Making Forbearances More Effective to Keep More Borrowers in Their Homes

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

In our last report, we described a **New Normal** for mortgage markets, characterized by forbearances settling in at below half a million, around 2 million delinquent mortgages, and around 30,000 foreclosure starts per month. With most of the 9 million mortgages that entered forbearance having exited successfully, we turn our attention to ways to integrate forbearance into the workout process to keep more borrowers in their homes. A recent paper from the Urban Institute proposed adding forbearance into the loss mitigation waterfall in a limited set of circumstances[2] that can be documented to test their viability in making forbearances a standard part of the workout process. With interest rates rising to new highs, we examine ways to make forbearances more effective for borrowers with hardships who want to remain in their homes.

In this report, we do three things. First, we update our forbearance and performance numbers through September 6, 2022. Second, like in previous months, we compute expected payment reductions for the two major loan modification programs.[3] Since loan mod payment-reduction goals are falling so far short of target, we explore ways to revise existing programs so more mortgages can meet their payment-reduction targets.[4] Finally, we continue examining redefault rates on the COVID-19 loss mitigation programs. At present, the overall redefault rate for these loans is 12 percent, with substantial variation among investors. It is encouraging that redefault rates have not spiked, as might be expected, but appear to be stabilizing.

Current Market Conditions

Delinquencies and forbearances appear to be settling into their New Normal at around 1.9 million mortgages. **Table 1** shows mortgage loans in forbearance at 470,969, similar to past months. FHA/VA mortgages are still around 40 percent of this total. 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.[5]

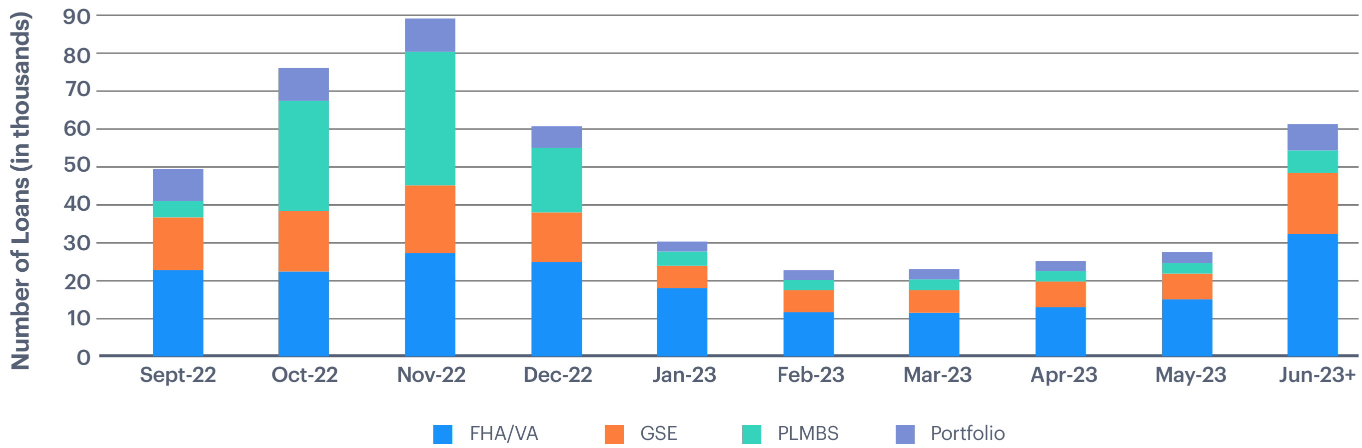
Figure 1 presents projected forbearance expirations over the next year, assuming borrowers take the maximum forbearance allowed by various programs. Forbearance expirations will be elevated for another four months, then settle in to around 20,000 to 30,000 per month after that. As before, the large number of FHA/VA loans still in forbearance provides more stresses on low- to moderate-income borrowers and minorities. These are explored below.

Table 1: Mortgage Loans in Forbearance by Investor Type as of September 6, 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	201,949	109,441	106,689	52,890	470,969
UPB of Loan Balances in Forbearance – UPB ($Bil)	42	23	19	5	89
Share of Loans in Forbearance	1.7%	0.4%	4.3%	0.5%	0.9%

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

Figure 1: Projected Forbearance Exits as of September 6, 2022

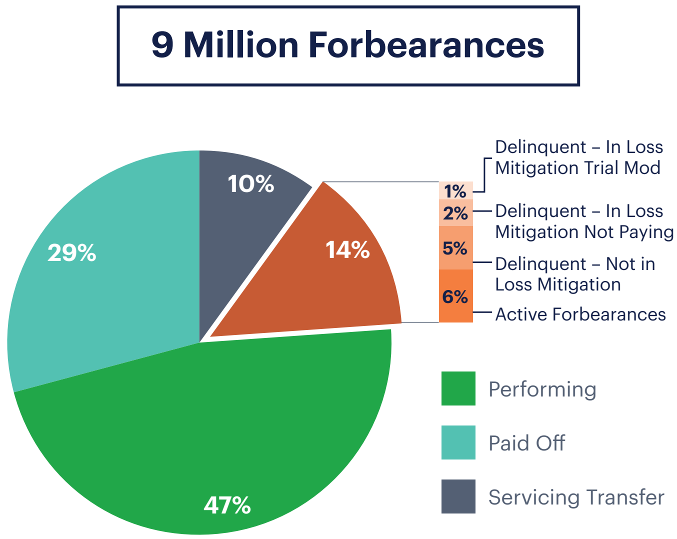


Sources: Black Knight Data & Analytics, LLC; and RADAR

Examining Home-Retention Options

As shown in the green shaded areas in **Figure 2**, of the 9 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 September 6, 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 14 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:[6]

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 by HUD for FHA and VA loans, summarized in **Appendix 1**.

As shown in **Appendix 2**, 28 percent of borrowers have taken the first option so far. Some borrowers will be unable — or choose not — to resume their regular mortgage payments. Loan modifications that reduce mortgage payments are available to these borrowers; 11 percent have already done so, with another 1 percent in transition for a modification (i.e., a *trial* modification). To achieve this, the FHFA and HUD adopted payment-reduction targets of 20 percent and 25 percent, respectively, as shown in Appendix 1.

To assess the effectiveness of the FHFA and HUD plans for FHA loans meeting their targets,[7] we calculate the average declines in principal and interest (P&I) payments and for full mortgage payments that include escrows, generally made up of principal, interest, taxes, and insurance (PITI).[8]

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, and followed by one with a 40-year mortgage, which was formally announced on April 1, 2022, and became available on June 1.[9] Each plan meets its targets differently.

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.[10] 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 2021, 10 percentage points more than in the current market in 2022. At the 5.25 percent modification rate starting on September 14, only 23 percent of modifications (Table 2) meet the GSE Flex Mod 20 percent P&I reduction target, as described in Appendix 1.

But what is causing so many GSE Flex Mods to miss their payment reduction targets? It 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 of less than 80 percent (using the interest-bearing principal balance and latest updated property value).[11] 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 that the only benefit they get comes from extending the term to 40 years.

But, as shown in Table 2, if we allow the post-mod LTV to drop to 50 percent, 64 percent of mortgages would meet the targeted payment reduction. With the post-mod LTV constraint completely removed, almost all mortgages can meet their targeted payment reductions, even while not allowing balance deferral amounts of more than 30 percent of the gross post-modification balance unpaid principal balance (UPB) of the mortgage loan.

For FHA loans, only 8 percent meet the existing FHA COVID-19 Recovery Mod's 25 percent P&I reduction target, with a 5.875 percent post-mod interest rate. With the FHA 40-year term becoming active on June 1, the longer term means that 9 percent of borrowers can meet their targets, even with an interest rate 50 basis points higher (6.375 percent) than for the 30-year mortgage.

Suspending the FHA mortgage insurance premium (MIP) payment can provide additional relief to borrowers' total payment burden; however, it will not reduce the P&I payment since the FHA MIP of 85 basis points (bps) is not included in the mortgage principal and interest (P&I) payment. However, as reported in Table 2, an MIP payment suspension would generate an 8 percentage point reduction in the total principal, interest taxes, and insurance (PITI) payment, from 9 percent to 17 percent.

Another option is to raise the partial claim limit from 25 percent to 30 percent. Our assessment shows that a 30 percent partial claim at a 30-year term would raise the share that meets its payment-reduction target from 8 percent to 12 percent; with the FHA 40-year term, it increases from 9 percent to 15 percent.

A final option is to drop the rate of the FHA 40-year term program (from PMMS+50 bps to PMMS+25 bps). With lower rates combined with higher partial claims and suspension of MIP payment, 19 percent of mortgages would meet their payment reduction targets.[12]

Finally, when all three options are combined, the reductions in total PITI payments range from 9 percent to 17 percent with a 30-year term and 9 percent to 18 percent with a 40-year term.

Table 2: The Effectiveness of the Agencies' Insured Modification Programs as of September 6, 2022

Program	Market Counts	Shares of Loan Mods Meeting P&I Reduction Targets	Average P&I Reduction	Average PITI Reduction
GSE Flex Mod (Mod Rate=5.25%) Balance Deferral Subject to 80% Post-Mod LTV Constraint	70,507	23%	17%	12%
Balance Deferral Subject to 50% Post-Mod LTV Constraint	70,507	64%	21%	14%
Balance Deferral Subject to No Post-Mod LTV Constraint	70,507	99%	23%	15%
FHA COVID-19 Recovery Mod (Mod Rate=5.875%) 30-Year Term, 25% Partial Maximum	122,303	8%	14%	9%
Suspend MIP Payment	122,303	8%	14%	17%
Partial Claim 30% Maximum	122,303	12%	15%	9%
Partial Claim 30% Maximum + Suspend MIP Payment	122,303	12%	15%	17%
FHA COVID-19 Recovery Mod (Mod Rate=6.375%) 40-Year Term, 25% Partial Claim Maximum	122,303	9%	15%	9%
Suspend MIP Payment	122,303	9%	15%	17%
Partial Claim 30% Maximum	122,303	15%	15%	9%
Partial Claim 30% Maximum + Suspend MIP Payment	122,303	15%	15%	18%
Partial Claim 30% Maximum + Suspend MIP Payment + Reduce Mod Rate to 6.125%	122,303	19%	15%	18%

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. A target goal of a 20% PITI reduction was added for this report. Market counts represent sample counts extrapolated to the market in the manner described in An et al. (2021, (see Endnote 1) Appendix Table A4). MIP = mortgage insurance premium.

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

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. The following months recorded foreclosure starts in the range of 24,000 to 37,000. While these numbers are far higher than those seen during the pandemic, they are now at levels below those observed prepandemic. As with other parts of the market, the New Normal for foreclosure starts is settling in at around 30,000 per month.

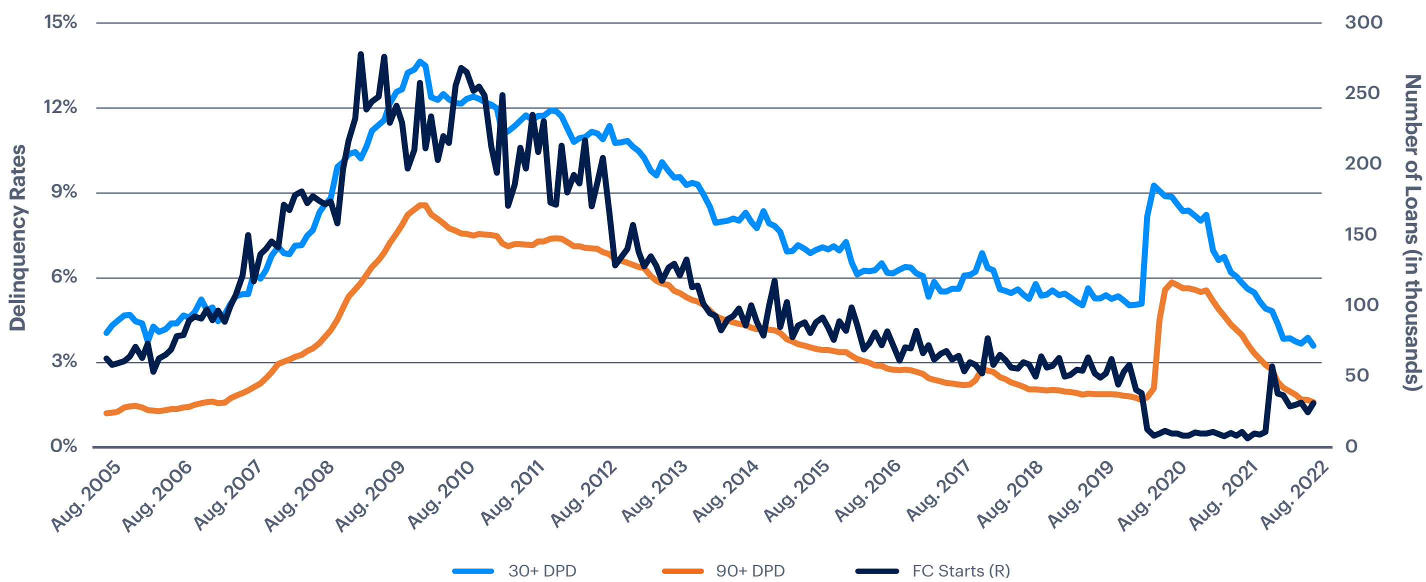
Performance of COVID-19 Loss Mitigation Programs

Starting in June, we began tracking the post-pandemic performance of mortgages that were delinquent during the pandemic, including those in, out of, and never in forbearance. While the COVID-19 emergency has still not been declared as being over and we are admittedly at a highly uncertain time for the economy and mortgage markets, it is important to track the performance of seriously delinquent loans, especially those that have gone through loss mitigation.

The flow chart (**Table 3**) evaluates the performance of loans that missed three or more mortgage payments before or during the pandemic. The flow chart starts on the left with all loans 90 or more days past due on or before April 2020. It then tracks performance going forward (from left to right), first breaking out those that entered or did not enter forbearance. As shown, 90 percent of all seriously delinquent loans entered forbearance; 10 percent never did. The next two columns also sum to 100 percent.

Of primary importance is the redefault rate of loans that servicers identify as having exited loss mitigation. As of September 6, the redefault rate for all mortgages has been 12 percent, which could be concerning, given strong market conditions. By investor, redefault rates are 5 percent for GSE loans, 15 percent for FHA/VA, 17 percent for portfolio, and 33 percent for PLMBS. We will continue to track redefault rates monthly.

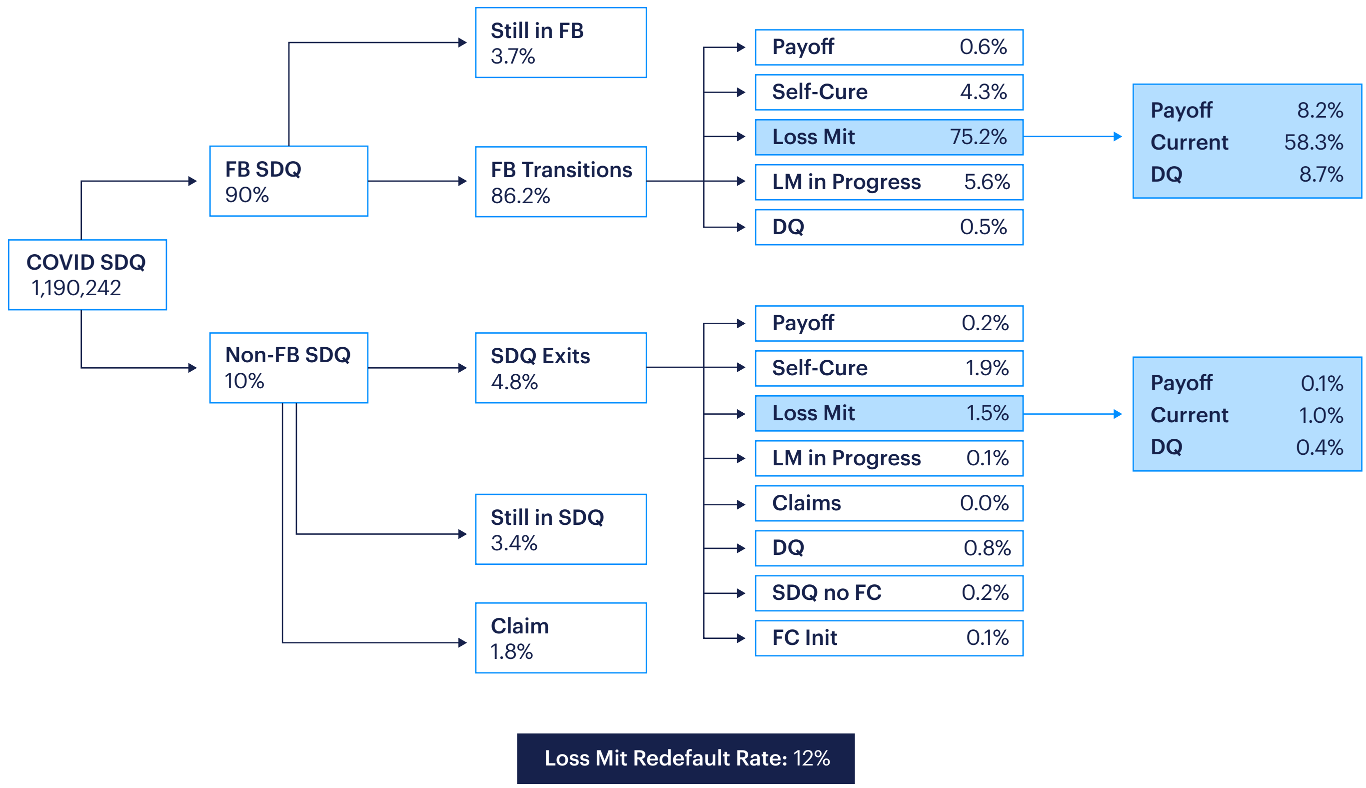
Figure 3: Delinquency Rates and Foreclosure Flows as of September 6, 2022
(Delinquencies as percent of balances, foreclosures (FC) in thousands)



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

Table 3: Performance of All COVID-19 Seriously Delinquent Mortgages as of September 6, 2022



Notes: Loss Mit refers to all loans listed as 90 or more days delinquent (SDQ) that were identified by servicers as having been in loss mitigation after March 2020; FB SDQ = SDQ in Forbearance; non-FB SDQ = SDQ but never in forbearance after March 2020; DQ = delinquent but not SDQ; FC = foreclosure; Claims = loan has defaulted with a claim being filed.

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

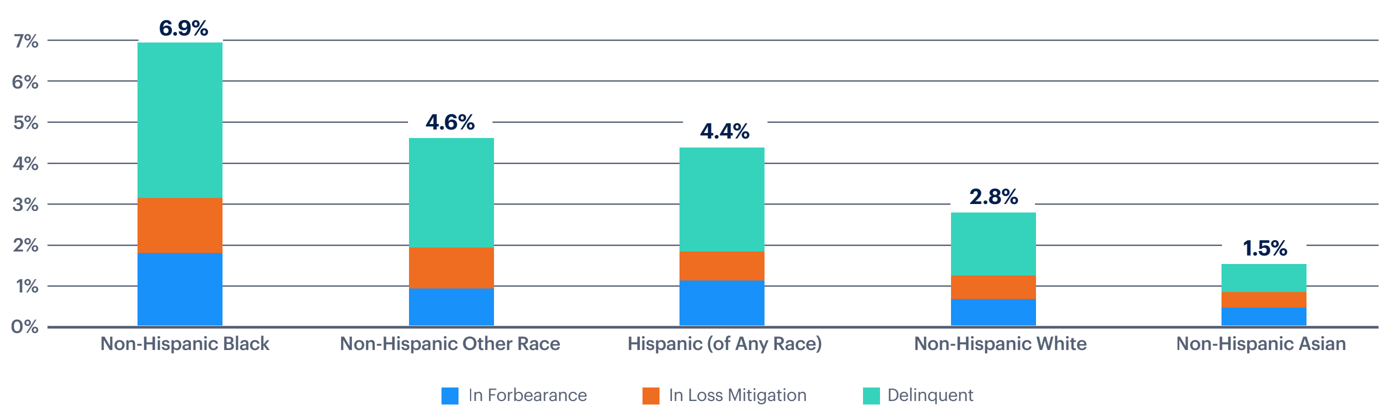
Demographic Characteristics of Past Due Mortgages

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 Data & Analytics with confidential Home Mortgage Disclosure Act (HMDA) data, where borrower race and household income are collected at application. As shown in **Figure 4**, 6.9 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,[13] 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.

Figure 4: Past Due Rates by Race and Ethnicity as of September 6, 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 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 20% but not more than 25% P&I reduction
Step 1	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 the PMMS rate** for term extensions to 360 months or PMMS rate plus 50 basis points for term extension to 480 months, each 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, 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 MTM LTV > 100%, forbear principal until MTM LTV = 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% MTM LTV 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; July 23, 2021, for FHA COVID-19 Recovery Modifications; and July 27, 2021, for VA Refund Modifications. P&I = principal & interest; MTM LTV = 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 22-07; 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 September 6, 2022

Category 1: Performing or Paid Off	
Performing	**47%**
Always Performing	7%
Lump-Sum Payment	12%
Repayment Plan	10%
Deferrals/Partial Claims	7%
Modification	11%
Payoff	**29%**
Payoff from Delinquency or Forbearance	9%
Payoff from Current	20%
Category 2: Still in Forbearance	
Active Forbearances	**6%**
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	**10%**
Total	**100%**
Share Lump-Sum Payment, Repayment Plan, Arrears Deferral — Option 1	28%
Share Paid Off Out of Forbearance or Delinquency	32%
Share Performing or Paid Off	76%
Share of Loans Delinquent in Loss Mitigation Not Paying	61%

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 with 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 September 6, 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	0.7%	0.6%	1.1%	0.4%	2.8%
Black, Non-Hispanic	1.8%	1.4%	2.8%	1.0%	6.9%
Asian, Non-Hispanic	0.4%	0.4%	0.5%	0.2%	1.5%
Other Race, Non-Hispanic	0.9%	1.0%	1.8%	0.9%	4.6%
Hispanic (of Any Race)	1.1%	0.7%	2.0%	0.5%	4.4%
Income at Origination					
1st Quartile (Lowest)	1.1%	1.0%	1.9%	0.7%	4.6%
2nd Quartile	0.9%	0.8%	1.5%	0.5%	3.7%
3rd Quartile	0.7%	0.5%	1.0%	0.3%	2.5%
4th Quartile (Highest)	0.4%	0.3%	0.5%	0.2%	1.4%
Investor Type					
GSE	0.5%	0.4%	0.5%	0.2%	1.5%
FHA/VA	1.4%	1.4%	2.8%	1.0%	6.7%
PLMBS	3.5%	1.2%	5.2%	1.7%	11.6%
Portfolio	0.4%	0.3%	0.9%	0.5%	2.0%
Servicer Type					
Bank	0.6%	0.5%	1.1%	0.4%	2.6%
Non-Bank	1.6%	1.6%	2.3%	0.8%	6.2%

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/R), 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] These circumstances include job loss, death of a coborrower, start of divorce proceedings, or a health issue that qualifies for leave under the Family and Medical Leave Act. See the Urban Institute Research Report, "Normalizing Forbearance," July 2022.

[3] The two major programs we analyze are the Government-Sponsored Enterprise (GSE) Flex Mod and the Federal Housing Administration (FHA) COVID-19 Recovery Mod Programs. Description of their programs and targets are detailed in Appendix 1. The two private sector investors — Portfolio Lenders and Private-Label Mortgage-Backed Securities (PLMBS) — are assumed to use the GSE Flex Mod Program.

[4] We thank Kanav Bhagat, president and founder of Housing Risk and Policy Advisors LLC, for these suggestions.

[5] 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).

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

[7] Because of special features of VA loan mods, we cannot assess them. See Appendix 1.

[8] Some borrowers pay their own escrows so these are not included in their PITIs. Most mortgages are escrowed.

[9] See HUD Mortgagee Letter 22-07. The GSEs presently offer a 40-year mortgage in their Flex Mod Program, which we assume private sector investors also adopt. 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.

[10] 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.

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

[12] We thank Kanav Bhagat for his discussion and helpful suggestions to our assessment on the Agency modification programs.

[13] 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.