The Collingwood Group Hosted a Third Call in a Series of Industry Conference Calls

July 26, 2012. WASHINGTON, D.C.

On Thursday, July 26, 2012, The Collingwood Group hosted an industry conference call on how lenders can maximize Federal Housing Administration (FHA) claims filing. The call, moderated by Chairman Brian Montgomery, reviewed the FHA claims filing process, compliance review process, common violations, and money left on the table that could’ve been recovered by servicers. Karen Garner, Managing Director, and Heidi Schranz, Senior Consultant, served as panelists on the call.

Garner began by outlining Parts A and B of the HUD’s Single-Family Application for Insurance Benefits. When an FHA-backed loan defaults and the borrower does not qualify for a home retention loss mitigation option, the servicer must move forward with a deed-in-lieu, pre-foreclosure sale or foreclosure. When that process is completed, a servicer files a claim with FHA for reimbursement of the unpaid principal balance, debenture interest, and fees and expenses incurred in the maintenance and disposition of the property.

Garner then instructed listeners that in order to maximize the allowable monetary return on your claim, a strong understanding of all of the process requirements is necessary. The application process begins with Part A, which includes general information about the loan. Among the information provided is the claim type, reason for default, date of foreclosure proceeding, unpaid loan balance, bankruptcy and vacancy. Part B of the application covers fees and expenses including the borrower’s escrow balance, disbursements for property preservation and protection, attorney fees, court costs, taxes, insurance and mortgage insurance premiums paid. Part B is where servicers claim expenses incurred since the default date.

Once Parts A and B are approved, the Department of Housing and Urban Development (HUD) typically pays out the claim within three days. There is a possibility for payment suspension however. The primary reason for the payment to be suspended is that the servicer or holder ID number does not match the information on file with FHA. For the Part B, if expenses are unusually high, the claim may be suspended and a request made for supporting documentation.

After a claim has been paid, FHA conducts compliance reviews. Schranz described this process on the call.
FHA looks for a complete claim file with proper and complete supporting documentation, including all legal documents eviction and conveyance documents, the Single-Family Default Monitoring System (SFDMS) default reporting, inspection reports, invoices, and photos. FHA will also examine whether the servicer met the necessary processing timelines including the initiation of foreclosure and prosecuting foreclosure according to the relevant state’s due diligence timeframes.

Schranz described that all expenses for property protection and preservation that are claimed must be fully documented. The same billing support applies to attorney fees and court costs. The expenses claimed must adhere to standards outlined in the relevant Mortgagee Letters.

In response to inquiries about how FHA determines when to conduct post claim compliance reviews, Schranz responded that FHA internally establishes the frequency of a compliance review according to the number of claims filed by a servicer. Generally, servicers filing five or more claims a year will be reviewed every year, or at a minimum every three years. The sample of claims reviewed is randomly selected based on a 90 percent confidence level.

Montgomery reiterated the themes of Garner and Schranz, that servicers and lenders must be certain to carefully document all aspects of the servicing and foreclosure process. Montgomery then asked the panelists to share some of the most common violations lenders make during the claims process.

Schranz cautioned that improper or missing documentation was a common error lenders make. She elaborated that missing chronology to support delays that may have occurred outside of the lender’s control will also be flagged in the review process. Garner added that that preservation and protection work (P&P) can also be heavily scrutinized during the review process. Lenders found out of compliance with the P&P requirements will have to reimburse HUD for claims money previously received. If P&P work is over the allowable limits or outside of the specified season HUD requires that lenders request approval through the P260 Lender Portal System. Failure to obtain approval will result in a monetary finding during the claims compliance review.

Another common violation is around eviction man-hours. These also must be supported by photographs. This is not always as easy as it sounds. Debris removal must also be supported by a dump fee receipt, invoice and photographs. If this is not produced at the time of the compliance review or the date of the dump receipt is prior to the debris being removed, all fees expensed for removing the debris will be disallowed and the servicer will be required to issue a refund to HUD.
A listener posed a question about foreclosure timeline requirements. Schranz responded that the processing timelines cover the institution of foreclosure, the due diligence timeframe for prosecuting foreclosure in the state where the property is located. HUD requires lenders to report the institution of foreclosure to the SFDMS. Submissions must be entered during the month in which the foreclosure is instituted, or the immediate following month. If a lender fails to properly report the foreclosure institution on time, then they will be subject to a monetary finding during the compliance review.

Two more important measures of compliance are eviction and conveyance timelines. Lenders are required to file the first legal document required by courts to begin an eviction process within 30 days of the recorded marketable title document according to HUD Mortgagee Letter 05-30. Lenders are also required to convey a property within 30 days of the later of either the recorded marketable title date or the eviction completion. Failure to meet these deadlines will result in a monetary finding. Schranz went on to explain that servicers may file for extensions for these deadlines using HUD’s Extensions and Variances Automated Requests System (EVARS).

Schranz continued that any unused hazard insurance premiums should be returned to HUD and entered in block 109 of the 27011 form, in Part B. If an actual refund was received, this should be entered, but if an actual refund has not been received then the lender should use the short rate calculation method found in the HUD Handbook to estimate the refund.

If any tax bills come in after conveyance then the lender should not pay them as the property now belongs to HUD. Lastly, the lender must pay all invoices on time to ensure that no additional penalties or interest are incurred.

Garner transitioned the discussion specifically to common pre-foreclosure sale (PFS) errors. HUD will request a refund of excessive debenture interest claimed when certain requirements are not met on a PFS claim. Garner clarified that debenture interest is the interest rate established by the US Treasury which FHA uses to calculate interest payments for claims. Mortgagee Letter 08-43, Appendix A, requires that the lender enter the PFS closing date in Item 10 of Part A, Form 27011. This date is the basis for the interest paid by HUD on the unpaid principal balance and expenses on the Part B.

For pre-foreclosure sale claims, the lender is instructed to compute debenture interest calculation on expenses to the date of closing. HUD then computes the additional interest on the unpaid principal balance from the date of the PFS closing to the date of the claim settlement if all time requirements are met. Garner instructed listeners who wanted more information to review HUD Handbook 4330.4 REV-1, Section 8-21 (D).
Claiming more than six percent realtor commissions for a sale or claiming unacceptable settlement costs will also be identified as violations during the review process. Garner outlined the various settlement costs considered unacceptable and directed listeners to HUD’s website for a complete list of permitted and prohibited fees.

Montgomery then asked the panelists to describe how these requirements, and failing to meet them, would impact lenders and services.

Schranz explained that FHA claim-related errors can result in fines ranging from one dollar to thousands or conceivably millions of dollars. She added that while only a sample of claims will be reviewed by FHA, a pattern of certain types of findings can result in a monetary request across all claims paid during the review period.

Montgomery cited the False Claims Act as another rising legal tool impacting lenders.

Garner echoed Montgomery’s sentiments adding that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) expanded the False Claims Act for financial fraud. Now whistleblowers in FHA False Claims suits are eligible for 10 to 30 percent of any damages recovered over $1 million. It has been reported that whistleblowers in False Claims suits that have already been settled have collected from one million to $95 million in damages.

Montgomery asked how can servicers ensure they are not leaving extra dollars on the table that they could have claimed with FHA, especially considering the small margins in the mortgage and servicing industry today?

Schranz answered that the single most common way servicers leave money on the table during the claims process, is by not putting a date in the extension blocks 19 and 21 of the HUD 27011A. When a timeframe has been delayed due to bankruptcy and/or loss mitigation, the servicer may be eligible for an automatic extension for the foreclosure processing timeline. Schranz urged servicers and subservicers to have a well-documented chronology to support extensions entered on the claims form.

Schranz also added that listeners should not forget about inspections. Lenders sometimes forget that there are justifiable reasons for claiming inspections on occupied properties.

Money can also be left on the table if you self-curtail your processing timeframes incorrectly. Servcers use block 31 of the claims form to self-curtail debenture interest. Servcers also tend to miscalculate their curtailment timelines for SFDMS reporting.
Montgomery concluded by asking Garner to add any closing remarks.

Garner summarized the key takeaways. FHA claims errors can cost a company a lot of money. Garner urged servicers to make sure to claim all of the money deserved from your FHA-backed loans and remember to make sure that collections and loss mitigation staff know FHA's requirements. Garner restated an earlier comment from Schranz that the most expensive errors occur when filing the Part A claim and these often relate to missed processing timeframes. Garner said that such errors are the fault of servicing staff, and not the people that are actually filing the claim.

After the conclusion of the panel discussion, Montgomery opened the call to questions from listeners. Additional questions submitted but not covered in the call included:

**Q:** Please clarify which extensions are requested on EVARS and which on P260?

**A:** Requests to exceed the first legal time frame lenders should use HUD’s Extensions and Variance Automated Requests System or (EVARS) for all other time extensions lenders should use HUD’s P260 system.

**Q:** Can you please repeat the most relevant Mortgagee Letters and guide references?

**A:** HUD Handbook 4330.4, REV-1 Chapter 2 for Conveyance, Chapter 8 for PFS Mortgagee Letters:
- For P&P: 02-10, 03-05, 07-03, 10-18
- Attorney fee limits: 01-19 and 05-30
- PFS: 08-43
- Interest Rates: 04-33

**Q:** Am I liable if my subservicer does not file claims correctly?

**A:** It all depends on the agreement you hold with your subservicer, but ultimately who ever receives the claim reimbursement will be liable for any deficiencies and fines assessed by HUD.

**Q:** Can you give more examples of claims filing errors that might be extrapolated across all claims filings?

**A:** Failure to initiate foreclosure timely, failure to obtain due diligence within the state timeframe, failure to convey the property to HUD timely, failure to enter an estimated/received HIP refund in line 109 of Part B, failure to support P&P with invoices or photos, P&P expenses exceeding the maximum allowable limits, attorney fees exceeding the maximum allowable limits, inappropriate attorney fees claims (eviction, bankruptcy, or foreclosure), and expenses being paid after
conveyance are additional examples of extrapolated claims filing errors.

Q: How long do I have to submit a Supplemental Claim? What if I realize I have additional expenses after this deadline?
   A: You have 6 months from the final payment to submit a supplemental, but you only have one chance to file a supplemental if you are requesting reimbursement. If you are returning money to HUD via a supplemental claim, you can do that at any time with one exception -- if you are chosen for a post claim review and have received your sample list of claims to be reviewed, HUD does not allow you to file any supplemental claims on the loans included in the sample list.

About The Collingwood Group

The Collingwood Group (www.collingwoodllc.com) is a Washington, DC-based business advisory firm focused on growing clients’ businesses, promoting revenue growth and increasing investment returns. The firm is led by Brian Montgomery, former Assistant Secretary for Housing and Federal Housing Commissioner. Montgomery played a major role in the federal government’s efforts to address the nation’s financial crisis and restore stability and liquidity to financial markets. The firm’s other founders have held leadership positions within other organizations in the financial services industry, including the GSEs. Collingwood’s expertise spans all aspects of Agency, non-Agency and FHA/VA housing financing programs; Ginnie Mae securitization activities; domestic and international secondary market activities and issues; primary and special servicing; full asset lifecycle vendor and talent management; and all elements of portfolio due diligence, acquisition, property management and asset disposition.

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