

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**[Docket No. FR-4691-N-02]****Notice of FHA Accelerated Claim Disposition Demonstration**

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Notice.

SUMMARY: This notice announces HUD's establishment of the Accelerated Claim Disposition (ACD) Demonstration. Under the ACD Demonstration, HUD will pay accelerated claims on certain defaulted FHA-insured mortgages. HUD intends to select up to nine mortgagees to participate in the ACD Demonstration. The demonstration will have a limited initial duration and will include mortgage loans secured by properties located within the jurisdiction of HUD's Philadelphia, Pennsylvania and Atlanta, Georgia Homeownership Centers (HOCs). At the conclusion of the demonstration, HUD will assess its success and determine whether to implement the ACD process, on a permanent basis, throughout the country. This notice follows publication of a February 5, 2002 **Federal Register** notice proposing the establishment of the ACD Demonstration, and takes into consideration the public comments received on the earlier notice.

FOR FURTHER INFORMATION CONTACT: Kathleen S. Malone, Director, Office of Asset Sales, Room 6266, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410; telephone: (202) 708-2625 (this is not a toll-free telephone number). Hearing- and speech-impaired persons may access this telephone number via TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:**I. Background—HUD's February 5, 2002 Federal Register Notice**

On February 5, 2002 (67 FR 5418), HUD published a notice in the **Federal Register** announcing its intent to establish the Accelerated Claim Disposition (ACD) Demonstration, and soliciting public comments on the proposal. The ACD Demonstration is authorized under section 204 of the National Housing Act (12 U.S.C. 1710), as amended by section 601 of the Fiscal Year 1999 Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act (Pub. L. 105-276, approved October 21, 1998) (the FY

1999 HUD Appropriations Act). Section 601 of the FY 1999 HUD Appropriations Act amended section 204 to make more effective the methods for paying insurance claims and disposing of HUD-acquired single family mortgages and properties.

Under amended section 204(a)(1)(A) of the National Housing Act, the Secretary of HUD is authorized to pay accelerated claims upon assignment of certain defaulted FHA-insured mortgage loans. Before implementing the new accelerated claim payment process authorized by amended section 204 on a nationwide basis, HUD has decided to conduct a demonstration involving a group of defaulted mortgages. The ACD Demonstration will allow HUD to assess the success of the new accelerated claim payment process and to address any programmatic concerns before authorizing its use throughout the country. Publication of the February 5, 2002 notice allowed HUD to solicit input on how the ACD Demonstration should be structured and its success evaluated.

II. Significant Changes to Proposed ACD Demonstration

This notice announces HUD's establishment of the ACD Demonstration. The notice follows publication of the February 5, 2002 notice, and takes into consideration the public comments received on the earlier notice. The most significant changes that have been made to the ACD Demonstration since publication of the February 5, 2002 notice are as follows:

A. Changes Regarding FHA Insurance Requirements

1. *Eligibility of FHA-insured mortgages on two to four-unit homes.* HUD has expanded eligibility for the ACD Demonstration to include FHA single family mortgages on one to four-unit homes. The February 5, 2002 notice limited eligibility to FHA mortgages on one-unit homes. Mortgages on two to four-unit homes have a higher risk of foreclosure, all other factors being equal. Inclusion of these mortgages in the ACD Demonstration will therefore increase the number of defaulted loans available for submission of an accelerated claim and enhance the usefulness of the ACD process for participating mortgagees. Accordingly, HUD has determined that inclusion of these mortgages in the ACD Demonstration is appropriate.

2. *FHA endorsement date.* The notice specifies that the FHA endorsement date of the mortgage loan must be prior to February 5, 2002.

3. *No pending or paid partial FHA insurance claim.* The notice provides

that there must be no pending or paid partial FHA mortgage insurance claim in connection with the defaulted mortgage.

B. Changes Regarding Loan Status

1. *Minimum unpaid principal balance.* The notice provides that the mortgage must have an unpaid principal balance of no less than \$20,000.

2. *Minimum length of default prior to payment of accelerated claim.* This notice clarifies that to be eligible for an accelerated claim, a mortgage must be in default for at least four full monthly installments (*i.e.*, four full mortgage payments are due and unpaid).

3. *Maximum length of default prior to payment of accelerated claim.* Related to the preceding clarification, HUD will also establish a maximum number of missed payments beyond which it will not pay an accelerated claim on a defaulted mortgage. This maximum number of missed payments will vary depending on the location of the underlying property, and will be based on the foreclosure timelines for the various jurisdictions in the Atlanta and Philadelphia Homeownership Centers (HOCs). The schedule of maximum missed mortgage payments will be provided to mortgagees prior to their agreement to participate in the ACD Demonstration.

4. *Revised loan to value requirements.* This notice provides that, to be eligible under the ACD Demonstration, a mortgage must have a loan to value ratio of 85 percent or greater, rather than the 90 percent specified in the February 5, 2002 notice. HUD has determined that a high percentage of claims meeting the lower loan to value ratio satisfy the other eligibility criteria for an accelerated claim. Revising the loan to value ratio will make more loans eligible for the ACD process, thereby increasing its usefulness for participating mortgagees and better enabling HUD to evaluate the success of the ACD Demonstration. Accordingly, HUD believes that inclusion of these mortgages in the ACD Demonstration is appropriate.

5. *Need for Broker's Price Opinion (BPO).* This notice clarifies that BPOs are not used to calculate loan eligibility for the ACD Demonstration. However, BPOs will be required for all loans for which a claim is submitted. The BPO will be made available to private sector firms who qualify to participate in a competitive bidding process to select a participant in the joint venture formed for disposition of the mortgage loans. Participating mortgagees will be reimbursed for BPOs on all loans for which a claim is submitted and paid.

6. *FICO score no longer an eligibility criterion.* This notice provides that a mortgagor's FICO score will no longer be used as an eligibility criterion under the ACD Demonstration. (FICO stands for Fair, Issac and Company—the company that has developed the mathematical formulas used to derive FICO scores.)

7. *Indemnification Agreement.* The notice provides that the mortgage loan must not be, to the knowledge of the participating mortgagee, subject to an Indemnification Agreement as of the provisional claim approval date.

C. Changes Regarding Loss Mitigation

1. *Loss mitigation evaluation.* The notice provides that, for each defaulted mortgage, the participating mortgagee (or the prior servicer of the defaulted mortgage) has evaluated all of the loss mitigation actions provided in 24 CFR 203.605 and determined that no such action is appropriate or, if appropriate, that such action has been tried and has failed.

2. *Special forbearance relief.* To be eligible under the ACD Demonstration, the mortgage loan must not be subject to special forbearance relief under 24 CFR 203.614.

D. Changes Regarding Property Securing Mortgage

1. *Exclusion of properties located in asset control areas.* This notice provides that the ACD Demonstration will exclude loans secured by properties located in asset control areas designated under section 204(h) of the National Housing Act, as added by section 602 of the FY 1999 HUD Appropriations Act.

2. *Properties seized by the United States.* The mortgage must not be secured by a property that has been seized by the U.S. Department of Justice or subject to a seizure order in connection with a drug-related case.

3. *Limit on cost of repairs.* As of the provisional claim approval date, the cost of any required repairs to the property must be less than 10% of the property's value.

E. Changes Regarding Foreclosure

1. *Foreclosure sales and deeds-in-lieu of foreclosure.* For a mortgage to be eligible for an accelerated claim, there must not have been a foreclosure sale or pre-foreclosure sale of the property, no deed-in-lieu of foreclosure has been accepted, and no foreclosure sale has been scheduled within sixty days following the claim date.

2. *Commencement of foreclosure proceedings.* If foreclosure of the property has been initiated, the foreclosure action may not have been

contested in order for the defaulted mortgage to be eligible under the ACD Demonstration.

III. Discussion of the Public Comments Received on the February 5, 2002 Notice

The public comment period on the February 5, 2002 notice closed on April 8, 2002. HUD received 21 comments on the notice. Mortgage companies, legal aid providers, nonprofit housing and community development organizations, and national organizations representing mortgage bankers and realtors submitted comments. This section of the preamble presents a discussion of the most significant issues raised by the public commenters on the February 5, 2002 notice, and HUD's responses to these comments.

Comment: Participation in the ACD Process should be voluntary. Several of the commenters made this suggestion.

HUD Response: Participation in the ACD Demonstration is voluntary.

Comment: Participating mortgagees should be required to fully comply with loss mitigation processes. Some commenters expressed concern that the ACD Demonstration could result in families losing their homes if participating mortgagees do not fully utilize the existing HUD loss mitigation process.

HUD Response: The ACD Demonstration will not compromise existing loss mitigation standards and requirements. Only those mortgagees qualified in the top tier of the FHA Tiering System (which ranks mortgagees in loss mitigation use) are eligible to participate in the ACD Demonstration. Participating mortgagees must exhaust all loss mitigation options prior to submitting a claim under the ACD Demonstration. Further, HUD expects that the joint venture Manager will be motivated to avoid foreclosure and seek to restructure loans in accordance with market value and owner income.

Comment: HUD should permit use of additional risk scoring models. Several commenters suggested that participating mortgagees be allowed to use risk scoring models, other than the Freddie Mac Early Indicator Risk Scoring System, to determine the eligibility of a mortgage for an accelerated claim.

HUD Response: HUD has not adopted the change suggested by the commenters. Mortgagees participating in the ACD Demonstration are required to use the Freddie Mac Early Indicator Risk Scoring System. However, HUD will explore the use of other risk scoring models for use in the permanent ACD program.

Comment: HUD should conduct an audit before terminating FHA mortgage insurance. One commenter suggested that HUD conduct pre-claim audits to ensure the eligibility of a loan for an accelerated claim prior to termination of FHA insurance. Alternatively, the commenter suggested that HUD conduct a post-claim audit but not terminate FHA insurance until the audit is complete.

HUD Response. HUD has not adopted the change requested by the commenter. The ACD Demonstration will contain several safeguards to ensure that a defaulted loan qualifies for payment of an accelerated claim. Participating mortgagees are required to assure that loans meet the eligibility criteria for an accelerated claim. HUD will also review the eligibility of defaulted loans during the pre-claim process and notify the participating mortgagees of provisional approval or disapproval of the submitted loans. FHA mortgage insurance will be terminated upon payment of the claim.

Comment: Will FHA insurance be restored for a mortgage loan reassigned to the participating mortgagee? One commenter asked this question.

HUD Response. If the FHA insurance was valid prior to submittal of the accelerated claim, HUD will reinstate the mortgage insurance after reassignment of the loan to the participating mortgagee.

Comment: ACD Demonstration should take into consideration other community revitalization and affordable housing programs and initiatives. One commenter made this suggestion. The commenter was particularly concerned about the potential impacts of the ACD Demonstration on the program for the disposition of HUD-owned single family assets in asset control areas authorized by section 602 of the FY 1999 HUD Appropriations Act.

HUD Response. HUD agrees and has revised the ACD Demonstration in response to the concerns expressed by the commenter. Specifically, the ACD Demonstration will not include any mortgages secured by a property located within an asset control area.

Comment: Objection to use of BPO in calculating loan to value ratio. Several commenters objected to the use of a BPO in calculating the loan to value ratio of the defaulted mortgage. The commenters suggested that HUD reimburse mortgagees for the cost of the BPO, or permit the use of an Automated Valuation Model (AVM) analysis to determine the value of the property.

HUD Response. BPOs are not used to calculate the loan to value ratios to determine eligibility for the ACD

Demonstration. Loan to value ratios will be determined using the original appraisal or, if none is available, the original principal balance of the mortgage. However, BPOs will be required for all loans for which a claim is submitted, and made available to bidders qualifying for participation in the joint venture. Participating mortgagees will be reimbursed for BPOs on all loans for which a claim is submitted and paid.

Comment: FICO score should not be used in determining loan eligibility. One commenter suggested that HUD eliminate some of the specific loan eligibility criteria during the demonstration period, and specifically suggested the removal of the FICO score requirement.

HUD Response. HUD will not use the FICO score eligibility criterion during this demonstration period. The FICO score requirement is being removed both in response to the public comments and because the requirement overlapped with other eligibility criteria.

Comment: Loans should be in default for longer than three months to qualify for the ACD process. Several commenters suggested that HUD extend the three-month period that a loan must be default to qualify for payment of an accelerated claim.

HUD Response. In response to these comments, this notice clarifies that HUD will not pay an accelerated claim until an eligible mortgage is in default for at least four full monthly installments (*i.e.*, four full mortgage payments are due and unpaid). Further, HUD will also establish a maximum number of missed payments beyond which it will not pay an accelerated claim on a defaulted mortgage. This maximum number of missed payments will vary depending on the location of the underlying property, and will be based on the foreclosure timelines for the various states located within the jurisdictions of the Atlanta and Philadelphia HOCs. The schedule of maximum missed mortgage payments will be provided to mortgagees prior to their agreement to participate in the ACD Demonstration.

Comment: Accelerated claim amount should be based on the mortgage note interest rate. Several commenters wrote that HUD should base the amount of the accelerated claim on the mortgage note rate of interest (rather than on the debenture rate). The commenters also suggested that the amount of the claim be calculated from the date of the last paid installment rather than from the date of default.

HUD Response. HUD is statutorily required to pay insurance claims based

on the debenture rate from the date of default.

Comment: Submission of a Mortgage Insurance Certificate (MIC) should not be required for payment of an accelerated claim. A few commenters opposed requiring the submission of a paper MIC as part of the claim submission process.

HUD Response. HUD has eliminated the submission of an MIC as a prerequisite for the payment of an accelerated claim. For claim payment under the ACD Demonstration, HUD will rely on representations and information provided by participating mortgagees (including a screen print-out from the FHA Connection portfolio screen verifying mortgagee identification number, property address and current holder) as well as internal information to determine insurance status. Participating mortgagees will, however, be required to submit the MIC with the collateral files (and obtain a duplicate original MIC if the original MIC is missing) following claim submission. Mortgagees will continue to be required to submit the original or a duplicate MIC as a prerequisite to submitting a conveyance or other disposition claim for FHA single family mortgage insurance benefits.

Comment: Factors for consideration in evaluating the success of the ACD Demonstration. Several commenters submitted helpful recommendations regarding the factors HUD should consider in evaluating the success of the ACD Demonstration.

HUD Response. HUD appreciates all of the suggestions made by these commenters. HUD will consider all of these comments in determining the criteria for evaluating the ACD Demonstration. A summary of the results of the evaluation will be published in the **Federal Register**.

IV. Overview of the ACD Demonstration

A. Duration

The ACD Demonstration will have a limited duration. HUD may extend the duration of the demonstration in order to accurately assess its effectiveness.

B. Geographic Scope

The demonstration will initially include mortgages secured by properties located within the jurisdiction of HUD's Philadelphia, Pennsylvania and Atlanta, Georgia HOCs. HUD may decide at a future date to expand the scope of the ACD Demonstration to include one or more additional HOCs.

The Philadelphia HOC serves Connecticut, Delaware, the District of Columbia, Maine, Maryland,

Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, and West Virginia.

The Atlanta HOC serves Alabama, Florida, Georgia, Kentucky, Illinois, Indiana, Mississippi, North Carolina, South Carolina, and Tennessee, as well as the Caribbean.

C. Participating Mortgagees

Mortgagee participation in the ACD Demonstration is voluntary. HUD will select up to 9 eligible mortgagees to participate in the ACD Demonstration. In order to be selected for participation in the ACD Demonstration, a mortgagee must satisfy all of the following criteria:

1. *Number of serviced loans.* The mortgagee must currently service in excess of 20,000 mortgage loans secured by properties that are located within the jurisdiction of the Philadelphia or Atlanta HOCs.

2. *Loss mitigation performance.* The mortgagee must be qualified in the top tier of the FHA Tiering System, which ranks mortgagees in loss mitigation use. The FHA Tiering System was developed by HUD's National Servicing and Loss Mitigation Center and is subject to future refinement.

3. *Computer system capabilities.* The mortgagee must have the technical capability to interface with the FHA Single Family Claims system, through the internet (using the FHA Connection System) and using Electronic Data Interchange (EDI) technology. In addition, the mortgagee must have the technical capability to interface with any other computer systems utilized by FHA or its contractors pertaining to the ACD Demonstration.

4. *Use of the Freddie Mac Early Indicator Risk Scoring System.* The mortgagee must have the ability to run risk scoring models using the Freddie Mac Early Indicator Risk Scoring software program.

5. *Other criteria.* The mortgagee will be required to meet any additional criteria that HUD may establish regarding the eligibility of mortgagees for participation in the ACD Demonstration.

D. Eligible Loans

Only certain defaulted FHA-insured loans are eligible for the accelerated claim payment process. To be eligible for payment of an accelerated claim, the defaulted mortgage must meet the following criteria:

1. FHA Insurance

(a) The mortgage is an FHA-insured single family mortgage loan on a one-to four-unit home.

(b) The mortgage loan is an actively insured by FHA under either section 203(b) or 234 of the National Housing Act (12 U.S.C. 1709(b) and 1715y).

(c) The FHA endorsement date of the mortgage is prior to February 5, 2002.

(d) There is no pending or paid partial FHA mortgage insurance claim in connection with the mortgage.

2. Loan Status

(a) The mortgage loan has an unpaid principal balance of no less than \$20,000.

(b) The mortgage must be in default for at least four full monthly installments (*i.e.*, four full mortgage payments are due and unpaid). However, the number of missed monthly installments on the mortgage as of the provisional approval date may not exceed the maximum number allowed by HUD for the jurisdiction in which the property securing the mortgage is located.

(c) The mortgage has a loan to value ratio of 85 percent or greater. The loan to value ratio represents the relationship between the amount of the mortgage loan and the value of the real estate. The loan to value ratio is to be determined using the original appraisal or, if none is available, the original principal balance of the mortgage loan.

(d) The mortgage must have received a score of D, E, or F on the Freddie Mac Early Indicator Risk Scoring software system.

(e) To the knowledge of the participating mortgagee, the mortgage loan is not subject to an Indemnification Agreement as of the provisional claim approval date.

4. Property Securing Mortgage

(a) The mortgage must be secured by a property located within the jurisdiction of HUD's Philadelphia, Pennsylvania or Atlanta, Georgia HOCs. However, the property must not be located in an asset control area designated under section 204(h) of the National Housing Act as added by section 602 of the FY 1999 HUD Appropriations Act.

(b) The mortgage must not be secured by a property that has been seized by the U.S. Department of Justice or otherwise subject to a seizure order in connection with a drug-related case.

(c) As of the provisional claim approval date, the cost of any required repairs to the property must be less than 10% of the property's value.

5. Foreclosure

(a) No foreclosure sale of the property has been scheduled within the sixty (60) day period after the claim date, there

has been no foreclosure sale or pre-foreclosure sale, and no deed-in-lieu of foreclosure has been accepted.

(b) If the first step required under applicable law to initiate a foreclosure of the property has been taken, the foreclosure action has not been contested.

6. Other Eligibility Requirements

The mortgage must meet any additional criteria that HUD may establish regarding the eligibility of defaulted mortgage loans for an accelerated claim under the ACD Demonstration.

E. Risk Scoring

At the 90th day of delinquency, mortgagees participating in the ACD Demonstration will be required to begin running scoring models using the Freddie Mac Early Indicator Risk Scoring System to confirm the eligibility of the mortgage for payment of an accelerated claim. Provided that the mortgage meets the eligibility criteria described in paragraph. IV.D. of this notice, participating mortgagees will have the option to submit an accelerated claim.

F. Disposition Methods

HUD will use one or both of the following disposition methods under the ACD Demonstration. HUD, in its sole discretion, will determine which of the two disposition methods to use for particular mortgages under the demonstration.

1. *Joint Venture.* The joint venture method will be the primary disposition method used under the ACD Demonstration. Under this disposition method, HUD will sell a majority interest in a public/private joint venture formed to acquire, service and dispose of the mortgage loans submitted under the ACD Demonstration. The private sector entity will be selected through a competitive bid process and will serve as the Manager of the joint venture. The joint venture Manager will receive a percentage of the net cashflow from the joint venture derived from the eligible mortgages submitted by mortgagees participating in the ACD Demonstration. The private sector joint venture Manager will be responsible for maximizing the value of each mortgage loan asset through re-performance, refinancing, workout, foreclosure and/or disposition. HUD expects the joint venture Manager to conduct its operations in a manner consistent with applicable FHA and industry standards for integrity and avoidance of predatory lending practices.

Private sector firms that pre-qualify will be given the opportunity to bid at a competitive auction to be the joint venture Manager. To qualify, bidders must be adequately capitalized and must meet other FHA standards for loan servicing, experience and integrity. Before bidding, investors will be required to make a security deposit with HUD.

2. *Other disposition methods may be used.* HUD may also consider using the special servicing disposition method or other disposition methods under later subsequent demonstrations. The ACD Demonstration will not initially use this method, and HUD may decide not to use this disposition method at all during the course of the demonstration. Under this disposition method, servicing of the mortgage may be transferred to a special servicer. The special servicer may provide assistance to HUD in undertaking one or more of the following actions: (a) Foreclosing and selling the properties; (b) accumulating mortgages for a whole loan sale; and/or (c) accumulating mortgages for disposition in a securitization.

V. Evaluating the Success of the ACD Demonstration

At the conclusion of the ACD Demonstration, HUD will assess its success and determine whether to implement the ACD process on a permanent basis throughout the country. In conducting this evaluation, HUD will assess such factors as whether the use of the ACD process will: (1) reduce loss rates; (2) reduce the cost and time associated with claim dispositions; and (3) enhance the ability of HUD to assess risk and manage the FHA mortgage insurance fund.

VI. Findings and Certifications

Environmental Impact

A Finding of No Significant Impact with respect to the environment was prepared for the February 5, 2002 notice in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(c) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332). That Finding of No Significant Impact remains applicable to this notice and is available for public inspection between the hours of 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC.

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating policies that have federalism implications and either impose substantial direct compliance costs on State and local governments

and are not required by statute, or preempt State law, unless the relevant requirements of section 6 of the Executive Order are met. This notice does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law

within the meaning of the Executive Order.

Dated: October 23, 2002.

Sean Cassidy,

General Deputy Assistant Secretary for Housing-Federal Housing Commissioner.

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