COST EFFECTIVENESS OF MORTGAGE FORECLOSURE PREVENTION

SUMMARY OF FINDINGS

FAMILY HOUSING FUND
MINNEAPOLIS, MINNESOTA

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The Family Housing Fund is a nonprofit organization whose mission is to preserve and expand quality affordable housing for families with low and moderate incomes in the seven county metropolitan area of Minneapolis and Saint Paul, Minnesota. The Fund supports the cities of Minneapolis and Saint Paul, the Metropolitan Council, and the Minnesota Housing Finance Agency in their efforts to preserve and expand the region's supply of affordable housing. The Fund was created in 1980 by the cities of Minneapolis and Saint Paul and The McKnight Foundation to address affordable housing needs in the two cities. Over the past several years, the Fund has broadened its focus to promote affordable housing also in the suburbs.

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ABOUT THIS STUDY

Low income families and individuals that become home owners are particularly vulnerable when faced with unforeseen crises. Their low incomes limit the number of options they can pursue when dealing with illness, unemployment, divorce or separation. Moreover, these home owners often lack the resources to pay for ongoing home maintenance costs and emergency repairs. These are all, in fact, the leading reasons stated by home owners for becoming delinquent on their mortgage payments.

The Mortgage Foreclosure Prevention Program (MFPP) in Minneapolis and Saint Paul was set up to help low- and moderate-income home owners resolve financial and personal problems that have put them at risk of losing their home through foreclosure. The goals of the program are to stabilize households, stabilize neighborhoods and preserve public and private resources. Current funders of the program include the Northwest Area Foundation, Honeywell Foundation, First Bank System Foundation, the cities of Minneapolis and Saint Paul, the Minnesota Housing Finance Agency and the Family Housing Fund of Minneapolis and Saint Paul. The Family Housing Fund administers the overall program in the Twin Cities, helping to coordinate services, training and fund raising activities. The Wilder Foundation's Research Center set up and maintains a data base and monitors the program's activity.

The Mortgage Foreclosure Prevention Program was modeled after a pilot program created by the Northside Residents Redevelopment Council (NRRC) in 1989 to respond to the needs of north Minneapolis residents. The expanded program that operates today began in July of 1991, with initial funding from the Northwest Area Foundation. The program was shaped by the day-to-day experiences of NRRC and the Saint Paul Housing Information Office (HIO) in dealing with distressed home owners as well as the experiences of the cities of Minneapolis and Saint Paul in dealing with vacant homes and neighborhood deterioration. With the 1993 addition of Twin Cities Habitat for Humanity as a service provider, the program expanded the geographic area it serves. Habitat has brought its own experiences in home ownership services and counseling to the overall program.

With three and a half years of successful experiences helping home owners avert foreclosure by providing counseling and, in some cases, financial assistance, the Family Housing Fund initiated an assessment of the cost effectiveness of foreclosure prevention. The study had two main objectives:

Primary Objective: To assess the cost effectiveness of mortgage foreclosure prevention by determining the cost of foreclosure to the various stakeholders involved in the process and comparing those costs to the cost of foreclosure counseling and financial assistance.

Secondary Objective: To identify public policy and procedural issues that exacerbate foreclosure costs and identify good practices that mitigate losses for all parties involved, including the home owner.

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SUMMARY OF FINDINGS

Assessing the cost effectiveness of mortgage foreclosure prevention involved two steps. The first step was to identify the cost of delivering the counseling and providing financial assistance to homeowners who were in default and at risk of losing their homes. The second step involved identifying the stakeholders affected by foreclosure and the losses they incur as a result of foreclosure.

THE MORTGAGE FORECLOSURE PREVENTION PROGRAM

To carry out the first step, the Family Housing Fund examined the operating costs and experiences of two of the agencies that provide foreclosure prevention services in Minneapolis and Saint Paul, the Northside Residents Redevelopment Council (NRRC) and the Saint Paul Housing Information Office (HIO).

Since July 1, 1991, when NRRC and the Saint Paul HIO began serving homeowners through the Mortgage Foreclosure Prevention Program:

- Over 800 homeowners in Minneapolis and Saint Paul received foreclosure prevention counseling and/or emergency assistance.

- Almost 60 percent of the homeowners (487) who received counseling and/or emergency assistance had their mortgages reinstated.

- Fifty percent of the homeowners (244) whose mortgages were reinstated were still current in their mortgage payments two years after coming to the program.[1]

- With total prevention program expenditures at $1.6 million, the cost of reinstating a mortgage averages $3,300 per homeowner served by the program.[2] This is the cost of providing both the counseling <u>and</u> financial assistance.

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[1] As MFP program staff continue to gain experience identifying homeowners who are likely to succeed when receiving counseling and financial assistance, the proportion of homeowners who avoid foreclosure and remain current will likely increase.

[2] The cost of reinstating a mortgage is a conservative estimate obtained by dividing the full program operating cost of $1.6 million by the 487 homeowners who had their mortgage reinstated between July 1, 1991 and March 31, 1995.

FORECLOSURE COSTS

In carrying out the second step, the following stakeholders were identified:

STAKEHOLDERS	FORECLOSURE IMPLICATIONS
Homeowners	Loss of stable housing. Legal, financial and tax consequences.
Public and Private Lenders	Unreimbursed expenses, losses beyond insured portion of loans.
Loan Servicers	Loss of income stream from servicing fees.
Mortgage Insurers. Public: FHA and VA. Private: MGIC, GE, United Guaranty, CMAC.	Claims paid to lenders or servicers.
Secondary Market: Fannie Mae, Freddie Mac*	Losses/expenses beyond insurance proceeds.
Cities of Minneapolis and Saint Paul	Costs to cities if property becomes vacant and boarded. Erosion of property tax base.
Neighborhoods	Negative neighborhood image and resulting decline in property values.

*Ginnie Mae is not included since foreclosure-related losses involving government-insured loans are absorbed by the issuer and servicer. Ginnie Mae takes a loss only if the issuer or servicer goes out of business.

Two scenarios were developed to quantify foreclosure losses to the stakeholders and to compare the losses to the cost of providing foreclosure prevention. These scenarios reflect two combinations of circumstances that can be present when a foreclosure takes place. It must be noted that the course a foreclosure takes and the magnitude of the losses are affected by a multitude of factors. These include, among others:

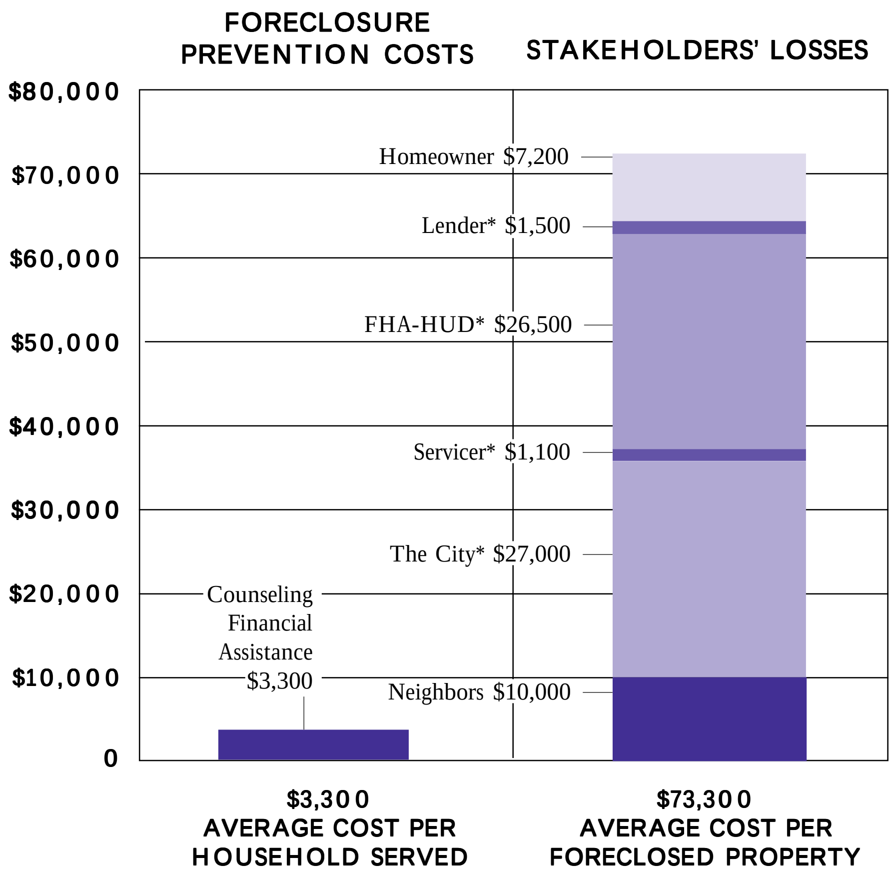
- interest rates that may give the homeowner the option to refinance;
- a strong or weak real estate market in the area where the property is located, which affects the sale price of the home;
- the type of mortgage insurance (FHA, VA or private) that determines how much of the losses is recovered;
- whether the property is sold quickly or is abandoned, boarded and perhaps eventually torn down.

The first scenario involves a house financed with an FHA mortgage that goes into foreclosure, the property becomes vacant and boarded and the city eventually acquires it, rehabilitates it and sells it. Under this scenario, the combined losses to the affected stakeholders are estimated at $73,300. This compares to $3,300 per homeowner served by the Mortgage Foreclosure Prevention Program.

SCENARIO I

Foreclosure involving an FHA-insured mortgage. The house becomes vacant and boarded. The city rehabs the house for resale.

*Losses listed in Scenario I for lenders, servicers, FHA-HUD and the city represent dollar losses directly related to the foreclosed property, unrecovered rehab subsidies and lost tax revenues. They do not include administrative costs, such costs as staffing of servicers' collection department, public health inspections and condemnation process, the cost of police calls or city staff time spent coordinating rehabilitation work.

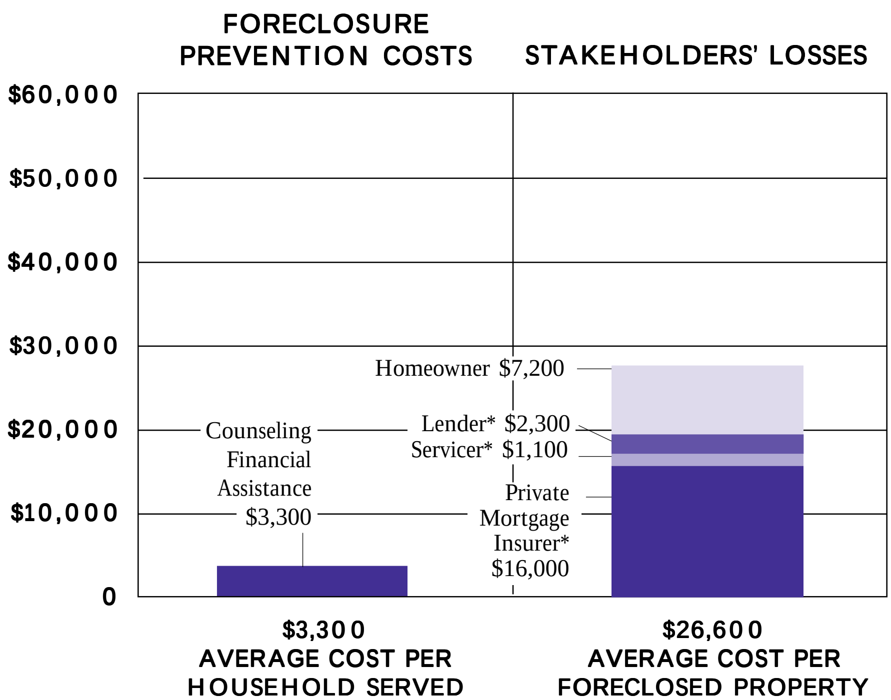


The loss figures in Scenario I and II represent average losses experienced by the typical homeowners served by the foreclosure prevention program, lenders and servicers, mortgage insurers and neighborhoods. Losses to the city represent the lower end of the range of losses that the city typically experiences.[3] Losses to lenders are lower in Scenario I than in Scenario II because FHA mortgage insurance provides more comprehensive coverage than private mortgage insurance.

[3] Refer to Section II of the full report for more detail on how the losses for individual stakeholders were determined.

In the second scenario, losses reflect a foreclosure involving a privately insured conventional mortgage; the property is put on the market, sold and some of the foreclosure expenses recovered. The stakeholders affected in this foreclosure scenario would collectively lose an estimated $26,600. This loss is still substantially higher than the $3,300 that the MFP program spends per homeowner served.

SCENARIO II
Foreclosure involving privately insured mortgage. House sold. Some foreclosure costs recovered.



*Losses listed in Scenario II for lenders, servicers and private mortgage insurers represent dollar losses directly related to the foreclosed property. They do not include administrative costs, such as paying for collections and foreclosure staff.

In addition to the two types of scenarios described above, foreclosures involving mortgage loans originated under some of the affordable home ownership programs can result in high losses for the lender. These loans are not insured or sold to investors because they do not meet conventional underwriting criteria. They are held in the lender's loan portfolio. If one of these loans goes into foreclosure, the lender absorbs the full loss.

COST EFFECTIVENESS OF MORTGAGE FORECLOSURE PREVENTION

The cost effectiveness of providing mortgage foreclosure prevention services becomes apparent when comparing total foreclosure prevention program costs to averted losses that would have been incurred by just one stakeholder--mortgage insurers.

- Total program costs experienced by NRRC and Saint Paul HIO from July 1, 1991, through March 31, 1995, amounted to **$1.6 million**. During this period the two agencies helped 487 homeowners reinstate their mortgages.

- Of the 487 mortgages reinstated, 432 (89%) were FHA, VA or privately insured. Averted losses to insurers of these mortgages alone amount to an estimated **$9.6 million.**[4]

- Estimated **averted losses drop to $5.4 million** when accounting for the fact that after two years, the number of homeowners still current on their mortgages had dropped to 244 (50 percent of total mortgages reinstated). The savings are still significant when compared to the $1.6 million cost of operating the foreclosure prevention program at NRRC and Saint Paul HIO.

THE MORTGAGE INDUSTRY'S RESPONSE TO FORECLOSURE

Delinquency and foreclosure rates have steadily increased in the last ten years:

- Delinquency rates for all loans, nationwide, increased from 3.9 percent in 1984 to 5.86 percent in 1994.

- The delinquency rate on FHA-insured loans, mostly used by low- and moderate-income home buyers, increased from 6.97 percent in 1984 to 7.57 percent in 1994.

- In Minnesota, data provided by the local HUD office indicates that the number of foreclosed properties in their inventory went from just under 700 in 1984 to almost 3,000 in 1994, an increase of over 300 percent.

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[4] Estimated savings from averted foreclosure losses are underestimated on two counts: a) they represent prevented losses that would have been incurred by **only one stakeholder** (the mortgage insurer); and b) the prevented dollar loss represents **only 89 percent of total foreclosures prevented** (i.e., for reinstated mortgages that had FHA, VA or conventional mortgage insurance).

In response to these trends, mortgage insurers and secondary market entities are putting in place a variety of approaches designed to mitigate their losses and spare homeowners some of the consequences of mortgage foreclosure. Examples of these approaches include:

- Mortgage Guaranty Insurance Corporation (MGIC) holds workshops for loan servicers and recommends the use of loan workouts, such as forbearance plans, loan modifications, pre-foreclosure sales and deeds in lieu of foreclosure.[5]

- PMI Mortgage Insurance and Consumer Credit Counseling Services (CCCS) have recently set up a partnership and a process to deliver early delinquency counseling to homeowners who miss payments on mortgage loans insured by PMI.

- The Federal Housing Administration (FHA) has introduced a pre-foreclosure sale program nationwide, after testing the program's effectiveness in mitigating losses on FHA-insured mortgages in five cities.

- The Veterans Administration uses a "refunding" strategy, which allows the VA to buy the loan back from the lender or investor in order to make loan modifications that help the homeowner handle the monthly payments. The VA also uses the "compromise sale" approach, whereby the loss is shared by the VA, lender/servicer and investor.

- In July 1995 the Federal Home Loan Mortgage Corporation (Freddie Mac) announced its Workout Incentive Program. Under this program, Freddie Mac pays servicers a fee to encourage loan modifications, pre-foreclosure sales and deeds in lieu of foreclosure.

- In June 1995 the Federal National Mortgage Association (Fannie Mae) issued new and amended guidelines for home buyer education and delinquency counseling for servicers of Fannie 97 and Start-Up Mortgages originated under Fannie Mae's Community Home Buyer's Program (Announcement 95-11).

The primary force driving the above procedures is loss mitigation for the mortgage insurer and the secondary market entities. Unlike the Mortgage Foreclosure Prevention Program, very little emphasis, if any, is placed on stabilizing the homeowner's housing and financial situation or on stabilizing neighborhoods.

[5] A forebearance plan allows a borrower to reduce or suspend monthly payments for a specific period of time. A loan modification involves changes to the original loan terms. A pre-foreclosure sale or "short sale" occurs when the insurer and investor agree to accept an amount for the sale of the mortgaged property smaller than the amount owed on the mortgage. In a deed in lieu of foreclosure the borrower voluntarily conveys the title to the property to the lender in exchange for release from the debt.

ISSUES RAISED DURING THE STUDY THAT AFFECT FORECLOSURE COSTS

A number of issues related to the foreclosure process or mortgage insurance programs surfaced in the course of the study. These were:

- Minnesota's lengthy redemption period. The lengthy redemption period (six months or 12 months depending on the age of the mortgage, home equity and property size) increases the opportunity for the property to deteriorate. This, in turn, may result in increases in repair costs and/or property devaluation.

- Climate of anonymity created by out-of-town loan servicing. Out-of-town servicers may not be acquainted with local community resources and counseling programs that can assist borrowers facing financial problems and the possibility of foreclosure. Furthermore, out-of-town servicers may also lack knowledge of and commitment to the community where the borrower lives.

- Barriers to loan modifications resulting from pooling and packaging mortgage loans into securities. Mortgages that are pooled and packaged into securities cannot be easily restructured or modified. This hampers the lender/servicer's ability to modify the loan's terms when a borrower faces financial difficulties. Freddie Mac's Workout Incentive Program and Fannie Mae's recently issued guidelines are steps toward providing more flexibility in this area.

- Misperception of FHA insurance coverage. Collections staff often have the misperception that if an FHA-insured loan goes into foreclosure, FHA will pay 100 percent of all losses. With this in mind, they often tend to give less attention to defaults on FHA loans than to defaults on VA and conventional loans. Servicers do incur losses related to FHA loan foreclosures related to interest payments they must continue to make to Ginnie Mae.

- Cities' and neighborhoods' late entrance in the foreclosure process. At present, the cities of Minneapolis and Saint Paul are unable to intervene, acquire the property and restore it to market standards until the foreclosure process is completed. This delay can result in properties deteriorating to the point where it is no longer economically feasible to restore them. Cities and neighborhood organizations have expressed the need to develop approaches that would allow them to intervene at an earlier time.

Through this study, the Family Housing Fund accomplished its objective to assess the cost effectiveness of the Mortgage Foreclosure Prevention Program. It determined that when a foreclosure occurs, the collective losses incurred by the many affected parties are many times the cost of working with a homeowner to prevent that foreclosure.

In the course of the study, some of the persons interviewed brought up foreclosure process issues and practices that need to be examined further. As the study findings are disseminated, the Family Housing Fund will invite the stakeholders identified in the report, public officials, policy makers and other appropriate groups to respond to the findings and issues raised and to help develop an action agenda that will provide continued support to foreclosure prevention.

Additional information or copies of the full report may be obtained by calling the Family Housing Fund at (612) 375-9644.

Questions regarding the individual program sites in the Twin Cities may be directed at:

CITY OF SAINT PAUL

SAINT PAUL HOUSING INFORMATION OFFICE (HIO)
(651) 266-6000
Serves the entire City of Saint Paul.

CITY OF MINNEAPOLIS

The City of Minneapolis service areas are divided by a boundary line drawn by Interstate 394, Wayzata Boulevard and Hennepin Avenue.

TWIN CITIES HABITAT FOR HUMANITY
(612) 378-2331
Serves the Minneapolis area south of the dividing line.

NORTHSIDE RESIDENTS REDEVELOPMENT COUNCIL (NRRC)
(612) 335-5849
Serves the Minneapolis area north of the dividing line.