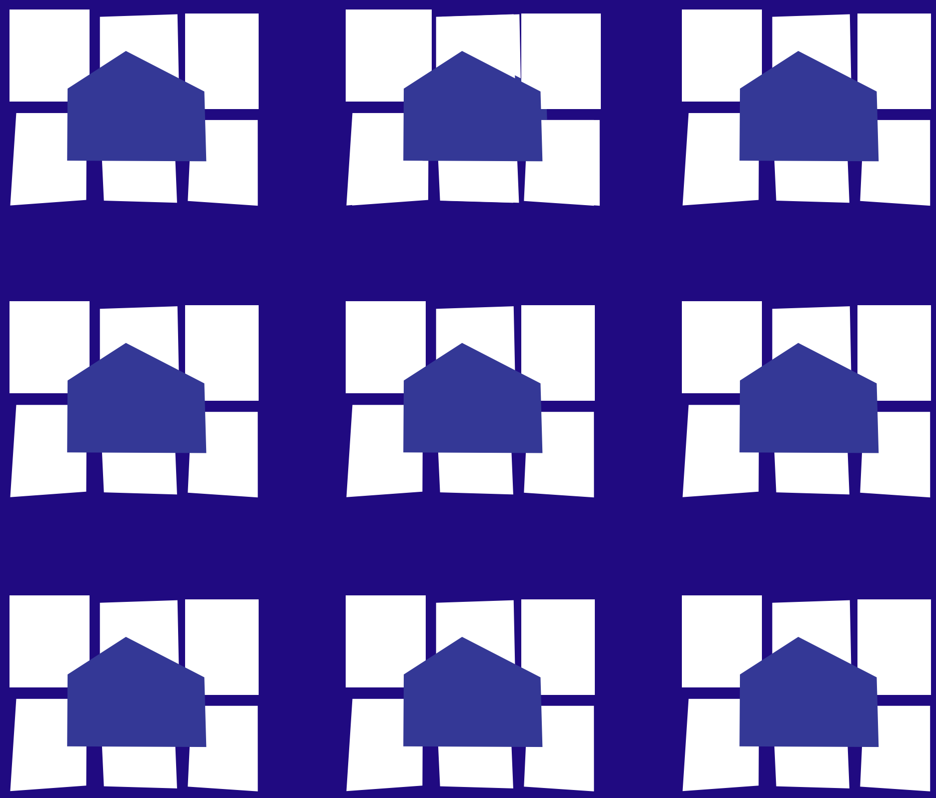

MORTGAGE FORECLOSURE PREVENTION: PROGRAM AND TRENDS

FAMILY HOUSING FUND
MINNEAPOLIS, MINNESOTA

December 1998

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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This study was funded by the Northwest Area Foundation and conducted by Ana Moreno, housing consultant.

ABOUT THIS REPORT

In November 1995 the Family Housing Fund published a study titled *Cost Effectiveness of Mortgage Foreclosure Prevention*. This study examined the costs of foreclosure prevention counseling and of providing financial assistance to homeowners at risk of losing their homes through foreclosure. It also documented the size of the losses that homeowners, lenders, servicers, mortgage insurers, cities and neighborhoods incur when a foreclosure takes place. The report concluded that foreclosure prevention activities are highly cost effective. The cost of foreclosure losses outweighs the cost of foreclosure prevention counseling and financial assistance to homeowners facing foreclosure.

In 1998, the Family Housing Fund updated and expanded its earlier research on mortgage foreclosure prevention. This report summarizes the results of the new effort. It includes the following topics:

- Accomplishments of the Mortgage Foreclosure Prevention Program during its first six years in Minneapolis and Saint Paul, Minnesota.
- Local and national strategies to increase home ownership rates.
- The mortgage industry's strategies to manage the increasing number of mortgage defaults.
- Various foreclosure prevention counseling programs around the country.
- The cost effectiveness of other national foreclosure prevention approaches.
- Recommendations that address issues regarding foreclosure prevention counseling.

CONTENTS

SUMMARY

A review of the accomplishments of the Mortgage Foreclosure Prevention Program in Minneapolis and Saint Paul, Minnesota, and a look at recent developments in home ownership and foreclosure prevention around the country resulted in the following findings and recommendations.

FINDINGS

The Mortgage Foreclosure Prevention Program (MFP Program)

- In its first six years of operation, the MFP Program provided intensive counseling to almost 1,700 homeowners and demonstrated success by helping over half of them reinstate their mortgages.

- Foreclosure prevention counseling remains a cost-effective and viable way to stabilize homeowners at risk of losing their home through foreclosure. The cost of the counseling and financial assistance to homeowners is considerably less than the losses experienced by mortgage insurers.

- It costs the MFP Program, on average, $2,800 to help a homeowner reinstate a mortgage. This compares to average foreclosure losses to mortgage insurers in the range of $10,000 to $28,000, depending on the type of mortgage insurance and location of the home.

- The mortgages reinstated by the MFP Program at the three Minneapolis/Saint Paul sites saved mortgage insurers an estimated $7.6 million in foreclosure losses during the first six years of program operation. Total program costs, including financial assistance to the homeowners, amounted to $2.5 million during the same period.

Foreclosure Trends and Mortgage Industry Responses

- Nationally, mortgage delinquency rates declined in the last ten years, from 4.97 percent in 1987 to 4.31 percent in 1997. However, the lower rate reflects primarily the decline in the delinquency rate of conventional loans. Delinquency rates for FHA and VA loans have increased steadily.

- The mortgage industry has responded in two ways to prevent delinquencies from advancing to foreclosure and turning into major losses: it has promoted the use of loss mitigation tools and it has developed statistical models to predict the probability of foreclosures.

- In 1997 the average FHA foreclosure loss nationally was $28,000. In Minnesota, the number of foreclosures of FHA-insured mortgages doubled during the same period. Overall, this appears to indicate that FHA loss mitigation tools have not been immediately effective in preventing foreclosures or the losses associated with them.

- Contrary to national trends involving VA loans, the number of foreclosures and the average foreclosure loss experienced by the VA regional loan center located in Minnesota have declined. The average foreclosure loss on VA loans reported by the Minnesota office was just over $10,600 in April 1998. These positive results can be traced to two key ingredients: early delinquency intervention and working closely with homeowners and servicers to explore loan workouts.

- The Twin Cities office of United Guaranty Corporation reported an increase in the average foreclosure claim for conventional mortgages, from $16,000 in 1995 to $17,300 in 1997. It is not clear, however, how the use of loss mitigation tools is affecting overall foreclosure losses involving conventional mortgages.

- The mortgage industry has also started to recognize the importance of working closely with homeowners when mortgage defaults occur. This recognition has prompted mortgage loan servicers to establish loss mitigation units and to create partnerships between the industry and counseling groups.

- The lack of systematic, published evaluations on the use of loss mitigation tools makes it difficult at this time to assess the tools' effectiveness in reducing losses to mortgage insurers and preserving home ownership.

- Despite the lack of published evaluations, there are signs that the industry is already modifying the loss mitigation approaches that were initially put in place. G.E. Capital Mortgage Insurance and Norwest Mortgage have modified their loss mitigation and collections process and reported reductions in their foreclosure rates.

RECOMMENDATIONS

Some issues are emerging that will need to be addressed to ensure the continued success of foreclosure prevention programs in assisting homeowners at risk of foreclosure and, in so doing, helping to stabilize neighborhoods and saving public and private dollars. Recommendations to address emerging issues include:

- Mortgage industry players using loss mitigation tools need to share the results of any evaluation work that has been done. This will allow investors, insurers, servicers and counseling agencies to work together and identify strategies that should be adopted to help homeowners stay in their homes and reduce foreclosure losses.

- The mortgage industry, especially investors and public and private insurers, needs to step up to the plate and join state and local governments, the philanthropic community and nonprofit organizations in providing adequate funding to foreclosure prevention counseling programs, thus ensuring their long-term viability.

- If true loss mitigation and foreclosure prevention are to be realized, mortgage loan servicers and foreclosure prevention counselors will need to work together and bring their individual strengths to the table: the servicers' knowledge on how to implement the loss mitigation tools and the counselors' skills on how to counsel homeowners and develop comprehensive financial plans with them.

- Programs that promote home ownership for households with very low incomes need to be linked to the full continuum of home ownership support services—pre-purchase education and counseling, financial assistance, post-purchase support, and delinquency and foreclosure prevention.

- Counselors and the mortgage industry need to monitor the trend in subprime lending which is marketed to consumers as a way to consolidate mortgage loan balances and other credit debt. They will need to work on resolving the negative impacts that these refinancing tools may have on homeowners.

THE MORTGAGE FORECLOSURE PREVENTION PROGRAM

The Mortgage Foreclosure Prevention Program (MFP Program) completed six years of operation in June 1997. It started at two sites in Minneapolis and Saint Paul, Minnesota, in 1991, with initial funding from the Northwest Area Foundation and administrative support from the Family Housing Fund. Data collection and analysis have been conducted since the beginning of the program by the Wilder Research Center, the research arm of the Amherst H. Wilder Foundation.

In 1992 the Minneapolis/Saint Paul program was expanded with the establishment of a third site in Minneapolis. At the same time, and with Northwest Area Foundation support, the program was replicated at four additional locations: two sites in the cities of Portland and Hillsboro, Oregon; one site in Coeur D'Alene, Idaho; and one site in Cedar Rapids, Iowa, bringing the total number of MFP Program sites to seven.

The program has three objectives:

- To stabilize homeowners at risk of losing their home to foreclosure.
- To stabilize neighborhoods by preventing vacant and boarded houses.
- To save public and private dollars by preventing foreclosure-related losses.

The program offers a variety of services: in-depth counseling to address financial and personal issues that may affect a homeowner's ability to make the mortgage payments, intervention and advocacy with mortgage servicers or lenders, financial assistance in some cases, referrals to other community services, and assistance in accessing funds from other programs that can contribute to the homeowner's financial stability.

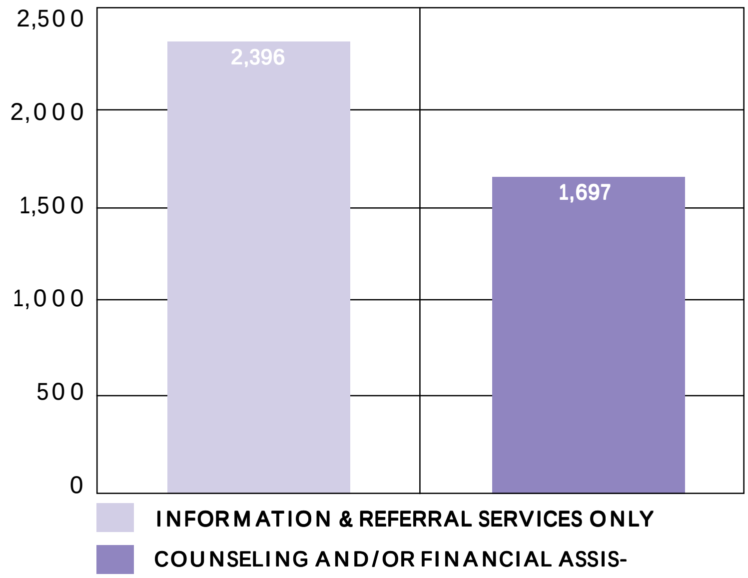
Following are some key statistics that paint a picture of the program's first six years. The information reflects the program operation at the three sites in Minneapolis and Saint Paul: the Northside Residents Redevelopment Council, Twin Cities Habitat for Humanity and the Saint Paul Housing Information Office. These program sites serve North Minneapolis, South Minneapolis and the City of Saint Paul, Minnesota, respectively.

HOMEOWNERS SERVED

- Between July 1, 1991, and June 30, 1997, the program served over 4,000 homeowners in Minneapolis and Saint Paul. Almost 1,700 of them received intensive counseling and, in some cases, financial assistance.

- Eighty percent of the homeowners served were employed when they came to the program. On average, they had an income of $22,800 and had been in their homes for six years.

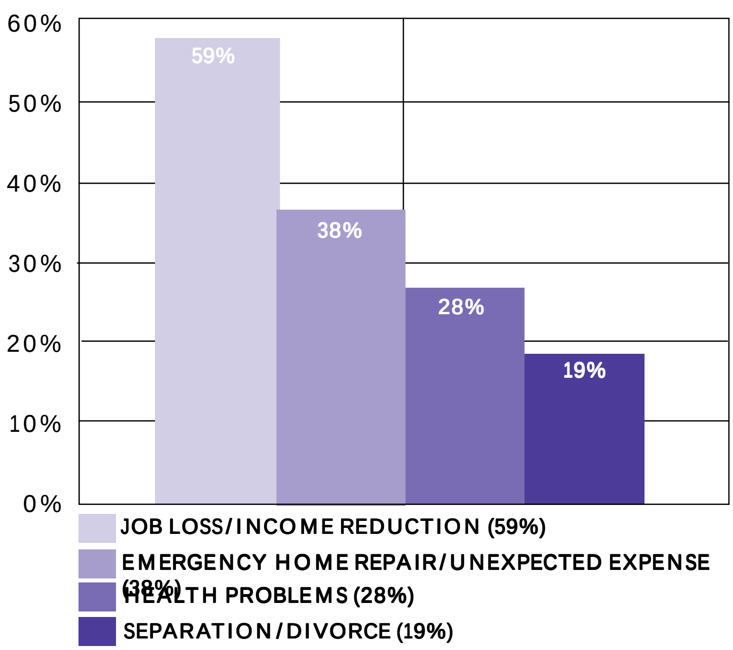
MORTGAGE FORECLOSURE PREVENTION PROGRAM
MINNEAPOLIS AND ST. PAUL, 1991-1997
NUMBER OF HOUSEHOLDS SERVED



- Over two thirds of the homeowners were families with children. Thirty-three percent were single parents.

- About half of the homeowners were white and half were persons of color.

MORTGAGE FORECLOSURE PREVENTION PROGRAM
MINNEAPOLIS AND ST. PAUL, 1991-1997
PRIMARY REASONS FOR DEFAULT*



*HOMEOWNERS MAY CITE MULTIPLE REASONS

- Close to two thirds of the homeowners reported a job loss or income reduction as the primary reason for mortgage default. Emergency home repairs and health-related problems were cited as the second and third reasons that triggered the financial crisis (38 and 28 percent, respectively). Separation and divorce ranked fourth (19 percent).

- On average, homeowners were four months behind with their mortgage payments; the arrears amounted to an average of $2,700.

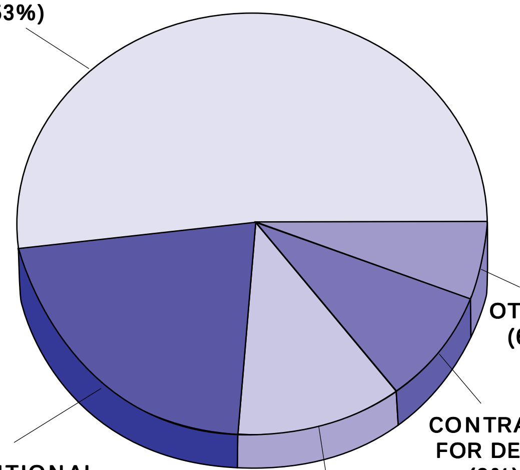
- Of the homeowners served, 53 percent had FHA mortgages, 21 percent had conventional mortgages and 11 percent had VA mortgages. The remaining 15 percent had contracts for deed or other types of mortgage financing.

PROGRAM ACCOMPLISHMENTS

- MFP Program counselors were able to reinstate mortgages and prevent foreclosures for half of the homeowners who received intensive counseling (841).

- The program provided emergency loans that averaged $2,700 to 57 percent of the homeowners who had their mortgages reinstated (483 loans).

MORTGAGE FORECLOSURE PREVENTION PROGRAM
MINNEAPOLIS AND ST. PAUL, 1991-1997
TYPE OF FINANCING

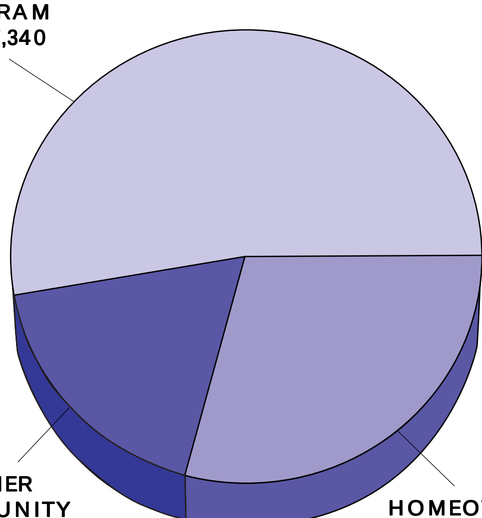


- The program also helped homeowners access other community resources, including rehab or home improvement loans and grants, that amounted to almost $450,000.

- In addition to the program's financial assistance and coordination of other resources, homeowners generally were expected to make a personal contribution toward solving the financial crisis. The total homeowner contribution was just under $700,000.

- The MFP Program prevented foreclosures using a variety of tools. The most common one was a mortgage reinstatement (77 percent). Repayment plans using Chapter 13 were second (nine percent) and forbearance plans were third (eight percent). Mortgage restructuring

MORTGAGE FORECLOSURE PREVENTION PROGRAM
MINNEAPOLIS AND ST. PAUL, 1991-1997
SOURCES OF SUPPORT FOR MORTGAGE REINSTATEMENT



TOTAL SOURCES: $2,440,435

and the HUD Assignment Program (available through April, 1996) also were used.

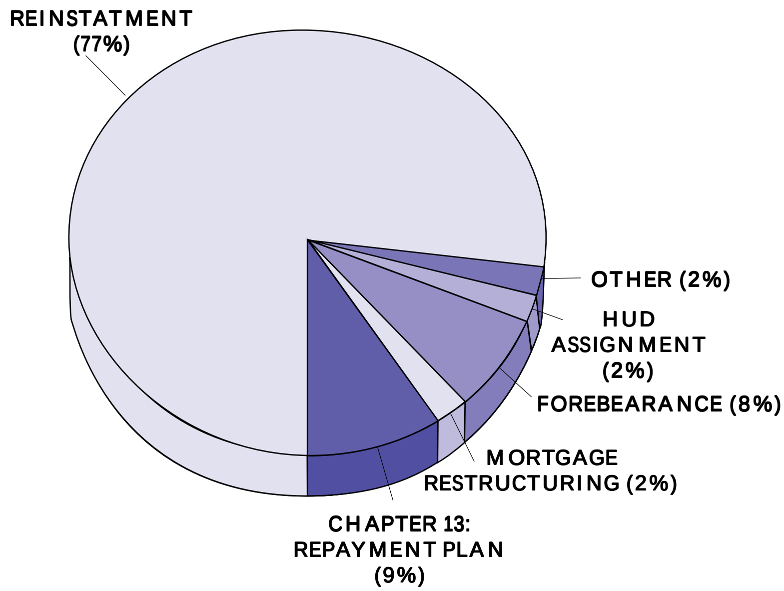
PROGRAM COSTS AND SAVINGS

- Through June 1997 the MFP Program in Minneapolis and Saint Paul cost $2.5 million to operate. This included counseling costs, financial assistance and program administration. This program cost translates into a cost of just over $600 per homeowner served since July 1991.

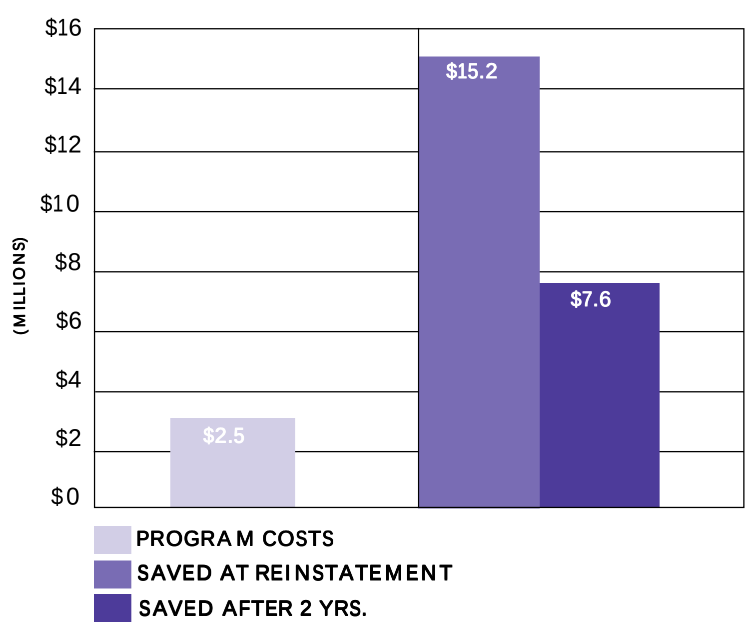
- During its first six years of operation, the MFP Program helped 731 homeowners bring current their FHA, VA and conventional mortgages which were in default. These reinstatements represented an immediate savings of $15.2 million in averted losses to mortgage insurers alone.

- Longer term--two years after reinstatement--50 percent of the reinstated mortgages were still current for a net savings of $7.6 million in averted losses. Savings to mortgage insurers were over three times the cost of operating the program.[1]

MORTGAGE FORECLOSURE PREVENTION PROGRAM
MINNEAPOLIS AND ST. PAUL, 1991-1997
TOOLS USED TO PREVENT FORECLOSURES



MORTGAGE FORECLOSURE PREVENTION PROGRAM
SAVINGS TO MORTGAGE INSURERS, 1991-1997



[1] Averted losses were calculated by multiplying the number of FHA-, VA- and conventionally-insured mortgages that were reinstated times the average foreclosure losses incurred by the three types of mortgage insurers.

RECENT TRENDS IN HOME OWNERSHIP

The last three years have witnessed positive developments in home ownership. The National Home ownership Strategy, launched by HUD in 1995 in partnership with 56 other national housing organizations, set a goal of making home ownership possible for at least eight million new households between 1995 and the year 2000. Underscoring this goal was the need to make home ownership more accessible to persons with low incomes, particularly minority and single-parent households.

Since adoption of this goal, over 4 million additional households nationwide have become homeowners. This translated into an increase in the national home ownership rate, from 64.2 in 1995 to 65.9 percent in the first quarter of 1998, the sharpest rate increase in history.[2] Credit for the dramatic progress towards achieving this goal goes to a variety of national and local initiatives. Most notable among the national efforts are Fannie Mae's trillion dollar, five-year commitment to promoting home ownership and the Neighborhood Reinvestment Corporation's NeighborWorks® Campaign for Home Ownership. The latter set a goal of achieving home ownership for more than 10,000 low- and moderate-income families in five years. The goal was met in a shorter time. Around the country, housing finance agencies, nonprofits through philanthropic organizations, and private lenders have also contributed to the rapid increase in home ownership through a large number of programs.

In Minnesota, for example, the Minnesota Housing Finance Agency, together with local lenders, helps low-income homebuyers through the Entry Cost Homeownership Opportunity (ECHO) Program. This program provides closing costs and down payment assistance, thus removing two major barriers that low-income households face when trying to buy a house. In addition, a number of financial institutions, including Norwest, Firstar, TCF National Bank, U.S. Bank and Marquette provide affordable mortgage programs to homebuyers with low incomes.

However, this success has come with a lesson. Promoting home ownership among low-income and minority populations and making housing financing more accessible are not enough. Those strategies need to go hand in hand with efforts that support homebuyers and help them become and remain successful homeowners. Forms of support include pre-purchase counseling, post-purchase support and, when necessary, foreclosure prevention counseling.

Comprehensive homeowner training in the form of pre-purchase counseling has matured considerably in the last few years. The advent of the American Homeowner Education and Counseling Institute (AHECI) promises to solidify that process even further. In July 1998 AHECI released two key draft documents for comment by the mortgage industry and counseling agencies. One was the "Core Curriculum," which will guide homebuyers through the various steps of home ownership. The other, "Core Certification Standards," is intended to set national standards for homeowner educators and counselors.is intended to set national

[2] *Keynotes*, A Quarterly Newsletter of the National Partners in Homeownership, Volume 10, Second Quarter, 1998.

Why are homeowner support services necessary? Because by definition, economic constraints often steer homebuyers with low incomes to neighborhoods with lower-price and aging housing stock that also may be depreciating in value and needing major repair. Low incomes, often coupled with a lack of personal savings, make these homeowners especially vulnerable to financial crises, such as unexpected house repairs, job loss, health problems, and separation or divorce.

INDUSTRY RESPONSES TO MORTGAGE DELINQUENCIES

At the same time that the mortgage industry, housing nonprofits, community organizations and cities are celebrating the increase in home ownership rates, they are also expressing concern about the increasing number of FHA and VA defaults. Overall mortgage loan delinquency rates have decreased in the last ten years, from 4.97 percent in 1987 to 4.31 in 1997. However, this decrease has not occurred across all types of mortgages. It has been driven by a decrease in the delinquency rate of conventional loans, from 3.15 to 2.82 percent over this ten-year period. Delinquency rates for FHA and VA loans, on the other hand, have increased. In 1987 FHA and VA delinquency rates were 6.56 and 6.21 percent, respectively. By 1997 the rates had increased to 8.13 percent for FHA and 6.94 percent for VA loans.[3] FHA and VA loans are taken out primarily by families and individuals of modest means.

Given the trends in delinquency rates, mortgage insurers and investors are working hard to find ways to prevent delinquencies from advancing to foreclosure and turning into major losses. The mortgage industry has come up with two main approaches for dealing with the troublesome and costly prospect of mortgage loan foreclosures. One approach is the use of loss mitigation tools. The other is the use of statistical models to predict the probability of foreclosures.

Loss Mitigation Tools. Loss mitigation tools consist of a variety of ways by which loan servicers work with a homeowner to bring delinquent loan payments current or make other arrangements to avoid foreclosure. Loss mitigation tools include such strategies as modifying the terms of the loan, setting up a repayment plan, refinancing the loan, a pre-foreclosure sale or a deed-in-lieu of foreclosure.[4]

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[3] Information collected through the National Delinquency Survey, Mortgage Bankers Association of America, and reported in *U.S. Housing Market Conditions*, 2nd Quarter 1998, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, August 1998.

[4] A pre-foreclosure sale, also known as a "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 title to the property to the lender in exchange for a release from the debt.

A number of entities in the mortgage industry promote the use of loss mitigation tools. In 1996 both Fannie Mae and Freddie Mac issued revised guidelines for servicers on the use of loss mitigation tools. In April 1996 HUD eliminated the Assignment Program, under which HUD could take over mortgages in default and adjust the borrower's mortgage payments for up to three years. As a replacement for the Assignment Program, HUD initiated an intensive effort to promote loss mitigation tools and educate servicers on the guidelines that govern the use of these tools. Mortgage Guaranty Insurance Corporation (MGIC), a major private mortgage insurer, conducts comprehensive workshops to train servicers and counseling staff on the use of loss mitigation tools. The secondary market entities as well as mortgage insurers provide servicers with some incentives in the form of monetary compensation or ratings for using these tools.

No long-term studies are available yet on the success rate and cost effectiveness of the various loss mitigation tools. However, some mortgage insurers and servicers have taken a hard look at how the loss mitigation process has been working. Through a customer survey, for example, GE Capital Mortgage Insurance Corporation determined that their loan workout process needed improvement. Using the collective wisdom of its most experienced representatives, GE Mortgage created a decision-making process that subsequently was automated and became a computerized database called Loss Mitigation Optimizer. GE reports having saved more than $8 million in the last year by using this new process. The number of homeowners who have avoided foreclosure and stayed in their homes has nearly doubled.[5]

Norwest Mortgage, the largest mortgage servicer in the country, also recognized the need to improve its loss mitigation process. Norwest's approach involves having staff in its collections and loss mitigation units work more closely together than in the past. Norwest Mortgage is changing the role that collections staff play by giving them more latitude in identifying loan workout options that may be appropriate for a particular homeowner. Since initiating this approach, Norwest Mortgage has reduced the foreclosure rate of the loans it services by 30 percent.[6]

Statistical Models to Predict Foreclosure. Computerized models developed in the last three years allow servicers to "score" the large number of delinquent loans that they process every month. The computer programs can identify those loans with the highest probability of going into foreclosure and to which the servicer needs to give special attention. Conversely, the servicer can afford to give less attention to the low-risk delinquent loans that are likely to be brought current without special intervention on the servicer's part. The most prominent of these scoring models are the EarlyIndicator, developed and introduced by Freddie Mac jointly with Mortgage Guarantee Insurance Corporation; and Risk Profiler, developed by Fannie Mae.

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[5] *Real Estate Finance Today,* Electronic Edition, May 22, 1998.

[6] Presentation by Robert Caruso, Senior Vice President, Norwest Mortgage, Inc., Charlotte, North Carolina, at the National Mortgage Servicing Conference, San Francisco, California, June 4-5, 1998.

The purpose of the loss mitigation tools and the statistical models is to reduce losses associated with the servicing of delinquent loans and, ultimately, with foreclosure. Both approaches are still too new to evaluate their effectiveness in the long-term prevention of foreclosures and the resulting dollar savings. Unlike foreclosure prevention counseling programs, however, they place little if any emphasis on stabilizing the homeowners' housing and financial situation or the neighborhoods and communities where the properties are located.

OTHER FORECLOSURE PREVENTION EFFORTS

In addition to the mortgage industry's efforts described above, counseling programs have been developed to address the increasing need to stabilize lower-income homeowners at risk of losing their homes. Examples include the Mortgage Foreclosure Prevention Program described earlier in this paper and other similar counseling initiatives that have been created in other parts of the country.

In some instances, the counseling programs operate in partnership with mortgage industry entities, including loan originators and servicers. Examples include the following arrangements:

- The Pennsylvania Housing Finance Agency funds and administers the Homeowners' Emergency Mortgage Assistance Program. Counseling services are available statewide through 44 counseling agencies.

- The Rhode Island Housing and Mortgage Finance Corporation works with Citizens Fleet, Rhode Island Hospital Trust, Shawmut, HUD and Consumer Credit Counseling Services to offer the Homeowner Retention Program. The program provides early delinquency intervention, counseling and, as needed, referral to the Emergency Housing Assistance Program for financial assistance.

- Neighborhood Housing Services of Chicago operates the Foreclosure Intervention Program with Consumer Credit Counseling Services of Greater Chicago.

- In Boston, the Organization for a New Equality works with Bank of Boston to provide mortgage default counseling services to homeowners in Massachusetts and Connecticut.

- The Minnesota Housing Finance Agency funds nine administrators, which contract with 21 agencies throughout Minnesota to deliver the Foreclosure Prevention Assistance Program.

- Freddie Mac works with the National Consumer Law Center and several neighborhood-based counseling agencies to provide foreclosure prevention services to homeowners in Massachusetts and Connecticut.

- Consumer Credit Counseling Services and PMI are working together to provide loss mitigation services to homeowners with mortgages in default and at risk of foreclosure.

COST EFFECTIVENESS OF VARIOUS FORECLOSURE PREVENTION APPROACHES

Although the mortgage industry and other agencies are using many approaches to prevent foreclosure and mitigate losses, it does not appear that there is much systematic information being collected and published to evaluate outcomes. On the foreclosure prevention counseling side, the Mortgage Foreclosure Prevention Program in Minneapolis and St. Paul has collected data from its inception in 1991 and, therefore, it is possible to assess its effectiveness. The answer is more complex, however, when looking at the cost effectiveness of loss mitigation tools. Without the benefit of published evaluation studies, it is difficult to assess the cost effectiveness of loss mitigation tools' cost effectiveness. Within these limitations, following is a brief assessment of the effectiveness of various approaches.

Foreclosure Prevention Counseling. Evaluation of the foreclosure prevention counseling draws on the experience of the three Twin Cities agencies that have operated the MFP Program in Minneapolis and Saint Paul since 1991. In this case it is clear that foreclosure prevention counseling continues to be cost effective. The average cost of preventing a foreclosure—including program administration, counseling and, in many cases, financial assistance—is substantially less than the losses experienced in a foreclosure (refer to the figures in the next three subsections). In fact, the average cost of preventing a foreclosure has gone down from $3,300 in 1995 to $2,800 in 1997.[7]

FHA Loss Mitigation Tools. The information that follows was provided by staff from the Minnesota HUD office and is based on FHA loan activity in Minnesota.

[7] Information on how the cost of preventing a foreclosure and the savings realized were calculated is contained in *Cost Effectiveness of Mortgage Foreclosure Prevention*, Ana Moreno, Family Housing Fund, November 1995.

In 1997 the average national loss on FHA foreclosures was $28,000. In Minnesota, also in 1997, the average FHA foreclosure loss was just under $20,000. At the same time, the Minnesota HUD office also reported a doubling of FHA mortgage foreclosures. This office was able to reduce its average loss per foreclosure by disposing quickly of foreclosed properties, thus substantially reducing the number of properties on its inventory of REOs (real estate owned).[8]

The high average foreclosure losses, nationally, for FHA-insured loans and the doubling in the number of foreclosures reported in Minnesota in 1997 appear to indicate that HUD's loss mitigation tools have not yielded the intended results.

However, without a systematic evaluation of HUD's loss mitigation tools, it is not possible at this time to make a more informed statement about their effectiveness. It is possible that the 1996-1997 period may eventually be seen as an aberration in the history of FHA mortgage insurance. It represented a transition period that included the elimination of the Assignment Program in April 1996 and the formal introduction of the loss mitigation tools in the fall of 1996.

The VA Approach to Preventing Foreclosure Losses. The information that follows was provided by the Minnesota office of the Department of Veterans Affairs (VA).

The average foreclosure loss on mortgages guaranteed by the Department of Veterans Affairs in Minnesota, North Dakota and South Dakota decreased from $11,400 in 1994 to just over $10,600 by April 1998.[9] The lower losses can be attributed to the proactive approach of the Minnesota VA office. In 1995 staff at this office initiated a "supplemental servicing" approach for VA loans that are reported in default. Staff work closely with homeowners to explore ways to cure a default or arrange for the sale of the home when appropriate. Under the Servicer Loss Mitigation Program, VA offers incentives to servicers to promote the use of loan workouts. From March 1995 through January 1997, loan service representatives increased their homeowner contacts by 94 percent. Implementation of the supplemental servicing approach has resulted in a significant decline in the number of foreclosures and a reduction in foreclosure losses.

Conventionally-Insured Loans. The information that follows was provided by staff for the Twin Cities office of United Guaranty Corporation, an insurer of conventional mortgages.

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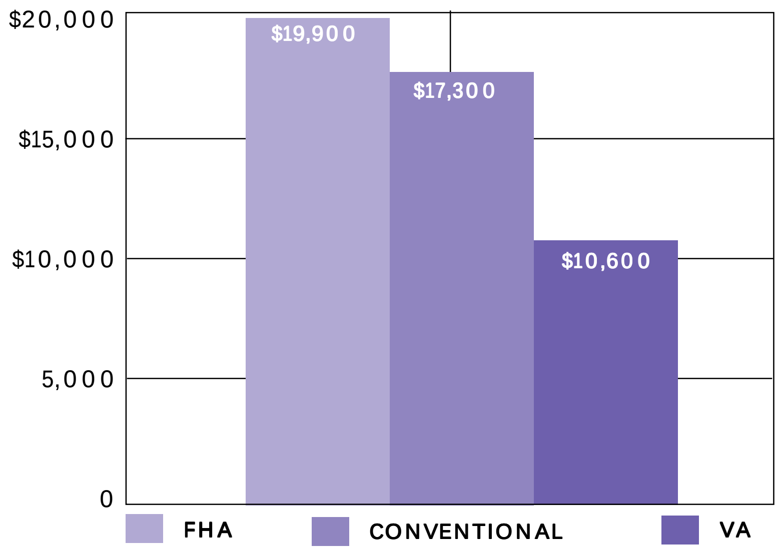
8 Minnesota HUD staff attribute this reduction in the average foreclosure loss to the high demand for HUD houses for investment purposes. This demand has lowered the holding and maintenance costs of foreclosed properties, thereby lowering the average loss per foreclosed property.

9 The Minnesota VA Loan Guaranty Office became a Regional Loan Center in February 1997 with loan servicing responsibilities for Minnesota, North Dakota, South Dakota, Iowa, Nebraska, Wisconsin and Illinois.

The average claim paid by the above office in 1997 was $17,300, compared with $16,000 in 1995. According to United Guaranty staff, the larger size of the average claim paid reflects increases in real estate market values, which translate into larger dollar claims when a foreclosure does occur.

MORTGAGE FORECLOSURE PREVENTION PROGRAM
AVERAGE FORECLOSURE LOSSES IN MINNESOTA



United Guaranty, like other mortgage insurers, is using loss mitigation tools to reduce the number of foreclosures. And as with the other mortgage industry players, the lack of published evaluations of the loss mitigation tools does not allow for an assessment of United Guaranty's approach at this time.

LOOKING AHEAD: ISSUES FACING FORECLOSURE COUNSELING PROGRAMS

The Mortgage Foreclosure Prevention Program in Minnesota has matured and taken root in the community and with local mortgage loan servicers. The generous and visionary support and funding from the Northwest Area Foundation continued through December 1997. Evaluation of the program's work between July 1991 and June 1997 demonstrated that foreclosure prevention counseling stabilizes homeowners at risk of losing their homes to foreclosure. In so doing, it preserves neighborhoods by preventing vacant and boarded houses. It does so in a cost effective way, with large savings to public and private entities.

The Family Housing Fund has supported the program for seven and a half years, providing program administration, coordination and funding. The Cities of Minneapolis (through the Minneapolis Community Development Agency) and Saint Paul as well as the Honeywell Foundation and the US Bancorp Foundation recognized the program's contributions and stepped in to provide program funding. In 1993 the Minnesota Housing Finance Agency (MHFA) also acknowledged the value of the program and sought funding from the Minnesota Legislature to replicate the program throughout Minnesota. MHFA presently provides funding to the Mortgage Foreclosure Prevention Program in Minneapolis and Saint Paul and eight other foreclosure prevention program administrators in Minnesota.

Thus, the financial picture currently looks good for the MFP Program and the other Minnesota foreclosure prevention programs. Nonetheless, several looming issues will need to be addressed at the national level to ensure the continued contribution of these programs to preserving home ownership, stabilizing neighborhoods and reducing the foreclosure-related losses to the public and private sectors.

ISSUES AND RECOMMENDATIONS

- The unavailability of published evaluations of loss mitigation tools make it difficult to assess the impact that these approaches are having on homeowners as well as on mortgage insurers and investors.

  Mortgage industry players using these tools need to share the results of any evaluation work that has been done. This will allow investors, insurers, servicers and counseling agencies to work together and identify strategies that should be adopted to help homeowners stay in their homes and reduce foreclosure losses.

- The emerging partnerships between counseling agencies and mortgage entities have resulted in some funding or compensation. But generally, funding has been short of what is needed to deliver the counseling and financial assistance.

  The mortgage industry, especially investors and public and private insurers, needs to step up to the plate and join state and local governments, the philanthropic community and nonprofit organizations in providing adequate funding to foreclosure prevention counseling programs and ensure their long-term viability.

- As the mortgage industry has started to implement loss mitigation tools in a vigorous way, it has become clear that the success of those efforts will depend on the servicers' ability to work closely with the homeowner in order to help resolve the financial crisis. Typically, however, servicers are not equipped to spend a lot of time with a homeowner. But foreclosure prevention counselors are. Counselors can develop a financial plan that addresses not only the mortgage default but also other problems that contribute to a homeowner's financial crisis.

If true loss mitigation and foreclosure prevention are to be realized, mortgage loan servicers and foreclosure prevention counselors will need to work together and bring their individual strengths to the table: the servicers' knowledge on how to implement the loss mitigation tools and the counselors' skills on how to counsel homeowners and develop a comprehensive financial plan with them.

- During the six-year period ending in June 1997, homeowners seeking services from the MFP Program had been in their home an average of six years. Increasingly, however, MFP Program counselors report seeing homeowners who have been in their homes for only a year or two. Typically, these shorter-term homeowners seeking program services are first-time homeowners who did not receive counseling or home buying preparation prior to purchasing the home. This reinforces the premise that true foreclosure prevention must start before a house is purchased. It highlights the importance of pre-purchase counseling and other support services, including foreclosure prevention.

  Programs that promote home ownership for households with very low incomes need to be linked to the full continuum of home ownership support services--pre-purchase education and counseling, financial assistance, post-purchase support and delinquency and foreclosure prevention.

CONTINUUM OF HOME OWNERSHIP SUPPORT SERVICES

<u>BEFORE-PURCHASE</u>		<u>PURCHASE</u>	<u>AFTER-PURCHASE</u>	
EDUCATION & OUTREACH	PRE-PURCHASE COUNSELING	AFFORDABLE FINANCING: LOANS & GRANTS	POST-PURCHASE COUNSELING, TRAINING & SUPPORT	FORECLOSURE PREVENTION COUNSELING & ASSISTANCE

- Foreclosure prevention counselors in Minneapolis and Saint Paul also report an increase in the number of homeowners who have refinanced their mortgage loan in order to consolidate other credit debt. The new arrangement is generally financed using subprime credit, often at a high interest rate. Although debt consolidation can be a good strategy to stabilize an individual or a family's finances, it can also lead to unaffordable monthly debt payments that may eventually result in the loss of a home.

  Counselors and the mortgage industry need to monitor the trend in subprime lending and work on resolving the negative impacts that these refinancing tools may have on homeowners.