N.E.2d 853 (Ind. Ct. App. 2010).
[27] 946 N.E.2d 777 (Ohio Ct. App. 2010).
[28] Id. at 784.
[29] Palma v. JPMorgan Chase Bank, 2016 WL 7176754, at *2 (Fla. Dist. Ct. App. Dec. 2, 2016).

In *Wells Fargo Bank v. Aey* the court directly addressed a lender filing foreclosure without having completed a modification evaluation or holding a face-to-face meeting. Ms. Aey fell behind when she had to take family medical leave. She started the modification process, but her lender filed foreclosure before the process was complete. Noting that both the note and mortgage incorporated by reference HUD regulations, the court held that the lender could not foreclose without complying with the loss mitigation and face-to-face meeting requirements.[30]

These reported cases are exceptions to the general pattern, in that the overwhelming majority of cases do not involve so much litigation that there is a reported decision. The compliance language, which is in place for the vast majority of outstanding FHA contracts, facilitates the parties reaching an agreement to avoid foreclosure. The purpose of the language is to improve compliance and provide more efficient resolutions.

7. The compliance language saves taxpayer funds by promoting compliance without creating significant cost.

When HUD initially put the compliance language in the form mortgage in 1989 through the Federal Register, it stated that "there should be no adverse impact of informing the borrower that some regulations procedures exist which limit a lender's rights to foreclose."[31] At least one commenter raised the argument that the language would involve additional cost from borrowers litigating non-compliance. HUD dismissed this argument. It recognized that the language would help compliance and it rejected the idea that the language would be costly.

That conclusion has been borne out. An exceptionally small number of homeowners obtain attorneys in foreclosure cases. In judicial and non-judicial foreclosure states, the vast majority of foreclosure cases occur by default without any legal intervention. According to the Mortgage Bankers Association, in the second quarter of 2016, there were 273,838 FHA loans serviced in Ohio and 5.41% were seriously delinquent (or 14,814 loans).[32] During the second quarter of 2016 (April through June), there were three cases reported to Westlaw that cite to the face-to-face meeting regulation (and one of them did not even involve a mortgage).[33] This shows how vanishingly sparse this litigation is when compared to foreclosure activity in general. The nationwide numbers amplify this point. Across the United States, there were approximately 6.26 million FHA loans that were serviced during the second quarter of 2016 and 4.43% of the loans were seriously delinquent (or 277,588 loans).[34] For the country, during this same period, there were only **five** cases reported to Westlaw citing to the face-to-face meeting regulation, including the three from Ohio. Moreover, as explained above, the overwhelming majority of these

[30] Wells Fargo Bank, N.A. v. Aey, 2013 WL 6500133 (Ohio Ct. App. 2013).
[31] Requirements for Single Family Mortgage Instruments, 54 Fed. Reg. 27596-01, 27599 (June 29, 1989).
[32] Mortgage Bankers Association, National Delinquency Survey Q2 2016 (August 2016).
[33] The face-to-face meeting regulation is found at 24 C.F.R. § 203.604.
[34] Mortgage Bankers Association, National Delinquency Survey Q2 2016 (August 2016).

disputes settle without prolonged litigation. The compliance language facilitates settlement by providing a legal mechanism to prevent foreclosure if the lender does not follow the mandatory regulations.

When HUD removed the language in 2014, it acted without publically releasing any data or evidence to establish that its previous conclusion was incorrect. NCLC, MFY Legal Services of New York, and the Legal Aid Society of Southwest Ohio made a Freedom of Information Act ("FOIA") request to determine if there were any internal explanations or assessments by HUD of the impact of removing the form note language. These organizations have received no documents in response to this FOIA request. Without any data to support its conclusion, HUD had no grounds for reversing its former conclusion that there should be "no adverse impact" from having the compliance language in the form mortgage. Its decision to restore the language is in line with its previous conclusion.

In fact, the data show that the FHA form language has not caused problems with the market. As explained above, the compliance language was a stable feature of the FHA mortgage for around 25 years. HUD's market share report shows that loan originations have fluctuated through that time in a way that appears independent of this language. [35] In fact, the market share of FHA-insured loans was at a relatively high point at the time before HUD removed the language.

Moreover, the Mutual Mortgage Insurance (MMI) fund continues to become more stable even though the vast majority of outstanding FHA loans include the compliance language. If such language caused such dramatic cost to the system, it would be currently revealing this in the MMI fund. To the contrary, the contract language helps the MMI fund and is contributing to its current strength.[36]

The evidence from both reported and unreported cases is that the compliance language has worked as HUD expected. HUD should maintain its former position and restore the language into the model mortgage as it plans to do.

8. In addition to including the compliance language, HUD should clarify certain additional matters from the Federal Register release.

A) The term "initiate foreclosure" should be clarified if HUD retains that language over the former compliance language, which is preferable.

[35] U.S. Department of Housing and Urban Development, FHA Single Family Market Share, Table 1 (September 9, 2016), https://portal.hud.gov/hudportal/documents/huddoc?id=FHA_SF_MarketShare_2016Q1.pdf.
[36] *See* Federal Housing Administration, Annual Report to Congress, The Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2016 (November 15, 2016).

As discussed above, we support HUD's inclusion of the compliance language. However, the new language is slightly changed from the language HUD previously used.

The proposed language in Paragraph 22 states: "Notwithstanding any other provision in this Security Instrument, other than for any default under Section 17, Lender **may not initiate foreclosure** for a monetary default unless permitted by regulations of the Secretary."

The inserted compliance language is a change from the removed language in 9(D), which stated "[t]his Security Instrument **does not authorize acceleration or foreclosure** if not permitted by regulations of the Secretary."

Because the previous language worked well to avoid unnecessary foreclosure, we prefer it to the slightly amended language. If HUD chooses to keep the proposed language as amended, which is far preferable to total removal, we seek clarification on the language HUD has chosen. We specifically want to know how "initiating foreclosure" differs from "acceleration or foreclosure."

This language appears to refer to HUD's own previous guidance on the issue. In Handbook 4000.1, HUD included a chart of first initial actions to institute foreclosure. The chart provides a state-by-state guide for what constitutes the first action to initiate foreclosure.[37] This chart closely tracks the Consumer Financial Protection Bureau's definition of "initiating foreclosure" provided in its regulations. We suggest that HUD clarify this in the final rule if the slightly amended language is favored over the original version.

B) HUD's amended language on third party beneficiaries has improved but is still unnecessary and confusing for judges.

HUD's new draft clearly improves Paragraph 20 of the mortgage. This paragraph, which HUD added in 2014, addresses a borrower's standing as a third party beneficiary. In general, efforts to obtain FHA loss mitigation do not rely on this theory and thus such language is still unnecessary.

Paragraph 20 of HUD's proposed mortgage states: "Mortgage Insurance reimburses Lender (or any entity that purchases the Note) for certain losses it may incur if Borrower does not repay the Loan as agreed. Borrower acknowledges and agrees that the Borrower is not a third party beneficiary to the contract of insurance between the Secretary and Lender." This language was first included in the revised form mortgage that HUD released around September of 2014 in connection with the release of the Single Family Housing Policy Handbook. This addition was in the same document that removed the compliance language.

[37] *See* U.S. Department of Housing and Urban Development, Single Family Housing Policy Handbook, Handbook 4000.1, Appendix 5.0 - First Legal Actions to Initiate Foreclosure and Reasonable Diligence Timeframes (Applies to Servicing Only).

Importantly, HUD's new version omits a confusing sentence that was at the end of the quoted language – "nor is Borrower entitled to enforce any agreement between Lender and Secretary, unless explicitly authorized to do so by Applicable Law." We support the removal of this sentence, which is irrelevant because such borrowers do not rely on any agreements between lenders and HUD. Instead, borrowers focus on the regulations and contracts that incorporate them.

Even with the improvement, however, the third party beneficiary language is still unnecessary, and it may also confuse courts in evaluating cases between borrowers and lenders.

C) It is important to ensure that the role of new notice language is clear and does not preclude challenges to unnecessary foreclosures.

In paragraph 22 of the revised form mortgage, HUD states:

> Neither Borrower nor Lender may commence, join, or be joined to any judicial action (as either an individual litigant or the member of a class) that arises from the other party's actions pursuant to this Security Instrument or that alleges that the other party has breached any provision of, or any duty owed by reason of, this Security Instrument, until such Borrower or Lender has notified the other party (with such notice given in compliance with the requirements of Section 14) of such alleged breach and afforded the other party hereto a reasonable period after the giving of such notice to take corrective action. If Applicable Law provides a time period which must elapse before certain action can be taken, that time period will be deemed to be reasonable for purposes of this paragraph. The notice of acceleration and opportunity to cure given to Borrower pursuant to Section 22 and the notice of acceleration given to Borrower pursuant to Section 17 shall be deemed to satisfy the notice and opportunity to take corrective action provisions of this Section

We realize that this language comes from Fannie Mae and Freddie Mac form instruments and that this is in line with HUD's policy of aligning with Fannie and Freddie.

This policy should not prevent homeowners from raising non-compliance. HUD should clarify that this language should not act to preclude homeowners from raising issues that are otherwise allowed by state law.

D) HUD should include the compliance language in the note as well as the mortgage.

When HUD originally instituted the contract language it was included in both the note and the mortgage. For some reason, HUD has only reinstituted the language in the mortgage and not the note. While including the language in the mortgage should work to prevent unnecessary foreclosures, we believe the language should also be reinstituted in the note. It is consistent with previous policy and does not involve any significant costs.

9. Conclusion

We applaud HUD for its decision to reinstate the compliance language into the form mortgage. For around 25 years, this language was critical in helping HUD avoid unnecessary foreclosures due to lender non-compliance. Unfortunately, lender non-compliance remains a problem, as indicated in the recent OIG report, which makes the language as important as ever. Without this language, homeowners' ability to stop unnecessary claim payments and foreclosures is undermined. As explained above and as HUD has already recognized, the decision to reinstate the compliance language will not add undue costs, and it will ameliorate the substantive impact of HUD's violation of the Administrative Procedure Act that occurred when HUD originally removed the language. We ask you to finalize your proposal for the sake of the Fund, homeowners, and communities.

Thank you for considering these comments.