U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

November 16, 2012 **MORTGAGEE LETTER 2012-22**

To **All Approved Mortgagees**

Subject **Revisions to FHA's Loss Mitigation Home Retention Options**

Purpose

This Mortgagee Letter includes revised requirements for FHA's Loss Mitigation Home Retention Options, in an effort to reduce the number of full claims against the FHA Mutual Mortgage Insurance Fund by assisting a greater number of qualified, distressed mortgagors in retaining their homes.

Effective Date

No later than 90 days after issuance of this Mortgagee Letter, mortgagees must begin to assess mortgagors in default under FHA's loss mitigation priority order and policies referenced herein.

Affected Policy

This Mortgagee Letter amends the following:

- FHA's Home Affordable Modification Program's (FHA-HAMP) guidelines in Mortgagee Letter 2009-23;
- The definition of "Special Forbearance" in Mortgagee Letter 2002-17; and
- Loss Mitigation priority order guidelines in Mortgagee Letter 2000-05.

Background on FHA's Loss Mitigation Program

FHA's Loss Mitigation Program was established in 1996 to ensure that distressed FHA mortgagors were afforded opportunities to retain their homes and to assist in minimizing losses to FHA's Mutual Mortgage Insurance Fund.

Changes to FHA's Existing Loss Mitigation Home Retention Options

The specific changes to FHA's existing Loss Mitigation options include the following:

- Eliminating the FHA-HAMP maximum Back End Debt-to-Income Ratio requirement of 55 percent;
- Eliminating the 12-month restriction on the amount of principal, interest, taxes and insurance (PITI) that may be included in an FHA-HAMP Partial Claim;
- Eliminating the FHA-HAMP eligibility requirement that the FHA-insured mortgage be no more than 12 full payments past due;
- Streamlining FHA's Loss Mitigation Home Retention Option priority order by replacing its current 4-tier incentive structure with a 3-tier incentive

structure, consisting of Special Forbearances, Loan Modifications, and FHA-HAMP;
- Redefining "Special Forbearance" to apply only in cases where the mortgagors are unemployed;
- Permitting mortgagors to receive a Loan Modification or FHA-HAMP only once in a 24-month period;
- Expanding FHA-HAMP so that it now consists of a stand-alone Modification, stand-alone Partial Claim, or a combination of a Loan Modification and Partial Claim;
- Permitting those mortgagors who were initially unsuccessful in completing Trial Payment Plans to re-apply for standard loan modifications or FHA-HAMP if their financial circumstances have changed since their initial application for assistance; and
- Defining "surplus income percentage" as surplus income divided by net income (i.e., net take-home income).

Updated Loss Mitigation Informal and Formal Forbearance Options

Before a mortgagee considers a delinquent mortgagor for one of FHA's Loss Mitigation Home Retention Options, the mortgagee must first evaluate the mortgagor for both Informal and Formal Forbearance Plans (See "Initial Assistance Screens" in Attachment A). Informal and Formal Forbearance Plans are the only options available for delinquent mortgagors without verifiable losses of income or increases in living expenses.

- Forbearance Plans are arrangements between a mortgagee and mortgagor that may allow for a period of reduced or suspended payments and may provide specific terms for repayment, depending on the circumstances.
- Informal Forbearance Plans are oral agreements relating to a period of three months or less. See Mortgagee Letter 2000-05 for further guidance on Informal Forbearance Plans.
- Formal Forbearance plans are written agreements relating to a period of greater than three months and less than six months. If the mortgagee has concluded that 85 percent of the mortgagor's surplus income is sufficient to bring the mortgage current within six months, the only available loss mitigation option is a Formal Forbearance plan that provides for repayment within the six months. (See Example 1(a) in Attachment B).
- Informal and Formal Forbearances are ineligible for loss mitigation incentive payments.

Updated Loss Mitigation and Priority Order Requirements

After evaluating a delinquent mortgagor for Informal and Formal Forbearance Plans, FHA's Loss Mitigation options must be considered in the following order: (1) Special Forbearances; (2) Loan Modifications; and (3) FHA-HAMP. The revised qualifications for FHA's Loss Mitigation Home Retention Options are reflected in Attachment A. Before four full monthly installments due on the mortgage have become unpaid, and monthly thereafter, the mortgagee must evaluate a mortgagor's financial situation to determine the appropriate Loss Mitigation option when the mortgage is in default or imminent default. The mortgagee's servicing records should include monthly notations, explaining the mortgagee's analysis used to determine the appropriate loss mitigation option. If there has been no change in the mortgagor's circumstances, the mortgagee may simply notate this in its records.

1. Special Forbearances: A Special Forbearance is a written agreement between a mortgagee and mortgagor to reduce and/or suspend mortgage payments. A Special Forbearance is now available only to mortgagors that experience a verifiable loss of income due to unemployment. Pursuant to Mortgagee Letter 2011-23, effective until July 31, 2013, Special Forbearance agreements must provide for a minimum of 12 months for re-employment and require subsequent evaluation for a more permanent loss mitigation option to cure the default. As mortgagees must re-evaluate mortgagors for more permanent loss mitigation options to cure the default, the terms of the Special Forbearance agreement itself will not provide for reinstatement, as was previously provided in Mortgagee Letter 2002-17. Please see Attachment B, *FHA Loss Mitigation Home Retention Option Priority Order*, Example 1(b).

   Special Forbearance agreements that are entered into due to unemployment are also referred to as "Type I Special Forbearances" and are the only forbearance agreements under which mortgagees may collect incentive payments. Please note that Type II Special Forbearances referenced in Mortgagee Letter 2002-17 have been eliminated.

   In cases in which the mortgagor is still employed or where 85 percent of the mortgagor's surplus income is sufficient to cure the arrearage within six months, the mortgagee must offer the mortgagor a Formal or Informal Forbearance Agreement, as described above.

   Special Forbearances are not available until three payments are due and unpaid, pursuant to Mortgagee Letter 2002-17. Thus, even if step 2 in Attachment A indicates a Special Forbearance outcome, the mortgagee must wait to implement the Special Forbearance until three payments are due and unpaid.

2. Loan Modifications: A Loan Modification is a permanent change to one or more of the terms of a mortgagor's loan. A Loan Modification allows the loan to be reinstated and results in a more affordable payment. Loan Modifications may include a change in the interest rate; capitalization of delinquent principal, interest or escrow items; extension of the mortgage term and/or re-amortization of the balance due. In order to qualify for a Loan Modification, a defaulting mortgagor must meet all of the following criteria:
   - The household or mortgagor(s) has experienced a verifiable loss of income or increase in living expenses;
   - One or more mortgagor(s) is currently employed with stabilized, surplus income;
   - The mortgagor's surplus income is at least the greater of \$300 or 15 percent of net monthly income;

- 85 percent of the mortgagor's surplus income is insufficient to cure arrearages within six months;
- The mortgagor's monthly PITI mortgage payment can be reduced by the greater of 10 percent of the original monthly mortgage payment amount or $100, as a result of the mortgagee setting the interest rate at the Market Rate[1] and amortizing the new loan over 30 years (See Attachment B, Example 2);
- The mortgagor has successfully completed a 3-month Trial Payment Plan based on the reduced mortgage payment amount or a 4-month Trial Payment Plan in cases of imminent default; and
- The mortgagor has not received a Loan Modification or FHA-HAMP in the previous 24 month period.

3. <u>FHA-HAMP</u>: FHA-HAMP typically involves the combination of a Loan Modification and a Partial Claim. However, FHA-HAMP may now involve the use of one or both of those Loss Mitigation options. As part of FHA-HAMP, a Partial Claim may include an amount needed to cover arrears in loan payments and, potentially, an additional amount for principal deferment. See Attachment A for guidelines in calculating principal deferment. See Attachment B, Examples 3(a) and (b), for guidance on qualifying mortgagors for FHA-HAMP and for calculating the amount of principal deferment.

   A mortgagee may use an FHA-HAMP stand-alone Partial Claim, without an accompanying Loan Modification, provided the following three conditions are met: (i) the mortgagor's current interest rate is at or below market rate, (ii) the mortgagor's current mortgage payment is at or below the target monthly payment (as defined in Attachment A), and (iii) the mortgagor otherwise qualifies for FHA-HAMP as described below.

   In addition, mortgagees may use an FHA-HAMP stand-alone Loan Modification, without an accompanying Partial Claim, if (i) an affordable mortgage payment at or below the targeted payment can be achieved by re-amortizing the mortgage for 360 months at or below the market rate; and (ii) the mortgagor qualifies for FHA-HAMP.

   In order to qualify for FHA-HAMP, a defaulted mortgagor or a mortgagor facing imminent default must meet all of the following criteria:
   - The household or mortgagor(s) has experienced a verifiable loss of income or increase in living expenses;
   - One or more mortgagor(s) is currently employed;

[1] Mortgagee Letter 2009-35 defines 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 permanent modification 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/." Mortgagee Letter 2011-28 modifies this definition by applying the Market Rate for a permanent modification *as of the time a trial payment is approved by the servicer*.

- The mortgagor(s) does not have surplus income that is at least the greater of 15 percent of net monthly income or $300;
- The mortgagor has not previously received a stand-alone Loan Modification or a FHA-HAMP in the previous 24 months;
- The mortgagor meets all applicable eligibility criteria set forth in Mortgagee Letters 2009-23 and 2010-04; and
- The mortgagor(s) of record must provide "individual" signed Hardship Affidavits.

This Mortgagee Letter eliminates the FHA-HAMP eligibility requirement established in Mortgagee Letter 2009-23 that the delinquent FHA-insured loan not be more than 12 full mortgage payments past due.

Updated FHA-HAMP Partial Claim Amount Calculation

The maximum value of all outstanding Partial Claims for a given loan cannot exceed 30 percent of the outstanding Unpaid Principal Balance (UBP) as of the date of the default.

To calculate the maximum Partial Claim amount available under FHA-HAMP, first calculate the sum of:

(i) Arrearages*;
(ii) Legal fees and foreclosure costs related to a canceled foreclosure action; and
(iii) Principal deferment.

Compare the resulting sum to 30 percent of the outstanding UPB of the loan. The amount of the Partial Claim must be the lesser of (1) the sum calculated above, or (2) thirty percent (30%) of the outstanding UPB of the loan. If there are existing Partial Claim amounts associated with the mortgage loan, then the maximum eligible amount for FHA-HAMP is 30% of the UPB less all existing Partial Claim amounts. For sample calculations of the allowable Partial Claim under FHA-HAMP, see Attachment B, Examples 3(a) and 3(b).

*The total of arrearages used in calculating the FHA-HAMP Partial Claim amount is no longer limited to 12 months PITI.

Loan Mitigation Assistance for Mortgagors Failing under Trial Payment Plans

If a mortgagor fails to successfully complete a Trial Payment Plan under a Loan Modification or FHA-HAMP, pursuant to 24 C.F.R. § 203.355, mortgagees must still re-evaluate the mortgagor's eligibility for other appropriate Loss Mitigation Options. If the mortgagor's circumstances have not changed, the mortgagee must evaluate the mortgagor for the Home Disposition Options prior to initiating foreclosure. If the cause of default is incurable (i.e., the mortgagor has no realistic opportunity of replacing his/her lost income or reducing his/her expenses enough to meet the mortgage obligation), Home Disposition Options are readily available upon default. See Mortgagee Letter 2000-05 and subsequent guidance for further discussion of Home Disposition Loss Mitigation options.

A mortgagor who did not succeed in completing a Trial Payment Plan is eligible to reapply for assistance and begin a second Trial Payment Plan only if his/her financial circumstances have changed since the last application for assistance.

Mortgagors must provide mortgagees with verifiable documentation supporting the change in their financial circumstances. Changes in employment must be verified by paystubs or by a Verification of Employment as described in Handbook 4155.1.

Surplus Income Percentage

Surplus Income Percentage is defined as surplus income divided by monthly net income (net take-home income). This Surplus Income Percentage is used in the mortgagee's financial analysis to determine which loss mitigation options are appropriate based on the mortgagor's income. See Mortgagee Letter 2000-05 for further discussion of the Surplus Income Percentage.

Re-assessment Requirement

If a foreclosure sale date is not within 30 days from the Issuance Date of this Mortgage Letter, a mortgagor must be reassessed for loss mitigation pursuant to the criteria denoted herein, prior to scheduling a foreclosure sale.

Information Collection Requirements

Paperwork reduction 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 Number 2502-0589. 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.

Questions

Any questions regarding this Mortgagee Letter may be directed to the HUD National Servicing Center at (877) 622-8525. Persons with hearing or speech impairments may reach this number by calling the Federal Information Relay Service at (800) 877-8339. For additional information on this Mortgagee Letter, please visit www.hud.gov/answers.

Signature

Carol J. Galante
Acting Assistant Secretary for Housing-Federal Housing Commissioner

Attachment A

FHA Loss Mitigation Home Retention Option Priority Order (Waterfall)

Initial Assistance Screens			
Step	Decision Point	Yes	No
1	Household or mortgagor(s) has experienced a verifiable loss of income or increase in living expenses?	Step 2	Informal or Formal forbearance/repayment plan.
2	One or more mortgagors are currently employed?	Step 3	Special Forbearance
3	Surplus income is at least the greater of $300 or greater than 15% of net income?	Step 4	**FHA-HAMP** (Step 6)
4	85% of surplus income is sufficient to cure arrears within 6 months?	Formal forbearance/ repayment plan for 6 months.	**Modification** (Step 5)

Modification *(Requires Successful Completion of Trial Payment Plan)*			
Step	Decision Point	Yes	No
5	Modification would reduce monthly payment by at least the greater of 10% or $100?	• Modified interest rate must not exceed 50 bps above Freddie Mac average, rounded to the nearest $1/8^{th}$, at time trial payment plan is offered to mortgagor; • Term of modified loan must be 30 years.	**FHA-HAMP** (Step 6)

Step 6	**FHA-HAMP**[1] *(Requires Successful Completion of Trial Payment Plan)*

- Use of FHA-HAMP is to both alleviate the burden of immediate repayment of arrears and to adjust monthly payments to a level sustainable by the household with current income. FHA-HAMP permits combining a Partial Claim and a Loan Modification.
- Partial Claim: Total amount available is the lesser of: 1) 30% of the outstanding unpaid principal balance less any previous Partial Claims paid on this mortgage; and 2) the sum of:
    1. Arrearages;
    2. Legal fees and foreclosure costs related to a canceled foreclosure action; and
    3. Principal deferment (per below calculation).
- Modification
    1. Calculate the target monthly payment:
        - A. Calculate 31% of gross income.
        - B. Calculate 80% of current mortgage payment
        - C. Calculate 25% of gross income
        - D. Take the greater of B and C
        - E. Take the lesser of A and D
    2. Calculate monthly payment on current loan balance at the market interest rate (not including arrears) and 360 months term.
    3. If result of Step 2 is lower than result from Step 1.E. then the mortgagor is eligible for a standard modification at the market interest rate and if necessary a Partial Claim for arrearages, legal fees, and foreclosure costs ONLY, but may not receive principal deferment; else go to Step 4.
    4. Calculate allowable principal deferment amount
        - A. Reduce loan balance used in Step 2 until calculated mortgage payment reaches target amount from Step 1 or else the maximum allowable principal deferment is reached per amount available as calculated above under Partial Claim.
        - B. If the final mortgage payment is greater than 40% of current income, and there is verifiable unemployment status, then mortgagor is eligible for reduced payment option under Special Forbearance. If there is no verifiable unemployment status, then mortgagor is eligible for Informal or Formal Forbearance or non-retention options.

[1] A stand-alone Partial Claim is permissible under FHA-HAMP if the mortgagor's (i) current interest rate is at or below market rate and (ii) the mortgagor's current mortgage payment is at or below the targeted payment. In addition, a stand-alone modification is permissible under FHA-HAMP if a mortgage payment at or below the targeted payment can be achieved by re-amortizing the mortgage for 360 months at or below the market rate.

Notes and Definitions

Special Forbearance: A Special Forbearance is a written agreement between a mortgagee and a mortgagor which contains a plan to reinstate a loan that has been delinquent for at least 90 days and which provides the mortgagor with relief not typically afforded under an informal forbearance plan. While Special Forbearance plans have no maximum duration, at no time may the maximum arrearage due under a Special Forbearance plan exceed the equivalent of 12 months of PITI. Special Forbearance is now available only for unemployment and no longer requires reinstatement/repayment as part of the plan. The mortgagor must be an owner occupant, committed to occupy the property as a primary residence during the term of the special forbearance agreement. However, unlike modification and partial claim which require that the mortgagor have a long term commitment to the home, special forbearance may be used to reinstate a loan to facilitate the eventual sale, or assumption of the property.

Market Interest Rate: Mortgagee Letter 2009-35 defines 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 date the permanent modification is executed. The weekly survey results are published on Freddie Mac's 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/." Mortgagee Letter 2011-28 modifies this definition by applying the Market Rate for a permanent modification *as of the time a trial payment is approved by the servicer*.

FHA Loss Mitigation Home Retention Option Prior Order (Waterfall): Examples

Example 1(a) – Formal forbearance for 6 months

Mr. and Mrs. Carlson have fallen two months behind on their mortgage. Mr. Carlson is unemployed, but Mrs. Carlson is employed and has monthly net take-home income of $3,000. Their monthly mortgage payment (PITI) is $900, and other monthly expenses total $1,500. Therefore, the Carlsons have monthly surplus income of $600 ($3,000 - $900 - $1,500), which is 20 percent ($600/$3,000) of their net monthly income. Their arrearages total $1,800 (2 months X $900). Using 85 percent of their monthly surplus income (.85 X $600), the Carlsons would be able to cure their arrearages within four months ($1,800/$510 = 3.5). The Carlsons are therefore eligible only for a formal forbearance for six months, because their surplus income exceeds 15 percent of their net monthly income and 85 percent of their surplus income is sufficient to cure their default within six months.

Example 1(b) – Special Forbearance

Mr. Madison has fallen four months behind on his mortgage. Mr. Madison is unemployed and receives an unemployment check of $250. There are no members of his household that are employed and contributing towards the mortgage payment. Therefore, Mr. Madison is eligible only for a Special Forbearance for 12 months. Once Mr. Madison becomes employed, the mortgagee should re-evaluate Mr. Madison for appropriate Loss Mitigation options to cure his default.

Example 2 – Loan Modification

Ms. Kim, who is employed and has a monthly net income of $4,000, has fallen three months behind on her mortgage. Ms. Kim has a loss of income that has been verified. Her monthly mortgage payment (PITI) is $1,450 and her other monthly expenses total $1800. Therefore, Ms. Kim has monthly surplus income of $750 ($4,000 - $1450 - $1800), which is 18.75 percent ($750/$4,000) of her net monthly income. Her arrearages total $4,350 ($1,450 X 3). Using 85 percent of her surplus income (.85 X $750), Ms. Kim would be able to cure her arrearages within 7 months ($4,350/$637.50=6.8).

Ms. Kim is not eligible for formal forbearance because 85 percent of her surplus income will not allow her to cure her default within six months. However, she is eligible for a Loan Modification, because her surplus income exceeds 15 percent of her net monthly income. After successfully completing a trial payment plan, when her modified loan is amortized for 30 years at the Freddie Mac weekly average rounded to the nearest 1/8, Ms. Kim's new PITI mortgage payment would be $1,250, so her original mortgage payment was reduced by at least 10%.

Example 3(a) – FHA-HAMP

Mr. Hernandez, who is employed, has gross monthly income of $2,500 and net monthly income of $2,000. He has fallen two months behind on his mortgage and his loss of income is verifiable. His monthly mortgage payment (PITI) is $1,000, and his other monthly expenses total $800. Therefore, Mr. Hernandez has surplus income of $200 ($2,000 - $1,000 - $800), which is ten percent ($200/$2,000) of his net monthly income. His arrearages total $2,000 ($1,000 X 2). Using 85 percent of his surplus income (.85 X $200), Mr. Hernandez would be able to cure his arrearages in 12 months ($2,000/$170=11.8). Mr. Hernandez is ineligible for formal forbearance because 85 percent of his surplus income is insufficient to cure his arrearages within six months. He is also ineligible for a stand-alone Loan Modification, because his surplus income is less than 15 percent of his net monthly income.

Although Mr. Hernandez does not qualify a Special Forbearance or a Loan Modification due to his employment and inability to cure arrears within six months, he is eligible for FHA-HAMP. His gross monthly income is $2,500 and his current monthly mortgage payment is $1,000. To calculate his targeted new monthly PITI payment, follow these steps:

A. Calculate payment at 31 percent of gross monthly income: .31 X $2,500 = $775
B. Calculate payment at 80 percent of current mortgage payment: .8 X $1000 = $800
C. Calculate payment at 25 percent of gross monthly income: .25 X $2,500 = $625
D. Take the greater of B or C: $800
E. New payment is lesser of A or D: $775
F. Increase E, if necessary, until it results in a Partial Claim equal to 30 percent of the unpaid principal balance at the time of default.

Step	New Payment	Payment Reduction	New Front-End DTI
A	$775	22.5%	31%
B	$800	20%	32%
C	$625	37.5%	25%
D	$800	20%	32%
E	$775	22.5%	31%

The targeted payment is $775, subject to the Partial Claim limit of 30 percent of the unpaid principal balance at the time of default.

Example 3(b) – FHA-HAMP

Ms. Jones, who is employed, has a gross monthly income of $3,000 and a net monthly income of $2,500. She has fallen two months behind on her mortgage. Ms. Jones' loss of income is verifiable. Her monthly mortgage payment (PITI) is $1,000, and her other monthly expenses total $1,400. Therefore, Ms. Jones has a monthly surplus income of $100 ($2,500- $1,000 - $1,400), which is four percent ($100/$2,500) of her net monthly income. Her arrearages total $2,000 ($1,000 X 2). Using 85 percent of her surplus income (.85 X $100), Ms. Jones would be able to cure her arrearages in 24 months ($2,000/$85=23.5). Ms. Jones is ineligible for a formal forbearance because 85 percent of her surplus income is insufficient to cure her arrearages within six months. She is also ineligible for a Loan Modification, because her surplus income is less than 15 percent of her net monthly income.

However, because Ms. Jones is employed and her surplus income is less than $300 and less than 15 percent of her net monthly income, Ms. Jones is eligible for FHA-HAMP. Her gross monthly income is $3,000 and her current monthly mortgage payment is $1,000. To calculate her targeted new monthly PITI payment, follow these steps:

A. Calculate payment at 31 percent of gross monthly income: .31 X $3,000 = $930
B. Calculate payment at 80 percent of current mortgage payment: .8 X $1,000 = $800
C. Calculate payment at 25 percent gross monthly income: .25 X $3,000 = $750
D. Take the greater of B or C: $800
E. New payment is lesser of A or D: $800
G. Increase E, if necessary, until it results in a Partial Claim equal to 30 percent of the unpaid principal balance at the time of default.

Step	New Payment	Payment Reduction	New Front-End DTI
A	$930	7%	31%
B	$800	20%	~26.7%
C	$750	25%	25%
D	$800	20%	~26.7%
E	$800	20%	~26.7%

The targeted payment is $800, subject to the Partial Claim limit of 30 percent of the unpaid principal balance at the time of default.