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VIA ELECTRONIC MAIL

Edward L Golding
Principal Deputy Assistant Secretary for Housing
U.S. Department of Housing and Urban Development
451 7th Street S.W.
Washington, DC 20410

Dear Mr. Golding:

Thank you for your June 16, 2015 letter regarding HUD's removal of homeowner-protective language from the form FHA Single Family Mortgage and Note. We also appreciate the phone conference we had with staff regarding this letter on June 17, 2015. On behalf of our low-income clients, we remain deeply concerned that HUD's action undermines the FHA mortgage program's statutory goals of "minimiz[ing] the default risk to the Fund and to homeowners ….and . . . meet[ing] the housing needs of the borrowers that the single family mortgage insurance program . . . is designed to serve."[1]

As we have discussed, HUD removed contract language from paragraph 9 of the form FHA mortgage and paragraph 6 of the form FHA note that bars lenders from pursuing foreclosure when they have failed to comply with loss mitigation regulations. Homeowners have relied on this language to stop unnecessary foreclosures and to save their homes. HUD removed this language from the form contracts without any notice or any opportunity for comment.

HUD asserts that the removal of the protective language does not amount to a change of policy and will not have the negative impact on borrowers that we outlined in our April 9, 2015 memorandum. To the contrary, as we describe below, removal of the language is indeed a change of policy, and it will harm homeowners. Moreover, it will harm the FHA insurance fund

[1] *See* 12 U.S.C. 1708(a)(7).

through unnecessary payouts of insurance claims while insulating servicers who fail to comply with FHA's loss mitigation requirements.

HUD's position seeks to minimize homeowners' role in the FHA insurance program. However, the central goal of the HUD government-sponsored insurance program is to support homeownership through the National Housing Act. As explained below, Congress has made it clear that loss mitigation exists to help homeowners. In fact, FHA's underwriting and downpayment standards support this goal as well, aiming to make homeownership available to borrowers who may not qualify for non-insured loans and who are more likely than conventional borrowers to fall behind on their loans in the face of financial hardship. Of course, HUD must achieve this goal in a fiscally responsible way through its management of the MMI fund, but management of the fund is not an end in and of itself.[2] HUD must take into account how its decisions affect the homeowners and neighborhoods it must promote. The homeowner protective language has been included in the contract for decades, and the period after an acute foreclosure crisis is not the time to remove it (especially when there are already documented problems with homeowners having their notes sold without proper loss mitigation reviews).

While homeowners are not parties to the insurance contracts between the lender and HUD, homeowners have pointed to their own contracts with the lenders when in court. When HUD first proposed adding the language in 1988 in the Federal Register, it made clear that this addition would explicitly incorporate the FHA loss mitigation regulations into the homeowner's contract. Courts have enforced those provisions to ensure that homeowners are provided with proper review under FHA's loss mitigation requirements. It is those contracts and the access to loss mitigation they provide that are at stake here.

HUD, for sound policy reasons, has required lenders since 1990 to include the borrower protective terms in the mortgage contracts. This language provides an essential means to support homeownership and promote loss mitigation. This approach is consistent with and helps implement HUD's mandate from Congress to promote homeownership.

1. **HUD's removal of the form note and mortgage language is contrary to its previous policy.**

HUD's June 16, 2015 letter states that the agency's policy has always been that "the HUD regulations that govern the conduct of the mortgagee in its performance of duties under the mortgage insurance contract are not components of the underlying private mortgage contracts." The plain language of the mortgage contracts and the documents outlining the development of those contracts demonstrate otherwise.

[2] *See* 12 U.S.C. 1708(a)(7) (which clearly states that the insurance fund has a goal of "meet[ing] the housing needs of the borrowers that the single family mortgage insurance program under this subchapter is designed to serve.")

a. The plain language of the removed contract language shows that HUD intended to incorporate the regulations into the contract despite its current claims to the contrary.

The text of the removed language clearly shows that the regulations were in fact intended as "components of the underlying private mortgage contracts." According to Paragraph 9 of the form mortgage, which was removed, "[i]n 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 if not paid. This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary."[3] By stating that the lender cannot accelerate or foreclose against the borrower without following the relevant regulations, the mortgage clearly makes them part of the contract. There is no other use for this language.

Courts have agreed and have had no problem reading this plain language. As explained by the Virginia Supreme Court:

> [Lender] offers no explanation for HUD's decision to require this language in deeds of trust which secure its insured loans if, as PHH contends, the regulations govern only the relationship between the lender and the government, rather than the lender and the borrower. The regulations themselves govern the relationship between the lender and the government; **there is no reason to refer to them in the deed of trust other than to affect the duties of the parties to it**.[4]

The California Second District Court of Appeal agreed that the contract language's intent is clear and stated "under the clear and unambiguous language in paragraph 9 of the deed of trust, the lenders had to comply with the HUD servicing regulations before commencing foreclosure on the [homeowner's] FHA mortgage."[5] Clearly, the language that HUD included incorporated the content of the regulations into the terms of the contract.

b. HUD's previous policy statements demonstrate that its current position is a change.

HUD's previous policy statements made in rulemaking also contradict the policy stated in its June 16, 2015 letter and demonstrate that there has been a change. HUD first proposed the homeowner-protective language in Paragraph 9 of the mortgage in a July 6, 1988 Notice of

[3] Lender's Guide to the Single Family Mortgage Insurance Process, HUD Handbook 4155.2, at 12-A-7.
[4] Mathews v. PHH Mortgage Corp., 283 Va. 723, 736-37, 724 S.E.2d 196, 202 (2012) (emphasis added).
[5] Pfeifer v. Countrywide Home Loans, Inc., 211 Cal. App. 4th 1250, 1278, 150 Cal. Rptr. 3d 673, 695 (2012); *see also* BAC Home Loans Servicing, LP v. Taylor, 2013-Ohio-355, ¶ 19, 986 N.E.2d 1028, 1035 (Ohio Ct. App. 2013) ("In this case, the mortgagee and the mortgagor agreed to limit the mortgagee's rights to accelerate and foreclose based on applicable HUD regulations. Thus, by contract, BAC Home Loans was required to comply with the HUD regulations governing acceleration and foreclosure.").

Proposed Policy.[6] In discussing the additions, HUD made it clear that the effect of adding the language to the form mortgage was to incorporate the relevant regulations:

> 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 1988, HUD clearly intended for the regulations to be a "component of the underlying private mortgage contracts." While the regulations already applied, HUD still believed that because they are a "major policy"of the program, they should be added to the language in the deal between the lender and the borrower. HUD's statement now that the regulations were never a part of the contract terms is contradicted by HUD's own documents and confirmed by the line of court cases discussed above.

Nothing in the subsequent 1989 Notice of Policy, which HUD referenced and which we have discussed previously, amended HUD's position regarding incorporation of the regulations into the terms of the contract.[8] In fact, HUD rejected concerns from commenters regarding the increased litigation expense that may occur due to this language. It determined that "we believe that a borrower could appropriately raise the regulatory violation in his or her defense."[9]

c. HUD failed to provide an opportunity for stakeholders to address its changes.

Importantly, HUD made its recent change without notice or an opportunity to comment and by means that are wholly inconsistent with the approach HUD followed in adding the language. As demonstrated by the 1988 and 1989 policy notices stated above, HUD had amended its form mortgage and note documents through a notice and comment procedure posted in the Federal Register. Stakeholders had the opportunity to address significant issues through this process and HUD had the benefit of that input. HUD has followed this notice and comment process with respect to its other programs, including its recent amendments to the closing documents for multi-family housing loans.[10]

Yet, despite this history, HUD offered no such avenue for stakeholders to comment on the recent changes to its forms. It simply posted the updated forms on its website. While it made its changes in connection with its work on the consolidated single-family handbook, HUD did not discuss any proposed changes in connection with the posting of that draft handbook and did not

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[6] Requirements for Single Family Mortgage Instruments, 53 FR 25434-01 (July 6, 1988).
[7] *Id.* at 25435 (emphasis added).
[8] Requirements for Single Family Mortgage Instruments, 54 FR 27596-01 (June 29, 1989).
[9] *Id.* at 27599.
[10] Federal Housing Administration (FHA) Multifamily Rental Project Closing Documents: Notice of Announcing Approval of Revised Documents, 79 FR 40131-01 (July 11, 2014).

post any proposed changes to the form mortgage posted with the draft handbook. In October 2013, HUD solicited public comment on the origination portions of its draft Single Family Insured Housing Program Handbook. At that time, HUD published nearly 300 pages of text addressing in detail all aspects of origination of FHA loans. Notably, when it came to the form note and mortgage, HUD published an empty box with the notation: "REMAINDER OF SECTION i Mortgage and Note PENDING – UNDER CONSTRUCTION."[11] This language suggests that HUD was contemplating some unspecified changes to the form documents at that time, and it provided no indication of any changes that were under consideration. We can see no reasonable basis for obscurity shrouding this process.

Because the changed contract language is a change in policy, HUD was required to provide an opportunity for notice and comment on the change, and it failed to do so.

d. Homeowners, and their advocates, are key stakeholders that HUD must consult with proposed policy changes that impact loss mitigation.

We are concerned that HUD's decision to remove homeowner-protective language without consulting homeowner advocates reflects an incorrectly limited view of the role that homeowners should have in loss mitigation decisions.

Congress has made it clear that homeowners are stakeholders in loss mitigation policy. For example, the law Congress passed in the wake of the financial crisis in order to promote loss mitigation, including FHA loss mitigation, is titled the "Helping Families Save Their Homes Act of 2009." Senator Christopher Dodd, the bill's sponsor, repeatedly stated on the Senate Floor that the act "is designed to help families save their homes. That is what it is designed to do."[12] He noted that the statutory language authorizing additional FHA options is intended to "bring a tremendous amount of relief to people" and was created because lenders were not doing enough to address "this issue of keeping people in their homes at rates and mortgages they can afford."[13]

HUD's own policy statements confirm that loss mitigation protects homeowners. In HUD's comprehensive guide to loss mitigation, Mortgagee Letter 2000-05, it states "[l]oss mitigation is considered critical to FHA because it works to fulfill the goal of helping borrowers in default retain home ownership while reducing, or mitigating the economic impact on the insurance fund." [14] Loss mitigation, under this statement, is not limited to protecting HUD. Historical HUD guidance on loss mitigation also confirms preventing foreclosure as a main purpose of loss mitigation and highlights the benefits to the homeowner.

[11] FHA Single Family Housing Policy Handbook Title II Forward Mortgages II.B.1.d.1.i ("Mortgage and Note") p. 184 (Nov. 5, 2013).
[12] 155 Cong Rec S 5052 (May 4, 2009).
[13] 155 Cong Rec S 5002 (April 30, 2009).
[14] Mortgagee Letter 2000-05 at pg. 1 (January 19, 2000).

Any claim that loss mitigation matters are only a matter between HUD and the servicer simply is incorrect and misses the broader purpose of the FHA program.

2. HUD's changes will lead to an increase in avoidable foreclosures.

Removal of the homeowner-protective language from the form mortgage and note undermines the strength of the MMI Fund and sets up roadblocks for homeowners seeking FHA loss mitigation by making it easier for servicers to ignore FHA loss mitigation requirements while pursuing foreclosures. Any benefit that HUD may gain from this change is outweighed by damage to the fund and to homeowners and communities. Courts have used the removed contract language to ensure that HUD guidelines are followed. Several cases upholding the mandatory nature of HUD's regulations have focused on the contract language.[15] This language has been especially important in non-judicial foreclosure states because homeowners in those states generally must ground their arguments on the lenders' breach of the contract terms in an affirmative suit to stop the improper foreclosure.[16]

Simply put, HUD's decision will lead to an increase in unnecessary foreclosures and will damage the MMI fund without providing any significant benefit. As explained in our previous letter, we have conferred with Professor Alan White of CUNY School of Law who agreed with our analysis and concluded that the changes in the forms will seriously weaken homeowner defenses to foreclosure based on servicer non-compliance with FHA requirements. The recent letter sent to Secretary Castro on August 20th from over 50 national, state and local organizations protesting HUD's decision underscores this point.

3. HUD's change in policy will have a disproportionately negative impact on communities of color.

HUD is charged with enforcing the Fair Housing Act and is also subject to its requirements, including the requirement that it has to affirmatively further fair housing. Therefore, in making decisions regarding its program, HUD must consider how such decisions impact communities of color, especially since the FHA insured mortgage program is a key program for helping people of color become homeowners.

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[15] 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); ABN AMRO Mortg. Grp v. Tullar, 770 N.W.2d 851, *3 (Iowa Ct. App. 2009).

[16] Mathews v. PHH Mortgage Corp., 283 Va. 723, 733, 724 S.E.2d 196, 200 (2012); 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."); Mullins v. GMAC Mortgage, LLC, 2011 WL 1298777, at *2 (S.D.W. Va. 2011); Covarrubias v. CitiMortgage, No. 14-2420 (4th Cir. September 1, 2015), *available at* http://www.ca4.uscourts.gov/Opinions/Unpublished/142420.U.pdf.

According to HMDA data, FHA-insured mortgages comprise around 23% of the market for home purchase loans.[17] Communities of color, however, rely much more heavily on FHA insured loans to obtain mortgage finance. In the annual report to Congress on the MMI fund, "FHA accounted for 46.3 percent of home purchases by African American households and 47.9 percent of purchases by Hispanic households."[18]

The choice, therefore, to remove homeowner-protective language and thus weaken the homeowner's ability to address lender non-compliance will disproportionately impact African American and Latino participants in the mortgage market. This is especially problematic given HUD's obligations and role with respect to the Affirmatively Furthering Fair Housing provisions of the Fair Housing Act. It is further problematic given the significant and again disproportionate loss that homeowners of color have faced in the wake of the financial crisis.[19]

We call on HUD to put the homeowner protective language back in the form mortgage and note in order to protect the Fund and to prevent unnecessary foreclosures. The language has been included in the single family mortgage forms for decades and it has helped both homeowners and the insurance fund. HUD should restore the important language to the forms. HUD's failure to do so would result in a change of policy that is unwarranted and harmful.

Sincerely,

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cc: Assistant Secretary Gustavo F. Velasquez

[17] *Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2014,* United States Department of Housing and Urban Development, at 18 (November 17, 2014).
[18] *Id.*
[19] *The State of the Nation's Housing 2012,* Joint Center for Housing Studies of Harvard University at 18 (2012) (noting, for example, that homeownership loss during the crisis was twice as large for African Americans than for white homeowners).