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Rising Rates Put Existing Agency Loan Mod Programs at Risk of Missing Targets

From the RADAR Group, Federal Reserve Bank of Philadelphia[1]

While mortgage forbearances and delinquencies are normalizing at or below prepandemic levels, sharply rising mortgage interest rates mean that most borrowers seeking loan modifications will not see their monthly payments reduced by their existing programs' targeted amounts. In this report, after we update our numbers for current market conditions, we compute expected payment reductions for the two major Agencies' existing loan modification programs[2] at current interest rates to show that most borrowers will not achieve their targeted payment reductions. We then discuss ways in which these programs can be adjusted, or are being adjusted, so that almost all borrowers seeking loan mods will achieve their targeted payment reductions.

Current Market Conditions

Strong housing market and employment conditions continue to lower mortgage delinquencies and forbearances, by latest count to 2 million, with **Table 1** showing forbearances falling below 600,000 for the first time since March 2020. Later, we show that foreclosure starts have not risen sharply since the temporary protections against foreclosures expired at year-end 2021 and appear to be continuing their prepandemic downward trend.

Figure 1 presents projected forbearance expirations, assuming borrowers take the maximum forbearance allowed by various programs. Note that 39 percent of forbearances are FHA/VA mortgages.[3] Unless mortgage servicers can successfully execute home-retention options in the coming months, many borrowers face the prospect of selling their homes or losing them to foreclosure.[4]

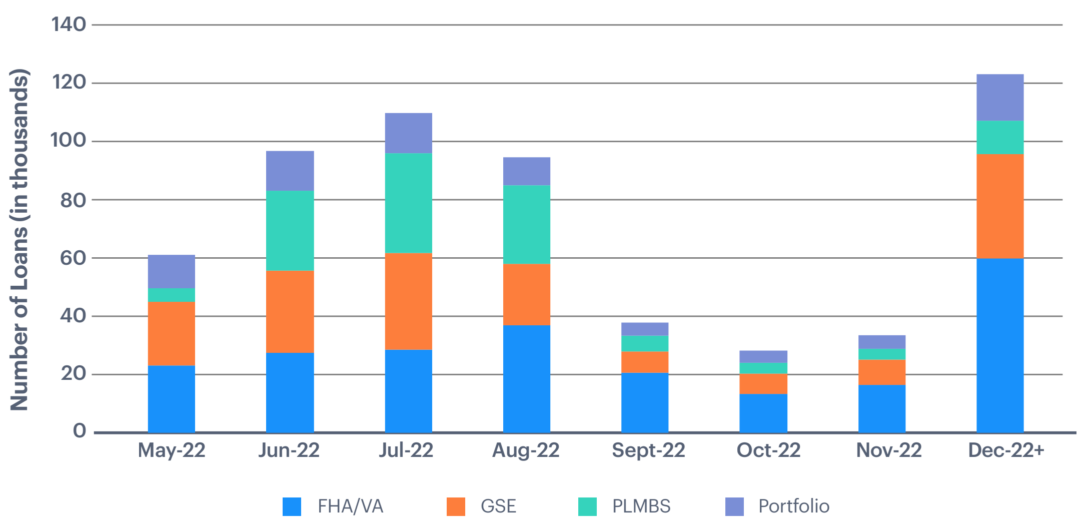
Figure 1 also lists the investor categories in Table 1. Of special note, FHA/VA have 227,532 mortgages still in forbearance. Their business is targeted at low- to moderate-income borrowers, who also have higher minority shares. We will discuss the demographic characteristics of borrowers past due on their mortgages later in this report.

Table 1: Mortgage Loans in Forbearance by Investor Type as of May 9, 2022

Counts and Balances	FHA/VA	GSEs	PLMBS	Portfolio	Total
Active Loan Count (Mil)	12.1	27.9	2.5	10.5	53.0
Loans in Forbearance – Counts	227,532	163,035	117,013	78,593	586,173
UPB of Loan Balances in Forbearance – UPB ($Bil)	48	34	22	8	112
Share of Loans in Forbearance	1.9%	0.6%	4.7%	0.7%	1.1%

Note: UPB = unpaid principal balance
Sources: Black Knight Data & Analytics, LLC; and RADAR

Figure 1: Projected Forbearance Exits as of May 9, 2022

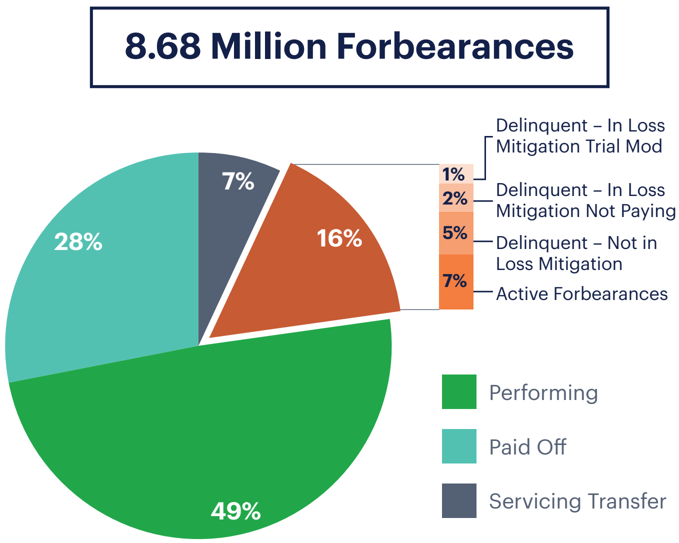


Sources: Black Knight Data & Analytics, LLC; and RADAR

Examining Home-Retention Options

As shown in the green shaded areas in **Figure 2**, of the 8.68 million mortgages that entered forbearance since the onset of the pandemic, more than three-quarters are performing or have voluntarily paid off.

Figure 2: Status of Loans Ever in a COVID-19 Forbearance as of May 9, 2022



Sources: Black Knight Data & Analytics, LLC; and RADAR

The focus of our analysis is on those who are still not paying, whether in forbearance or not, depicted by the orange segments pulled out of Figure 2. Together, these make up about 16 percent of borrowers who entered forbearance.

For these borrowers, the U.S. Department of Housing and Urban Development (HUD) and the Federal Housing Finance Agency (FHFA) are offering two main home-retention options for borrowers:[5]

1. For borrowers who can resume regular payments, missed payments can be paid back in a lump sum, with a repayment plan or with a deferral or *partial claim*, in which missed payments are put into a noninterest-bearing subordinate lien to be paid back when the mortgage pays off.

2. For borrowers who cannot resume regular payments, loan modifications to reduce monthly payments are available with plans announced by the FHFA for GSE loans and HUD for FHA and VA loans.

As shown in **Appendix 2**, 30 percent of borrowers have taken the first option thus far. Some borrowers will be unable — or choose not — to resume their regular mortgage payments. Loan modifications that reduce the mortgage payment are available to these borrowers; 11 percent have already done so, with another 1 percent in transition for a modification (i.e., on a trial modification). To achieve this, the FHFA and HUD adopted payment-reduction targets of 20 percent and 25 percent, respectively, with special features for each summarized in **Appendix 1**.

To assess the effectiveness of the FHFA and HUD plans for FHA loans meeting their targets,[6] we calculate the average declines in principal and interest (P&I) payments and for the full mortgage payments that include escrows, generally made up of principal, interest, taxes, and insurance (PITI).[7]

The three major federally insured programs are the GSE Flex Mod and the two FHA COVID-19 Recovery Modifications, starting with a 30-year mortgage, to be followed by one with a 40-year mortgage, which was formally announced on April 1 and is expected to be available in June.[8] Each plan meets its targets differently. For conservatism, in the analysis below, we assume all borrowers will forbear to their full terms.

For the FHFA and HUD programs, **Table 2** reports shares of loan modifications meeting their P&I reduction targets, as well as the average declines in P&I and PITI monthly payments. Note that with recent interest-rate increases, average payment reductions have decreased significantly and are now below program targets for most borrowers. For example, the average P&I reduction for GSE Flex Mods was 27 percent in December

Table 2: The Effectiveness of the Agencies' Insured Modification Programs as of May 9, 2022

Program	Market Counts	Shares of Loan Mods Meeting P&I Reduction	Average P&I Reduction	Average PITI Reduction
GSE Flex Mod with Balance Deferral Subject to 80% MTM LTV Constraint	113,237	23%	16%	11%
GSE Flex Mod with Balance Deferral Not Subject to 80% MTM LTV Constraint	113,237	98%	36%	25%
FHA COVID-19 Recovery Mod & 30-Year Term	141,213	34%	22%	14%
FHA COVID-19 Recovery Mod & 40-Year Term	141,213	90%	26%	16%

Notes: This table provides statistics on the reduction in principal and interest (P&I) and principal, interest, taxes, and insurance (PITI) fees under the various programs implemented for government-insured (i.e., Agencies) programs described in Appendix 1. Market counts represent sample counts extrapolated to the market in the manner described in An et al. (2021, (see Endnote 1) Appendix Table A4).

Sources: Black Knight Data & Analytics, LLC; *Inside Mortgage Finance*; and RADAR

2021, 11 percentage points more than in the current market in 2022. At the 5 percent modification rate announced starting on May 13, only 23 percent of modifications meet the GSE Flex Mod 20 percent P&I reduction target, as described in detail in Appendix 1.

But what is causing so many GSE Flex Mods to miss their payment reduction targets is the constraint on deferrals of principal balances, which states that any deferred principal can be no more than an amount that would create a post-modification mark-to-market loan-to-value (MTM LTV) ratio less than 80 percent (using the interest-bearing principal balance and latest updated property value).[10] With this constraint, only 23 percent of past due mortgages in our sample meet their 20 percent target. This is because strong house price growth has put most mortgages below the 80 percent threshold, meaning the only benefit they get comes from extending the term to 40 years.

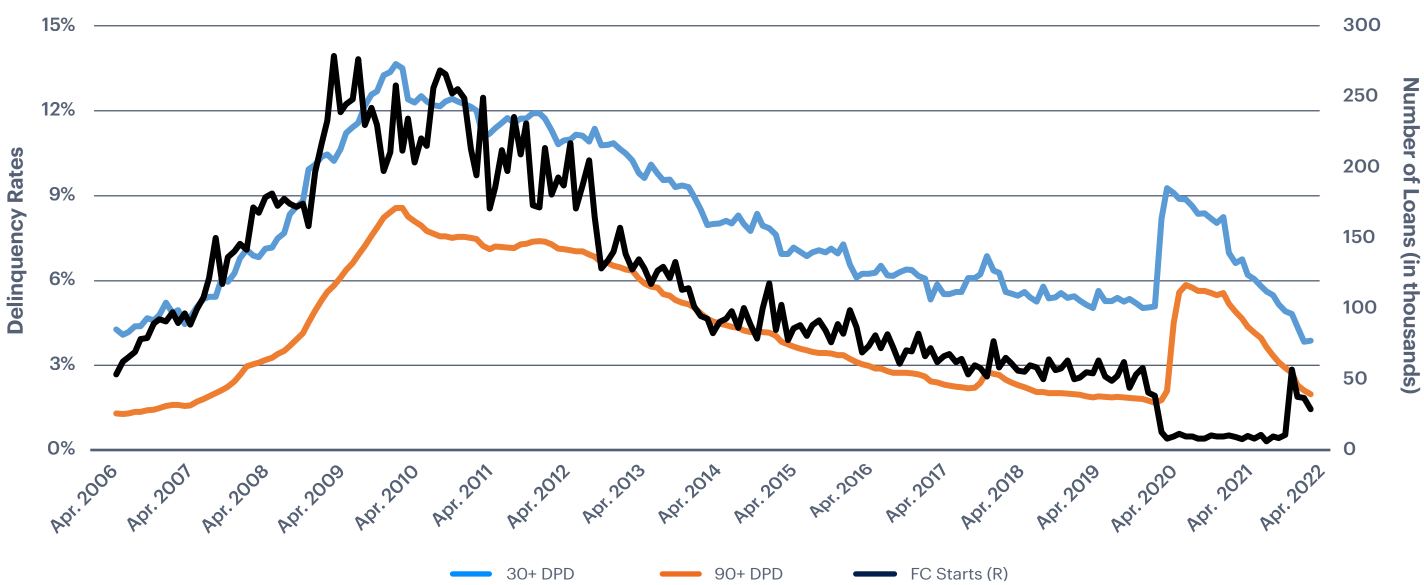
But, as shown in Table 2, if we drop this 80 percent MTM LTV constraint, almost all mortgages meet their targeted payment reductions, even while not allowing balance deferral amounts of more than 30 percent of the gross post-modification unpaid principal balance (UPB) of the mortgage loan.

For FHA loans, only 34 percent of FHA loans meet the existing FHA COVID-19 Recovery Mod's 25 percent P&I reduction target with a 5 percent post-mod interest rate. This is primarily because the post-mod term is currently set at 30 years. If the 40-year term gets adopted in June, 90 percent of FHA mortgages will meet their targets. Thus, a big factor in the success of the FHA program will be how soon servicers start extending mod terms to 40 years.

Foreclosure Activity

As shown in **Figure 3**, because of various foreclosure moratoria and temporary protections, foreclosure activity stopped abruptly in March 2020. These protections ran out on January 1, 2022. In January, foreclosure starts rose sharply to an estimated 56,000. February, March, and April recorded another 37,000, 36,000, and 28,000 foreclosure starts, respectively. While these numbers are far higher than seen during the pandemic, they are now at levels below those observed prepandemic. So we have not yet seen a surge in foreclosures once protections ran out at year-end. In fact, foreclosure starts appear to be following the downward trend observed prepandemic, another reflection of the strong housing market.

Figure 3: Delinquency Rates and Foreclosure Flows as of May 9, 2022
(Delinquencies as percent of balances, foreclosures (FC) in thousands)



Notes: These delinquency figures reflect investor reporting and will not match reporting to the credit bureaus, which the CARES Act prohibits reporting as delinquent if the mortgage was current on March 1, 2020, is past due, and in a CARES Act forbearance.

Sources: Black Knight McDash Data and Black Knight Data & Analytics, LLC

Demographic Characteristics of Past Due Mortgages

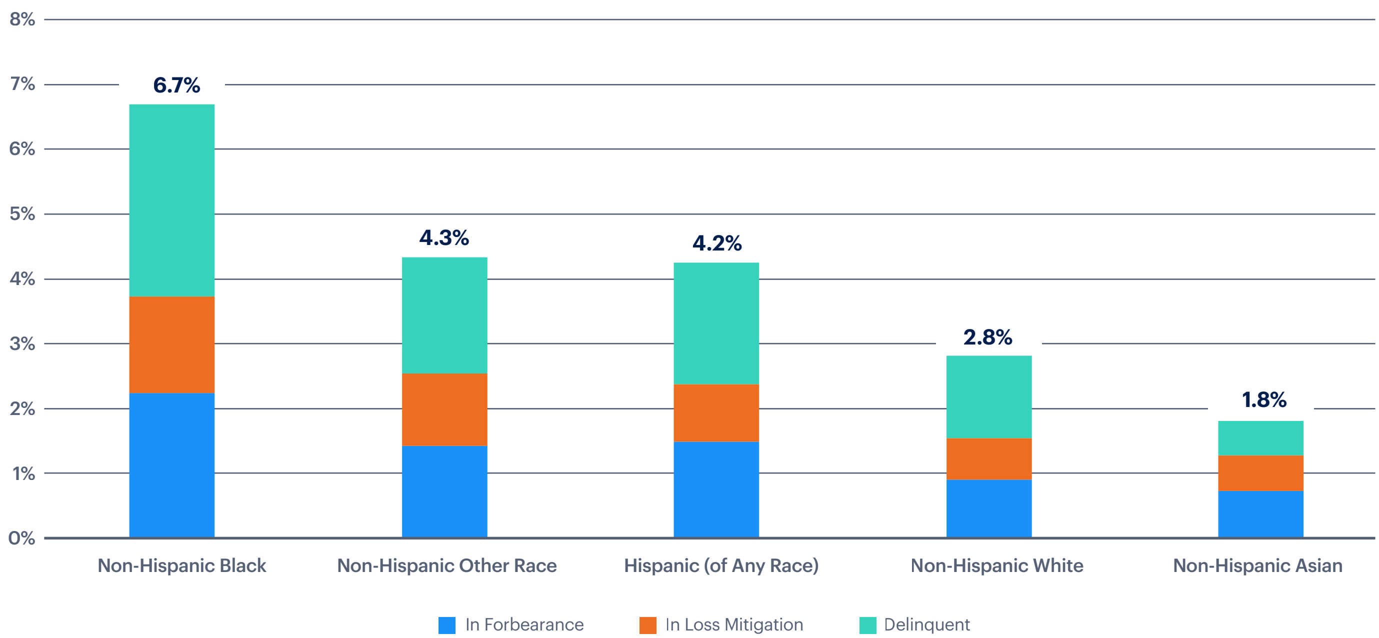
An important aspect of the pandemic is its uneven impact on different racial and ethnic groups. To examine these effects, we merged a sample of our servicing data from Black Knight Analytics with confidential Home Mortgage Disclosure Act (HMDA) data, where borrower race and household income are collected at application. As shown in **Figure 4**, 6.7 percent of Black borrowers are in some past due state, the highest of any group. Hispanic borrowers have the next highest rate, above those of White or Asian borrowers.

Past due states include borrowers in forbearance, borrowers not in forbearance but in some stage of loss mitigation, and borrowers who are delinquent but neither in forbearance nor in loss mitigation.

For further details on Figure 4, see **Appendix 3**, which includes these past due percentage breakouts as well as past due rates by income quartile and for our four major investors described in Table 1.

Demographic Shares of Past Due Mortgages

Figure 4: Past Due Rates by Race and Ethnicity as of May 9, 2022



Sources: Black Knight Data & Analytics, LLC; Home Mortgage Disclosure Act (HMDA); and RADAR

Appendix 1
Modification Programs Offered by the GSEs, FHA, and VA

Target/Steps	GSE Flex Mod	FHA Advance Loan Mod (ALM)	FHA COVID-19 Recovery Modification	VA COVID-19 Refund Modification
Target	Minimum 20% reduction in P&I payment	Minimum 25% reduction in P&I payment	Minimum 25% reduction in P&I payment	Minimum 20% but not more than 25% P&I reduction
Step 1	Capitalize arrears in loan balance	Capitalize arrears in loan balance	Apply arrears to a partial claim up to 25% of current loan balance	VA purchases arrearages and deferrals up to 30% of balance, refunds proceeds to servicer for pulling loan from pool
Step 2	Set interest rate to lower of contractual rate or modification interest rate*	Set interest rate to lower of contractual rate or PMMS rate,** rounded to nearest one-eighth	Set interest rate to lower of contractual rate or PMMS rate, rounded to nearest one-eighth	Set interest rate at PMMS rate plus 50 basis points but no more than 1% higher than existing rate
Step 3	Extend maturity to 480 months from mod effective date	Extend maturity to 360 months from mod effective date	Extend maturity to 360 months from mod effective date, 480 months later in this year	Extend loan terms to 360 months from mod effective date or 120 months past remaining loan maturity
Step 4	If post-mod MTMLTV > 100%, forbear principal until MTMLTV = 100% up to 30% of post-capitalized loan cap		If 25% P&I reduction not met, apply principal deferral until 25% reduction reached up to 25% of current loan cap; place additional arrearages above cap into loan	If PITIA payment exceeds 31% of gross income, servicer contacts VA to consider additional assistance
Step 5	If 20% P&I reduction and PMHTI ratio ≤ 40% not met, forbear principal until met or 80% MTMLTV is met up to 30% post-capitalized balance		If 25% payment reduction not met, offer borrower the terms from Step 4	

Note: COVID-19 Flex Modification Terms were put in effect on June 30, 2021, for the GSEs; June 25, 2021, for the FHA ALM; and July 23, 2021, for the FHA COVID-19 Recovery Modifications. P&I = principal & interest; MTMLTV = mark-to-market loan-to-value ratio; PMHTI = post-modification payment-to-income ratio; PITIA = principal, interest, property taxes, insurance, and association fees; PMMS = Primary Mortgage Market Survey.

Sources: FHFA, FHFA Expands Use of Interest Rate Reduction to Help Borrowers with a COVID-19 Hardship Reduce Their Monthly Mortgage Payment | Federal Housing Finance Agency;

FHA: HUD Mortgagee Letter 21-18, Mortgagee Letters | HUD.gov / U.S. Department of Housing and Urban Development (HUD); and VA; Circular 26-21-13 26_21_13.pdf (va.gov).

*The current modification interest rate is found at Freddie Mac Modification Interest Rate — Freddie Mac Single-Family.

**The current Freddie Mac PMMS rate is found at Mortgage Rates — Freddie Mac.

Appendix 2
COVID-19 Forbearance Dispositions as of May 9, 2022

Category 1: Performing or Paid Off	
Performing	**49%**
Always Performing	7%
Lump-Sum Payment	12%
Repayment Plan	11%
Deferrals/Partial Claims	8%
Modification	11%
Payoff	**28%**
Payoff from Delinquency or Forbearance	9%
Payoff from Current	19%
Category 2: Still in Forbearance	
Active Forbearances	**7%**
Category 3: Delinquent, Defaulted	
Delinquent — In Loss Mitigation Trial Mod	**1%**
Delinquent — In Loss Mitigation Not Paying	**2%**
Delinquent — Not in Loss Mitigation	**5%**
Default	**0%**
Servicing Transfer	**7%**
Total	**100%**
Share Lump-Sum Payment, Repayment Plan, Arrears Deferral — Option 1	30%
Share Paid Off Out of Forbearance or Delinquency	32%
Share Performing or Paid Off	77%
Share of Loans Delinquent in Loss Mitigation Not Paying	63%

Notes: This table summarizes from our sample the disposition of all loans that entered forbearance during the pandemic. Dispositions were determined by gathering servicers' classifications and examining monthly payment patterns compared against scheduled payments. Deferrals place past due arrears to the end of the loan; *partial claims* are the names given to FHA/VA deferrals. *Trial modifications* are defined as those classified in loss mitigation, still delinquent but where borrowers are making payments. Servicing transfers are loans sold where a status could not be determined.

Sources: Black Knight Data & Analytics, LLC; and RADAR

Appendix 3

Mortgage Shares in Different States of Nonpayment by Demographic/Investor Groups as of May 9, 2022

Demographic/Investor Classifications	In Forbearance	Delinquent, No Forbearance			Total
		In Loss Mitigation	Not in Loss Mitigation		
			30-60DPD	90+DPD	
Race and Ethnicity					
White, Non-Hispanic	0.9%	0.6%	0.9%	0.4%	2.8%
Black, Non-Hispanic	2.2%	1.5%	2.1%	0.9%	6.7%
Asian, Non-Hispanic	0.7%	0.5%	0.4%	0.2%	1.8%
Other Race, Non-Hispanic	1.4%	1.1%	1.2%	0.6%	4.3%
Hispanic (of Any Race)	1.5%	0.9%	1.4%	0.5%	4.2%
Income at Origination					
1st Quartile (Lowest)	1.5%	1.0%	1.4%	0.6%	4.4%
2nd Quartile	1.3%	0.9%	1.1%	0.5%	3.7%
3rd Quartile	0.9%	0.6%	0.7%	0.3%	2.6%
4th Quartile (Highest)	0.6%	0.4%	0.4%	0.2%	1.6%
Investor Type					
GSE	0.7%	0.4%	0.4%	0.1%	1.7%
FHA/VA	1.8%	1.5%	2.0%	0.9%	6.2%
PLMBS	3.8%	1.1%	4.3%	1.6%	10.8%
Portfolio	0.6%	0.5%	0.7%	0.5%	2.3%
Servicer Type					
Bank	0.8%	0.6%	0.8%	0.3%	2.5%
Non-Bank	2.2%	1.3%	1.9%	0.8%	6.1%

Notes: Figures are from a 20 percent random sample of data from Black Knight Data & Analytics originated in 2019 and prior matched with confidential Home Mortgage Disclosure Act (HMDA) data.

Sources: Black Knight Data & Analytics, LLC; HMDA; and RADAR

In this table, we further break out past due loans between those 30- to 60-days past due (DPD) and those 90 or more DPD, which includes loans in foreclosure.

For borrowers' household income data, we divide them by metropolitan statistical areas (MSA) median income (also in HMDA), then categorize into quartiles. We categorize borrowers relative to median income in their MSAs in the application year to make household purchasing power at application comparable across MSAs and time.

For our four major investor groups described in Table 1, consistent with these demographic trends, FHA/VA loans have significantly higher shares in nonpayment, as their business is targeted at low- to moderate-income borrowers, who also have higher shares of minorities. PLMBS loans have the highest nonpayment rates; they primarily hold nonagency nonconforming mortgages.

Endnotes

[1] For a more thorough treatment of issues raised in this report, see "Inequality in the Time of COVID-19: Evidence from Mortgage Delinquency and Forbearance" (philadelphiafed.org) by An, Cordell, Geng, and Lee (2021), who are the primary authors of this report from the Risk Assessment, Data Analysis, and Research (RADAR) Group. The views expressed in this report are solely those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

[2] In this case, the *Agencies* refer to the two government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac; the Federal Housing Administration (FHA); and Veterans Affairs (VA). Description of their loan mod programs and targets are detailed in Appendix 1.

[3] CARES Act forbearance terms were first extended by the Biden administration, then further refined by regulators. For the latest terms for federally insured mortgages, see Extending Your Mortgage Forbearance | Consumer Financial Protection Bureau (consumerfinance.gov). Industry sources have informed us that PLMBS and portfolio forbearance programs match the GSE programs.

[4] Federal foreclosure moratoria expired on July 31, 2021. The CFPB amended Regulation X to provide "temporary special COVID-19 procedural safeguards" on most mortgages before servicers can start foreclosure, inclusive of all in forbearance, effective on August 31, 2021. For details, see Protections for Borrowers Affected by the COVID-19 Emergency Under the Real Estate Settlement Procedures Act (RESPA), Regulation X | Consumer Financial Protection Bureau (consumerfinance.gov).

[5] More details are provided by the CFPB at Repay Your Forbearance | Consumer Financial Protection Bureau (consumerfinance.gov).

[6] Due to special features of VA loans, we cannot assess them. See Appendix 1 for a description of the VA plan.

[7] Some borrowers pay their own escrows, so they are not included in their PITIs.

[8] The Department of Housing and Urban Development (HUD) proposed a rule on April 1, 2022, to increase the term of modified loans up to 480 months. With the comment period ending on May 31, the 40-year term for FHA loan modifications is expected to be rolled out in June. GSEs presently offer a 40-year mortgage in their Flex Mod Program, which private sector investors have also adopted. As explained in An et al. (2021), extending terms to 40 years is the lowest cost option for reducing payments for loan mods, lower than reducing interest rates or forbearing on past payments or additional principal.

[9] Loan counts vary from those reported in Table 1; in Table 2, we only include mortgages in forbearance that are 90 or more days delinquent.

[10] Since our process to "mark to market" home values uses CoreLogic Solutions repeat sales indexes, our figures are likely upper bound percentages of modifications missing their targets since these indexes more accurately reflect normal market transactions, not distressed sales.

[11] Borrowers in loss mitigation and not in forbearance include borrowers in a "trial" loan modification in which borrowers are offered lower payments and the servicer requires several consecutive payments to be made before these more favorable loan terms are made permanent and borrowers are brought current on their mortgages.