September 23, 2009

MORTGAGEE LETTER 2009-35

TO: ALL APPROVED MORTGAGEES

SUBJECT: Loan Modifications: FHA Loss Mitigation Incentives - Update

The purpose of this Mortgagee Letter is to update the conditions under which FHA will pay loss mitigation claims for modifications of loans where the current note rate is 50 basis points or more over the current market rate as defined herein. To qualify for the incentive payment and allowable costs on such cases, the modified loan must meet the term and interest rate requirements prescribed in this Mortgagee Letter. These requirements are effective thirty days from the date of this letter.

Background

The recent economic slow-down has increased demand for loss mitigation actions, including but not limited to, loan modifications. Recent industry studies of these loan modifications revealed that borrowers who experienced an increased mortgage payment on a modified loan had a significantly higher re-default rate than borrowers whose loan modification provided a lower payment.

FHA reviewed its recent insured loan modifications and found that, generally, they resulted in higher payments to the borrower. The higher payment was the result of not lowering the interest rate to the current market rate and/or not extending the term to the maximum of thirty years authorized under 24 CFR 203.616. Generally, the loan modifications simply capitalized the past due amounts and allowable charges and did not extend the term of the loan.

Consequently, FHA is updating its term and interest rate requirements for loan modifications to provide for a reduction in the mortgage payment whenever possible and help more mortgagors avoid re-default, (and potential foreclosure). Mortgagees are cautioned that Loan Modifications not meeting FHA's requirements will not be considered as valid loss mitigation actions. Therefore, the workout ratios that the Department uses in determining Tier Ranking Scores will exclude those Loan Modifications not in compliance.

Mortgagee Incentives for Loan Modifications

This Mortgagee Letter clarifies and updates the guidance provided in Mortgagee Letter 2000-05, Loan Modification, section F, Allowable Provisions (pages 21 and 22), and Mortgagee Letter 2008-21, Page 1, and Mortgagee Letter 2009-23, Page 1, with respect to interest rate and term requirements for loan modifications that are eligible for payment of a mortgagee incentive and costs for a title search and/or recording fees on the Loan Modification.

Interest rate and term requirements

In cases where the current note rate is 50 basis points or more over the current market rate:

- The Mortgagee shall reduce the loan modification note rate to the current Market Rate. For purposes of this requirement, the Department shall consider Market Rate to be no more than **50 basis points** greater than the most recent Freddie Mac Weekly Primary Mortgage Market Survey Rate for 30-year fixed-rate conforming mortgages (US average), rounded to the nearest one-eighth of one percent (0.125%), as of the date the Modification Agreement is executed. The weekly survey results are published on the Freddie Mac website at http://www.freddiemac.com/pmms/ and the Federal Reserve Board includes the average 30-year survey rate in the list of Selected Interest Rates that it publishes weekly in its Statistical Release H.15 at http://www.federalreserve.gov/releases/h15/.

- The Mortgagee must re-amortize the total unpaid amount due over a 360 month period from the due date of the first installment required under the modified mortgage.

Example

The Mortgagee approves a Loan Modification that is executed by the borrower 35 days after the date of this Mortgagee Letter. The current note rate is 7 percent and the most recent Freddie Mac Weekly Primary Mortgage Market Survey Rate for 30-year fixed rate conforming mortgages (US average) as of the Modification date is 5.04 percent. To be eligible for payment of a mortgagee incentive and costs for a title search and/or recording fees on the Loan Modification, the fixed note rate on the modified loan may not exceed 5.50 percent (The Freddie Mac US average rate of 5.04 percent rounded to the nearest eight of a percent plus 50 basis points). The modified mortgage must also re-amortize the total unpaid amount over a 360 month period from the due date of the first installment required under the modified mortgage.

FHA holds servicers accountable for their servicing practices in order to protect the public trust and the FHA Insurance Fund. When a servicer fails to comply with FHA's policies and procedures, FHA will take appropriate action. Servicers that violate FHA program statutes, regulations, handbook requirements and mortgagee letters may be subject to numerous actions including: the repayment of loss mitigation incentives, indemnification, and referral to HUD's Mortgagee Review Board for appropriate sanctions.

Information Collection Requirement

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control numbers 2502-0060, 2502-0523, and 2502-0429. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB Control Number.

Any questions regarding this Mortgagee Letter may be directed to HUD's National Servicing Center at (888) 297-8685 or hsg-lossmit@hud.gov. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

Sincerely,

David H. Stevens
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Federal Housing Commissioner