



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

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

August 29, 2002

MORTGAGEE LETTER 2002-17

TO: ALL APPROVED MORTGAGEES

ATTENTION: Single Family Servicing Managers

SUBJECT: Special Forbearance: Program Changes and Updates

The purpose of this mortgagee letter is to remind lenders of the proper use of the special forbearance agreement as a loss mitigation tool and to introduce several changes in the special forbearance program including new flexibility to utilize special forbearance to assist otherwise creditworthy borrowers who are experiencing temporary unemployment.

Definition and Existing Guidance

A special forbearance is a written repayment agreement between a lender and a mortgagor that contains a plan to reinstate a loan that is a minimum of three payments due and unpaid. To qualify as a special forbearance and entitle the lender to incentives, the agreement must provide the mortgagor with relief not typically afforded under a repayment plan or an informal forbearance plan. Requirements for use of special forbearance are detailed in Mortgagee Letter 2000-05, Loss Mitigation – Comprehensive Clarification of Policy and Notice of Procedural Changes.

This mortgagee letter supersedes the portion of Mortgagee Letter (ML) 2000-05 that addresses Special Forbearance, starting on page 14 through page 18 and those portions of paragraph M on page 13 that pertain to special forbearance. Included in this mortgagee letter are changes and clarifications for most of the sections related to special forbearance in ML 2000-05, but other loss mitigation provisions within ML 2000-05 were left intact. Several additional sections have been provided to clarify time frame and payment application issues. This mortgagee letter does not supersede those portions of Handbook 4330.1 REV-5, paragraph 8-4 that pertain to special forbearance agreements for investors or non-owner occupants.

Changes to and Clarifications to the Special Forbearance Procedures

Type I Special Forbearance

Type I special forbearance is a structured plan that allows a borrower to repay a loan delinquency over time. The plan must provide relief not typically afforded under an informal forbearance or short-term repayment plan including an initial period for financial recovery followed by a payment schedule based on the borrower's ability to repay.

To be considered a valid Type I special forbearance agreement by the Department, a special forbearance agreement must:

- Identify the specific months for which the account is delinquent and note the total arrearage that accrued prior to the beginning of the agreement.
- Must fully reinstate the loan.
- Ensure that the repayment installments required under the terms of the special forbearance are based on the borrower's ability to pay. (Note: the lender must retain in the claim review file, evidence that the lender analyzed the borrower's financial condition as described in paragraph H, page 10 of ML 2000-05, and that the repayment schedule is supported by the financial analysis. (For example, a special forbearance plan may not include a balloon payment unless the borrower's financial analysis indicates the source of the funds for this payment.)
- May allow reasonable foreclosure costs and late fees accrued prior to the execution of the special forbearance agreement to be included as part of the repayment schedule. However, they may only be collected after the loan has been reinstated through payment of all principal, interest, and escrow advances. At no time shall the loan be considered delinquent solely because the borrower has not paid late fees or other foreclosure costs.
- Provide relief that is not typically afforded under an informal forbearance plan, including one or more of the following: (a) suspension or reduction of payments for a period sufficient to allow the borrower to recover from the cause of default; (b) a period during which the borrower is only required to make his/her regular monthly mortgage payment before beginning to repay the arrearage; (c) a repayment period of at least six months.
- Have a minimum duration of four months. There is no maximum length of time to repay the arrearage.
- Not allow late fees to be assessed while the borrower is performing under the terms of a special forbearance plan or allow the loan to be considered delinquent solely because the borrower has not paid late fees or other foreclosure costs.

Type I Special Forbearance (continued)

- Not allow the accrued arrearage to exceed the equivalent of 12 months of principal, interest, taxes and insurance (“PITI”). The twelve months of PITI for ARMS, GPMS, and GEMS will be calculated by multiplying 12 times the monthly payments due on the date of default.
- Allow the borrower to pre-pay the delinquency at any time.
- Maintain a copy of the forbearance agreement that is signed and dated by at least one borrower and by an authorized agent of the lender.

Special Provisions for Type I when the Cause of Default is Unemployment

As stated above, the lender is required to make a determination, based on an evaluation of the borrower’s financial information that the special forbearance will lead to reinstatement of the loan. When the cause of default is unemployment and the borrower has no immediate prospect of re-employment, it is often not possible for the lender to reach this determination. With this mortgagee letter, HUD is providing additional flexibility for lenders to provide relief to otherwise creditworthy borrowers who have become unemployed and have a reasonable prospect of re-employment in the foreseeable future.

Lenders may now enter into a special forbearance agreement with a borrower who has both a good payment record and a stable employment history, but has not received a commitment of re-employment at the time the lender is reviewing the borrower’s financial information. As an indication of the borrower’s commitment to retaining homeownership, the borrower should be required to make partial payments in an amount determined by the lender based on the borrower’s ability to repay. Further, the borrower must agree to actively seek employment during the term of the reduced payments and to immediately notify the lender when the borrower’s employment status changes.

The lender is required to verify the borrower’s employment status monthly and renegotiate the terms of the special forbearance plan when the borrower’s status changes. As with other Type I special forbearances, the plan must be for a minimum of four months but may be any length. However, at no time may the plan provide for the delinquency to exceed the equivalent of 12 monthly PITI installments.

Type II Special Forbearance

A Type II special forbearance combines a short-term special forbearance plan and a modification or partial claim as a single loss mitigation plan. Lenders should use a Type II special forbearance whenever the loss mitigation evaluation determines that the borrower's best option is either a modification or a partial claim but there is any concern about the borrower's ability or commitment to keep the payments current following reinstatement. Borrower must make at least three full monthly payments prior to execution of a modification or partial claim. Where a short term special forbearance is used to allow borrowers to demonstrate their ability to support the debt, FHA is further protected from the risk of workout failure. Generally, during the trial period the amount of the monthly payment due will not exceed the borrower's normal monthly payment.

To be considered a valid Type II special forbearance agreement by the Department, a special forbearance agreement will contain elements of a Type I, in addition to the following :

- Identify the loss mitigation initiative that will be used to cure the default, i.e., loan modification or partial claim.
- Not allow late fees to be assessed while the borrower is performing under the terms of a special forbearance plan. Because Type II special forbearance plans culminate in either a loan modification or a partial claim, foreclosure costs and fees may be collected in accordance with the requirements applicable to those options.
- Require a minimum of three monthly installments before the completion of the modification or partial claim.
- A Type II special forbearance is not entitled to receive a special forbearance incentive fee, but may file for the loss mitigation option incentive fee, used to cure the default, when the loss mitigation action is finalized.

Regardless of type, a special forbearance plan must be designed to eventually lead to reinstatement of the loan either directly or in combination with a loan modification or partial claim. While there is no maximum duration requirement for special forbearance agreements and lenders are encouraged to allow as much time for repayment as is reasonable based on the borrower's ability to repay, at no time may the maximum mortgage arrearage due under a special forbearance plan exceed the equivalent of 12 months of principal, interest, taxes and insurance ("PITI").

The special forbearance agreement must be in writing and must be executed by the mortgagor and lender. The agreement must acknowledge previously missed mortgage payments and provide notice that failure to comply with the terms of the special forbearance agreement can result in initiation of foreclosure.

General Requirements

Loan Default

The loan must be at least three months, but not more than 12 months due and unpaid, and may not be in foreclosure when the special forbearance agreement is executed. Loans that had previously been referred to foreclosure may be removed from foreclosure status prior to execution of a special forbearance. On advice of lender's legal counsel, foreclosure may be suspended subject to the borrower's performance under the terms of the special forbearance agreement, if the suspension is stipulated in writing in the agreement.

Borrower Qualifications

Special forbearance may be offered to borrowers who have recently experienced a verifiable loss of income or increase in living expenses, but who have or will have sufficient monthly income to correct the delinquency and reinstate the loan within the duration of the plan either through gradual repayment of the arrearage, or through a combination of repayment and modification or partial claim. Special forbearance should not be offered to borrowers who have repeatedly broken past informal or formal forbearance plans without good cause.

The borrower must be an owner occupant, committed to occupy the property as a primary residence during the term of the special forbearance agreement. However, unlike modification and partial claim, which require that the borrower have a long-term commitment to the home, a special forbearance may be used to reinstate a loan to facilitate the eventual sale, or assumption of the property. HUD Handbook 4330.1, REV-5, Chapter 8 provides additional forbearance relief options for non-owner occupants. Agreements executed per these handbook guidelines are not eligible for special forbearance incentive claim payments.

Property Condition

The lender must conduct any review it deems necessary to verify that the property has no physical conditions which adversely impact the borrower's continued use or ability to support the debt. A borrower will not be able to support payments under a special forbearance plan if the property is in such a deteriorated condition that repairs drain the borrower's monthly resources. An analysis of the borrower's surplus income should consider obvious property maintenance expenses.

If significant deferred maintenance contributed to the cause of the default, it may be appropriate that the special forbearance plan provide a period of mortgage forbearance during which repairs specified in the agreement will be completed at the borrower's expense. If the lender's review identifies a property in extremely poor physical condition, a special forbearance plan, especially one that allows reduction or suspension of payments not tied directly to property

repair, may not offer a permanent resolution to the default. Lenders must use good business judgment relative to property condition.

Financial Analysis

The lender is required to assess the borrower's ability to repay the entire delinquency as described in ML 2000-05, section H, page 10. HUD expects the lender to project the borrower's surplus monthly income for the duration of the special forbearance period, and to propose repayment terms consistent with the borrower's ability to pay.

The lender must exercise good business judgment in determining that the borrower has the capacity to resume full monthly payments, and eventually reinstate the loan under the terms of the plan. If the financial analysis reveals that the borrower does not, or has no reasonable expectation that his/her financial situation will recover in the foreseeable future, a Type I special forbearance should not be used. The lender should consider other loss mitigation options in the priority detailed in ML 2000-05, section F, page 10.

Review and Re-negotiation

Lenders must review the status of forbearance plans each month and take appropriate action if the borrower is not complying with the terms of the plan. A system report confirming that the loan is performing under the terms of the forbearance is sufficient to document the lender's compliance with this review requirement except when the cause of the default is unemployment (see, ***Special Provisions for Type I when the Cause of Default is Unemployment***). When a lender enters into a special forbearance agreement with a borrower whose continued unemployment is the cause of the default, the lender must document the borrower's employment status monthly and adjust the terms of the plan to reflect changes in income.

Plans may be re-negotiated if the borrower's financial circumstances change. However, re-negotiated plans may not exceed HUD's requirement that the loan be no more than 12 months delinquent. Lenders may only file for the special forbearance incentive claim once per default.

Combining Options

Mortgage Letter 2000-05 states that a special forbearance (now defined as Type I) can be used alone or combined with any reinstatement option, but that the options would be sequential, not simultaneous. The new Type II special forbearance option that combines special forbearance with either a modification or a partial claim will be considered as a single loss mitigation plan.

Lenders may continue to execute loan modifications and partial claims as stand-alone loss mitigation options; however since the combined Type II option serves to protect FHA from the risk of workout failure, the claim file should provide justification of the lender's decision to skip this option. A Type II special forbearance may not be combined with a delinquent refinance and may not be used to reinstate a loan to facilitate assumption.

Other Provisions

Payment Application

In cases in which the mortgagor is entitled to pre-foreclosure relief (24 CFR 203.606), the lender should be entering into special forbearance and other loss mitigation agreements before foreclosure is considered, and foreclosure costs are incurred. However, in those cases where the borrower brings forth new information after foreclosure has been initiated, lenders are encouraged to evaluate this information and consider all appropriate loss mitigation options. When this reconsideration indicates that it is appropriate to enter into a special forbearance agreement, some special arrangements may need to be made to allow the borrower to repay the foreclosure costs and fees over the term of the forbearance agreement.

In these cases, the borrower will be required to reimburse the lender for only those foreclosure costs accrued to the date the foreclosure was cancelled. Under no circumstances will the borrower be required to pay the lender more than the Department identified as customary and reasonable for claim purposes in the Mortgagee Letter 2001-19, or any subsequent mortgagee letter issued on that subject.

As part of the written special forbearance agreement, the lender and borrower may agree that in addition to the required forbearance installment, the borrower will remit a portion of the foreclosure costs each month. In this instance, the lender must place the foreclosure costs collected each month into a suspense or memo fund account properly identified as belonging to the borrower. When the borrower completes his/her forbearance and the account is current, those funds held in suspense may be released and used to reimburse the lender for foreclosure costs incurred. If the borrower does not complete the special forbearance, all fees held in suspense are to be applied to the borrower's account in the order of priority established in 24 CFR 203.24, before calculating the claim for insurance benefits.

Foreclosure Time Requirements

In cases where foreclosure had begun, but the borrower is given an opportunity to attempt to save his/her home through special forbearance, an extension of time to initiate foreclosure (24 CFR 203.355) may be necessary.

Generally in non-judicial states, the foreclosure action must be cancelled to allow the borrower the opportunity to attempt a special forbearance. 24 CFR 203.355 provides additional time if the lender engages in one of the actions listed, which includes entering into a special forbearance agreement. The regulation does not provide any additional time for the lender if the borrower does not engage in a special forbearance but agrees to a repayment plan instead. In cases with informal forbearance plans, the lender should request an extension of time from the National Servicing Center (NSC). Additional guidance and information can be found on NSC's website at www.hud.gov.

Foreclosure Time Requirements, (continued)

If the case in question is in a judicial foreclosure state it may not be necessary to cancel the foreclosure action, because the lender may be able to temporarily suspend the foreclosure action. In such cases, the lender may be concerned about meeting the reasonable diligence time requirement (24 CFR 203.356). For such cases, the lender should have adequate documentation to support that the borrower provided new information to support that a special forbearance was appropriate after foreclosure was initiated.

The lender's reasonable diligence time frame will be extended for the time the borrower was performing under the terms of the special forbearance agreement as well as an allowance of no more than ninety days (90) to get the foreclosure back on schedule from the date the borrower defaulted under the special forbearance agreement. Additional information on reasonable diligence is found in the Claims Handbook, 4330.4, paragraph 3, page 1-11.

Automatic Extensions

If a lender has initiated, but is unable to complete a special forbearance within the six-month time limit, the lender is entitled to a 90-day extension of the foreclosure deadline provided the initiative was begun prior to the expiration of the initial six months. Therefore, if there have been no other intervening delays (such as bankruptcy) this "automatic" extension will extend the six month deadline to initiate foreclosure by 90 days. To qualify for the automatic extension, the lender must have completed the loss mitigation evaluation required by 24 CFR 203.605 and have documentation of this analysis in the claim review file. In addition, the loss mitigation initiative must be reported to the Single Family Default Monitoring System (SFDMS), using the appropriate status code (09, 12, or 32). All extensions of time to initiate foreclosure including "automatic extensions" must be properly identified on HUD-27011, Block 19 on the conveyance claim.

Option Failure

Foreclosure action is suspended during special forbearance. In the event this option fails, an additional 90-day extension is provided in which the lender must commence or recommence foreclosure or initiate another loss mitigation option.

A special forbearance is considered a failure when any of the following occur:

- The borrower abandons the property;
- The borrower advises the lender that he/she will not follow through and fulfill the terms of the special forbearance agreement; or,
- The borrower allows two installments to become due and unpaid without any advisement to the lender of any problems that rendered the borrower unable to stay current under the terms of the forbearance.

Lender Incentives

FHA believes that well structured special forbearance agreements will resolve the majority of curable loan delinquencies. The Department strongly encourages use of this option and has provided attractive lender incentives.

- First, for each special Type I forbearance agreement executed by a lender, regardless of the outcome, FHA will pay a \$100 incentive fee. Lenders whose overall loss mitigation performance is ranked in the top quarter will be eligible for an incentive payment of \$200 per Type I special forbearance claim.
- Second, when either a Type I or Type II special forbearance has been utilized and failed, and a conveyance claim is filed, lenders are entitled to collect unpaid interest at the note rate rather than at the debenture rate of interest.
- Finally, the number of months of interest that may be claimed is computed to the earliest of several dates as provided in 24 CFR 203.402a. This computation generally allows two additional months of interest than would be payable on a conveyance claim where special forbearance had not been utilized.

These are significant claim benefits, intended to reduce the risk to lenders of offering reduced or suspended payments, and/or longer than normal repayment terms. These incentives are not available in combination with any other loss mitigation option.

Filing For Incentive Payment

The lender must file the claim for a Type I special forbearance incentive payment within 60 days of the date of execution of the special forbearance agreement. It is not necessary to submit a copy of the special forbearance agreement or checklist. However, all documentation pertaining to the special forbearance must be retained in the claim review file and provided to HUD promptly upon request.

If Type II special forbearance is used, the lender is not entitled to file a claim for the special forbearance incentive fee, but may file for the incentive fee for the loss mitigation option which is used to cure the default when this other loss mitigation action is finalized.

Any questions regarding this mortgagee letter may be directed to HUD's National Servicing Center at (888) 297-8685 or hsg-lossmit@hud.gov. These clarifications and changes in this mortgagee letter are effective immediately.

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