

## **COST EFFECTIVENESS OF MORTGAGE FORECLOSURE PREVENTION**

**FAMILY HOUSING FUND  
MINNEAPOLIS, MINNESOTA**

Published November 1995  
(Reprinted November 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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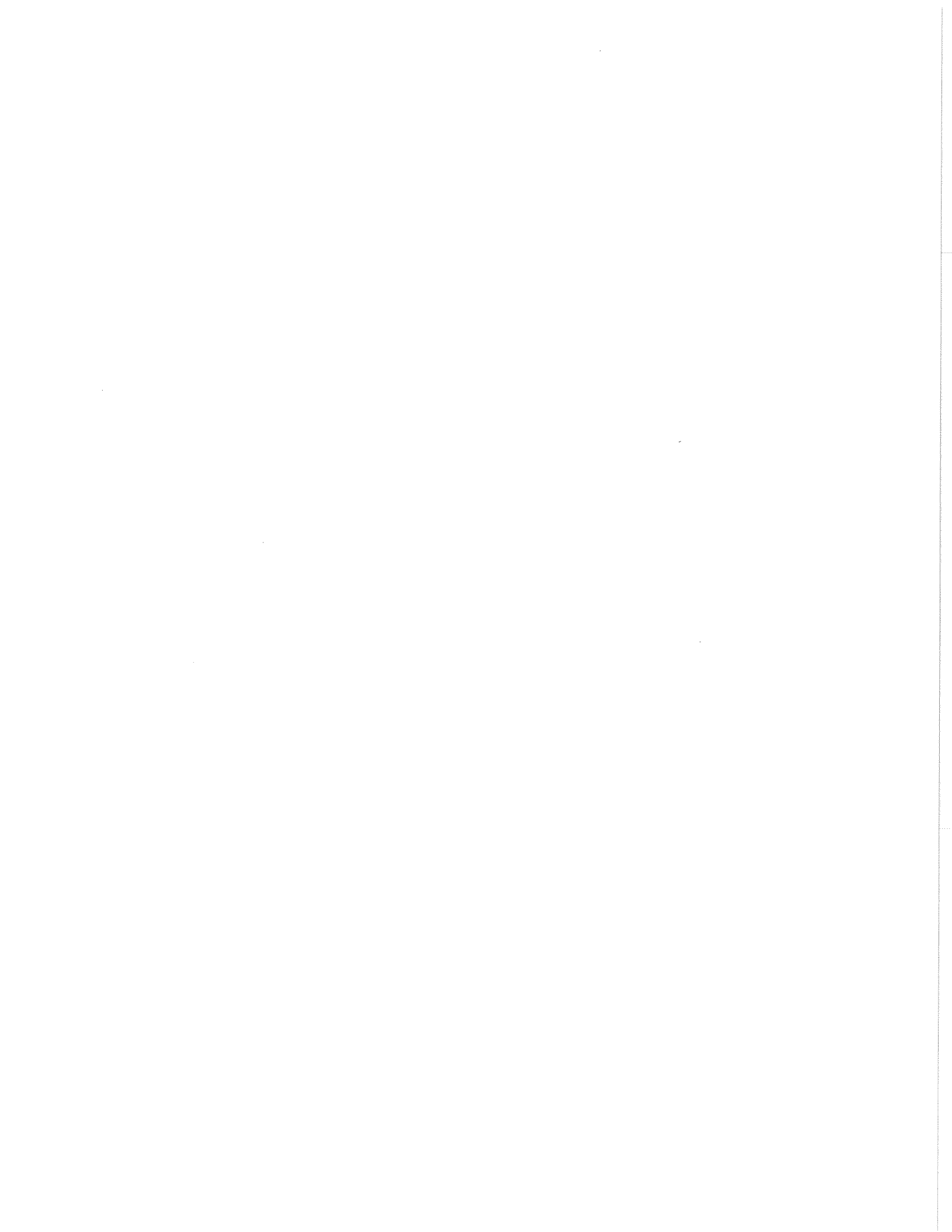
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*This study was funded by the Northwest Area Foundation and  
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## **ABOUT THIS STUDY**

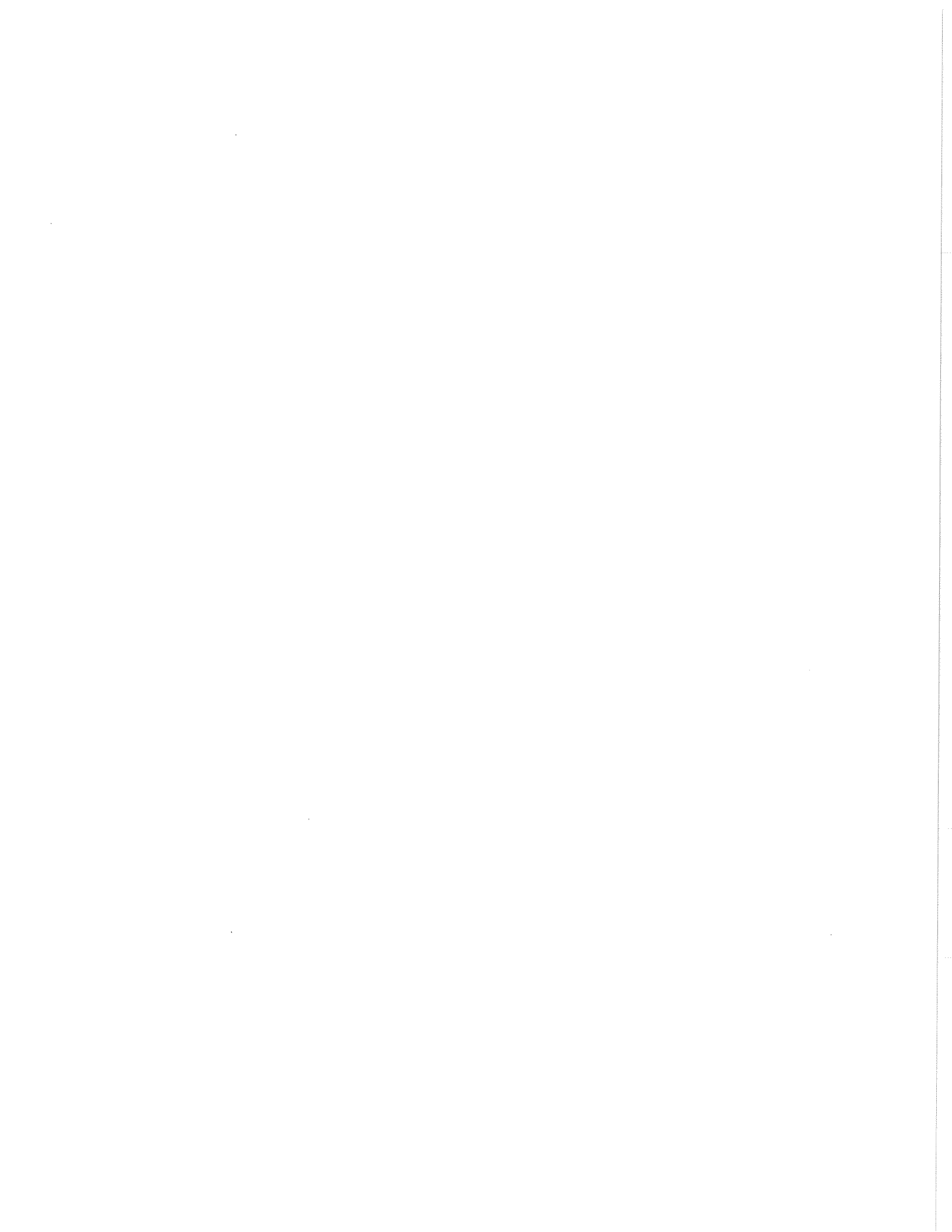
Low-income families and individuals that become homeowners are particularly vulnerable when faced with unforeseen crises. Their low incomes limit the number of options they can pursue when dealing with illness, unemployment, divorce or separation. Moreover, these homeowners often lack the resources to pay for ongoing home maintenance costs and emergency repairs. These are all, in fact, the leading reasons stated by homeowners 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 homeowners 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 (through its Minneapolis Community Development Agency) and Saint Paul, the Minnesota Housing Finance Agency and the Family Housing Fund. 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 homeowners 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 homeowners avert foreclosure by providing counseling and, in some cases, financial assistance, the Family Housing Fund initiated this assessment of the cost effectiveness of foreclosure prevention.





## SUMMARY

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.<sup>1</sup>
- With total prevention program expenditures at \$1.6 million, the cost of reinstating a mortgage averages \$3,300 per homeowner served by the program.<sup>2</sup> This is the cost of providing both the counseling and financial assistance.

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<sup>1</sup> 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.

<sup>2</sup> 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.

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.

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, which generally involves the outstanding principal, accrued interest, legal fees, cost of holding and maintaining the property and real estate broker fees minus the amount recovered through sale of the property.

## **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 percent) were FHA, VA or privately insured. Averted losses to insurers of these mortgages alone amount to an estimated **\$9.6 million**.<sup>3</sup>
- 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.

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<sup>3</sup> 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).



## **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 homebuyers, 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.

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.<sup>4</sup>
- PMI Mortgage Insurance and Consumer Credit Counseling Services (CCCCS) 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.

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<sup>4</sup> A forbearance 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 title to the property to the lender in exchange for a release from the debt.



- 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 homebuyer 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.

### **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 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.



## I. STUDY METHODOLOGY

The project 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 the figure(s) 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 the parties involved, including the homeowner.

Sections I, II and III focus on the primary objective--determining the cost effectiveness of mortgage foreclosure prevention. Section IV describes the mortgage industry's response to increases in foreclosure rates. And Section V discusses foreclosure issues raised during the data collection process and at two meetings held with persons who reviewed a preliminary draft of this report.

Early steps of this project included identification of the various parties impacted by a foreclosure. The following stakeholders were identified:

**TABLE 1**

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.



Representatives of the stakeholders listed in Table 1 were interviewed either in person or by phone. The interviews were used to gather information on the foreclosure process with special focus on the losses and impacts experienced by the stakeholders. Exhibit B lists the persons and organizations interviewed.

A literature search paralleled the data collection. The purpose was to identify other efforts that have examined foreclosure costs. Exhibit C lists the persons interviewed, publications checked and library searches.

## **II. COST ASSESSMENT: PREVENTION VS. FORECLOSURE**

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. To do this, the study examined the operating costs and experiences of two of the agencies that provide foreclosure prevention services in the Twin Cities, the Northside Residents Redevelopment Council (NRRC) and the Saint Paul Housing Information Office (HIO). They were chosen because they had been in operation since the beginning of the Mortgage Foreclosure Prevention Program and data on their program activity was available since that time also.

The second step involved quantifying the cost of foreclosure. Foreclosure costs represent the estimated losses for each of the stakeholders that is affected by foreclosure. The figures were provided by the various persons interviewed.

Following are some specifics on how costs were assessed:

### **COST OF MORTGAGE FORECLOSURE PREVENTION<sup>5</sup>**

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.

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<sup>5</sup> Information on the two foreclosure program sites and homeowners served was derived from the Wilder Research Center's Quarterly Report, Cumulative from 7/1/91 to 3/31/95. Wilder Research is funded by Northwest Area Foundation to monitor the Mortgage Foreclosure Prevention Program.



- Of the mortgages reinstated:
  - 279 were FHA loans 57.2%
  - 63 were VA loans 12.9%
  - 90 were conventional loans 18.5%
  - 41 were contracts for deed 8.4%
  - 14 used other financing 3.0%<sup>6</sup>
- Fifty percent of the homeowners (244) whose mortgages were reinstated were still current in their mortgage payments two years after coming to the program.<sup>7</sup>
- With total prevention program expenditures at \$1.6 million, the cost of reinstating a mortgage averages \$3,300 per homeowner served by the program, as indicated in Table 2.<sup>8</sup> This is the cost of providing both the counseling and financial assistance.

**TABLE 2**

<b>MORTGAGES REINSTATED</b>	<b>COST OF REINSTATING THE MORTGAGES</b>	<b>AVERAGE PROGRAM DOLLARS SPENT PER HOMEOWNER</b>
487	\$1.6 Million	\$3,300

Who are the homeowners served by the MFP programs operated by NRRC and St. Paul HIO? Following is a profile of homeowners served through March, 1995:

- On average, households were made up of three persons. Married couples with children accounted for one third of those served. Single parents with children represented another third. Single adults, including elderly, made up about 22 percent.
- Forty-two percent of households served reported falling behind on their mortgage payments due to job related problems, e.g., job layoffs, cuts in pay. Health problems, separation or divorce and unexpected expenses were the other main reasons cited.
- Typically, homeowners were four to five payments behind when they came to the program and owed close to \$3,000 in overdue payments.

<sup>6</sup> These loans are primarily second mortgages financed through home equity loans or lines of credit with private lending institutions.

<sup>7</sup> 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.

<sup>8</sup> 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 mortgages reinstated between July 1, 1991 and March 31, 1995.



- Average household income was \$22,500. Monthly housing payments averaged \$554.
- On average, homeowners had lived in their houses seven years and the assessed market value of their home was \$55,400.

## **FORECLOSURE COSTS**

As indicated in Table 1, a number of parties are impacted by foreclosure. Negative effects can take the form of dollar losses as well as of social and neighborhood environment changes. Following is a summary of the impacts felt by the various stakeholders.

### *The Homeowner*

Homeowners can experience a variety of consequences as a result of foreclosure, namely:

- Loss of a stable and secure place to live. On average, homeowners participating in the mortgage prevention program had lived in their home about seven years.<sup>9</sup>
- Long-term loss of the financial investment in the property. For the homeowners served by NRRC and St. Paul HIO the difference between the assessed market value and the balance on the home mortgage was \$7,200 on average.<sup>10</sup>
- A damaged credit rating that may become a barrier in accessing rental housing or buying a home again.
- Potentially higher costs to replace lost housing. The average monthly house payment of persons receiving foreclosure prevention counseling, through December 31, 1994, was \$554. Average monthly rents for a two-bedroom unit were over \$600 in the Minneapolis and Saint Paul area in late 1994. With a typical family including at least one adult and two or more children, families would need to look for larger units. Rents for three-bedroom apartments, more comparable in size to a single-family home, run upwards of \$700 a month.<sup>11</sup>

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<sup>9</sup> Wilder Research Center's Quarterly Report, Cumulative from 7/1/91 to 12/31/94.

<sup>10</sup>Ibid. Of the homeowners served, almost a quarter had two or more mortgages on their house. Therefore, for those homeowners the home equity would be reduced by the amount of other mortgages on the home.

<sup>11</sup>Information collected by the Apartment Search for fourth quarter of 1994. The quoted figures do not take into account the inclusion or exclusion of utility costs in the rent prices or maintenance and utility costs incurred as part of home ownership.





- Possible tax consequences on the forgiven indebtedness. For tax purposes a foreclosure is treated the same as a home sale. The principal balance on the mortgage and any accrued interest that are forgiven are treated as income to the previous homeowner. The amount of gain or loss on the property is determined the same way as if the property had been sold for cash equal to the face amount of the debt. The amount of forgiven indebtedness is reported to the IRS on a 1099 form for the year when the foreclosure is completed. If the foreclosure is contested, it is reported for the year when the legal proceedings are completed.

Exhibit D contains an example of a family that faced foreclosure as a result of job loss and illness. With assistance from Saint Paul HIO's Mortgage Foreclosure Prevention Program, the family was able to have its mortgage reinstated and avoid the loss of its home of seven years.

### Private Lenders

Lenders are protected from large foreclosure losses on the majority of loans they originate via the mortgage insurance programs (FHA, VA and private mortgage insurance) and/or sale of those mortgages. Lenders typically sell their insured loans to the secondary market entities--Fannie Mae and Freddie Mac. In the case of the majority of government insured loans, authorized lenders package the loans and securitize them. The securities then "pass through" Ginnie Mae, which guarantees them and sells them to investors. Therefore, foreclosure losses incurred by lenders are associated with expenses that are not reimbursable, such as:

- Interest payments advanced to the investor and not reimbursed by the insurer.
- Expenses related to holding and maintaining the property not reimbursed by the insurer.

Average losses per foreclosure reported by lenders range between \$1,500 on FHA and VA loans and \$2,300 for conventional loans insured by private mortgage insurers.

Additionally, some lenders originate mortgage loans under their own affordable home ownership programs. These loans are not insured or sold to the secondary market and investors because they do not meet conventional underwriting criteria. Instead, these loans are kept in the lender's loan portfolio. If one of these loans goes into foreclosure, the lender absorbs the full loss, which generally involves the outstanding principal, accrued interest, legal fees, cost of holding and maintaining the property and real estate broker fees minus the amount recovered through sale of the property.



### Loan Servicers

Foreclosures also impact loan servicers. The income stream that a servicer realizes from servicing fees stops when the borrower stops making mortgage payments. According to a study conducted by the Mortgage Bankers Association of America, servicing fees for 1991, 1992 and 1993 averaged \$225 a year<sup>12</sup>. The typical life of a 30-year mortgage is five to seven years and foreclosure tends to occur in years two, three or four<sup>13</sup>. Therefore, the servicer's income stream loss due to a foreclosure can be estimated at about \$1,125, obtained by multiplying \$225 times the approximately five years that a foreclosure takes away from the typical life of a mortgage.

### Public Lenders

The three major public lenders interviewed were the Minnesota Housing Finance Agency (MHFA), the Minneapolis Community Development Agency (MCDA) and the Saint Paul Housing and Redevelopment Authority. Losses to these public lenders generally range from \$0 to \$500. Loan servicers and mortgage insurers carry the major portion of losses associated with public lenders' programs.

Although in their public lender role Minneapolis and Saint Paul's losses are small, the two cities do experience major losses when foreclosed properties become vacant and boarded (see *The Cities*, later in this section).

### Mortgage Insurers

For mortgage insurers, the cost of foreclosure is defined as the net loss they incur as insurers of public mortgage programs (FHA and VA) or as private mortgage companies that insure conventional loans. Average losses shown in Table 3, represent the proceeds of the sales of foreclosed properties minus all expenses incurred. Expenses include the outstanding loan principal, accrued interest, unpaid taxes and insurance, legal fees, the costs of holding/maintaining the property, real estate broker fees and other expenses reimbursable to the lender or loan servicer.

The FHA and VA numbers are the average losses in 1994 reported by the U.S. Department of Housing and Urban Development for the state of Minnesota and by the Veterans Administration for their Minnesota, South Dakota and North Dakota region. The insured conventional number is based on average claims paid by a major insurer of conventional mortgage loans, United Guaranty Corporation. It is the average settlement on 17 foreclosed properties in Minnesota in 1994.

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<sup>12</sup>1993 Cost Study, *Income and Cost of Origination and Servicing of 1-4 Unit Residential Loans*, Mortgage Bankers Association of America, 1994.

<sup>13</sup>Mortgage Bankers Association of America, Economic Department staff.



**TABLE 3**  
**AVERAGE FORECLOSURE LOSSES IN 1994**  
**BY LOAN TYPE**

<b>FHA LOANS</b>	<b>VA LOANS</b>	<b>INSURED CONVENTIONAL</b>
\$26,500	\$11,400	\$16,000

As shown in Table 3, the average loss to mortgage insurers varies greatly depending on the type of mortgage insurance program. FHA mortgage insurance, for instance, offers the most comprehensive coverage. The program covers 100 percent of the principal balance and reimburses a significant number of expenses incurred by the loan servicer during the foreclosure process. As such, when a foreclosure takes place, the claim amount paid by the FHA tends to be high.

Under either a VA loan guaranty or private mortgage insurance the reimbursement is a percentage of the total mortgage loan plus some of the expenses incurred during the foreclosure period. In VA's case, for mortgage loans taken out before 1990, the maximum guaranty could not exceed \$36,000. Now, for home mortgage loans of more than \$144,000 the guaranty can be the lesser of \$46,000 or 25 percent of the loan. The VA often mitigates foreclosure losses by directly assuming certain property management responsibilities. For instance, the regional VA office takes control of the property after the sheriff's sale and restores it to "neighborhood standards." This step prevents the likely deterioration of properties during the foreclosure process and makes it possible for the property to be sold for a price comparable to other homes in the same area.

Private mortgage insurers typically insure about 25 percent of the mortgage loan. If the loss incurred after selling the property exceeds the insured portion of the loan, the servicer or investor takes the loss.

It should be noted that in the last few years mortgage insurers, both public and private, have increased their efforts to reduce the number of foreclosures and thus mitigate their losses. These efforts promote the use of a variety of loan workouts, including repayment plans, forbearance plans, loan modifications, pre-foreclosure sales and deeds in lieu of foreclosure. HUD's evaluation of the FHA pre-foreclosure sale demonstration program indicated that HUD saves an average of \$5,900 for the average property sold, of which \$5,000 is the reduction in claim size and \$900 is the reduction in administrative costs.<sup>14</sup>

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<sup>14</sup>*Evaluation of the Federal Housing Administration Pre-foreclosure Sale Demonstration*, Charles A. Capone, Jr., Office of Policy Development and Research, U.S. Department of Housing and Urban Development, June 1994.



A lengthy foreclosure process results in increased foreclosure costs. The foreclosure process in Minnesota can typically take from 12 to 18 months to complete. It can be even longer when the homeowner files for bankruptcy. Refer to Exhibit E for a description of the foreclosure process and the timing of each step.

### *The Secondary Mortgage Market*

Fannie Mae, Freddie Mac and Ginnie Mae are the three principal players in the secondary mortgage market. For purposes of determining losses related to foreclosure, only Fannie Mae and Freddie Mac were contacted. Ginnie Mae takes a foreclosure loss only if the issuer or servicer goes out of business.

Both Fannie Mae and Freddie Mac declined to disclose figures on foreclosure losses. The Chicago office of Fannie Mae, however, did provide a list of average expenses incurred during foreclosure of 97 properties acquired in Minnesota in 1994. Working with the figures provided, Fannie Mae's expenses (not losses) ranged between \$6,400 and \$8,000, depending on whether the foreclosure process was routine or involved special steps, such as eviction, boarding up the house or bankruptcy. Exhibit F details those expenses.

### *The Cities*

Although in their role as public lenders Minneapolis and Saint Paul do not directly incur large foreclosure losses, the two cities do experience significant consequences related to foreclosed properties. As a foreclosure proceeds, maintenance of the property is often neglected, the property deteriorates and its value goes down accordingly. As time goes by, the house can become an abandoned property, creating further problems for the neighborhood and the city. "Problem properties" may require substantial investment to restore or may need to be boarded and, eventually, torn down. Following are examples of costs that Minneapolis and Saint Paul bear due to foreclosed, abandoned properties:<sup>15</sup>

- Unrecovered rehab costs incurred while bringing house up to code and for improvements to make the property marketable: \$25,000 to \$40,000 for a single-family home depending on house size and extent of restoration done.<sup>16</sup>
- The cost of demolishing a house that is beyond repair: \$6,000 to \$10,000, depending on the type of house construction.

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<sup>15</sup>Minneapolis Community Development Agency and St. Paul Planning and Economic Development staff.

<sup>16</sup>The cities' subsidy when restoring vacant and boarded properties goes beyond bringing the property up to code. It is seen as an investment in stabilizing and improving the neighborhood.



- Lost tax revenues: An average of \$2,000 for a home that is vacant for a year.<sup>17</sup>

Administrative costs involved in rehabbing a vacant and boarded house or getting city council approval to demolish a property are not included in above costs. Neither are costs incurred by the Health Department regarding property checks for health and safety violations and condemning the property.

### *The Neighborhood*

Anecdotal information indicates that foreclosed properties that result in vacant and boarded houses or empty lots have a negative impact on the property values and marketability of adjacent homes and on the neighborhood.

Based on realtors' experiences, in inner city neighborhoods, houses on the same block as a vacant and boarded house can experience decreases in property value of \$2,500 and more. Conservatively speaking, the two houses on each side of a vacant and boarded property and the two directly across the street can be expected to suffer an estimated cumulative loss in property values of \$10,000.

Other impacts on the neighborhood include:

- reluctance to buy a house on a block with a boarded-up house;
- neighbors having to take responsibility for that house: mowing the lawn and removing the snow to improve the appearance of the block;
- probability of vandalism to houses near a boarded-up property.<sup>18</sup>

A foreclosed property can also have a negative impact on the sale price of properties beyond those on the same block. To determine the sale price of a home, real estate agents typically look at the sale price of comparable properties in a neighborhood. If one or more of the so called "comparables" happen to be foreclosed properties, the price of the home going on the market will reflect the lower sale price often associated with foreclosed properties.

Neighborhood housing organizations that work with the cities to revitalize housing and neighborhoods have first-hand experience with the high costs and negative impacts of foreclosure and vacant houses. (See Exhibit G, "A Story of a Foreclosed Property"). The East Side Neighborhood Development Company (ESNDC) in St. Paul provided figures on the holding costs of a rehabbed property adjacent to a vacant and boarded house. Holding costs average about \$600 per month for one to two years, the typical

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<sup>17</sup>This estimate represents total tax revenue loss to the various local units of government that collect taxes--the city, county, school district and others.

<sup>18</sup>This and preceding information on loss in property values was derived from an interview with a representative of the Saint Paul Area Association of Realtors.



length of time it takes to sell homes next to boarded properties. This cost includes payment of non-homesteaded taxes, insurance, utilities, principal and interest payments plus exterior maintenance work (mowing the lawn and snow removal).

Therefore, total holding costs to the neighborhood organization can be \$7,000 to about \$14,000. ESNDNC indicated that the sale period is affected by the buyer's perception of neighborhood disinvestment (a vacant house seen as a symbol of neighborhood deterioration) or neighborhood revitalization (neighboring houses being or scheduled to be rehabbed).

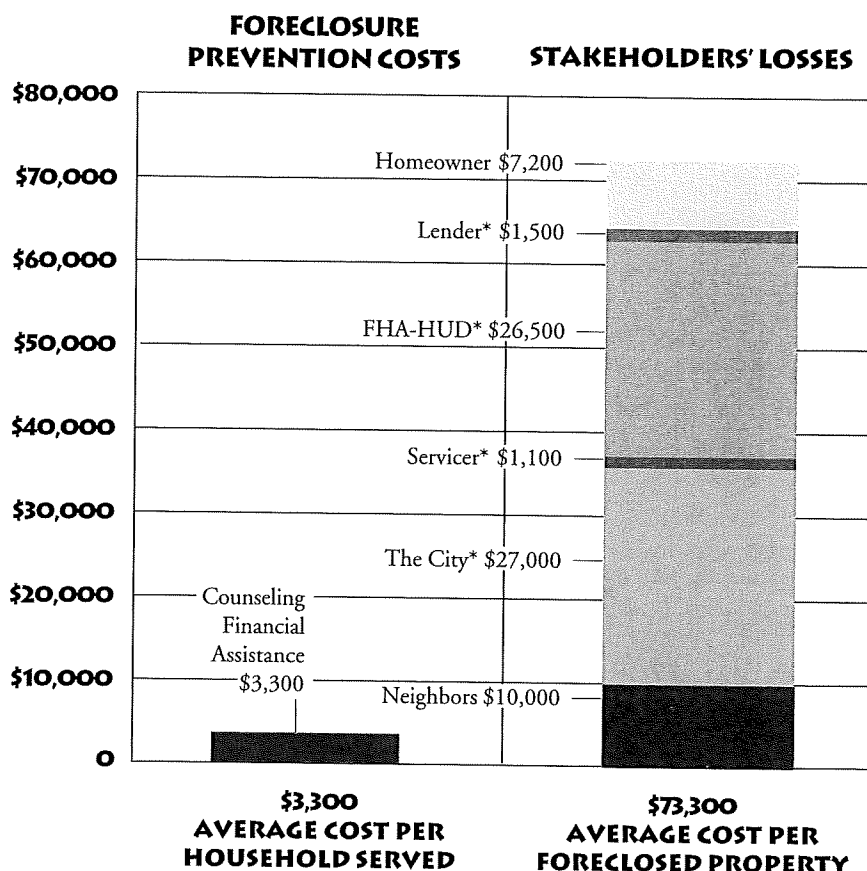


### III. COST BENEFIT ANALYSIS: DOES THE MORTGAGE FORECLOSURE PREVENTION PROGRAM SAVE PUBLIC AND PRIVATE DOLLARS?

The answer is yes. And the dollar savings involved are large. Figure 1 shows the average cost of reinstating a mortgage as \$3,300. This compares with about \$73,300 in total average losses when foreclosure takes place. This 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, rehabs it and sells it.

**FIGURE 1**

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



\*Losses listed in Figure 1 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.



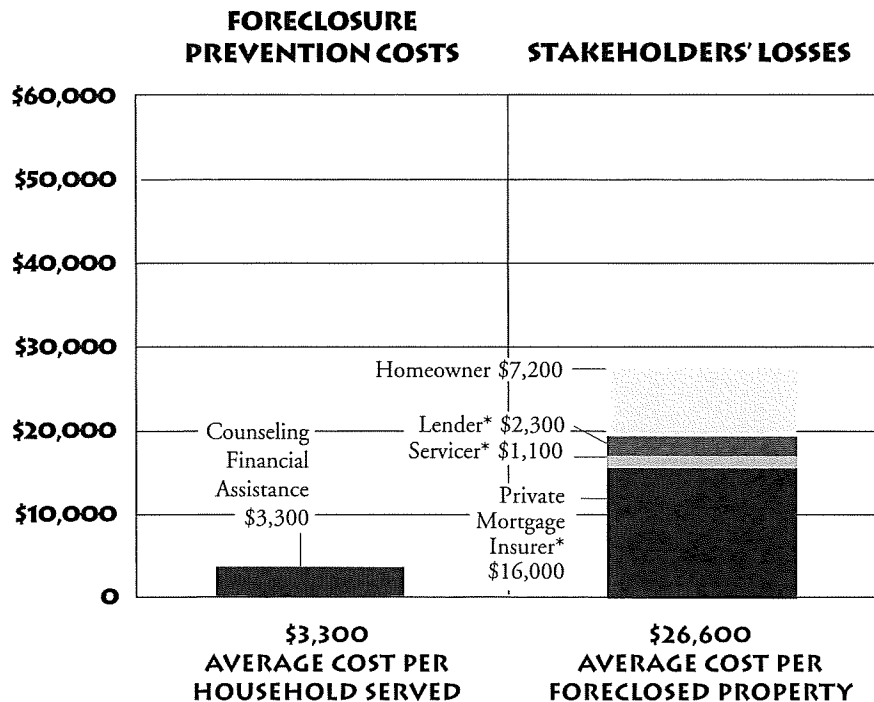
Figure 1, illustrates a “worst case” scenario regarding the costs of foreclosure.<sup>19</sup> Not every house that goes through foreclosure ends up as a vacant and boarded property. However, the chart reflects the reality of the numerous parties affected and high losses that can be incurred when foreclosure runs a full course. To provide a context for the seriousness of the problem, close to 1,000 houses were reported as vacant/boarded up in Minneapolis and Saint Paul in early 1995.

In the majority of cases, the foreclosed property is sold and spared abandonment and deterioration. Nevertheless, even in these cases, the financial losses to the stakeholders far exceed the cost of foreclosure prevention. Figure 2 presents a less severe scenario of foreclosure losses. It involves a privately insured conventional loan where the property is put on the market, sold and some of the foreclosure expenses recovered. The loss to stakeholders averages about \$26,600. The cumulative losses to the affected stakeholders (homeowner, lender, servicer and mortgage insurer) are smaller than in Scenario I but still far in excess of the average \$3,300 per household cost involved in operating the Mortgage Foreclosure Prevention Program.

**FIGURE 2**

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

\*Losses listed in Figure 2 for lenders, servicers, 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.



<sup>19</sup>It should be noted that Scenario I is a “worst case” only in terms of the long process that results in a deteriorated property with many parties incurring losses. The loss figures provided are not “worst case” numbers. They are average losses; and in the case of the city, they are low end of the range.





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. Losses to lenders are lower in Scenario I than in Scenario II because FHA mortgage insurance provides more comprehensive coverage than private mortgage insurance.

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. They are held in the lender's loan portfolio. If one of these loans goes into foreclosure, the lender absorbs the full loss. Refer to Section II, Private Lenders.

### **SAVINGS TO THE PRIVATE AND PUBLIC SECTORS**

As mentioned earlier, through March 1995, the Northside Residents Redevelopment Council and the St. Paul Housing Information Office had reinstated 487 mortgages. Of those, 432 or 89 percent were FHA, VA or privately insured. (See Section II, Cost of Mortgage Foreclosure Prevention, for breakdown of reinstated mortgages by type).

Table 4 calculates what the average cost to mortgage insurers alone would have been had foreclosure not been averted for the 432 homeowners served by the MFPP who had FHA, VA and conventional loans.

**TABLE 4**  
**ESTIMATED FORECLOSURE COSTS WITHOUT**  
**MORTGAGE FORECLOSURE PREVENTION PROGRAM INTERVENTION**

<b>LOAN TYPE</b>	<b>NUMBER</b>	<b>AVERAGE LOSS</b>	<b>COST TO INSURER</b>
FHA Insured	279	\$26,500	\$7,393,500
VA Guaranteed	63	\$11,400	\$718,200
Insured Conventional	90	\$16,000	\$1,440,000
<b>TOTAL</b>	<b>432</b>	<b>\$22,100 *</b>	<b>\$9,551,700</b>

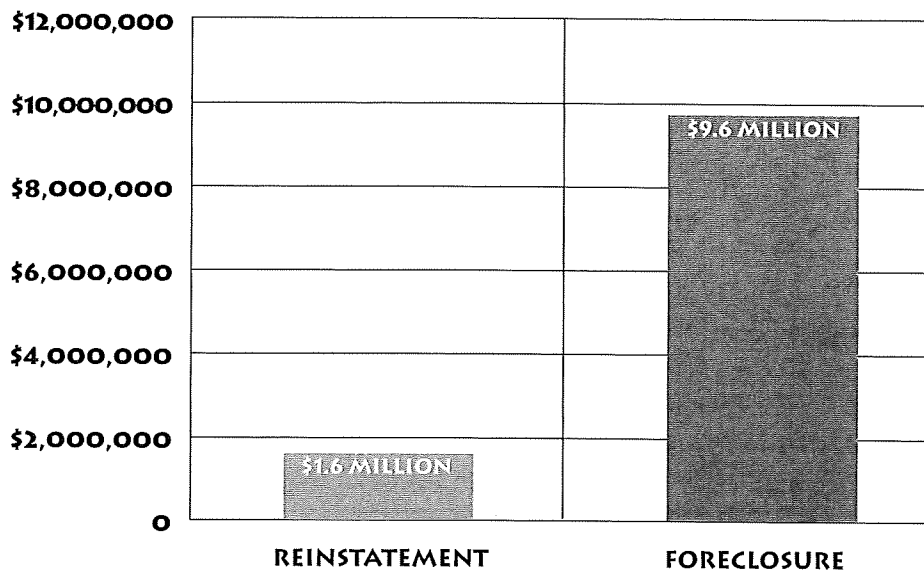
\*Weighted average.

It should be noted that the savings resulting from foreclosure prevention, as illustrated in Figures 3 and 4, are underestimated on two counts: a) they represent prevention of 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).



Figure 3 shows the economic benefit of the Mortgage Foreclosure Prevention Program. At an average of \$3,300 per homeowner served by NRRC and HIO, the cost of reinstating 487 loans (all types of loans) amounted to \$1.6 million. Had foreclosure not been averted, the estimated losses that FHA, the VA and conventional mortgage insurers would have incurred on their 432 insured mortgage loans (89 percent of total reinstatements) would have amounted to \$9.6 million.<sup>20</sup>

**FIGURE 3**  
Prevention Program Cost vs. Foreclosure Cost  
to Mortgage Insurers if Foreclosure not Averted  
(487 Mortgages Reinstated)



As mentioned above, 487 homeowners left the program with reinstated mortgages. A sample survey conducted by the Wilder Research Center shows that 268 of those homeowners, or 55 percent, were still current on their mortgage payments two years after they came to the program.

Adjusting the figures shown in Figure 3 to account for the drop in homeowners current on their mortgages, the foreclosure losses averted through use of the program would drop from \$9.6 million to an estimated \$5.4 million.<sup>21</sup> Even with this drop, foreclosure prevention services at a cost of \$1.6 million prove cost effective. See Figure 4.

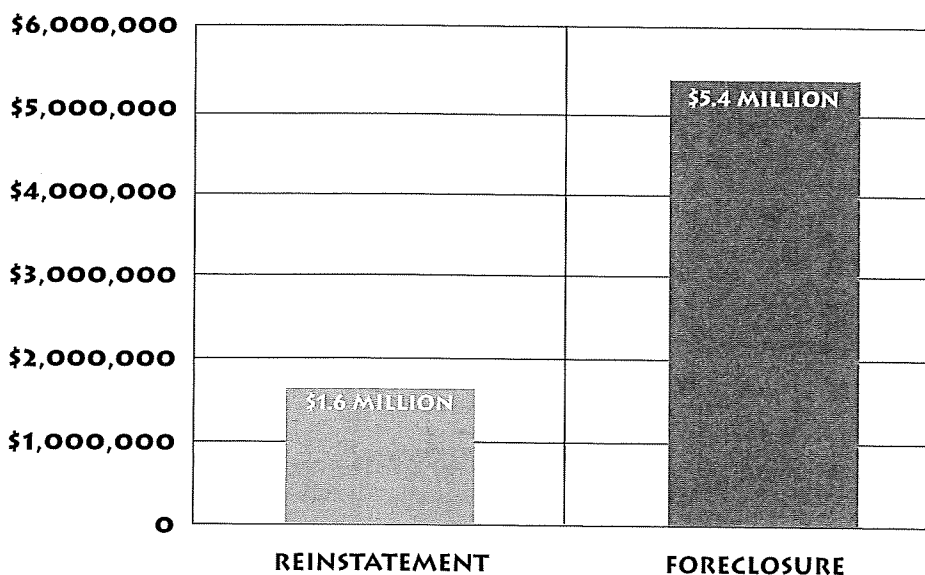
<sup>20</sup>It is not possible to calculate the savings on the remaining 55 reinstated mortgages (11 percent). These involved contracts for deed and other types of financing.

<sup>21</sup>Because of the size of the survey sample, it is not possible to figure out the estimated savings by mortgage type. The \$5.4 million figure was derived through the following equation: \$9.6 million/432 reinstated mortgages = X dollars/244 still-current mortgages.



**FIGURE 4**

Prevention Program Cost vs. Foreclosure Cost  
to Mortgage Insurers if Foreclosure not Averted  
(2 Years After Homeowner Came to MFPP)



#### **IV. THE MORTGAGE INDUSTRY'S RESPONSE TO FORECLOSURE**

The last ten years have seen significant modifications in mortgage underwriting guidelines and the creation of special home ownership programs that make home ownership more accessible to groups traditionally under served by the ownership market. Some of these changes have been influenced by Community Reinvestment Act requirements. Others have been propelled by Congressional directives to Fannie Mae and Freddie Mac. Still other efforts have been initiated at the state and local level by housing finance agencies, cities and housing nonprofits. These groups have worked closely with investors, insurers and private lenders to develop programs that make home ownership more accessible for lower-income families and individuals.

With the success of these efforts has also come the awareness of the need to provide support and counseling to these new homeowners. The groups mentioned above have also collaborated on efforts to provide both pre- and post-purchase support to these homeowners. Low income families and individuals that become homeowners are particularly vulnerable when faced by unforeseen crises. Their low incomes limit the number of options they can pursue when dealing with illness, unemployment, divorce or separation. Moreover, these homeowners often lack the resources to pay for ongoing home maintenance costs and emergency repairs. These are all, in fact, the leading reasons stated by the homeowners served by the foreclosure prevention programs for becoming delinquent on their mortgage payments.



The *National Delinquency Survey*, conducted quarterly by the Mortgage Bankers Association of America, shows a steady increase in delinquency rates for all loans, from 3.9 percent in the third quarter of 1984 to 5.86 in the third quarter of 1994. The delinquency on FHA loans, most commonly used by low- and moderate-income people, increased from 6.97 percent in 1984 to 7.57 percent in 1994.<sup>22</sup> In Minnesota, a heavy FHA lending state, 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.

In response to the increased number of foreclosures in recent years, mortgage insurers, both public and private, and investors have put in place procedures intended to reduce the number of foreclosures. These procedures are intended to mitigate their losses and spare homeowners some of the consequences of foreclosure. Following are examples of some of the practices aimed at mitigating the impacts of foreclosure:

#### **MORTGAGE GUARANTY INSURANCE CORPORATION (MGIC)**

MGIC holds one-day workshops for loan servicers to review loan workout plans that MGIC endorses and are designed to cure delinquencies or lower the cost of an unavoidable foreclosure. Loan workouts recommended by MGIC include forbearance plans, loan modifications, pre-foreclosure sales and deeds in lieu of foreclosure.<sup>23</sup> Fannie Mae's and Freddie Mac's requirements are spelled out for each workout plan.

In addition, MGIC is seeking opportunities to set up a partnership with a national nonprofit organization to deliver "enhanced servicing." This arrangement will take the form of ongoing post-purchase contact, counseling and, if necessary, early delinquency intervention and budgeting counseling.<sup>24</sup>

#### **PMI MORTGAGE INSURANCE AND CONSUMER CREDIT COUNSELING SERVICES**

The National Foundation for Consumer Credit, on behalf of Consumer Credit Counseling Services (CCCS) agencies around the country, partnered with PMI Mortgage Insurance Co. (PMI) to deliver early delinquency counseling. All homeowners whose mortgages carry PMI insurance are eligible to receive

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<sup>22</sup>FHA-insured loans have traditionally been favored by lower-income buyers because of their low down payment requirements.

<sup>23</sup>A forbearance 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 title to the property to the lender in exchange for a release from the debt.

<sup>24</sup>*Mortgage Banking*, "Ready to Make the Grade," by Gordon H. Steinbach, June 1995.



the counseling. If the borrower becomes 16 days delinquent, the loan servicer notifies PMI, which, in turn, refers the delinquent borrower to the CCCS office in San Francisco, selected to be the central referral coordinator. Once the San Francisco office determines that the homeowner would benefit from face-to-face counseling, the client is referred to the closest CCCS office. PMI and CCCS have a procedure in place to work with the homeowner and resolve the delinquency.

## **FEDERAL HOUSING ADMINISTRATION (FHA)**

Until recent years, FHA relied on its Assignment Program to help homeowners resolve financial problems without having the loan go into foreclosure. A homeowner holding an FHA-insured mortgage and threatened by foreclosure due to circumstances beyond his/her control may apply for assignment of the mortgage to HUD. If HUD accepts the assignment, it takes over the mortgage and adjusts the mortgage payments for up to three years. This program can help the homeowner “buy some time” to put the finances in order. However, accrued interest over three years can significantly increase the borrower’s total debt and make it unmanageable.

In September 1991 HUD launched a demonstration of a pre-foreclosure sale program in five cities-- Denver, Phoenix, Atlanta, Houston and Milwaukee. Having demonstrated success, the program is now implemented across the country. As stated in HUD’s Mortgagee Letter 94-45, “a pre-foreclosure sale is a sale of property, at fair market value, in which the lender agrees to accept the proceeds of the sale in satisfaction of a defaulted mortgage--even though this is less than the amount owed on the mortgage--to avoid foreclosure.” HUD believes that avoiding a foreclosure by following the pre-foreclosure sale guidelines is advantageous to the homeowner, the lender and HUD itself.

## **THE VETERANS ADMINISTRATION (VA LOAN GUARANTY PROGRAM)**

In default situations, the Veterans Administration works with the homeowner to solve the financial problem. Its philosophy is to try to keep the veteran in the home, not just save the property from foreclosure. In default situations triggered by reductions in income, for instance, the VA may use its “refunding” strategy to buy the loan back from the lender or investor thus allowing the VA to make loan modifications that help the homeowner handle the monthly payments.

In situations when foreclosure cannot be avoided, the VA uses the “compromise sale” approach, whereby the loss is shared by the VA, lender/servicer and investor.

## **THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC)**

In July 1995 Freddie Mac announced its Workout Incentive program aimed at preventing borrowers from losing their homes to foreclosure. Freddie Mac pays servicers a fee to encourage loan modifications,



short sales and deeds in lieu of foreclosure. The fee partially offsets costs incurred while pursuing loan workouts. Freddie Mac will pay \$300 for loan modifications; between \$700 and \$1,100 for short sales (pre-foreclosure), depending on the completion date; and \$250 for deeds in lieu of foreclosure. In addition, Freddie Mac will reimburse servicers for expenses involved in obtaining realtors' sale price estimates, credit reports and title searches.

## **THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE)**

Fannie Mae's Announcement 95-11, issued in June 1995, sets up new and amended guidelines for homebuyer education and delinquency counseling for servicers of Fannie 97 Mortgages and Start-Up Mortgages originated under Fannie Mae's Community Home Buyer's Program.

As stated in Announcement 95-11, "...early delinquency counseling involves a more hands-on, personal, interactive relationship with the borrower that is designed to address broader financial issues (such as family money management, budgeting and, if appropriate, arrangements and/or referrals for debt management programs)." To accomplish this work, the servicer is expected to involve a third-party counseling agency or mortgage insurer.

Under Fannie Mae's guidelines, early delinquency counseling is preceded by early delinquency intervention. This consists of a letter or phone call to the borrower no later than the 10th day of delinquency. If the missed payment is not received, a written notice of late payment follows by the 17th day and another call and/or face-to-face meeting by the 20th day.

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.

## **V. FORECLOSURE PROCESS AND RELATED ISSUES**

A number of issues related to the foreclosure process or mortgage insurance programs surfaced while holding the interviews to collect data and discussing early drafts of the report. Following is a summary of the most commonly mentioned issues:

- **Minnesota's lengthy redemption period.** In Minnesota, the redemption period for the majority of mortgage foreclosures is six months. It can be 12 months for cases involving older mortgages, if the property involved is larger than 10 acres or at least  $66 \frac{2}{3}$  of the original loan balance has been paid off. A lengthy redemption period increases the opportunity for the property to deteriorate with resulting increases in repair costs and/or property devaluation. When the sheriff's sale takes place,



the mortgage is extinguished but title remains with the borrower; therefore, the servicer, mortgage insurer or secondary market entity cannot proceed with the sale of the property. In the meantime, the former homeowner is allowed to continue to live in the house. With no stake in the property any longer, former homeowners lack the incentive to maintain the house; the property may then start to deteriorate.

- **Climate of anonymity created by out-of-town loan servicing.** It is a common practice among many lenders, both public and private, to contract with companies that specialize in loan servicing and to delegate to them the servicing associated with the loans the lender originates. If the servicer is not a local company, the arrangement is not conducive to working with borrowers that run into financial problems. 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.** The majority of mortgage loans are pooled and sold to the secondary market, which, in turn, issues securities backed by mortgage pools; the securities are then sold to investors. Conventional loans are sold to Fannie Mae and Freddie Mac; FHA insured loans and VA guaranteed loans are securitized by HUD-approved lenders; those mortgage pools then “pass through” Ginnie Mae, which acts as a guarantor of the securities. Mortgages that are pooled and packaged into securities cannot be easily restructured or modified. (For changes occurring to deal with this issue, refer to section IV, Freddie Mac’s Workout Incentive Program and Fannie Mae’s recently issued guidelines for dealing with mortgage loan delinquencies.)
- **Misperception of FHA insurance coverage.** When a mortgage goes into foreclosure, FHA insurance covers 100 percent of the loan balance and reimburses servicers for other eligible expenses. Collections staff often have the misperception that when an FHA-insured loan is involved, FHA will pay 100 percent of all losses. With this in mind, they 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. Government insured loans are securitized, Ginnie Mae provides the federal government guarantee and the securities are sold to investors. During the foreclosure process, servicers are under obligation to continue to make interest payments to Ginnie Mae, which, in turn, pays investors.
- **Cities’ and neighborhoods’ late entrance in the foreclosure process.** In Minneapolis and Saint Paul, both the cities and neighborhoods have programs in place to acquire properties that are in disrepair, restore them and sell them in an effort to stem neighborhood deterioration. At present, however, they are unable to intervene and acquire the property until the foreclosure process is completed. Waiting for the foreclosure process to run its course 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. (Refer to Exhibit G for illustration of this problem).



*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.*





## **EXHIBIT A**

### **MORTGAGE FORECLOSURE PREVENTION PROGRAM**

*Serving Minneapolis and Saint Paul*

#### ***WHAT DOES THE PROGRAM OFFER?***

The Mortgage Foreclosure Prevention Program helps homeowners who are in danger of losing their homes through foreclosure. Homeowners may receive any or all of the services outlined below, depending on the homeowner's eligibility for the program and the specific nature of the foreclosure situation.

- Information on options and services available to homeowners in default.
- Screening to determine services for which the homeowner is eligible.
- Assessment of the owner's current financial situation and the physical condition of the home.
- In-depth counseling to address financial and personal issues that are effecting the homeowner's ability to remain current on his or her mortgage.
- Intervention and advocacy, such as negotiation with the mortgage servicer or lender.
- Emergency financial assistance, to the extent that funds are available, to help the homeowner become current on his or her mortgage.
- Referral to services offered by other agencies.

#### ***WHAT ARE THE REQUIREMENTS TO QUALIFY FOR THE PROGRAM?***

- The homeowner's financial problems must result primarily from circumstances beyond his or her control-- for example, health problems, large unforeseen expenses, job loss, divorce, separation, or death of a spouse.

#### ***HOW TO RECEIVE HELP***

Call the agency that serves the area in which you live:

##### **City of Saint Paul**

Saint Paul Housing  
Information Office (HIO)  
(651) 266-6000

Serves the 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 area south of the  
dividing line.

Northside Residents Redevel-  
opment Council (NRRC)  
(612) 335-5924

Serves the area north of the  
dividing line.



- The homeowner's financial problem must be solvable, and the homeowner must be willing to work with program staff to develop and follow a plan to resolve these problems. Specifically, the homeowner must provide necessary information and documentation as requested, and commit to individualized plans that address personal, financial and physical structure issues.
- The homeowner must be a resident of the City of Saint Paul or the City of Minneapolis.
- The homeowner must be at least 60 days behind in his or her mortgage payments.
- If any financial assistance is received from the program, the homeowner must agree to have a lien filed against his or her property in the amount of the assistance. The homeowner must also agree to repay the full amount of financial assistance upon transfer of title of the home.



## **EXHIBIT B**

### **INDIVIDUALS AND ORGANIZATIONS INTERVIEWED (REGARDING THE FORECLOSURE PROCESS AND COSTS)**

#### **LENDERS**

**PRIVATE:** FBS Mortgage  
Heigl Mortgage  
TCF Mortgage

Universal Mortgage

**PUBLIC:** Minneapolis Community Development Agency  
Minnesota Housing Finance Agency  
St. Paul Planning and Economic Development

Chris Lubin  
Mark Savoie  
Janean Berggren  
Doug Dinndorf  
Debra Hanson  
Jack Fleming  
Jayne Rizner  
Autumn Schlegel  
Katy Lindblad

#### **MORTGAGE INSURERS**

**PRIVATE:** Commonwealth Mortgage Assurance Company (CMAC)  
Mortgage Guaranty Insurance Corporation (MGIC)  
GE Capital Mortgage Insurance

United Guaranty Corporation

**PUBLIC:** Federal Housing Administration (FHA), Minneapolis

Federal Housing Administration (FHA), Washington, D.C.  
Department of Veterans Affairs (VA)

Christopher Kessler  
Fred Eng  
Barbara Weier  
Todd Ringenberg  
Gerry Fenno Gardner  
John Buenger  
Ruth Drolsum  
Shirley Sailors  
Larry Shefvland  
Jackie Campbell  
John Helgason  
Julie Terrell

#### **SECONDARY MARKET/INVESTORS**

Fannie Mae, Chicago  
Fannie Mae, Minnesota Partnership Office  
Fannie Mae, Washington D.C.

Denise Gans  
Gloria Bostrom  
Garry Klegin

#### **CITIES/NEIGHBORHOODS**

East Side Neighborhood Development Company  
Minneapolis Community Development Agency  
St. Paul Planning and Economic Development

Dawn Goldschmitz  
Bernie Ciurej  
Sheri Pemberton

#### **OTHERS:**

Evensen Dodge, Inc.  
Saint Paul Housing Information Office  
Stapleton, Nolan and McCall, Legal Firm  
Thompson Associates, Inc.  
Mortgage Bankers Association of America

Alan Hans  
Lowell Yost  
Terri McCloughan  
Missy Thompson  
David LeReah



## **EXHIBIT C**

### **LITERATURE SEARCH (INQUIRIES REGARDING SIMILAR AND RELATED STUDIES)**

#### **ORGANIZATIONS AND PERSONS CONTACTED:**

Illinois Public Action Policy Center	Mary Schaafsma
Minnesota Mortgage Bankers Association	Daniel Hardy
Mortgage Insurance Companies of America (MICA)	Frank A. Balsler
Mortgage Bankers Association of America, Economics Department	Doug Dunkin
PNC Mortgage Corporation, Vernon Hills, IL	Donna Burge
University of California at Berkeley, Visiting Scholar	Roberto Quercia
U. S. Department of Housing and Urban Development Office of Policy Development and Research	Charles Capone, Jr.
Community Action Organization, Hillsboro, Oregon	Leon Laptook

#### **PUBLICATIONS REFERENCED:**

*1993 Cost Study, Income and Cost of Origination and Servicing of 1-4 Unit Residential Loans*, Mortgage Bankers Association of America, 1994.

*Discrimination, Default, and Loss in FHA Mortgage Lending*, Berkovec, Canner, Gabriel and Hanan, Federal Reserve System, Freddie Mac and Finance and Business Economics Department of the University of Southern California, November 1994.

*Evaluation of the Federal Housing Administration Preforeclosure Sale Demonstration*, Charles A. Capone, Jr, Office of Policy Development and Research, U. S. Department of Housing and Urban Development, June 1994.

*Mortgage Banking*, "Ready to Make the Grade," Gordon H. Steinbach, June 1995.

*A Study of Remedies for Chronic Problem Properties*, Boraas, Drescher, Moermond and Strathman, City Council Investigation & Research Center, Saint Paul, Minnesota, March 1995.

"Tax Consequences of Foreclosure," paper prepared by David C. Bahls, Gray, Plant, Mooty & Bennet, Public Accountants, Minneapolis, Minnesota.

#### **LIBRARY SEARCH**

Kitty Cline, librarian with the Minnesota Housing Finance Agency, conducted a search for foreclosure cost studies in the University of Minnesota (Lumina System) Libraries, State of Minnesota Departments' Libraries, and the State Colleges' Libraries.



## **EXHIBIT D**

### **STORY OF A FAMILY FACED WITH FORECLOSURE**

The story that follows was provided by Lowell Yost, Housing Counselor and Manager with the Mortgage Foreclosure Prevention Program operated by the Saint Paul Housing Information Office. It tells the story of a family in a seemingly stable financial situation that is suddenly struck with job loss, health problems and unexpected expenses. The story also illustrates the types of assistance that mortgage foreclosure prevention program staff can provide to help families deal with temporary financial problems and thus avoid the loss of their home. The couple's real names and place of employment have been suppressed to protect the family's privacy.



Mark and Laura had lived in their home for eight years. They purchased the house for \$61,900 with FHA financing in October 1986. Their monthly payments were \$640. Their family included two children, ages 11 and 13.

Prior to the fall of 1994, both Mark and Laura were employed and had a combined income of over \$45,000 a year. Mark was employed as a manager and salesperson. Laura had stable and steady employment with a government agency for the previous seven years.

By early fall, Mark had lost the manager and sales jobs due to company closings and downsizing. In October 1994, Mark found employment in a manufacturing facility, but shortly afterwards was injured on the job and unable to continue to work full time. Following the injury, Mark's doctor allowed him to start back to work only part time. To make matters worse, Laura got sick and missed work with no pay. Further compounding their financial problems, one of their cars broke down and both their vehicles needed repairs before passing the auto emission test required for license renewal.

The family struggled to stay ahead of their bills and house payments. In an effort to do so, they started selling some of their belongings. This included returning the home computer purchased for their teenage children.

Faced with notices to shut-off the gas, electricity and water, they contacted the Saint Paul Housing Information Office (HIO) for assistance. At that point, they were four months behind on their mortgage payments.

HIO staff worked with the family to avert the utility shut-offs and to prioritize their debt repayments. Staff also put together a financial management plan that included budget counseling, application for the HUD Assignment Program<sup>1</sup> and application for emergency assistance funds from Ramsey County.

Six weeks later, the application for mortgage assignment to HUD and the county assistance were denied. At this time, though, both Mark and Laura had resumed full employment and had regained control of their finances. They were then in a position to resume payments on their financial responsibilities.

After reviewing the couple's credit report and their home's title work report, HIO's Mortgage Foreclosure Program approved a \$3,800 loan in program funds. This amount, together with \$1,000 from Mark and Laura, allowed the family to reinstate their mortgage.

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<sup>1</sup> A homeowner holding an FHA-insured mortgage and facing foreclosure may apply for assignment of the mortgage to HUD. If HUD accepts the assignment, it takes over the mortgage and adjusts the mortgage payments for up to three years.



## **EXHIBIT E**

### **THE FORECLOSURE PROCESS IN MINNESOTA**

**1**      **DEFAULT**

- Homeowner misses 1-3 payments\*

#### **IF OVERDUE PAYMENTS ARE NOT MADE, FORECLOSURE BEGINS**

**2**      **NOTICE OF FORECLOSURE**

- Mortgage is 3 months delinquent
- Servicer notifies insurer and investor
- Homeowner served with notice of foreclosure

**3**      **PUBLICATION OF NOTICE OF FORECLOSURE**

- Notice published in legal ledger for six consecutive weeks

**4**      **SHERIFF'S SALE**

- Servicer or insurer submit bid in amount of indebtedness
- Mortgage is extinguished
- Home title remains with homeowner

**5**      **REDEMPTION PERIOD 6 MONTHS\*\***

- Homeowner may continue to live in house
- Homeowner may repay debt through sale of the home or other cash payment

**6**      **FORECLOSURE COMPLETED\*\*\***

- Title goes to lender/servicer/investor
- Former homeowner vacates house
- Property is sold and proceeds are used to offset losses

#### NOTES:

\* When an FHA-insured loan is involved, the homeowner may apply to have the mortgage "assigned" to HUD. If accepted, the homeowner may have as long as three years to resume full mortgage payments.

\*\* If the property is vacant, the attorney for the servicer can petition the court to shorten the redemption period, to five weeks, usually. On the other hand, the redemption period can be 12 months when older mortgages are involved or the property is larger than 10 acres.

\*\*\* The time it takes to complete a foreclosure is lengthened considerably when the homeowner files for bankruptcy under Chapter 7 or Chapter 13.



## **EXHIBIT F**

### **FANNIE MAE'S TYPICAL EXPENSES DURING FORECLOSURE PROCESS**

Fannie Mae's regional office in Chicago provided the following average expenses incurred during foreclosure. The numbers are based on 97 properties acquired in Minnesota in 1994.

<b>FORECLOSURE EXPENSES</b>	<b>COST</b>
Foreclosure legal fees	\$800
Legal Expenses (title work, filing fees, publication costs)	\$1,200
Taxes Owed	\$1,530
Homeowner's Insurance	\$329
Monthly Inspection Fee (6 months redemption period + 3 months selling time, at \$12.50 per month)	\$113
New Locks	\$75
Grass Cutting (4 months, at \$25 every 2 weeks)	\$200
Snow removal (at \$50 each time if it snows 1" or more; 8 times during 4 winter months)	\$400
Utilities (at \$500 average per quarter, for 3 quarters)	\$1,500
Winterizing Property	\$300
<b>SUBTOTAL</b>	<b>\$6,447</b>
<b><i>Other Costs that may be incurred:</i></b>	
Eviction (if former homeowner refuses to leave at end of redemption period)	\$300
Boarding up property when located in area with probability of vandalism	\$300
Bankruptcy	\$500
Proceeding Subsequent (a separate legal action if the title is in Torrens)	\$500
<b>TOTAL</b>	<b>\$8,097</b>



## **EXHIBIT G**

### **A STORY OF A FORECLOSED PROPERTY NOTES BY DAWN GOLDSCHMITZ**

Dawn Goldschmitz, former Housing Development Director at East Side Neighborhood Development Company, and present Executive Director of the Greater Frogtown Community Development Corporation, recorded the following chronology on a property in the East Side of Saint Paul. It illustrates the possible progression of events when a house goes through foreclosure and is left vacant: property abandonment, vandalism, deterioration, and eventually demolition. It also points out the long and drawn-out process that takes place when the servicer and the owner are not part of the community, thus curtailing city and neighborhood organization efforts to intervene and preserve housing and neighborhoods. These notes are reprinted with permission from East Side Neighborhood Development Company.



#### **FEBRUARY 15, 1994**

The City [St. Paul] opened a vacant building file on the property. I accompanied the vacant building inspector on his visit to the site. Building was open and unsecured. Front porch windows broken. Property abandoned by occupants. Personal property and debris left in all areas of the house. Evidence of trespassing and ransacking of building. Large rodent (possibly a raccoon) scurried from building. Several dead and decomposing squirrels and animal feces in upstairs rooms. Cats also present. House was originally single family, converted to duplex. Hardwood floors and oak woodwork intact. Five stained-glass windows intact and in good condition. Has two stories, attached garage, narrow-lap wood siding. Sits on nice-size corner lot.

This house would work nicely with the city's Houses to Homes Program [a special rehab program run by the city of Saint Paul] if we [ESNDC] could acquire it for a reasonable price. City vacant building inspector classified the property as category III, which requires code compliance and the posting of a \$2,000 performance bond.

Research at tax department shows ownership interest by :

Co-Owner I  
St. Paul, MN 55117

and

Co-Owner II  
St. Paul, MN 55101

Neither owner responded to any of the notices mailed to them by the city of St. Paul.





## **SUMMER 1994**

I passed by the property several times each week during the summer months, hoping for some sign of the property either being maintained or offered for sale. The condition of the property continued to deteriorate throughout the summer. Vandalism and signs of illegal entry were evident almost weekly. The city took over the boarding of the building and maintenance of the grounds because the owner or mortgage company did not respond to orders. Costs of these services were assessed against the property.

## **SEPTEMBER 1994**

I learned that [an out-of-town servicer] has the mortgage on the property. I called their office and was immediately referred to their [regional] office. The [regional] office would give me no information on the property or on the status of the loan foreclosure. They said they would give me information if I gave them the loan number, the Social Security number of the mortgagor and a check for \$25. I have no access to the loan number or Social Security number of the owner. So hit a big dead end.

House continues to be entered by vandals regularly.

## **DECEMBER 27, 1994**

Accompanied city vacant building inspectors to the property to inspect and secure the house. All parties listed on the property tax records were given legal notice to meet the inspectors at the property but failed to do so. The city then has the right, by city ordinance, to enter, inspect and secure the property.

The condition of the property had deteriorated significantly over the past 10 months. Building was not winterized and had not been heated. Water main to the building had ruptured at the water meter. Water was gushing into the basement and down the drain. Water was several inches deep throughout basement. Water utility was called to shut off the water at the street.

The inside of the building was exposed to the elements in at least four areas where windows had been broken out but not boarded. Four of the five stained-glass windows were stolen; the fifth one was destroyed. Casings around the windows were damaged. Fires had been started in at least three areas of the first floor and a hole was burned all the way through the hardwood floors in the living room damaging a support beam and exposing the basement. My estimate on damage to the building during the past 10 months is \$15,000 to \$20,000. This included damage to the building caused by lack of routine maintenance, such as rotting wood siding from overdue painting.

This house would no longer be a financially feasible candidate for treatment through Houses to Homes [the Saint Paul program].



### **EARLY JANUARY 1995**

I had a conversation with a representative of the mortgage company. Explained the house was in danger of being destroyed by vandals or demolished by the city. The response: "We don't own the property, we own the mortgage and HUD will pay us off despite what happens to the property."

### **LATE JANUARY 1995**

I received a call from the attorney representing the mortgage company. He stated they are two to three weeks away from getting HUD approval to secure the building.

### **FEBRUARY 10, 1995**

St. Paul Health Department mailed a notice of public hearing to be held March 7, 1995, considering orders to repair or remove the house.

I am not sure of the outcome of this hearing. My understanding from the attorney is that HUD would ask for a one-year grace period so they could have an opportunity to sell the property thereby recouping some of the cost paid to the mortgage company for the unpaid principal balance.

### **LATE APRIL 1995**

The building was demolished by the City of St. Paul with the use of the Public Nuisance Ordinance. The cost of demolition was assessed against the property.

### **JUNE 11, 1995**

The lot was listed in the HUD ads of the Sunday paper as being up for sale. The price: \$3,000, with HUD willing to pay the demolition lien.

