Third Report

Evaluation of 601 Accelerated Claims Disposition Demonstration

U. S. Department of Housing and Urban Development

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Executive Summary

The Accelerated Claims Disposition (ACD) Demonstration is designed to provide an alternative disposition strategy for delinquent Federal Housing Administration (FHA) loans. Enacted as Section 601 of the Appropriations Act for Fiscal Year 1999, ACD gives the Department of Housing and Urban Development (HUD) the authority to experiment with a more flexible method of paying claims for FHA-insured loans and disposing of foreclosed, single-family properties. The legislation permits the Federal Housing Administration (FHA) to accelerate the claim on delinquent mortgage notes and transfer them to a public/private joint venture (JV) for disposition. FHA sells the notes to the JV at a discounted price determined by competitive bid. The JV then manages the restructuring of notes for securitization and sale or the foreclosure and property sale of non-performing loans. FHA retains an equity interest in the partnership undertaking asset disposition.

This is the Third Interim Report of the Evaluation of the 601 ACD Demonstration, reporting progress on the first three Joint Ventures (JV2002, JV2003 and JV2004) between HUD and the private partners. The purpose of the evaluation is to determine whether JV processing of seriously delinquent mortgages is cost effective under existing conditions or feasible alternatives. The evaluation also considers whether JV processing enhances HUD's ability to achieve policy objectives, including homeownership retention. In order to determine the cost effectiveness and policy impacts of JV processing, the evaluation compares the outcomes of JV loans to a 10 percent holdout sample of loans that met the eligibility criteria for JV processing. The holdout loans receive standard FHA processing—that is, servicing by a participating servicer (p-servicer) using standard FHA techniques of loss mitigation or foreclosure and then disposition of foreclosed properties by management and marketing (M&M) contractors. The evaluation compares the claim rates and loss rates between the JV loans and the holdout sample and also compares the extent to which JV and standard FHA processing result in homeownership retention.

The first JV (JV2002), which began in October 2002, has reached 93 percent final resolutions as of August 31, 2005. The holdout loans from the same period have attained 67 percent resolutions including 18 percent reinstatements. Faster disposition is a common characteristic of the JVs. While it was expected that most of the ACD loans would have gone to foreclosure without aggressive intervention, only 22 percent of ACD and 18 percent of holdout loans have been sold as REO (as of August 31, 2005). Managed by Citigroup, the remainder of the ACD resolutions have involved note sales, including a large securitization sale.

The second JV (JV2003) began in August 2003 and has resolved 80 percent of its loans. Two major changes in JV2003 are the national coverage and the lower JV discount rate (29 percent for JV2003 vs. 38 percent for JV2002). The discount rate is the JV purchase price of the loan relative to the Broker's Price Opinion of the underlying property. Another difference for JV2003 and subsequent JVs is that the loans come from a pipeline of delinquencies rather than a combination of a designated pool and pipeline as in JV2002. Managed by Lehman, JV2003 is resolving loans faster than JV2002 by selling notes in moderate-sized batches as they become ready. Despite the 10-month lag, JV2003 has a higher share of REO sold (25 percent for JV2003 vs. 22 for JV2002) with another 7 percent in REO inventory. The low share of REO sold for the 2003 holdouts may partly reflect slower disposition, but even if all the REO inventory and foreclosure in process ended in property sale, the REO share would be less than 35 percent. The low share of REO for either ACD or holdouts shows a common difficulty for participating servicers in selecting the high-risk loans for provisional approval or ACD treatment.

The third JV (JV2004) began in June 2004 and the managing partner, Citigroup, has resolved 42 percent of the loans. The JV discount has dropped to 19 percent and FHA's ownership share has increased from 30 percent for the earlier JVs to 40 percent for JV2004.

The homeownership retention rates are approximately the same between ACD and holdouts, though a lower level for the 2003 cohort corresponds to the higher rate of REO sale. The homeownership determination is preliminary for those cases with interim status, e.g., 33 percent for 2002 holdouts and 44 percent for 2003 holdouts. Once those cases have reached final resolution, it will be much clearer whether ACD does a better job than standard FHA processing at preserving homeownership.

In terms of financial results, JV2002 has a lower average claim cost (106 percent) relative to unpaid principal balance (UPB) compared to 116 percent for the holdouts. The ACD loans also have a higher net recovery rate (69 percent) relative to holdouts (65 percent) owing to high recoveries for Paid in Full (PIF) and note sales (nonforeclosure resolutions). However, the JV loss rates for PIF and note sales are substantially higher than for the holdouts due to the JV discount. JV2002 loans have an average discount of 38 percent. Every loan starts ACD with a significant discount, which is a loss from HUD's point of view. Even the PIFs for ACD have a loss rate of 24 percent compared to a holdout loss rate of 0.4 percent. Holdout PIFs or reinstatements have small claims from loss mitigation, but those claims are much smaller than the JV discount. The ACD loss rate for all the final resolutions is 33 percent compared to 10 percent for the holdouts. The gap between those loss rates is likely to narrow significantly as the holdout resolutions catch up to ACD and the foreclosures go to REO sale. There are 33 percent of holdout loans in interim status nearly three years after default compared to only 7 percent in interim status for ACD. It is reasonable to expect most of those properties to end in foreclosure with a lower recovery rate from difficult to sell properties than recorded to date. Lower recovery rates on seasoned REO will increase the holdout loss rate (10 percent) more than the ACD loss rate (33 percent). Nevertheless, it is unlikely that the first JV will have losses less than the comparison group of holdouts.

The financial results for JV2003 show lower claims costs and higher net recovery rates, so the gap in loss rates is a little less large. The claims costs for REO are 105 percent for ACD and 111 percent for holdouts. The net recovery for REO is nearly the same between ACD (68 percent) and holdouts (67 percent). Higher recoveries for PIF and note sales lift ACD recovery rates to 75 percent. JV2003 is interesting because the REO loss rate (34 percent) is less than the holdout loss rate for REOs (36 percent). Accentuating lower loss rates for ACD REOs is one way that JV can reduce losses compared to standard FHA processing. Despite lower losses on REOs and smaller loss rates for PIF and note sales relative to JV2002, the overall loss rate for JV2003 resolutions is 26 percent compared to 12 percent for the holdouts. Again, that gap will likely narrow as holdout foreclosures become REO sales and the holdout loss rate increases, but the gap is unlikely to be closed.

The recovery rates seem to fall with seasoning, but the downward trend may be a national phenomenon not connected to ACD. The FHA recovery rates declined by 2 to 3 percentage points since last year particularly in the Atlanta (-1.4 points) and Philadelphia (-3.1) Homeownership Centers.

A claims model is estimated on FHA delinquencies from 2001 in order to predict what would have happened to the ACD loans under standard FHA processing. The 2nd Interim Report used the 1997 cohort of delinquencies. There was concern that the differences in loss mitigation treatment and M&M contractor property disposition might make 1997 loans a poor control for the 2002 loans even though the 1997 loans have more time to resolve. Another change is to estimate the probability of conveyance claims rather than all claims as a way to focus on the largest claims and the distinction between REO and non-REO sales. The conveyance claim model could also be more useful for scoring loans according to the probability of foreclosure without the dilution of much smaller loss mitigation claims. The new model works well in predicting conveyance claims for the 2002 and 2003 cohort of holdouts. The model also shows that ACD reduces the REO sale rate 2 or 3 percentage points from what could have been expected under standard FHA processing. ACD treatment seems to restructure some notes that would have gone to foreclosure. It is possible that such restructuring will preserve homeownership for some ACD cases in the long run. Targeting to high-risk loans is likely to make this restructuring more difficult because fewer loans would reperform and thus become viable note sales.

A Glossary of Terms and Abbreviations follows the Executive Summary.

Glossary of Terms and Abbreviations

601 Program – refers to Section 601 of the Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Act, 1999. Section 601(d) amends Section 204(g) of the National Housing Act to allow for structured financing such that FHA retains an equity interest in a partnership and the private partner manages the asset disposition. The 601 Program is also called ACD or the JV Program.

ACD – Accelerated Claims Disposition Demonstration (also called 601 Program or JV Program). ACD represents the alternative of delinquent loans being selected for prompt claim payment by FHA and the loan being transferred to a joint venture in which the private partner sells the loan without FHA insurance for the best available price.

BPO – Broker's Price Opinion, the report that values properties at the time a loan is submitted for ACD claim.

Eligible loans – remaining set of provisionally approved loans after holdout loans and ACD loans have been selected out. Delinquent loans cycle through eligibility with new delinquent loans becoming provisionally approved and older delinquent loans losing eligibility. Provisional approval status only lasts for 60 days. In any month, eligible loans could be drawn into the set of holdout loans or selected for ACD treatment. More information on the eligibility criteria is found in the entry for Provisional Approval.

FMV – Fair Market Value, the value of the loan as determined by the private partner in the Joint Venture. The fair market value is the discounted amount relative to the Broker's Price Opinion.

Holdout loans – a set of comparison loans that are similar to the set of eligible loans from which ACD loans are drawn. A 10 percent random sample of provisionally approved loans is set aside each month before the participating servicer selects loans for ACD treatment. The holdout loans cannot be submitted for ACD under the current or subsequent joint ventures.

Homeownership Retention – loan restructuring or loss mitigation such that the borrower remains in his or her home. In standard FHA processing, the loss mitigation techniques of special forbearance, loan modification and partial claim are the three versions of loss mitigation homeownership retention. Non-homeownership retention means the loan is terminated – for example, through a preforeclosure sale or deed-in-lieu. In JV processing, homeownership retention is more difficult to track because the loan is often sold in a note sale. It is assumed that the borrower retains her home in a note sale, particularly in securitization sales because the loans are performing, but there is no information available on the retention after the sale.

Interim PIF – Interim Paid In Full. Loans that are paid in full during the transition from FHA to the JV are considered ACD loans, but the payment does not actually reflect JV servicing. In JV2004 and later JVs, the interim PIFs paid prior to the 4th business day after the settlement date are treated as repurchases, i.e., the full payment goes to FHA. Loans paid on or after the 4th business day following settlement, but before the loan is transferred to the LLC servicer, are also considered interim PIFs. However, the payment for these later PIFs are treated like other note sales in that FHA gets 40 percent of the recovery. For this report, all interim PIFs are categorized as PIFs.

JV – Joint Venture. FHA enters a public/private joint venture in which the private partner is responsible for managing the asset disposition of delinquent loans. The Joint Ventures are distinguished by the year in which the auction was conducted.

JV2002 – The Joint Venture begun in 2002 and managed by Citigroup. FHA's ownership share is 30 percent. To arrive at the fair market value, the average discount on loans relative to BPO was 37.7 percent.

JV2003 – Joint Venture begun in 2003 and managed by Lehman. FHA's ownership share is 30 percent. To arrive at the fair market value, the average discount on loans relative to BPO was 29.3 percent.

JV2004 – Joint Venture begun in 2004 and managed by Citigroup. FHA's ownership share is 40 percent. To arrive at the fair market value, the average discount on loans relative to BPO was 19 percent.

JV processing – The alternative to standard FHA processing is JV processing, in which the joint venture services the original loan, restructures the loan or forecloses on the loan and sells the property. The joint venture is not restricted by the same servicing rules as standard processing, which means the loan can be sold as a discounted note, with or without restructuring.

Liquidation – the final termination of a loan, either as a sale (note sale or property sale) or as Paid in Full (PIF).

Loss Mitigation – techniques used by FHA servicers to help delinquent loans cure their default or reinstate. The homeownership retention loss mitigation tools are: special forbearance, loan modification, and partial claim. The non-homeownership retention loss mitigation tools are: preforeclosure sale and deed-in-lieu of foreclosure. JV servicers have a wider range of loss mitigation techniques, often referred to as loan restructuring.

Loss Rate – The ratio of claims less net recovery to unpaid principal balance. Claims are the total accelerated claim, including participation fee, paid to the participating servicer in order for FHA to obtain the loan. For JV2002 and JV2003, net recovery is 70 percent of the Fair Market Value plus 30 percent of the note or property sale plus other income less other expenses. In JV2004, the ownership share for FHA increased to 40 percent, so the net recovery is 60 percent of the Fair Market Value plus 40 percent of the note or property sale plus other income less other expenses.

LTV - Loan-to-Value is the ratio of unpaid principal balance to property value, based on either the BPO or the original appraisal.

Non-Foreclosure Final Status – Loans that reached a final status but did not complete foreclosure. For ACD loans, the loans in this category are note sales sold below the unpaid principal balance. For non-ACD loans, this category includes preforeclosure sales, deed-in-lieu of foreclosure dispositions and any other termination involving a partial claim.

Note Sale – the Joint Ventures have the option of selling loans either at full value or at a discount relative to the unpaid principal balance. The note sale could be a pool sale or a securitization sale. Only the Joint Ventures have done note sales during the ACD Demonstration. FHA has done single family note sales in the past, but has not done any note sales during the ACD Demonstration.

P-servicers – Participating Servicers, mortgage servicers who agreed to participate in the Accelerated Claims Disposition Demonstration. The p-servicers send delinquent loans for provisional approval and select which loans are ultimately submitted for accelerated claim. The p-servicers also collect a participation fee to offset the added costs of participation in the ACD Demonstration.

PIF – Paid in Full, loans that are terminated with full payment, usually by the borrower. In the 2nd Interim Report, the PIF category included note sales at or above par, i.e., note sales in which the amount paid was at least as much as the UPB at settlement. However, this expansion in the PIF designation was considered too confusing, so in the 3rd Interim Report we revert to the more conventional designation of PIF as loans paid off and all the note sales are included in the non-foreclosure final status category.

Property Sale – sale of foreclosed properties after the title has been conveyed to HUD or the Joint Venture.

Provisional Approval – the criteria used to determine which delinquent loans are eligible for accelerated claims and joint venture processing. To be provisionally approved a loan must meet the following criteria:

- Serviced by a Participating Servicer
- Unpaid principal balance no less than $20,000
- Loan must be four full payments past due (5 payments starting with JV2005)
- Loan-to-value (LTV) ratio of 85 percent or higher
- P-servicer used reasonable judgment to conclude loss mitigation would not be successful
- Freddie Mac EarlyIndicator Risk Grade of D, E or F
- Mortgaged property not subject to Department of Justice seizure order or in an Asset Control Area
- Mortgaged property has not sustained more than 10 percent damage regardless of insurance
- Loan not subject to partial claim or special forbearance relief
- Loan not accepted for preforeclosure sale or deed-in-lieu of foreclosure
- No contested foreclosure and no foreclosure sale has been scheduled within 60 days
- (Added for JV2005) For mortgage loans in bankruptcy, the mortgagor is not current under the terms of a confirmed repayment plan under Chapter 13.

There is also a maximum number of missed payments that varies by state, ranging from 5 to 13 months. For ACD loans, the participating servicer must order a Broker's Price Opinion (BPO) report and submit the Monthly Supplemental Defaulted Loan Payment History. The provisional approval lasts 60 days.

Recovery Rate – the ratio of the sale price less net expenses to the claim amount. In this report, the recovery rate is the net recovery rate relative to claims. FHA recovery rates are the loss amount subtracted from the acquisition cost divided by the acquisition cost. The recovery rate differs from the loss rate in two ways. The recovery rate is net recovery relative to claims, whereas the loss rate is relative to UPB. Also, the recovery rate is calculated for sales, either property sales or note sales. Loss rates are calculated as claims minus net recovery and includes all resolutions, even cases with zero claims.

Reinstatement – sufficient payment by the borrower to bring a delinquent loan current. There is no presumption that reinstatement loans will not default again.

REO inventory – Real Estate Owned, property owned by either FHA or the Joint Venture and waiting to be sold. REO Sale is the loan category for REO properties after the sale.

Standard processing (or standard FHA processing) – Under current FHA rules, the servicer collects payments and forwards the premium to FHA. Delinquent loans are given loss mitigation treatment, either using retention tools (special forbearance, loan modification or partial claim) or non-retention tools (preforeclosure sale or deed-in-lieu of foreclosure). If loss mitigation fails, the servicer proceeds with foreclosure. Upon completion of foreclosure, the title is delivered to FHA in exchange for a claim payment and the property is sold by Management and Marketing (M&M) contractors for HUD.

UPB – unpaid principal balance, the amount of principal owed on the loan. For ACD cases, the UPB is recorded when the loan enters the Joint Venture. For non-ACD loans, the UPB is updated monthly and represents the amount at the cutoff date, or August 31, 2004, used in the analysis for this report.

Background on the ACD Demonstration Design and JV Processing

The Accelerated Claims Disposition Demonstration comes from Section 601 of the Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Act, 1999. The Act allows the Federal Housing Administration (FHA) additional flexibility to choose the most cost effective methods for paying claims and disposing of foreclosed, single-family properties. It specifically authorizes FHA to take assignment of mortgage notes and transfer them to private partners for servicing, property management and asset disposition. Section 601(d) amends Section 204(g) of the National Housing Act to allow for structured financing such that FHA retains an equity interest in the partnership undertaking the asset disposition.

The purpose of the 601 Evaluation is to answer the following questions:

- What is the return to HUD from the JV structure compared to standard HUD processing? What explains the difference in cost? How have the increased use of loss mitigation and evolving performance of Management & Marketing (M&M) contractors affected the differences?
- How has the design of the ACD Demonstration affected the outcomes? Which incentive systems were productive? Which were counterproductive?
- Are the outcomes compatible with FHA's policy objectives?
- Are there alternative structures that would have improved the outcomes?
- What are the implications of the ACD Demonstration outcomes for expansion of the program?
- To what extent are the results seen in the Demonstration predictive of servicer behavior on a larger-scale?
- What should be the next steps? Should the ACD Demonstration be expanded, changed or rejected altogether?

Not all of these questions are addressed definitively in this report because the final outcomes for many ACD loans and most FHA comparison loans have not happened yet. Nevertheless, the major patterns are becoming clearer. For ACD to reduce costs to FHA, the p-servicers will have to improve targeting to high-risk loans and reduce the discount on loans sold to the JV. Even under those conditions, a strong housing market could make the FHA claims rate from delinquencies so low that it is extremely difficult for ACD loss rates to fall below FHA loss rates. The focus of this report is to present the facts based on data through August 31, 2005. The implications of those facts remain tentative while we await final loan outcomes and more complete analysis.

How ACD Works

The selection of loans under the ACD Demonstration starts with the participating servicers (p-servicers) of FHA loans who have agreed to submit their delinquent loans to FHA for provisional approval. There are a number of eligibility criteria, including:

- Serviced by a Participating Servicer
- Unpaid principal balance (UPB) no less than $20,000
- Loan must be four full payments past due (increased to five payments for JV2005)
- Loan-to-value (LTV) ratio of 85 percent or higher
- P-servicer used reasonable judgment to conclude loss mitigation would not be successful
- Freddie Mac EarlyIndicator Risk Grade of D, E or F
- Mortgaged property not subject to Dept. of Justice seizure order or in Asset Control Area
- Mortgaged property has not sustained more than 10 percent damage regardless of insurance
- Loan not subject to partial claim or special forbearance relief
- Loan not accepted for preforeclosure sale or deed-in-lieu of foreclosure
- No contested foreclosure and no foreclosure sale has been scheduled within 60 days.
- (Added for JV2005) if a bankruptcy loan, it is not current under the Ch.13 repayment plan.

Loans that meet the eligibility requirements are divided into two groups, the holdout loans and the eligible loans. The holdout loans are a 10 percent random sample of the provisionally approved loans. The holdout loans are set aside to create a comparison cohort for the evaluation of the ACD loans selected by p-servicers from the provisionally approved loans. From an experimental design point of view, it would have been better for holdout loans to be randomly drawn after p-servicers selected loans for ACD. If the holdouts had been a random subset of the loans selected for ACD treatment but not given JV processing, then it would be clear that the differences in outcomes between holdouts and ACD were due to the JV processing. However, that would have required larger sampling rates from the provisionally approved loans to reach statistically meaningful sample sizes of ACD and holdouts. Instead, HUD chose a sequential design whereby the p-servicer first selected loans for provisional approval, a 10 percent random sample of the approved loans was set aside as the holdout sample, then the p-servicers selected the loans for ACD from the remaining approved loans. In the sequential design, the comparison between ACD and holdout loans is a combination of the p-servicer selection effect and the JV processing effect.

All three groups, ACD, holdouts and eligibles, have passed through the provisional approval screen, but the order of selection after that screening is potentially important. The holdouts are the first to be drawn from the provisionally approved, so the distribution of characteristics for holdouts should be most representative of the larger set of provisionally approved loans. The ACD loans are then selected from the provisionally approved excluding the holdouts. The assumption is that foreclosure is expensive for the p-servicers as well as for FHA, so the p-servicers have an incentive to select the high-risk loans from the approved cases. The approval lasts for 60 days and it is certainly possible that new information becomes available to the p-servicer that was not known at provisional approval. It is also likely that the p-servicer has more information, such as credit scores or the borrower's employment history, which is used in the selection process but not reported to HUD. Unfortunately, we know relatively little about how the p-servicers select loans for ACD, but selection models reported in the 2nd Interim Report show substantial differences among the p-servicers. Some p-servicers target the highest risk loans before submitting for provisional approval. Whereas, other p-servicers submit nearly all their delinquencies, and subsequently pick the highest risk loans for ACD from the provisionally approved cases. Under either approach, it is apparently quite difficult to identify which delinquent loans are most likely to go to foreclosure.

After the holdouts and ACD are selected, the remaining set of provisionally approved loans are the eligible loans. If the high-risk loans are selected for ACD, we would expect the eligible loans to be lower risk than the ACD loans on average. However, the pool of eligible loans is quite dynamic with new approvals being added each month and continuing eligibles being drawn off to holdouts, JV2002 or subsequent JVs. In that respect, the eligible loans are not a well-defined cohort of loans and yet, the characteristics and outcomes of the eligible loans are not that different from ACD or holdouts. Given our limited knowledge about the selection process for ACD and to get a more complete view of all the provisionally approved loans, we report results for all three loan groups.

From the set of eligible loans, the p-servicers select a subset of loans for accelerated claim paid by FHA. The loans submitted for ACD claim must have a Broker's Price Opinion (BPO), but the holdouts do not. At settlement, the ACD loans are transferred from the p-servicers to the Joint Venture. The value of the loan as it enters the JV is based on the accepted bid for the risk category containing the loan. The risk categories are based on UPB or BPO, LTV and days in foreclosure. High-risk loans are discounted more than low-risk loans, though ACD loans as a group are relatively high risk because they are all at least 90-day delinquent loans (4 payments past due; 5 payments past due for JV2005) and many have defaulted more than once.

JV2002 was the first joint venture, and there was considerable uncertainty about how the process would work and how successful the JV partner, Citigroup, would be. The average discount rate, measured as the ratio of BPO minus the fair market value (FMV) relative to BPO, was 37.7 percent, though the discount rate for any particular risk category could be much higher or lower than that average. JV2002 began taking in loans in October 2002 and now contains 6,656 loans from the Philadelphia and Atlanta Homeownership Centers (HOC). The final settlement date for JV2002 was September 15, 2003. By the second Joint Venture, there were several competitive bids and the winning bid to Lehman resulted in a discount rate of 29.3 percent. JV2003 began in August 2003 and has 6,153 loans from all four HOC regions as of August 31, 2005. The final month of settlement for JV2003 was September 15, 2004. In both JVs, HUD has a 30 percent ownership share and the private partner has a 70 percent share. When the loan is transferred to the JV, the private partner pays FHA 70 percent of the FMV.

The Demonstration continues with JV2004, won by Citigroup again. The major change in the third joint venture is that the discount, or rate at which JV buys the loans from FHA, has declined substantially to 19 percent. The smaller discounts show that private partners recognize the value contained in FHA delinquent loans and have overcome their uncertainty about the ACD Program. Another sign of confidence in the profitability of the joint ventures is that FHA has increased its ownership share from 30 percent in JV2002 and JV2003 to 40 percent in JV2004. The reduction in discounts and increase in ownership share should increase the recovery rate that FHA obtains from the latest joint venture. The last settlement date for JV2004 is June 14, 2005 for a total of 6,813 loans. Subsequent delinquent loans flow into JV2005. Exhibit 1 shows the participating servicers for each Joint Venture.

Exhibit 1

Participating Servicers by Joint Venture

JV2002	JV2003	JV2004	JV2005
Wells Fargo	Wells Fargo	Wells Fargo	Wells Fargo
Chase	Chase	Chase	Chase
PHH (Cendant)	PHH (Cendant)	Aurora	Aurora
Countryside		Washington Mutual	Washington Mutual
			Bank of America
			EverHome

Loans transferred from p-servicer to JV are evaluated by the private partner to determine how best to maximize the return on the loan. Some loans are restructured with new terms, some loans pay in full, and some loans go to foreclosure and then REO status. In most cases, the JV attempts to bring the loan back to performing status and then sell the note either in a pool sale or securitization sale. Loans liquidated through note sales generally earn a higher return than property sales, so the JV has an incentive to maximize the share of note sales relative to property sales. When the note or property is sold, FHA receives 30 percent of the sales price less 30 percent of the expenses for servicing and selling the asset. FHA's percentage increased to 40 percent for JV2004. The net recovery is the amount remaining after adjusting for income and expenses. In this report, the recovery rate is the net recovery amount divided by the claims amount. The loss rate is measured as the total costs less recoveries divided by the UPB. The UPB is the unpaid principal balance reported by the p-servicer when the loan is submitted for provisional approval.

Outcomes

The progress of the first three Joint Ventures up to August 31, 2005 is shown in the following three exhibits. The loan status in counts of loans is shown in Exhibit 2. Dollar values (UPB) for the same categories of loans are displayed in Exhibit 3 and average UPB per loan are presented in Exhibit 4. The benchmark for progress is the share of loans that have reached resolution. For JV2002, 93 percent of ACD loans compared to 67 percent of holdout loans have been resolved. JV2003 does not lag far behind with 80 percent ACD loans and 56 percent holdouts having reached resolution. The most recent JV to complete settlements, JV2004, has only 42 percent of ACD loans and 30 percent of holdout loans having resolved. For each JV cohort, it is clear that a higher percentage of ACD loans have resolved than either the holdouts or eligible loans. In a deteriorating market, quick resolution can be important and the Joint Ventures have demonstrated that they can resolve loans in less time than standard FHA processing.

Exhibit 2

Loan Status by Numbers of Loans (Data as of 8/31/2005)

	2002			2003			2004		
Loan Status	**ACD**	**Eligible**	**Holdout**	**ACD**	**Eligible**	**Holdout**	**ACD**	**Eligible**	**Holdout**
Paid in Full (PIF)[1]	925	3,271	1,061	581	3,098	466	442	2,641	288
	14%	32%	30%	9%	18%	19%	7%	16%	12%
REO Sold	1,496	1,171	623	1,535	2,448	418	329	788	81
	22%	11%	18%	25%	15%	17%	5%	5%	3%
Non-foreclosure Final Status	3,776	91	40	2,794	234	42	2,065	284	49
	57%	1%	1%	45%	1%	2%	34%	2%	2%
Reinstatements		2,363	643		3,397	421		5,784	712
		23%	18%		20%	17%		34%	29%
Total Resolutions	**6,197**	**6,896**	**2,367**	**4,910**	**9,177**	**1,347**	**2,836**	**9,497**	**1,130**
	93%	**67%**	**67%**	**80%**	**55%**	**56%**	**42%**	**33%**	**30%**
REO Inventory	180	340	141	461	926	153	715	1,563	253
	3%	3%	4%	7%	6%	6%	12%	9%	10%
Non-retention Loss Mitigation	10	10	6	19	38	5	115	132	28
	0.2%	0.1%	0.2%	0.3%	0.2%	0.2%	2%	0.8%	1%
Foreclosure in Process	80	983	341	115	1,628	263	1,312	4,842	810
	1%	9%	10%	2%	10%	11%	21%	29%	33%
Reinstatements Pending Sale	18			234			130		
	0.3%			4%			2%		
Retention Loss Mitigation Action Taken	62	1,273	397	166	3,116	380	492	6,593	894
	1%	12%	11%	3%	19%	16%	8%	39%	37%
Bankruptcy	68	178	100	140	410	83	244	1,351	211
	1%	2%	3%	2%	2%	3%	4%	8%	9%
Unresolved Delinquency	36	402	142	87	794	104	212	2,430	351
	1%	4%	4%	1%	5%	4%	3%	14%	14%
Unknown	5	285	59	21	735	87	757	2,368	147
	0.1%	3%	2%	0.3%	4%	4%	12%	14%	6%
Total Loans	**6,656**	**10,367**	**3,553**	**6,153**	**16,824**	**2,422**	**6,813**	**28,776**	**3,824**

Note:
One eligible loan from 2003 and 91 eligible loans from 2004 with unknown status and missing unpaid principal balance (UPB) are excluded. In addition, all eligible loans in a year that also become an ACD loan in a later year are also excluded from the eligible group for that year. For example, eligible loans from 2002 that later become ACD loans in 2003, 2004 or 2005 are excluded from the eligible group in 2002.

1. ACD PIF loans include interim PIFs. In 2002, there were 128 interim PIFs that were paid on or after the 4th business day of the settlement month. In 2003, there were 182 interim PIFs that were paid on or after the 4th business day of the settlement month. And in 2004, there were 110 interim PIFs that were paid before the 4th business day of the settlement month and 84 interim PIFs that were paid on or after the 4th business day of the settlement month. This table does not make differentiate between the two types of interim PIFs in 2004.

Exhibit 2

Loan Status by Numbers of Loans (Data as of 8/31/2005) - *continued*

Rules Used in Loan Status Assignment

JV Processing (in the order of preference)

1 Paid in Full if the ratio of sales price to UPB is 1 or greater, includes interim PIFs.
2 REO Sold if property sale.
3 Non-foreclosure Final Status if note sale, PFR17, SAL9A, SAL9B, SAL9C or TPS30.
4 REO Inventory if FOR46, DIL47, PST01, PST06 or PST08.
5 Non-retention Loss Mit if PFR15 or DIL44.
6 Foreclosure if FOR43, FOR45, FOR68, OCC02 or OCC03.
7 Reinstatement if REI20.
8 Retention Loss Mit Action Taken if FGV9E, FRB09, FRB12, LNM28, NWB01, NWR01 or NWT01.
9 Bankruptcy if BK07S, BK11S, BK12S or BK13S.
10 Unresolved Delinquency if DEL42, BK07E, BK11E, BK12E or BK13E.
11 Unknown if not a property sale, note sale or no non financial transaction code.

Standard Processing (in the order of preference)

1 Paid in Full if default status code is 13, 22, 25 or 30 or termination code is 11, 13, 22 or 23.
2 REO Sold if termination code is 15 and disposition date exists.
3 Non-foreclosure Final Status if default status code is 17, 48 or 49 or termination code is 25
4 REO Inventory if default status code is 24, 46 or 47 or termination code is 15 and disposition date is missing.
5 Non-retention Loss Mit if default status code is 15 or 44.
6 Foreclosure if default status code is 43, 45 or 68.
7 Reinstatement if default status code is 14, 20 or 21.
8 Retention Loss Mit Action Taken if a) default status codes is 09, 10, 12, 19, 26, 28, 32, 39 or 41, b) loss mitigation claim prepared date is after the default status date, or c) loss mitigation record exists but current default record does not.
9 Bankruptcy if bankruptcy code is 1, 2, 3 or 4 and bankruptcy date is after the default status date.
10 Unresolved Delinquency if default status code is 42 or 99.
11 Unknown if default status codes is 77 or current default record does not exist.

Exhibit 3

Loan Status by Amount of Unpaid Principal Balance (Data as of 8/31/2005)

Loan Status	2002 ACD	2002 Eligible	2002 Holdout	2003 ACD	2003 Eligible	2003 Holdout	2004 ACD	2004 Eligible	2004 Holdout
Paid in Full (PIF)[1]	$104,238,949 17%	$321,430,171 39%	$107,579,893 34%	$65,080,576 11%	$357,759,792 20%	$53,870,100 21%	$57,797,730 9%	$309,445,192 17%	$35,232,432 14%
REO Sold	$119,876,818 20%	$98,096,554 12%	$51,524,590 16%	$147,433,377 24%	$250,278,539 14%	$41,741,668 16%	$31,752,966 5%	$81,204,327 5%	$8,408,406 3%
Non-foreclosure Final Status	$345,478,541 57%	$10,166,757 1%	$4,290,128 1%	$274,491,864 45%	$31,006,761 2%	$5,308,822 2%	$223,081,840 37%	$36,365,601 2%	$5,929,434 2%
Reinstatements		$104,238,949 12%	$53,481,174 17%		$351,230,689 20%	$43,970,430 17%		$618,794,696 35%	$76,044,762 30%
Total Resolutions	**$569,594,308 94%**	**$533,932,430 64%**	**$216,875,785 68%**	**$487,005,817 80%**	**$990,275,780 56%**	**$144,891,021 57%**	**$312,632,537 41%**	**$1,045,809,817 34%**	**$125,615,033 30%**
REO Inventory	$14,566,732 2%	$27,641,682 3%	$11,401,911 4%	$41,913,696 7%	$93,236,585 5%	$14,350,206 6%	$73,128,665 12%	$154,283,656 9%	$25,352,062 10%
Non-retention Loss Mitigation	$1,068,904 0.2%	$1,085,539 0.1%	$679,337 0.2%	$2,074,942 0.3%	$3,945,696 0.2%	$678,165 0.3%	$15,366,519 3%	$16,855,193 1%	$3,791,709 1%
Foreclosure in Process	$6,794,985 1%	$83,988,686 10%	$29,333,462 9%	$10,216,071 2%	$166,708,311 9%	$27,537,114 11%	$145,990,922 24%	$501,129,148 28%	$88,773,743 35%
Reinstatements Pending Sale	$1,421,639 0.2%			$24,782,093 4%			$14,266,713 2%		
Retention Loss Mitigation Action Taken	$5,480,814 1%	$114,495,077 14%	$35,247,236 11%	$18,506,349 3%	$324,469,783 18%	$38,455,363 15%	$60,368,920 10%	$725,137,476 41%	$98,948,657 39%
Bankruptcy	$5,682,380 1%	$16,077,513 2%	$9,292,712 3%	$14,563,769 2%	$42,033,330 2%	$8,268,655 3%	$26,920,874 4%	$140,686,780 8%	$21,842,849 9%
Unresolved Delinquency	$3,497,715 1%	$33,645,977 4%	$12,364,215 4%	$9,146,963 1%	$80,087,986 5%	$11,055,675 4%	$23,274,097 4%	$253,271,863 14%	$37,302,503 15%
Unknown	$485,548 0.1%	$23,946,776 3%	$5,054,712 2%	$2,454,581 0.4%	$70,932,443 4%	$8,742,129 3%	$85,178,861 14%	$261,754,910 15%	$15,523,468 6%
Total Loans	**$608,593,026**	**$834,813,680**	**$320,249,370**	**$610,664,280**	**$1,771,689,914**	**$253,978,328**	**$757,128,108**	**$3,098,928,843**	**$417,150,024**

Note:
Unpaid principal balance (UPB) amounts were obtained from the Accelerated Claim Criteria Report Application (ACCRA) data. When UPB was not available in ACCRA (0.01% of 601loans, 0.02% of holdout loans and 0.46% of eligible loans in 2002; 0.04% of 601 loans, 0.38% of holdout loans and 1.7% of eligible loans in 2003; and 0.29% of eligible loans in 2004), UPB from the Accelerated Claims Disposition (ACD) data or the Single Family Data Warehouse (SFDW) was used.

One eligible loan from 2003 and 91 eligible loans from 2004 with unknown status and missing unpaid principal balance (UPB) are excluded. In addition, all eligible loans in a year that also become an ACD loan in a later year are also excluded from the eligible group for that year. For example, eligible loans from 2002 that later become ACD loans in 2003, 2004 or 2005 are excluded from the eligible group in 2002.

1. ACD PIF loans include interim PIFs. In 2002, there were 128 interim PIFs that were paid on or after the 4th business day of the settlement month. In 2003, there were 182 interim PIFs that were paid on or after the 4th business day of the settlement month. And in 2004, there were 110 interim PIFs that were paid before the 4th business day of the settlement month and 84 interim PIFs that were paid on or after the 4th business day of the settlement month. This table does not make differentiate between the two types of interim PIFs in 2004.

Exhibit 4

Loan Status in Average Unpaid Principal Balance (Data as of 8/31/2005)

	2002			2003			2004		
Loan Status	**ACD**	**Eligible**	**Holdout**	**ACD**	**Eligible**	**Holdout**	**ACD**	**Eligible**	**Holdout**
Paid in Full (PIF)[1]	$112,691	$98,267	$101,395	$112,015	$115,481	$115,601	$130,764	$117,170	$122,335
REO Sold	$80,132	$83,772	$82,704	$96,048	$102,238	$99,860	$96,514	$103,051	$103,807
Non-foreclosure Final Status	$91,493	$111,723	$107,253	$98,243	$132,508	$126,401	$108,030	$128,048	$121,009
Reinstatements		$112,691	$83,174		$103,394	$104,443		$106,984	$106,804
Total Resolutions	**$91,915**	**$94,792**	**$94,776**	**$99,187**	**$110,561**	**$108,986**	**$110,237**	**$115,005**	**$118,589**
REO Inventory	$80,926	$81,299	$80,865	$90,919	$100,687	$93,792	$102,278	$98,710	$100,206
Non-retention Loss Mitigation	$106,890	$108,554	$113,223	$109,207	$103,834	$135,633	$133,622	$127,691	$135,418
Foreclosure in Process	$84,937	$85,441	$86,022	$88,835	$102,401	$104,704	$111,274	$103,496	$109,597
Reinstatements Pending Sale	$78,980			$105,906			$109,744		
Retention Loss Mitigation Action Taken	$88,400	$89,941	$88,784	$111,484	$104,130	$101,198	$122,701	$109,986	$110,681
Bankruptcy	$83,564	$90,323	$92,927	$104,027	$102,520	$99,622	$110,331	$104,135	$103,521
Unresolved Delinquency	$97,159	$83,696	$87,072	$105,138	$100,866	$106,305	$109,783	$104,227	$106,275
Unknown	$97,110	$84,024	$85,673	$116,885	$96,507	$100,484	$112,522	$110,538	$105,602
Total Loans	**$91,435**	**$89,990**	**$90,135**	**$99,247**	**$105,307**	**$104,863**	**$111,130**	**$107,691**	**$109,087**

Note:
Unpaid principal balance (UPB) amounts were obtained from the Accelerated Claim Criteria Report Application (ACCRA) data. When UPB was not available in ACCRA (0.01% of 601loans, 0.02% of holdout loans and 0.46% of eligible loans in 2002; 0.04% of 601 loans, 0.38% of holdout loans and 1.7% of eligible loans in 2003; and 0.29% of eligible loans in 2004), UPB from the Accelerated Claims Disposition (ACD) data or the Single Family Data Warehouse (SFDW) was used.

One eligible loan from 2003 and 91 eligible loans from 2004 with unknown status and missing unpaid principal balance (UPB) are excluded. In addition, all eligible loans in a year that also become an ACD loan in a later year are also excluded from the eligible group for that year. For example, eligible loans from 2002 that later become ACD loans in 2003, 2004 or 2005 are excluded from the eligible group in 2002.

1. ACD PIF loans include interim PIFs. In 2002, there were 128 interim PIFs that were paid on or after the 4th business day of the settlement month. In 2003, there were 182 interim PIFs that were paid on or after the 4th business day of the settlement month. And in 2004, there were 110 interim PIFs that were paid before the 4th business day of the settlement month and 84 interim PIFs that were paid on or after the 4th business day of the settlement month. This table does not make differentiate between the two types of interim PIFs in 2004.

The loan status for each loan is classified into one of eleven categories arranged with the three final status categories at the top followed by various grades of interim categories. The rules used for loan status assignment follow Exhibit 2. The ordering follows the programming code, which gives preference to final status categories over interim status categories.

The three final status categories are:

- Paid In Full (PIF),
- REO Sold and,
- Non-foreclosure Final Status.

In the Second Interim Report, the Paid in Full (PIF) category included not only the loans in which the borrower paid the outstanding balance (prepays), but also the note sales for which the amount received was greater than or equal to the UPB. Including note sales at or above par in the PIF categorization was confusing, so in this report we revert to the more conventional definition for paid in full when the borrower pays the amount of the outstanding balance according to the servicer. For JV2002, 1,527 note sales were at or above the UPB recorded at settlement and 133 PIF cases paid less than the UPB recorded at settlement. Small discrepancies in the UPB value between the servicer and the PeopleSoft data may cause differences in the categorization. Using the servicer identification of PIF resolutions, there are 925 PIF loans in JV2002 or 14 percent of 6,656 JV2002 loans.[1] Similarly for JV2003, there are 581 PIF loans or 9 percent of 6,153 loans. Given the high risk of these loans and the extended number of months since delinquency began, we expect little gain in the share of PIF loans as the JVs finalize.

Another distinction in the 3rd Interim Report is the explicit inclusion of interim PIF in the PIF category. In the case of interim PIF, the "interim" means during the transfer between the participating servicer and the JV servicer. Interim PIF is a designation given by the Asset Sales Office and the "interim" does not refer to the non-final status of the loan. Identification of interim PIFs is not available in the ACCRA or PeopleSoft data. For JV2002, there were 128 interim PIFs and for JV2003 there were 182 interim PIFs. In JV2004, there were 110 loans that paid before the 4th business day after the settlement and another 84 that paid in between the 4th business day and when the transfer was completed to the JV or LLC servicer. The 110 interim PIFs are treated as repurchases in that 100 percent of the payment goes to FHA although they are still categorized as PIFs among the ACD outcomes. The 84 interim PIFs are treated as note sales in that FHA gets 40 percent of the recovered amount. In this report, both types of interim PIFs are categorized as PIFs.

To the extent that ACD loans are selected to be high risk of foreclosure, the share of REO Sold resolution should be higher for ACD than holdout loans. In all three joint ventures shown in Exhibit 2, the percent of ACD resolutions in the REO sold category is larger than the corresponding shares for holdouts or eligibles. For example in the 2002 cohort, JV2002 has 22 percent REO sold compared to 18 percent for holdouts and 11 percent for eligibles. Some of the difference is likely attributed to the faster resolution in ACD. As seen in the interim status Foreclosure in Process, there is only 1 percent of ACD loans compared to 10 percent of holdouts and 9 percent of eligibles that have started

[1] Under the approach used in the 2nd Interim Report for PIFs, there would be 2,219 loans that paid at or above the UPB value at settlement as reported in the PeopleSoft data.

foreclosure. If all those holdout loans in foreclosure ultimately become REO sold, it is quite possible that the final share of REO sold is lower for ACD than holdout loans.
To date, the predominant difference in disposition strategies between JV processing[2] and standard FHA processing is the option by the JV to conduct note sales and securitizations. The disposition strategy for the standard FHA processing is foreclosure and subsequent sale by HUD's M&M contractors. Note sales are commonly done in ACD, but not done by FHA servicers. In particular, the JV can write down or forgive a portion of the principal as part of the loan restructuring, which FHA servicers cannot do. As of August 31, 2005, there have been 3,776 or 57 percent of the JV2002 loans sold as notes. Of the JV2002 notes, 2,599 were sold in a single securitization sale in August 2004. JV2003 has had smaller (about 600 loans per sale) and more frequent pool sales. In June 2005, JV2004 had a whole loan sale of 1,814 reperforming loans, which accounts for the bulk of its note sales to date.

Reinstatements of eligible and holdout loans are included as resolutions because they continue as active FHA loans making regular payments. There is no presumption that reinstatements will remain active and current. Rather, Exhibits 2 and 3 show the number of reinstatements as of August 31, 2005. Reinstatements of standard FHA loans are considered resolutions because the servicer is no longer trying to change the status of the loan, which is similar to the other final resolution categories. ACD reinstatements (reperforming loans) are listed with the other non-final categories because all ACD loans eventually are sold as notes or properties. Therefore, ACD reinstatements are waiting for the next note sale either as a pool sale or a securitization sale (see Reinstatements Pending Sale in the interim status category).

The non-final status categories are listed below the Total Resolutions in Exhibit 2. REO inventory and non-retention loss mitigation, are properties waiting to be sold. The distinction is that REO inventory completed foreclosure, while non-retention loss mitigation means the borrower has started a preforeclosure sale or deed-in-lieu transfer. In percentage terms, there is little difference between the ACD and non-ACD loan groups.

All the loans in the remaining non-final status categories could recover so that the borrower could retain the ownership of his or her home. Under the foreclosure in process category, the foreclosure has begun but not yet completed. A significant share of non-ACD loans (about 10 percent in the 2002 and 2003 cohorts) compared to only 1 or 2 percent of the ACD loans have begun foreclosure. It is likely that this reflects a difference in timing. In the 2004 cohort, about 30 percent of the non-ACD loans are in the process of foreclosure compared to 21 percent of ACD loans.

Standard FHA servicing appears to give the borrower more time as they attempt to reinstate the loan through loss mitigation strategies. The JV servicer has a broader set of loss mitigation options, including restructuring the loan with a loan amount below the original UPB. If the JV servicer determines that the borrower will not be able to make payments, the appropriate loss mitigation alternatives are explored with the borrower including, but not limited to, short sales or deed-in-lieu of foreclosure. Moving promptly to foreclosure should only be considered after all non-foreclosure alternatives have been considered. In the original concept for ACD, the p-servicers were expected to submit loans for ACD that would not benefit from loss mitigation treatment because those loans had

[2] The term "processing" is used in place of "servicing" because processing encompasses a broader range of activities including loan servicing, note sales and property sales.

such a high probability of going to foreclosure. Although few of the JV2002 loans are still getting loss mitigation treatment, 3 percent of JV2003 and 8 percent of JV2004 loans are getting some form of retention loss mitigation. Given the substantial share of ACD note sales, it appears that the JV servicer considers the loss mitigation servicing to be worthwhile.

The bright spot for standard FHA processing is that a substantial portion of their loans are reinstating, 18 percent of holdouts and 23 percent of eligible loans compared to only 0.3 percent for JV2002 (shown as the fourth category among the Interim Resolutions). Most of the ACD loans that reinstate have already been sold in the note sales and thus grouped in the PIF or non-foreclosure final status. The same pattern appears in 2003 with 17 percent of holdouts and 20 percent of eligibles reinstated compared to 4 percent of JV2003 loans waiting for the next note sale. The low rate of ACD reinstatement is offset by the high rate of PIF and discounted note sales relative to standard FHA processing. In fact, many of the ACD note sales may be reinstated loans such that the only difference from the borrower's point of view is the termination of FHA mortgage insurance on the note. For example, using the standard of "3 payments in 3 months," we found that 35 percent of the JV2002 loans were performing in the 3 months prior to August 2004. Those loans were sold in a securitization sale in August. It suggests that the rate of reinstatement may be as high among ACD loans as standard FHA processing, though the reinstatement status is preempted by the note sales (non-foreclosure final status).

The high rate of reinstatement for both ACD and FHA is notable because all of these loans were considered a high risk of claim by the p-servicers. Favorable housing market conditions with rising house values and low interest rates get credit for much of this success. Another factor in the high rate of reinstatement is the apparent difficulty for p-servicers in selecting high-risk cases. At the time of provisional approval, all of the loans had Early Indicator grades of D, E or F, which means they are likely to foreclose and claim without aggressive intervention. The fact that so many loans re-performed under ACD could be a testament to the superior servicing under JV. Yet, a large share of holdout and eligible loans also reinstated without JV processing. There appears to be a "trough" phenomenon, whereby loans are selected at provisional approval when borrower income and payments have dropped to a low point. Many of those loans will recover under standard FHA servicing as borrower income and payments are restored. The challenge is to determine which loans will not recover. The high rate of reperformance under JV processing or reinstatement under FHA processing shows that it is quite difficult to predict ultimate foreclosure and claims.

The Loan Status by amount of UPB is shown in Exhibit 3. The results are quite similar to the percentages based on numbers of loans in Exhibit 2. The percentage of loans with Paid In Full (PIF) status is larger in terms of UPB suggesting that loans with above average UPB are more likely to pay off or prepay. On the other hand, the share reinstating under standard processing is slightly smaller in terms of UPB than for numbers of loans, suggesting the smaller value loans are more likely to reinstate.

Loan Status in average UPB is presented in Exhibit 4. Overall, the 2003 averages are larger in part because the loans originated more recently. Another reason the 2003 loan values are higher is that they are drawn from all four Homeownership Centers, including the West Coast where house values are substantially higher. A consistent pattern for both loan cohorts is that average UPB for REO sales is about 70 to 90 percent of the UPB for PIF. Similarly, REO inventory and, to a lesser extent, foreclosure in process loans tend to be below average of UPB.

Homeownership Retention

Homeownership retention is an important goal for FHA and one concern about the ACD program is that faster processing could push more borrowers out of their homes. Unfortunately, the data is truncated to the extent that we do not know the homeownership retention status after the note sale. In the short run, every note sale counts as homeownership retention. The JV2002 securitization sale in August included 2,599 performing loans. The holder of the note changed hands, but the borrower kept her home and continues with monthly payments. All those note sales should count as homeownership retention. For whole loan sales, the servicing is transferred and no further information is available.

A simple approach is to count all the cases that are not REO (either REO sold or REO inventory) as possible homeownership retentions, as shown in Exhibit 5. By that measure in 2002, 74.8 percent of ACD and 78.5 percent of the holdouts could retain their homes. The same pattern holds for 2003, 67.6 percent retention for ACD vs. 76.4 percent retention for holdouts. In the latest ACD cohort, JV2004, 84.7 percent of the loans could retain their homes compared to 91.3 percent of the holdouts. The sample sizes for eligible loans are considerably larger and support the finding that standard FHA processing is better at avoiding REO, at least in the short run.

Exhibit 5

Homeownership Retention Rates (Data as of 8/31/2005)

Loan Status	ACD	Eligible	Holdout
2002			
Loans not in REO sold, nor REO inventory	74.8%	85.4%	78.5%
Not in REO sold , REO inventory, nor Foreclosure	73.6%	75.9%	68.9%
2003			
Loans not in REO sold, nor REO inventory	67.6%	79.9%	76.4%
Not in REO sold , REO inventory, nor Foreclosure	65.7%	70.3%	65.6%
2004			
Loans not in REO sold, nor REO inventory	84.7%	91.8%	91.3%
Not in REO sold , REO inventory, nor Foreclosure	65.4%	75.0%	70.1%

If we include foreclosure with REO, on the presumption that most foreclosures end in REO inventory, ACD has higher homeownership retention than holdouts in 2002 (73.6 percent vs. 68.9 percent) but the same in 2003 (65.7 percent for ACD vs. 65.6 percent for holdouts). However, the comparison of ACD with holdouts in 2004 or with eligibles for any year shows higher retention for standard processing. Note, eligibles are not a good comparison group for homeownership retention because the more advanced foreclosure cases have been selected out of the eligibles for subsequent ACD.

Given the limited data, it appears that standard FHA processing has a small advantage in homeownership retention, at least in the short run.

Some ACD loans are further advanced in the foreclosure process when they are sold to the JV and JV processing through note sales is faster at reaching final resolution than standard FHA processing through REO sales. Therefore, much of the short run difference in homeownership retention may simply be due to faster processing by JV than FHA. As the ACD loans reach final status, the long run homeownership retention can be more reliably measured at that time.

Costs and Recoveries

The financial outcomes for the 2002 to 2004 loan groups are presented in Exhibits 6, 7 and 8 respectively. The values are as of August 31, 2005. For ACD, eligibles and holdouts, the top three panels show outcome counts, unpaid principal balances and claims costs to HUD by outcome category. The fourth panel shows net recovery rates relative to claims and the fifth panel shows the loss rates relative to UPB. An important issue in comparing rates, for example between ACD and holdouts, is whether the reinstatements and partial claims are included. The reinstatements have very low claims relative to foreclosures and no recovery because there is no sale. Therefore including reinstatements in the loss rate greatly reduces the loss rate from what it would be just considering REO sales.

As shown in the ACD column of Exhibit 6, JV2002 has 6,656 loans with a total value of $609 million and total claims cost to HUD of $643 million. Those totals are unchanged from the 2nd Interim Report. What has progressed is the share of resolutions. With 93 percent in final status, we have more confidence that the final results will be similar to the results reported in Exhibit 6. Even if all remaining loans end in REO sale, the share of REO will be under 30 percent, which is much lower than the 40 percent foreclosure rate assumed before the demonstration began. The claims cost is 106 percent of UPB and quite consistent by outcome. In comparison, the claims cost ranges from essentially zero for PIF to 116 percent REO. The lower claims cost of JV loans is a key source of the expected savings for the ACD Program. Combining final resolutions for the holdout loans, the claims cost rate for holdouts is 28 percent, which is much lower than ACD's 106 percent because all ACD loans start with an accelerated claim to the p-servicer.

The net recovery measures the sales amounts net of costs relative to the claim amount. All ACD loans are ultimately sold as either notes or properties, so all ACD final resolutions are included in the net recovery rate. For JV2002, the recovery rate ranges from a high of 78 percent for PIF to a low of 57 percent for property sales. The largest share of loans end as note sales with a recovery rate of 71 percent. The overall recovery rate for JV2002 is 69 percent. Only REO properties have recoveries from sale of the holdout loans. The recovery rate is 67 percent of REO claims and 65 percent of total claims for final resolutions. Clearly, ACD loans have a higher recovery rate relative to the FHA foreclosures.

The bottom panel of Exhibit 6 shows the loss rates relative to claims. Even though the loss rates are highest for REO sales (45 percent), most of the outcomes are note sales with a loss rate of 31 percent. The overall loss rate for resolved loans in JV2002 is 33 percent. By comparison, the loss rate for REO holdout loans is 38 percent of claims and 10 percent overall. The large drop in loss rates is due to the very low losses in PIF and reinstated loans. Nearly half of the holdouts resolved into categories with very low losses. The unexpectedly high rate of PIFs and reinstatements among holdouts make it difficult for ACD to have a lower loss rate than the control group. It is likely that the difference between the 33 and 10 percent loss rates will narrow, particularly if many holdouts end in REO sales. However, it is highly unlikely that the JV2002 loss rates will ultimately be less than the loss rates for standard FHA processing.

The JV2003 loans follow a similar pattern as JV2002 though fewer loans have reached final resolution. See Exhibit 7. The claims costs are lower (105 percent for JV2003 and 111 percent for REO holdouts). The net recovery rates for JV2003 are 6 to 11 percentage points higher than JV2002, which probably reflects the national coverage of JV2003 including California. The higher recoveries are enough for JV2003 REO loss rates (34 percent) to dip below REO holdout loss rates (36 percent). However, as with JV2002, when the comparison of loss rates includes all final resolutions, the JV2003 loss rate of 26 percent is much higher than the 12 percent loss rate for standard FHA processing of the holdouts.

The JV2004 loans have more limited resolutions (42 percent). Although the claims cost is 109 percent (higher than the other JVs and higher than REO holdouts in the 2004 cohort), the net recovery rate is also higher. Essentially the REO loans have about the same recovery rates and loss rates for ACD, eligibles or holdouts. The higher recoveries and lower losses from PIF and note sales of JV loans is not enough to offset the near zero losses from reinstatements of holdout loans. In terms of final resolutions, the 24 percent loss rate for JV2004 is much higher than the 3 percent loss rates for holdouts. However, the 2004 cohort is relatively young and these results are likely to change as more loans reach final resolution.

Focusing on just the REO sales, Exhibit 9 shows the costs and recoveries from REO sales by each loan cohort. The most distinct separation between ACD and holdouts are the recovery rates for 2002. Relative to UPB, the recovery rate of REO properties is 60.3 percent for ACD and 77.8 percent for holdouts. The emphasis in JV2002 is on note sales and especially the large securitization. The quality of properties that go through foreclosure is apparently quite low. The recovery rate relative to claims presents a smaller differential (57.1 percent for ACD vs. 67.2 percent for ACD) due to the higher claims costs for holdout loans.

For the 2003 cohort, the recovery rates relative to UPB are much closer together (71.3 percent for ACD vs. 74.3 percent for holdouts). Again, the high claims costs for the holdouts reduce the holdout recovery rate relative to claims so that the recovery rates are essentially equal (67.8 percent for ACD vs. 67.1 percent for holdouts).

Exhibit 6

Financial Outcomes of the 2002 Loans (Data as of 8/31/2005)

	ACD		Eligibles		Holdouts	
Accounting Measure	**Value**	**Percent**	**Value**	**Percent**	**Value**	**Percent**
Outcomes						
PIF[1]	925	14%	3,271	32%	1061	30%
REO[2]	1,496	22%	1,164	11%	614	17%
Nonforeclosure Resolution	3,776	57%	91	1%	40	1%
Reinstatements			2,363	23%	643	18%
Resolutions	6,197	93%	6,889	66%	2,358	67%
Interim Status	459	7%	3,471	34%	1,186	33%
Total Loans	6,656	100%	10,360	100%	3,544	100%
Unpaid Principal Balance						
PIF	$104,238,949	17%	$321,430,171	34%	$107,579,893	34%
REO	$119,876,818	20%	$96,996,849	10%	$49,955,827	16%
Nonforeclosure Resolution	$345,478,541	57%	$10,166,757	1%	$4,290,128	1%
Reinstatements			$202,350,340	22%	$53,481,174	17%
Resolutions	$569,594,308	94%	$630,944,116	68%	$215,307,022	68%
Interim Status	$38,998,718	6%	$300,881,249	32%	$103,373,585	32%
Total Loans	$608,593,025	100%	$931,825,366	100%	$318,680,607	100%
Claims Cost to HUD		% of UPB		% of UPB		% of UPB
PIF	$110,675,274	106%	$967,076	0.3%	$412,003	0.4%
REO	$126,474,918	106%	$110,061,929	113%	$57,774,344	116%
Nonforeclosure Resolution	$364,837,664	106%	$2,422,232	24%	$798,420	19%
Reinstatements			$1,300,040	0.6%	$391,697	0.7%
Resolutions	$601,987,856	106%	$114,751,277	18%	$59,376,465	28%
Interim Status	$41,273,662	106%				
Total Loans	$643,261,518	106%	$114,751,277	12%	$59,376,465	19%
Net Recovery		% of Claim		% of Claim		% of Claim
PIF	$86,077,973	78%				
REO	$72,238,438	57%	$73,537,955	67%	$38,850,430	67%
Nonforeclosure Resolution	$257,909,108	71%				
Resolutions	$416,225,518	69%	$73,537,955	64%	$38,850,430	65%
Loss		% of UPB		% of UPB		% of UPB
PIF	$24,597,302	24%	$967,076	0.3%	$412,003	0.4%
REO	$54,236,481	45%	$36,523,974	38%	$18,923,914	38%
Nonforeclosure Resolution	$106,928,556	31%	$2,422,232	23.8%	$798,420	18.6%
Reinstatements			$1,300,040	0.6%	$391,697	0.7%
Resolutions	$185,762,338	33%	$41,213,322	7%	$20,526,035	10%
Interim Status	$41,273,662	106%				
Total Loans	$227,036,000	37%				

Note: These numbers are likely to change when all cases have been resolved.

1. ACD PIF loans include interim PIFs. In 2004, there were 110 interim PIFs that were paid before the 4th business day of the settlement month and 84 interim PIFs that were paid on or after the 4th business day of the settlement month. Interim PIFs paid before the 4th business day of the settlement month were treated as paying 100% of recoveries to HUD.
2. Recovery amounts could not be calculated for 3 Eligible REOs because of missing or zero sales price. Those loans are excluded from this table.
3. Recovery amounts for 1753 notes sales and 312 other nonforeclosure resolutions were obtained from Corvus.

Exhibit 7

Financial Outcomes of the 2003 Loans (Data as of 8/31/2005)

	ACD		Eligibles		Holdouts	
Accounting Measure	**Value**	**Percent**	**Value**	**Percent**	**Value**	**Percent**
Outcomes						
PIF[1]	581	9%	3,098	18%	466	19%
REO[2]	1,535	25%	2,432	14%	415	17%
Nonforeclosure Resolution	2,794	45%	234	1%	42	2%
Reinstatements			3,397	20%	421	17%
Resolutions	4,910	80%	9,161	55%	1,344	56%
Interim Status	1,243	20%	7,647	45%	1,075	44%
Total Loans	6,153	100%	16,808	100%	2,419	100%
Unpaid Principal Balance						
PIF	$65,080,576	11%	$357,759,792	20%	$53,870,100	21%
REO	$147,433,377	24%	$247,393,467	14%	$41,310,817	16%
Nonforeclosure Resolution	$274,491,864	45%	$31,006,761	2%	$5,308,822	2%
Reinstatements			$351,230,689	20%	$43,970,430	17%
Resolutions	$487,005,817	80%	$987,390,709	56%	$144,460,169	57%
Interim Status	$123,658,463	20%	$781,414,134	44%	$109,087,307	43%
Total Loans	$610,664,280	100%	$1,768,804,843	100%	$253,547,476	100%
Claims Cost to HUD		% of UPB		% of UPB		% of UPB
PIF	$68,746,464	106%	$786,458	0.2%	$277,975	0.5%
REO	$154,962,619	105%	$271,070,504	110%	$45,707,959	111%
Nonforeclosure Resolution	$289,827,562	106%	$6,267,118	20%	$1,256,341	24%
Reinstatements			$1,572,043	0.4%	$246,794	0.6%
Resolutions	$513,536,645	105%	$279,696,123	28%	$47,489,068	33%
Interim Status	$129,811,341	105%				
Total Loans	$643,347,986	105%	$279,696,123	16%	$47,489,068	19%
Net Recovery		% of Claim		% of Claim		% of Claim
PIF	$58,426,082	85%				
REO	$105,049,845	68%	$183,630,788	68%	$30,673,512	67%
Nonforeclosure Resolution	$222,967,702	77%				
Resolutions	$386,443,629	75%	$183,630,788	66%	$30,673,512	65%
Loss		% of UPB		% of UPB		% of UPB
PIF	$10,320,382	16%	$786,458	0.2%	$277,975	0.5%
REO	$49,912,775	34%	$87,439,716	35%	$15,034,447	36%
Nonforeclosure Resolution	$66,859,860	24%	$6,267,118	20.2%	$1,256,341	23.7%
Reinstatements			$1,572,043	0.4%	$246,794	0.6%
Resolutions	$127,093,016	26%	$96,065,335	10%	$16,815,556	12%
Interim Status	$129,811,341	105%				
Total Loans	$256,904,357	42%				

Note: These numbers are likely to change when all cases have been resolved.

1. ACD PIF loans include interim PIFs. In 2003, there were 182 interim PIFs that were paid on or after the 4th business day of the settlement month.
2. Recovery amounts could not be calculated for 16 Eligible REOs and 3 Holdout REOs because of missing or zero sales price. Those loans are excluded from this table.

Exhibit 8

Financial Outcomes of the 2004 Loans (Data as of 8/31/2005)

	ACD		Eligibles		Holdouts	
Accounting Measure	**Value**	**Percent**	**Value**	**Percent**	**Value**	**Percent**
Outcomes						
PIF[1]	442	6%	2,641	9%	288	8%
REO[2]	329	5%	785	3%	81	2%
Nonforeclosure Resolution[3]	2,065	30%	284	1%	49	1%
Reinstatements			5,784	20%	712	19%
Resolutions	2,836	42%	9,494	33%	1,130	30%
Interim Status	3,977	58%	19,279	67%	2,694	70%
Total Loans	6,813	100%	28,773	100%	3,824	100%
Unpaid Principal Balance						
PIF	$57,797,730	8%	$309,445,192	10%	$35,232,432	8%
REO	$31,752,966	4%	$80,771,107	3%	$8,408,406	2%
Nonforeclosure Resolution	$223,081,840	29%	$36,365,601	1%	$5,929,434	1%
Reinstatements			$618,794,696	20%	$76,044,762	18%
Resolutions	$312,632,537	41%	$1,045,376,597	34%	$125,615,033	30%
Interim Status	$444,495,571	59%	$2,053,119,026	66%	$291,534,991	70%
Total Loans	$757,128,108	100%	$3,098,495,623	100%	$417,150,024	100%
Claims Cost to HUD		% of UPB		% of UPB		% of UPB
PIF	$64,099,784	111%	$926,598	0.3%	$25,275	0.1%
REO	$34,723,054	109%	$86,974,401	108%	$9,082,276	108%
Nonforeclosure Resolution	$251,947,527	113%	$7,534,408	21%	$1,033,883	17%
Reinstatements			$2,712,485	0.4%	$253,890	0.3%
Resolutions	$350,770,364	112%	$98,147,891	9%	$10,395,324	8%
Interim Status	$485,110,367	109%				
Total Loans	$835,880,731	110%	$98,147,891	3%	$10,395,324	2%
Net Recovery		% of Claim		% of Claim		% of Claim
PIF	$55,550,141	87%				
REO	$24,479,701	70%	$61,776,208	71%	$6,330,493	70%
Nonforeclosure Resolution	$195,949,854	78%				
Resolutions	$275,979,696	79%	$61,776,208	63%	$6,330,493	61%
Loss		% of UPB		% of UPB		% of UPB
PIF	$8,549,643	15%	$926,598	0.3%	$25,275	0.1%
REO	$10,243,352	32%	$25,198,193	31%	$2,751,783	33%
Nonforeclosure Resolution	$55,997,673	25%	$7,534,408	20.7%	$1,033,883	17.4%
Reinstatements			$2,712,485	0.4%	$253,890	0.3%
Resolutions	$74,790,668	24%	$36,371,683	3%	$4,064,831	3%
Interim Status	$485,110,367	109%				
Total Loans	$559,901,034	74%				

Note: These numbers are likely to change when all cases have been resolved.

1. ACD PIF loans include interim PIFs. In 2004, there were 110 interim PIFs that were paid before the 4th business day of the settlement month and 84 interim PIFs that were paid on or after the 4th business day of the settlement month. Interim PIFs paid before the 4th business day of the settlement month were treated as paying 100% of recoveries to HUD.
2. Recovery amounts could not be calculated for 3 Eligible REOs because of missing or zero sales price. Those loans are excluded from this table.
3. Recovery amounts for 1753 notes sales and 312 other nonforeclosure resolutions were obtained from Corvus.

ACD recovery rates for the 2004 cohort have started out at a relatively high level (77.1 percent for JV2004 compared to 71.3 percent for JV2003 and 60.3 percent for JV2002). It appears that the better properties sell first because the recovery rate declines over time. For example, the recovery rate relative to UPB for JV2002 reported in the 2nd Interim Report was 63.2 percent and a year later it has slipped to 60.3 percent. Similarly for JV2003, the recovery rate last year was 74.0 percent compared to 71.3 percent this year. The decline for the holdouts of 2003 is even greater (80.3 percent vs. 74.3 percent) though the sample size of holdout REOs was only 88 properties last year. The sample size for REO holdouts in the 2004 cohort is only 81 properties, so that recovery rate is likely to change.

An alternative view about the decline in recovery rates is shown in Exhibit 10. This table shows the recovery rates relative to claims broken down by homeownership center along with the national summary. The three cohorts are compared to the official FHA recovery rates for the 12 months through August 2004 and the 12 months through August 2005. The main point is that FHA recovery rates have declined between 2004 and 2005. Independent of ACD or any selection effect as the cohort ages, the overall FHA recovery rates are slipping and the declines are most notable in Philadelphia (-3.1 points) and Atlanta HOCs (-1.4 points). So far, JV2004 has a relatively high share of property sales in the Atlanta HOC compared to the 2003 cohort. Sample sizes for 2004 are modest. The distribution of property sales by HOC as well as national trends in recovery rates will influence the future trend in recovery rates. Weaker housing markets are likely to lead to lower recovery rates for ACD and holdouts alike.

Claims Model

By this point in the evaluation, it is clear that the challenge for the ACD Demonstration is selecting the loans that are highly likely to go to foreclosure and then converting those loans to note sales. Although that is the intention and expectation that most loans chosen for ACD will foreclose, less than 30 percent of the delinquent loans with provisional approval are going to foreclosure. FHA could save money on the REO sale cases by using ACD. The problem is that FHA loses money on the non-REO cases and most of the loans have non-REO resolutions.

Reducing the discount at which the loans are sold to the JV will help. Another positive change is increasing the ownership share in the JV, which helps when the housing market is strong enough to absorb reperforming notes and REO properties. However, it is possible that the JV will show it best advantage in a weakening housing market when speed of disposition matters most. Those “soft” markets are riskier and FHA may want a smaller ownership share to mitigate risk. Ultimately, the critical factor is limiting the ACD loans to cases that are highly likely to foreclose.

The challenge is to find the combination of loan selection criteria, JV discount rate, FHA ownership share and a housing market environment in which ACD can save FHA money – at least most of the time. We have accumulated some experience in variation of JV discounts and FHA ownership shares. The housing markets have been generally strong owing to low interest rates, but there is some variation among the states and rising interest rates may weaken select markets further. Also, JV2005 has implemented new rules on loan selection such that a loan must be at least 5 months delinquent before it is accepted for ACD. It is too soon to tell whether that limitation will be sufficient.

Exhibit 9

Costs and Recoveries to HUD from REO Sales (Data as of 8/31/2005)

	ACD				Eligibles				Holdouts			
Accounting Measure	**N**	**Total Value**	**Loan Average**	**Ratio of Totals**	**N**	**Total Value**	**Loan Average**	**Ratio of Totals**	**N**	**Total Value**	**Loan Average**	**Ratio of Totals**
2002												
Unpaid Principal Balance	1496	$119,876,818	$80,132		1164	$96,996,849	$83,331		614	$49,955,827	$81,361	
Claims Costs to HUD	1496	$126,474,918	$84,542		1164	$110,061,929	$94,555		614	$57,774,344	$94,095	
Net Recovery from Property Sales	1496	$72,238,438	$48,288		1164	$73,537,955	$63,177		614	$38,850,430	$63,274	
Recovery Rate from Properties (Relative to UPB)	1496			60.3%	1164			75.8%	614			77.8%
Recovery Rate from Properties (Relative to Claims)	1496			57.1%	1164			66.8%	614			67.2%
2003												
Unpaid Principal Balance	1535	$147,433,377	$96,048		2432	$247,393,467	$101,724		415	$41,310,817	$99,544	
Claims Costs to HUD	1535	$154,962,619	$100,953		2432	$271,070,504	$111,460		415	$45,707,959	$110,140	
Net Recovery from Property Sales	1535	$105,049,845	$68,436		2432	$183,630,788	$75,506		415	$30,673,512	$73,912	
Recovery Rate from Properties (Relative to UPB)	1535			71.3%	2432			74.2%	415			74.3%
Recovery Rate from Properties (Relative to Claims)	1535			67.8%	2432			67.7%	415			67.1%
2004												
Unpaid Principal Balance	329	$31,752,966	$96,514		785	$80,771,107	$102,893		81	$8,408,406	$103,807	
Claims Costs to HUD	329	$34,723,054	$105,541		785	$86,974,401	$110,795		81	$9,082,276	$112,127	
Net Recovery from Property Sales	329	$24,479,701	$74,406		785	$61,776,208	$78,696		81	$6,330,493	$78,154	
Recovery Rate from Properties (Relative to UPB)	329			77.1%	785			76.5%	81			75.3%
Recovery Rate from Properties (Relative to Claims)	329			70.5%	785			71.0%	81			69.7%

Note: Unpaid principal balance (UPB) amounts were obtained from the Accelerated Claim Criteria Report Application (ACCRA) data. When UPB was not available in ACCRA (0.4% of 2002 eligible and holdout loans and 1.4% of 2003 eligible and holdout loans), UPB from the Single Family Data Warehouse (SFDW) was used.

Exhibit 10

HUD's RE O Sale Net Recovery Rates Relative to Claims by Homeownership Center (Data as of 8/31/2005)

	2002				2003				2004				FHA 9/2003 - 8/2004		FHA 9/2004 - 8/2005	
	ACD		Holdouts		ACD		Holdouts		ACD		Holdouts					
HOC	N	Recovery Rate	N	Recovery Rate	N	Recovery Rate	N	Recovery Rate	N	Recovery Rate	N	Recovery Rate	N	Recovery Rate	N	Recovery Rate
Atlanta	865	58.5%	366	69.0%	474	66.8%	94	70.2%	137	71.1%	21	73.6%	26,999	69.0%	18,874	67.6%
Denver					684	67.4%	224	64.4%	156	70.5%	53	0.0%	23,235	66.3%	21,644	66.1%
Philadelphia*	631	55.2%	248	64.7%	216	65.2%	43	64.3%	20	56.4%	4	78.8%	19,968	69.6%	15,233	66.5%
Santa Ana					161	74.5%	54	74.3%	16	81.8%	3	83.9%	8,339	85.5%	3,388	85.2%
National	**1,496**	**57.1%**	**614**	**67.2%**	**1,535**	**67.8%**	**415**	**67.1%**	**329**	**67.1%**	**81**	**67.1%**	**78,541**	**70.5%**	**59,139**	**67.6%**

Nevertheless, there is enough data to experiment with simulations to see if high-risk loans and low JV discount rates can be combined with FHA ownership shares and housing markets to make ACD worthwhile.

The first step is to model claims under standard FHA processing. The claims model essentially measures risk based on the probability of a loan ending in foreclosure.[3] The data come from FHA loans that became delinquent in 2001 and would have been provisionally approved (had ACD existed in 2001). The prediction of the claims model is a probability of conveyance claim given what was known at delinquency. That prediction can be used as a risk score. And the model coefficients can be applied to any set of loans to predict the likelihood of claim under FHA processing.

The predicted risk score can be used in several ways. The simplest use is to aggregate the loan scores to measure and compare the portfolios of loans by risk. If the p-servicers are picking out the high-risk loans for ACD, then the risk score for the JV portfolio should be substantially higher than the risk score for the holdout portfolio from the same time. Even if the ACD vs. holdout risk scores start out relatively close together in 2002, is there a trend to show a greater distinction by the 2004 cohort? Suppose the selection criteria for ACD loans were tightened to include just the high-risk loans. Would the share of foreclosures for this high-risk set of loans be high enough that ACD has lower loss rates than they would have had under standard FHA processing?

These experiments in loan selection can be combined with a simulation of different JV discount rates, FHA ownership shares and state housing markets to see how far the program parameters would have to change to make ACD cost saving. Given unexpected difficulties with the JV2004 data, we have not had much time to carry out the simulations. However, we can report estimates from the claims model and show exploratory simulations.

Claims Model Estimation

In the 2nd Interim Report, we estimated a claims model using the 1997 cohort of delinquents. We were concerned that the FHA processing was substantially different in the early phases of loss mitigation and M&M contractors. Therefore, in this report we have shifted to a 2001 cohort of delinquents with more parallel experience compared to the current cohort of ACD loans. As shown in Exhibit 11 for 2001, the only drawback of the 2001 cohort is that slightly more loans have not terminated (27.2 percent for 2001 vs. 23.4 percent for 1997). Relative to the terminations, only 42.0 percent ended in conveyance claim and 44.5 percent (not shown in Exhibit 11) had any claim in the 2001 cohort compared to 63 percent in 1997. Also, fewer reinstatements claims (11.8 percent in 2001 vs. 14.8 percent in 1997), but more loss mitigation cases claimed (10.2 percent in 2001 vs. 2.9 percent in 1997). Overall, it appears the 2001 cohort is less prone to claim than the 1997 cohort.

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[3] In the 2nd Interim Report, the claims model estimated the probability of any claim, including loss mitigation and partial claims. The claims model in this report focuses on foreclosure and conveyance claims to emphasize the distinction between REO and non-REO outcomes.

Exhibit 11

Final Status of Eligible Loans in 2001 (Data as of 8/31/2005)

			Terminations		
	All	**Active[1]**	**All Terminations**	**Non Conveyance Claims[2]**	**Conveyance Claims[3]**
Number of Loans	157,520	42,831	114,689	66,472	48,217
% of All	100.0%	27.2%	72.8%	42.2%	30.6%
% of All Terminations			100.0%	58.0%	42.0%
Reinstatements	76,458	33,139	43,319	37,609	5,710
% of All Reinstatements	100.0%	43.3%	56.7%	49.2%	7.5%
% of Final Status	48.5%	77.4%	37.8%	56.6%	11.8%
Loss Mitigation	34,367	15,623	18,744	13,805	4,939
% of All Loss Mitigation	100.0%	45.5%	54.5%	40.2%	14.4%
% of Final Status	21.8%	36.5%	16.3%	20.8%	10.2%

Notes:
1. Active loans have not been terminated and they do not have claims.
2. Non conveyance claims are terminated loans without claims and with non conveyance claims. They include the following Single Family Data Warehouse termination types: paid in full, nonconveyance foreclosure, voluntary termination of insurance by lender, netting refinance, assignment of note for insurance benefits, conversion title or assigned note and nonconveyance claims.
3. Claims are terminated loans with conveyance of title for insurance benefits.

The claims model is a multinomial logit model with two outcomes relative to active, non-conveyance claim terminations and conveyance claim terminations. See Exhibit 12. The specification is essentially the same as estimated in the last report. Fixed effects are included for servicer (Wells is the reference) and state (Illinois is the reference). Loans with LTV above 97 percent are particularly likely to foreclose. Also, loans in MSAs with a high default rate in previous years are more likely to default.

To test the claims model, we compare the predicted conveyance claim rate for holdouts to the actual conveyance claim rate, shown in Exhibit 13. In 2002, the predicted claim rate is 22.0 vs. 21.21 percent actual. In 2003, the prediction is 23.2 percent compared to 23.45 percent. The model did not work well for 2004 (22.2 percent predicted vs. 8.26 percent actual), but the 2004 cohort is so recent that most of the foreclosures have not been completed yet.

Assuming the claims model predictions are fairly reliable, the difference between the predicted claims rate and the actual JV REO sales rate is the improvement due to JV servicing. The predictions use the coefficients from the claims model, but the data come from the JV loans at provisional approval. In JV2002, the predicted conveyance claim is 25.4 percent compared to actual JV2002 REO sales of 22 percent (see Exhibit 2). This finding implies that JV servicing can reduce the REO share by 3 percentage points. Similarly for JV2003, the predicted claim rate is 27.1 percent compared to the actual of 25 percent REO sales, a gain of 2 percentage points. Though small, these gains are important because converting foreclosures to note sales is one way ACD can reduce the loss rate.

Although there are modest reductions in the property sale rate by ACD, Exhibit 14 shows that most of those reductions occur in the low-risk loans. The JV2002 loans are sorted from low risk to high risk based on the predicted probability of conveyance claim by the claims model.

Exhibit 12

Claims Model Using Eligible Loans in 2001 (Data as of 8/31/2005)

Dependent Variable: Outcome	Non Conveyance Claim Terminations					Conveyance Claim Terminations				
Explanatory Variables	**Coef.**	**Std. Err.**	**RRR**	**Std. Err.**	**P>|z|**	**Coef.**	**Std. Err.**	**RRR**	**Std. Err.**	**P>|z|**
Number of Defaults	0.101	0.007	1.106	0.008	0.000	-0.183	0.010	0.832	0.008	0.000
Total Months in Default	-0.035	0.001	0.965	0.001	0.000	-0.052	0.001	0.949	0.001	0.000
Months till First Default	-0.001	0.000	0.999	0.000	0.001	-0.013	0.000	0.987	0.000	0.000
Foreclosure	-0.026	0.318	0.974	0.310	0.934	0.371	0.327	1.449	0.474	0.257
LTV: < 90%	0.209	0.026	1.233	0.032	0.000	-0.251	0.029	0.778	0.023	0.000
LTV: 90 - 94%	0.180	0.019	1.198	0.023	0.000	-0.063	0.020	0.939	0.019	0.002
LTV: > 97%	-0.172	0.021	0.842	0.018	0.000	0.204	0.020	1.226	0.025	0.000
LTV Unknown	0.091	0.032	1.095	0.035	0.004	-0.007	0.038	0.994	0.038	0.864
UPB: $50,000 - $80,000	0.285	0.021	1.329	0.028	0.000	-0.225	0.021	0.798	0.017	0.000
UPB: > $80,000	0.753	0.023	2.124	0.049	0.000	-0.360	0.024	0.698	0.017	0.000
PTI	0.000	0.000	1.000	0.000	0.343	0.001	0.000	1.001	0.000	0.000
ARM	-0.149	0.021	0.862	0.018	0.000	-0.097	0.023	0.908	0.021	0.000
Purchase	0.197	0.034	1.217	0.041	0.000	0.189	0.038	1.208	0.046	0.000
Borrower's Age	-0.006	0.001	0.994	0.001	0.000	-0.002	0.001	0.998	0.001	0.032
Separated Borrower	-0.058	0.062	0.944	0.058	0.349	0.057	0.064	1.059	0.067	0.370
Unmarried Borrower	0.040	0.015	1.041	0.016	0.008	0.170	0.016	1.186	0.019	0.000
Marital Status Unknown	0.075	0.040	1.078	0.043	0.058	0.520	0.047	1.681	0.079	0.000
Black Borrower	-0.315	0.018	0.730	0.013	0.000	-0.516	0.019	0.597	0.011	0.000
Hispanic Borrower	-0.028	0.023	0.972	0.022	0.211	-0.087	0.024	0.916	0.022	0.000
Asian Borrower	0.086	0.069	1.090	0.075	0.211	-0.063	0.076	0.939	0.071	0.407
Native American Borrower	-0.164	0.101	0.848	0.086	0.103	-0.051	0.102	0.950	0.096	0.612
Other or Undisclosed Race	-0.091	0.028	0.913	0.025	0.001	-0.141	0.031	0.868	0.027	0.000
First Time Homebuyer	-0.156	0.019	0.856	0.016	0.000	-0.115	0.021	0.892	0.018	0.000
Chase Manhattan	0.161	0.025	1.174	0.029	0.000	0.347	0.026	1.415	0.037	0.000
Countrywide	0.128	0.054	1.136	0.061	0.018	-0.136	0.056	0.873	0.049	0.015
Cendant	-0.222	0.024	0.801	0.020	0.000	-0.039	0.026	0.961	0.025	0.130
Aurora	-0.306	0.027	0.736	0.020	0.000	-0.500	0.030	0.606	0.018	0.000
Washington Mutual	-0.241	0.032	0.786	0.026	0.000	-0.220	0.035	0.803	0.028	0.000
Other P-Servicer	-0.131	0.023	0.877	0.020	0.000	0.222	0.024	1.249	0.030	0.000
MSA Default Rate	-0.052	0.002	0.950	0.002	0.000	0.035	0.002	1.036	0.002	0.000
AK	-0.337	0.174	0.714	0.124	0.053	0.026	0.215	1.026	0.221	0.904
AL	-0.664	0.074	0.515	0.038	0.000	-0.232	0.065	0.793	0.052	0.000
AR	-0.731	0.091	0.481	0.044	0.000	-0.216	0.084	0.805	0.067	0.010
AZ	0.339	0.049	1.403	0.069	0.000	-0.222	0.057	0.801	0.046	0.000
CA	0.994	0.038	2.702	0.103	0.000	0.191	0.043	1.210	0.052	0.000
CO	0.465	0.067	1.592	0.106	0.000	0.039	0.077	1.040	0.080	0.613
CT	-0.114	0.081	0.893	0.073	0.163	-0.042	0.090	0.959	0.087	0.640
DC	0.390	0.136	1.477	0.200	0.004	-0.108	0.161	0.897	0.145	0.502
DE	-0.584	0.100	0.558	0.056	0.000	-0.792	0.115	0.453	0.052	0.000
FL	0.352	0.036	1.422	0.051	0.000	-0.159	0.039	0.853	0.033	0.000
GA	-0.415	0.043	0.661	0.028	0.000	-0.393	0.045	0.675	0.030	0.000
IA	-0.475	0.107	0.622	0.067	0.000	-0.307	0.106	0.736	0.078	0.004
ID	-0.209	0.118	0.812	0.096	0.077	0.394	0.116	1.482	0.172	0.001
IN	-0.617	0.051	0.540	0.027	0.000	-0.012	0.048	0.988	0.047	0.800
KS	-0.347	0.097	0.707	0.068	0.000	-0.229	0.100	0.796	0.079	0.022
KY	-0.464	0.084	0.628	0.053	0.000	-0.087	0.082	0.917	0.075	0.290
LA	-0.534	0.064	0.586	0.037	0.000	-0.468	0.066	0.626	0.041	0.000
MA	0.318	0.088	1.374	0.120	0.000	-0.631	0.120	0.532	0.064	0.000
MD	-0.104	0.042	0.901	0.038	0.013	-0.192	0.046	0.825	0.038	0.000
ME	-0.031	0.149	0.970	0.145	0.836	-0.399	0.181	0.671	0.121	0.027
MI	-0.194	0.047	0.824	0.038	0.000	-0.525	0.049	0.591	0.029	0.000
MN	0.076	0.065	1.079	0.070	0.242	-0.978	0.094	0.376	0.035	0.000
MO	-0.190	0.059	0.827	0.049	0.001	-0.271	0.063	0.763	0.048	0.000
MS	-0.838	0.092	0.433	0.040	0.000	-0.079	0.083	0.924	0.077	0.344
MT	-0.404	0.163	0.668	0.109	0.013	0.058	0.171	1.059	0.181	0.736
NC	-0.990	0.059	0.371	0.022	0.000	-0.050	0.056	0.951	0.053	0.371
ND	-0.761	0.220	0.467	0.103	0.001	-0.249	0.251	0.779	0.196	0.321
NE	-0.399	0.136	0.671	0.091	0.003	-0.702	0.161	0.496	0.080	0.000

Exhibit 12

Claims Model using Eligible Loans in 2001 (Data as of 8/31/2005) - *continued*

NH	0.252	0.172	1.287	0.221	0.142	-0.824	0.242	0.439	0.106	0.001
NJ	0.191	0.043	1.210	0.052	0.000	-0.419	0.050	0.658	0.033	0.000
NM	-0.982	0.120	0.375	0.045	0.000	0.223	0.103	1.250	0.129	0.031
NV	0.384	0.066	1.468	0.097	0.000	0.286	0.071	1.331	0.095	0.000
NY	0.149	0.039	1.160	0.045	0.000	-0.353	0.043	0.702	0.030	0.000
OH	-0.523	0.045	0.593	0.027	0.000	-0.165	0.045	0.848	0.038	0.000
OK	-0.457	0.074	0.633	0.047	0.000	-0.079	0.071	0.924	0.066	0.265
OR	-0.104	0.093	0.901	0.084	0.264	0.575	0.093	1.778	0.165	0.000
PA	-0.730	0.044	0.482	0.021	0.000	-0.315	0.044	0.730	0.032	0.000
PR	-0.950	0.070	0.387	0.027	0.000	-4.059	0.191	0.017	0.003	0.000
RI	0.662	0.179	1.940	0.347	0.000	-1.119	0.290	0.327	0.095	0.000
SC	-0.655	0.080	0.519	0.042	0.000	-0.327	0.077	0.721	0.056	0.000
SD	-0.457	0.258	0.633	0.163	0.076	-0.446	0.299	0.640	0.192	0.137
TN	-0.616	0.052	0.540	0.028	0.000	-0.272	0.050	0.762	0.038	0.000
TX	-0.601	0.037	0.548	0.020	0.000	-0.432	0.038	0.649	0.025	0.000
UT	-0.058	0.082	0.943	0.078	0.479	0.724	0.079	2.064	0.162	0.000
VA	-0.079	0.047	0.924	0.043	0.092	-0.333	0.054	0.717	0.039	0.000
VT	-0.657	0.333	0.518	0.173	0.049	-0.308	0.352	0.735	0.259	0.382
WA	-0.003	0.062	0.997	0.062	0.961	0.333	0.065	1.395	0.091	0.000
WI	0.190	0.108	1.209	0.131	0.080	0.009	0.116	1.009	0.117	0.937
WV	-0.922	0.200	0.398	0.079	0.000	-0.489	0.190	0.613	0.116	0.010
WY	-0.063	0.290	0.939	0.272	0.828	-0.258	0.325	0.773	0.252	0.428
Intercept	0.840	0.064			0.000	1.170	0.069			0.000

Number of Observations	156,229
Log-likelihood with only Incercept	-168782.3
Log-likelihood for the Full Model	-147031.6
Pseudo R-squared	0.129
McFadden's R-squared	0.129

Note: Active Loans is the outcome relative to which Non Conveyance Claim and Conveyance Claim Terminations are estimated.

The ACD solid line shows the actual property sale rate by decile and the dotted counterfactual line shows the predicted conveyance claim rate for the same loans had they gone to standard FHA processing. The main point is that the curves are close together, which suggests very little difference in the actual outcome relative to the predicted outcome. Where there is a consistent gap, however, the risk of foreclosure is relatively low. This finding makes sense. The ACD loans most likely to be sold as notes are the low-risk ACD loans. It is worth keeping this in mind when we consider targeting of ACD to high-risk loans. While it is true that ACD generally has lower losses on the REO sales than FHA REO sales, there may be less opportunity for the bigger savings of converting those foreclosures into note sales.

Exhibit 15 compares the actual property sale rate for JV2003 (solid line) to the counterfactual claims rate if those same loans had received standard FHA processing. Except for the lowest two deciles (low-risk cases), the actual ACD curve is higher than the counterfactual. This finding suggests that loans in JV2003 are more likely to be sold as REO than if they had been selected as holdouts.

Exhibit 13

Average Predicted Outcomes by Loan Groups and P-Servicers Using Claims Model Estimated on 2001 Eligible Loans (Data as of 8/31/2005)

	ACD			Holdout		
	N	Non Conveyance Claims[1]	Conveyance Claims[2]	N	Non Conveyance Claims[1]	Conveyance Claims[2]
2002 Loans	6,655	42.7%	25.4%	3,553	39.9%	22.0%
Wells Fargo	3,501	-2.0%	0.5%	1,208	-0.7%	0.4%
Chase Manhattan	2,682	2.2%	-1.2%	475	1.6%	0.0%
Cendant	276	1.5%	4.8%	233	4.1%	1.3%
Countrywide	196	3.6%	1.4%	1,613	-0.6%	-0.5%
2003 Loans	6,152	47.1%	27.1%	2,422	48.3%	23.2%
Wells Fargo	3,492	-0.3%	0.3%	1,804	-0.1%	-0.2%
Chase Manhattan	2,442	0.4%	-0.3%	436	-0.9%	2.2%
Cendant	218	1.2%	-1.3%	162	3.2%	-3.0%
2004 Loans	6,813	49.2%	26.8%	3,823	48.8%	22.2%
Wells Fargo	3,176	1.4%	0.7%	1,895	0.8%	1.6%
Chase Manhattan	1,946	-0.5%	2.5%	386	0.6%	2.8%
Washington Mutual	1,561	-2.0%	-3.7%	1,507	-1.1%	-2.6%
Aurora	128	-2.8%	-11.0%	30	-2.5%	-10.2%

Notes:
1. Non conveyance claims are terminated loans without claims and with non conveyance claims. They include the following Single Family Data Warehouse termination types: paid in full, nonconveyance foreclosure, voluntary termination of insurance by lender, netting refinance, assignment of note for insurance benefits, conversion title or assigned note and nonconveyance claims.
2. Claims are terminated loans with conveyance of title for insurance benefits. Actual conveyance claims rate for holdout loans are 21.21% for 2002, 23.45% for 2003 and 8.26% for 2004.

Exhibit 14

Actual Property Sale Rate and Counterfactual Claims Rate of 2002 ACD by Claims Rate Decile

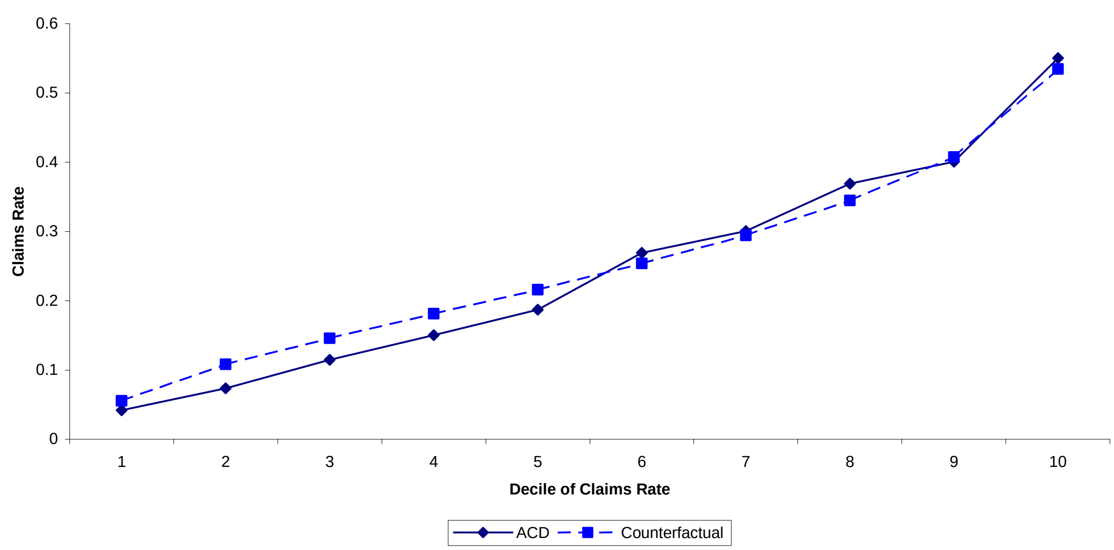

Exhibit 15

Actual Property Sale Rate and Counterfactual Claims Rate of 2003 ACD by Claims Rate Decile