



FHA PROPERTY PRESERVATION

Improving Processes and Reducing Risks in FHA Property Preservation Services

EXECUTIVE SUMMARY

With smaller down payment requirements and flexible qualification criteria, FHA loans have become increasingly attractive to first-time home buyers in recent years. While foreclosure rates have been dropping to new lows, FHA-insured loans make up an increasingly larger proportion.¹ As a result, property preservation field services for properties secured by FHA-insured loans in delinquency and REO phases present a growing area of risk for loan servicers. However, due to complex FHA guidelines, tight timelines and cost penalties, managing preservation services for these properties is a time-consuming, labor-intensive process that could end in financial loss.

Loan servicers can streamline the conveyance process of FHA foreclosure properties and decrease operational risk and financial loss by utilizing a property preservation company that has a proactive, technology-enhanced approach designed specifically for FHA requirements. This white paper outlines the particular challenges of managing property preservation for FHA properties during the period from delinquency to conveyance and provides an efficient framework based on a deep understanding of FHA guidelines and requirements, a nationwide vendor network and a robust technology platform.

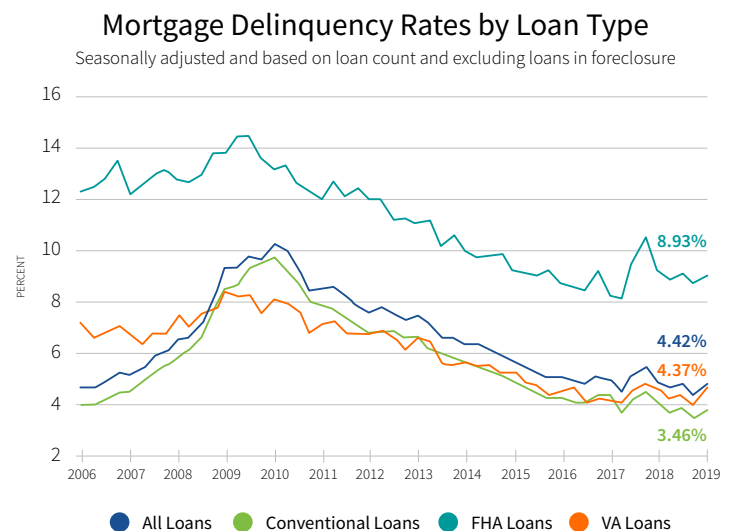
THE GROWING POPULARITY AND RISKS OF FHA LOANS

The specific percentage varies from year to year, but approximately one out of every five home loans is FHA-insured with 82% of FHA loans in FY 2019 given to first-time home buyers.² Their popularity with first-time home buyers as well as low- and moderate-income households makes it likely that the number of FHA-insured loans will increase as members of the millennial generation pursue homeownership: In November 2018, 26% of all closed loans to millennials were FHA-insured.³

82% OF FHA LOANS IN 2019 WERE GIVEN TO FIRST-TIME HOME BUYERS.

While FHA loans may be beneficial for home buyers who might not qualify for a conventional loan, statistics show that borrowers with FHA loans more frequently go into foreclosure. The 8.93% delinquency rate on FHA loans is nearly three times that of conventional loans.⁴ This presents a significant need for mortgage servicers to

effectively provide property preservation services aligned with FHA requirements and timelines. In fact, 80% of default servicers in a 2019 survey expected the volume of FHA foreclosures to increase in the following 12 to 24 months.⁵ To manage the risks of FHA loans, servicers need to be prepared with efficient workflows, field services managers who are well-versed in FHA guidelines and processes, and intuitive, data-driven technology platforms.



THE CHALLENGES AND COSTS OF FHA GUIDELINES AND REQUIREMENTS

The U.S. Department of Housing and Urban Development (HUD) lists extensive guidelines for property preservation, protection and cost reimbursement of properties under FHA-insured mortgages in a 26-page Mortgagee Letter.⁶ The document provides guidance on conveyance condition standards, inspection requirements and claims calculation and documentation requirements. Of particular note is the mandated 30-day period for conveyance after a foreclosure sale is completed during which servicers must inspect the property, identify and complete repairs, maintain the property according to FHA standards and obtain approval where repair costs are higher than allowable thresholds. (In February 2020, HUD proposed extending this period to 60 days,⁷ although even that time frame, if passed, would still be almost impossible to meet.)

Meeting this timeline has proven extremely challenging, requiring coordination and communication between servicers, property preservation companies, property preservation vendors, inspectors, contractors, mortgagee compliance managers and field service managers — especially given that each property can present unique issues that must be individually addressed. Despite their apparent specificity, FHA guidelines for property preservation can also become ambiguous or inconsistent when applied to a wide range of properties with varying features, making it difficult to apply

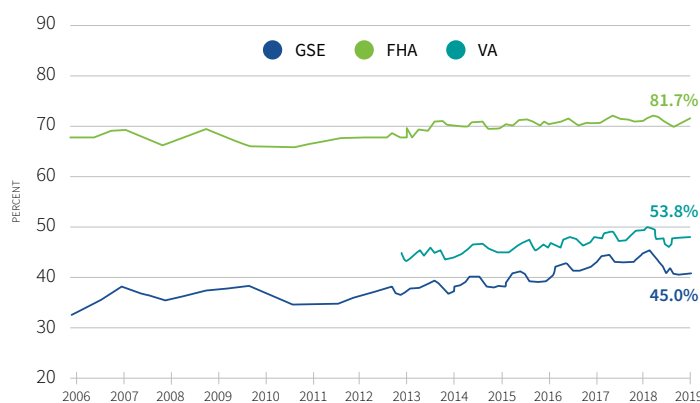
standardized processes. Further, where guidelines are unclear, servicers often interpret them according to their own standards or apply GSE guidelines, resulting in varied approaches for different properties.

Along with ensuring comprehensive inspections are conducted, servicers must have constant photographic documentation of the property, keep all invoices and receipts related to property expenses, and maintain a chronology of preservation and repair actions on the property. If needed repairs are overlooked during inspections or the property incurs damage while vacant, a vicious cycle of delays can occur in which servicers must seek additional repair estimates and approvals — especially when repairs go over the \$5,000 cap for allowable expenses.⁸ Finally, a shift from metropolitan to rural properties in loan portfolios makes it difficult to find inspectors and contractors who will service them due to the additional expenses and time involved in traveling to widely dispersed properties.⁹ Given all these factors, it is not surprising that the average conveyance timeline for FHA properties is 12 months instead of the 30 days contemplated by HUD rules.¹⁰

The costs to servicers are significant. Failure to meet the 30-day cycle deadline results in the curtailment of debenture interest, which adds up quickly: The average interest curtailment on claims for missing the FHA's first legal action date is \$5,360 while the average interest curtailment on claims for missing the reasonable diligence date is \$4,619. The average property preservation loss for FHA default properties is \$4,179 — making the cost of servicing an FHA-insured delinquent loan approximately three times higher than servicing a comparable GSE-insured delinquent loan.¹¹

FIRST-TIME HOME BUYER SHARE

In November 2019, the FTHB share for FHA, which has always been more focused on first-time home buyers, rose very slightly to 81.7 percent. The FTHB share of VA lending decreased slightly in November to 53.8%. The GSE FTHB share in November was 45.0%. The table shows that based on mortgages originated in November 2019, the average FTHB was more likely than an average repeat buyer to take out a smaller loan and also have a lower credit score, a higher LTV and a higher DTI, thus paying a higher interest rate.



Sources: eMBS Federal Housing Administration (FHA) and Urban Institute.
Note: All series measure the first-time home buyer share of purchase loans for principal residences.

THE 8.93% DELINQUENCY RATE ON FHA LOANS IS NEARLY THREE TIMES THAT OF CONVENTIONAL LOANS.

SUGGESTED PRACTICES FOR MINIMIZING RISK AND LOSSES FOR FHA DEFAULT PROPERTIES

The complexity of servicing FHA default properties and the high costs involved in delays have made this area of property preservation a challenge across the industry.¹² As a result, working with third-party vendors with FHA expertise and experience, as well as proven systems and infrastructure aligned with the agency's requirements, is the most desirable solution to help mitigate risks and optimize the FHA conveyance process.

When choosing a property preservation vendor, servicers should look for three areas of capabilities and practices: a wide network of capable field service management contractors; an end-to-end, established system and technology platform for tracking timelines, documentation requirements and claims in the FHA conveyance cycle; and comprehensive technology tools for data analytics and modeling.

PROPERTY PRESERVATION FIELD SERVICES

Access to field services professionals strategically located throughout the country who can be on-site quickly, ideally within 24 hours, in both rural and urban areas is a crucial aspect of this proposed framework for effective FHA property preservation. Vendors' personal knowledge is an advantage when connecting with repair crews and other resources, especially when they live in or near the communities where properties are being serviced. Utilizing regional field services managers with FHA property preservation expertise who are given detailed and continuous training helps ensure follow-through on timelines and up-to-date requirements for property securing, insurance claims and conveyance.

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MILESTONE TRACKING AND REPORTING

Other key elements of property preservation servicing are an established process for detailed milestone tracking and reporting (such as first-time vacant, initial secure and conveyance) and workflows and control points that are mapped to meet the full array of FHA milestones, requirements and processes. Regular inspections serve as checkpoints to log the property's condition, coordinate activities and communications internally and externally, and monitor risks with decision-tree frameworks and exception reporting to quickly address issues.

This system should be integrated into a user-friendly technology platform (ideally one that is also available as a mobile app) that supports the milestone tracking and reporting process by functioning as a centralized location for all data and activities, including documentation, requirements, timelines and reports. The resulting centralization and ease of access streamline the conveyance process for servicers and field services managers by eliminating operational and information silos, promoting accountability and ownership, and supporting greater transparency and faster communication.

DATA AND ANALYTICS FOR MODELING

The mortgage and real estate industry is gradually moving toward leveraging more data, technology and automation across the breadth of its services and products, supporting faster timelines, improved quality of service and cost savings as well as providing greater insights: In 2019, 68% of respondents to a survey about default servicing reported "having access to data and analytics" as an important consideration in their decision-making.¹³

Available technology ranges from drones and satellites that can be used to gather flyover and 3D images to artificial intelligence (AI) that can pull appraisal and field inspection photos, financial data, property records, damage reports and more from government and commercial sources. By aggregating and analyzing this diverse range of information on specific properties as well as similar homes and structures then comparing it to regional and national trends, AI can serve as a modeling tool to suggest potential outcomes and support decision-making for each property based on likely timelines, risks and costs.

By consolidating data, facilitating efficient communication and anticipating the complexities of the FHA conveyance process and timeline, this three-pronged, technology-enhanced approach helps support shorter conveyance timelines, reduce property preservation losses and increase property liquidation.

CONCLUSION

Because of the complex property preservation and field services requirements of current FHA guidelines, it can be incredibly difficult for servicers to meet mandated time frames and avoid penalties. Developing the staff, capabilities and technology to effectively and efficiently manage the process requires resources many loan servicers do not have in-house. Consequently, working with a vendor that has FHA expertise, established operational and process excellence, and a proven technology platform is the most practical solution for servicers who want to make the FHA conveyance process more efficient as well as mitigate risks and loss.

Effectively servicing FHA default properties requires a combination of FHA expertise, established systems for milestone tracking and reporting, the technology infrastructure to support multiple FHA properties at a time and data-driven modeling tools for enhanced decision-making. Together, these capabilities help servicers address the complexity of FHA regulations, the non-standardization of properties and the increasing volume of FHA-insured properties in default, enabling them to maximize and scale their efforts while reducing risks in this expanding area of field services and property preservation.

**THE AVERAGE
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¹ Mortgage Bankers Association press release, February 11, 2020, <https://www.mba.org/2020-press-releases/february/mortgage-delinquencies-decrease-in-fourth-quarter-of-2019>

² eMBS, Federal Housing Administration (FHA) and Urban Institute, https://www.urban.org/sites/default/files/publication/101611/january_chartbook_2020.pdf

³ Ellie Mae press release, January 15, 2019, <https://www.elliemae.com/about/news-reports/press-releases/millennial-borrowers-taking-out-larger-fha-loans-to-compete-for-limited-inventory-latest-elliemae-millennial-tracker-finds>

⁴ Mortgage Bankers Association National Delinquency Survey, <https://www.mortgage-media.com/mba/chart-of-the-week/mortgage-delinquency-rates-by-loan-type-mba-chart-of-the-week>

⁵ Altisource, "The State of the Default Servicing Industry," https://pages.altisource.com/2020-Servicing-Report_LPform.html

⁶ U.S. Department of Housing and Urban Development, Mortgagee Letter 2016-02, <https://www.hud.gov/sites/documents/16-02ML.PDF>

⁷ U.S. Department of Housing and Urban Development, FHA INFO #20-15, https://www.hud.gov/sites/dfiles/SFH/documents/SFH_FHA_INFO_20-15.pdf¹¹ Urban Institute, "Reforming the FHA's Foreclosure and Conveyance Process"

⁸ U.S. Department of Housing and Urban Development, Mortgagee Letter 2016-02, <https://www.hud.gov/sites/documents/16-02ML.PDF>

⁹ "Insiders to Discuss Changes, Trends in Property Preservation," <https://themreport.com/daily-dose/02-10-2020/industry-leaders-discuss-changes-trends-in-property-preservation>

¹⁰ Urban Institute, "Reforming the FHA's Foreclosure and Conveyance Process," https://www.urban.org/sites/default/files/publication/96801/reforming_the_fhas_foreclosure_and_conveyance_processes_1.pdf

¹¹ Urban Institute, "Reforming the FHA's Foreclosure and Conveyance Process"

¹² Mortgage Bankers Association, "Reforming FHA Servicing," <https://www.mba.org/advocacy-and-policy/residential-policy-issues/government-housing-finance-programs/fha-policies-and-programs>

¹³ Altisource, "The State of the Default Servicing Industry," https://pages.altisource.com/2020-Servicing-Report_LPform.html



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