Home Retention Programs Save the GSEs and FHA Billions by Avoiding the High Cost of Preventable Dispositions

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This paper evolved from policy discussions with the Housing Policy Council and the author and formalizes research results presented and discussed at the Housing Policy Council's Annual Meeting in May 2025. HPC's goal in publishing this work is to make this important research available to a broader audience. HPC believes that it is important to enhance understanding of the purposes, limitations, and results of servicer loss mitigation activities on behalf of mortgage credit risk holders. The author received valuable input and feedback from HPC during the course of his research but retains sole responsibility for the analysis and conclusions in the paper. The author would like to thank Recursion for providing access to their data and analyzers, which were instrumental to the analysis described in this paper.

About the Housing Policy Council

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Revisions

This paper was revised in July 2025 to reflect revisions made to a companion paper, *Quantifying the Savings from the GSEs' Home Retention Programs* (HPC Educational Resources). The results in the companion paper have been revised after incorporating a second redefault function for borrowers who state that they can afford to resume their monthly payment, yet are provided with market-rate modifications that provide varying amounts of payment changes. While the savings from the GSE home retention programs relative to market-rate modifications have been reduced modestly, the substance of the original findings, recommendations, and conclusions in this paper and the companion paper are unchanged.

Introduction and Executive Summary

For decades now, federal housing agencies that guarantee or insure mortgages, most significantly Fannie Mae and Freddie Mac (the Government Sponsored Enterprises or GSEs) and the Federal Housing Administration (FHA), have engaged in loss mitigation activities, with the singular intent of resolving loan delinquencies to reduce foreclosure-related losses. These agencies hold the risk of loss associated with borrower default, so it is in their economic interest to engage in risk management techniques that will moderate the number and severity of losses. We estimate, for example, that the average GSE home disposition costs them about $72,000.[1]

The purpose of loss mitigation, then, is to minimize both the number of defaults that transition to foreclosure and the related losses. To do so, government agencies dictate the order and circumstances in which loss mitigation solutions are deployed, moving from early intervention assistance to home retention and then home disposition. Home disposition includes short sales, deeds-in-lieu of foreclosure, and, as the final option deployed in the hierarchy, foreclosure.

Government guarantors[2] require mortgage servicers to move sequentially through the loss mitigation hierarchy, which is organized from least costly to most costly for the guarantor, to find the least-costly solution that effectively resolves the delinquent loan. Within loss mitigation, home retention programs serve a specific purpose: to enable delinquent borrowers to reperform and allow guarantors to avoid the high cost of dispositions and thus mitigate losses that they would otherwise incur. As a result, the home retention programs offered by the three most important sources of government support for the mortgage market, Fannie Mae, Freddie Mac, and FHA, have averted billions of dollars in government losses.

After accounting for self-cures and post-intervention redefaults, **every home retention action that the GSEs complete saves them $19,000 compared to a disposition and $11,000 compared to a traditional market-rate modification.**[3] For FHA, the results are also meaningful; over 20 years, **FHA's home retention programs saved $23.2 billion** by averting hundreds of thousands of dispositions.[4] **The more dispositions these programs**

[1] See *Quantifying the Savings from the GSEs' Home Retention Programs* (HPC Educational Resources). $72,000 is the average estimated loss across all GSE home dispositions, including foreclosures, third-party sales, short sales, deeds-in-lieu of foreclosure, and non-performing loan sales, and therefore underestimates the average foreclosure loss.
[2] We will refer to Fannie Mae and Freddie Mac, government guarantors, as well as FHA, a government insurer, as "guarantors" throughout the rest of this paper.
[3] See *Quantifying the Savings from the GSEs' Home Retention Programs* (HPC Educational Resources). We treat foreclosure and disposition alternatives as a single outcome in our analysis. Self-cures occur when a seriously delinquent borrower repays past-due amounts without using loss mitigation, for example by selling their home on the private market or borrowing funds from family or friends. A traditional market-rate modification adds missed payments to the loan balance, sets the modified interest rate to the current Freddie Mac Primary Mortgage Market Survey rate + 0.25%, and extends to the term to 30 years.
[4] Based on analysis in https://www.huduser.gov/PORTAL/publications/Analysis-and-Evaluation-of-Loss-Mitigation-Efforts.html. See Section I for our calculations.

prevent, the more the government saves, even after taking into account post-intervention redefault rates.

Today, the home retention programs offered by the GSEs and FHA reflect the collective best practices learned over the years:

- Carefully calibrated home retention programs can prevent mortgage defaults from ending in dispositions and result in savings for government guarantors.
- Home retention programs must be designed to address both temporary and permanent liquidity-driven financial hardships.
- Mortgage forbearance, when used judiciously, can be an effective early intervention tool but must be followed by suitable, permanent home retention alternatives.
- Deferring arrearages to the end of the loan, which can allow the loan to remain in the mortgage-backed security and retain its note rate, is an effective home retention alternative for borrowers who have resolved a temporary hardship.
- Reducing the monthly payments of borrowers who are facing ongoing financial hardships is the most efficient way to generate loan reperformance, but must be cost-effective given the interest rate environment at the time.
- Streamlined assessment practices are necessary to resolve delinquencies quickly and efficiently and are cost-effective for the guarantor.

In this paper, Section I summarizes the findings from analysis that quantifies the through-the-economic-cycle savings generated for taxpayers by the GSE and FHA home retention programs. Importantly, our analysis accounts for borrowers in default who choose to complete a market sale and borrowers who receive a home retention alternative but then redefault and lose their home to disposition. In Section II, we walk through the best practices noted above that prevent defaults from transitioning to dispositions and thus reduce disposition-related losses. In Section III, we conclude.

In the Appendix, we summarize the current GSE and FHA home retention alternatives and show how each agency has incorporated the best practices to avoid the costs of preventable dispositions.

To be sure, disposition is still necessary when a home is abandoned, a delinquent borrower fails to sell their home or engage with their servicer, or the borrower's financial circumstances deteriorate too much. But the central lesson is clear: the GSE and FHA home retention programs reduce dispositions and thereby save the government billions of dollars.

Estimates of Portfolio-Level Savings from Home Retention Programs*

The current GSE home retention programs, after consideration of market sales and redefaults that lead to disposition, avert 64% of dispositions that would otherwise occur. While the serious delinquency (SDQ) rate for GSE loans today remains historically low, the current GSE home retention programs will still prevent 34,000 of existing SDQ loans from ending in disposition, thereby saving the GSEs $1.7 billion. Should a sharp economic downturn take the GSE SDQ rate back to the pandemic-induced high of 3.32%, the current program would avoid about 363,000 dispositions, saving the GSEs $17.6 billion.

The savings relative to a market-rate modification are similar: the GSE home retention programs cut the disposition rate for SDQ loans by 52% and for the existing SDQ GSE loan population, will save the GSEs $1.1 billion by averting 23,000 dispositions. In the economic downturn scenario described above, the relative savings increase to $11.8 billion and 244,000 avoided dispositions.

The FHA home retention program has been similarly effective. Over a 20-year period, the program cut the disposition rate by 55%, averting 310,000 dispositions and saving FHA $23.2 billion.

*Savings from the GSE home retention programs are calculated in *Quantifying the Savings from the*

Section I. Quantifying the Savings from the Current GSE and FHA Home Retention Programs

Considering the high cost of disposition, the purpose of home retention programs is to generate borrower reperformance by bringing the delinquent loan current and, if necessary, reducing the monthly payment to make it more affordable.

Home retention alternatives are not free for mortgage guarantors by any measure. However, retention programs are designed to minimize the losses; the resulting reduction in post-intervention default rates and subsequent dispositions more than offset the cost of providing the intervention.[5] Once optimized, home retention becomes a win-win: the government agencies that guarantee mortgages reduce their losses, borrowers who use home retention programs successfully keep their homes, and the potential negative impact on neighborhoods is avoided.

[5] See, for example, the discussion regarding the optimal modification waterfall in ssrn_id3849054_code2699240.pdf.

Research quantifies the savings generated by the GSE and FHA home retention programs. Our analysis provides through-the-economic-cycle estimates of the savings generated by the GSE home retention programs relative to disposition, after taking into consideration market sales and post-intervention redefaults. We estimate that the current GSE home retention programs save the GSEs $19,000 per completed action by reducing the disposition rate on SDQ loans by 64%.[6] Applying these results to the 96,450 SDQ GSE loans as of February 2025 suggests that home retention will save the GSEs $1.7 billion by preventing 34,000 dispositions.[7]

Moreover, the benefits of the GSE home retention programs grow as the SDQ rate increases. For example, should the economy falter and the SDQ rate on GSE loans return to the COVID-pandemic peak of 3.32%, these programs would save the GSEs $17.6 billion by avoiding 363,000 dispositions.[8]

Our analysis also includes a comparison of the current GSE home retention programs to the traditional pre-Great Recession **market-rate modification**, in which arrearages are added to the loan balance, the interest rate is set to the current Freddie Mac Primary Market Mortgage Survey (PMMS) rate + 0.25%, and the term is extended to 30 years. Relative to a market-rate modification, the GSEs' current home retention programs save the GSEs $11,000 per retention action completed by cutting the disposition rate by 52%.[9] Applied to the SDQ GSE portfolio today, relative to a market-rate modification, the GSE home retention programs will save them $1.1 billion as a result of 23,000 fewer dispositions.[10] If the GSE SDQ rate returns to the pandemic peak, the benefits of the current programs relative to a traditional market-rate modification increase to $11.8 billion and 244,000 avoided dispositions.[11]

Based on analysis of FHA home retention actions taken between 1997 and 2016, our calculations provide a back-of-the-envelope estimate that FHA home retention saved the Mutual Mortgage Insurance Fund (MMIF) $23.2 billion by cutting the disposition rate by more than half and averting 310,000 dispositions.

Over the 20-year study period, 51.5% of the 2.41 million borrowers who did *not* receive a home retention alternative ended up losing their home to disposition, compared to just 23% of the 1.09 million FHA borrowers who *did* receive a home retention alternative.[12] Assuming that without assistance the 1.09 million borrowers would have lost their homes

[6] See HPC Educational Resources: *Quantifying the Savings from the GSEs' Home Retention Programs*. Serious delinquency is defined as missing three or more payments.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] Ibid.
[11] Ibid.
[12] Source: https://www.huduser.gov/PORTAL/publications/Analysis-and-Evaluation-of-Loss-Mitigation-Efforts.html.

at the same 51.5% rate as the borrowers who did not receive assistance suggests that the FHA home retention program saved over 310,000 dispositions over the 20-year period.

If the average home retention alternative provided cost FHA $1,500, assisting 1.09 million FHA borrowers cost FHA $1.6 billion. Moreover, assuming that SDQ loans had an average unpaid principal balance (UPB) at default of $200,000 and applying a more-conservative loss severity figure of 40%, we estimate that the average disposition would have cost the MMIF $80,000. In sum, the FHA home retention program averted about $24.8 billion in claims over the period, resulting in a net savings to FHA of $23.2 billion.[13] The order of magnitude difference between the benefit and cost of FHA's home retention program is striking.

Importantly, the analyses noted above account for the fact that some SDQ borrowers have positive equity and will complete a market sale of their home, while other SDQ borrowers who make use of a home retention alternative will redefault and lose their home to disposition. Moreover, the savings generated by the GSEs' home retention programs persist in a wide range of economic scenarios, and the MMIF savings calculated above accumulated across several economic cycles.[14] These studies also show that cost-effective home retention programs increase in importance as the serious delinquency rate rises. The more SDQ borrowers make use of FHA or GSE home retention programs, the greater the savings they provide to guarantors.

Freddie Mac succinctly highlights these savings as the rationale behind their home retention program in their seller/servicer guide:[15]

> *Freddie Mac wants the Servicer to pursue alternatives to foreclosure whenever possible, because they benefit not only the Borrower, but also the Servicer, Freddie Mac and other interested parties in the Mortgage by:*
>
> - *Eliminating the staff time and expense the Servicer incurs to service a delinquent Mortgage or a Mortgage in foreclosure*
> - *Reinstating the Servicing fee income the Servicer earns if a Mortgage Delinquency is cured, or reinstating part or all of the Servicing fee income if a Mortgage is modified*
> - *Improving the Servicer's relationship with the Borrower*
> - ***Minimizing Freddie Mac's credit losses** [emphasis added]*
> - *Reducing an MI [mortgage insurer] or guarantor's claim payment, when applicable*

[13] Ibid. The authors assume a 50% loss severity.
[14] See HPC Educational Resources: *Quantifying the Savings from the GSEs' Home Retention Programs*.
[15] Source: Guide Section 9201.1.

Section II. Understanding the Causes of Mortgage Default and the Best Practices to Reduce Dispositions

Today, the GSE and FHA home retention programs reflect the best practices developed over time, and these best practices explain why they are so cost-effective.

Best Practice 1: Carefully calibrated home retention programs can prevent mortgage defaults from ending in disposition and result in savings for government guarantors.

Mortgage defaults that result in dispositions are extremely costly—we estimate the average home disposition today results in a loss to the guarantor of about $72,000.[16] Society bears a cost as well, as the average foreclosure resulted in a deadweight loss of $70,800 in 2010 dollars, of which $26,000 is borne by the government guarantor.[17]

In today's housing finance system, these losses are borne mainly by the GSEs, FHA, the Department of Veterans Affairs (VA), and the Department of Agriculture (USDA). This is because these housing agencies guarantee or insure the vast majority of mortgages, holding both the credit risk (the risk that the borrower defaults) and the collateral risk (the risk that the home serving as collateral against the loan depreciates and will not cover mortgage losses). As stated in the introduction, it is this powerful economic incentive that motivated the GSEs and FHA decades ago to institute cost-effective loss mitigation solutions.

Over the last 30 years, loss mitigation solutions have been improved, in an effort to achieve an optimal balance between the cost of providing the assistance and the resulting benefit from reduced defaults and dispositions. Although we only describe in the Appendix the GSE and FHA early interventions (e.g., forbearance and repayment plans) and home retention alternatives (e.g., for the GSEs, payment deferral followed by Flex Mod), both the GSEs and FHA also offer disposition alternatives (e.g., deed-in-lieu of foreclosure and short sales) that are designed to moderate their losses, relative to foreclosure.

As mentioned above, the government agencies' objective is to order their loss mitigation solutions from least costly to most costly. Then, they direct mortgage servicers to deploy the loss mitigation hierarchy in order, to identify and offer the alternative that resolves the borrower's delinquency at the lowest cost for the guarantor after considering expected redefaults.

The solutions are ordered optimally both at the category level (i.e., early intervention repayment plans are cheaper than home retention tools) and within each category (i.e. payment deferral is cheaper than the Flex Mod). Moreover, to the extent there are steps

[16] See HPC Educational Resources: *Quantifying the Savings from the GSEs' Home Retention Programs*.
[17] Deadweight loss refers to the portion of foreclosure costs that are not gained by anyone else and is therefore a loss to society. Source: S. Rept. 110-251 - THE 2007 JOINT ECONOMIC REPORT | Congress.gov | Library of Congress.

within a modification, those steps are also typically ordered from least costly to most costly (e.g., in the Flex Mod, term extension is used before principal is deferred).

Best Practice 2: Home retention programs must be designed to address temporary and permanent liquidity-driven financial hardships.

Analysis of mortgage borrowers after the Great Recession provides compelling evidence that liquidity shocks trigger mortgage default, regardless of the borrower's original debt-to-income ratio and regardless of the amount of home equity the borrower has accrued. Recent research catalogs the types of shocks that make it difficult for borrowers to make their mortgage payments. Table 1 shows the percentage of responders to an anonymous, nationally-representative survey of delinquent borrowers who reported each shock as a cause of their inability to make their mortgage payments.

Table 1. Triggers of Mortgage Default.

Liquidity Shock	Percent of Defaulters Citing Shock
Unexpected expenses	63.8%
Job Loss	56.4%
Payments on other large debts	44.3%
Illness, disability, death	43.3%
Change in mortgage payments	31.9%
Separation / Divorce	18.4%
Business Failure	15.2%
Retirement	4.1%
Payment on other mortgages	3.1%

Source: Figure 1 from ssrn_id4136704_code2653132.pdf.

There are two notable results to highlight from Table 1. First, while conventional wisdom might assume job loss or a loss of income is the most likely trigger of mortgage default, and it is a significant driver, the *most* frequently cited trigger is unexpected expenses. Second, many mortgage defaults are caused by multiple shocks, as demonstrated by the respondents who indicated more than one reason for their missed payments, which is why the figures in Table 1 sum to more than 100%.

Moreover, the author's analysis of linked loan performance and borrower survey data reinforces the finding that few, if any, borrowers default solely because their loan balance exceeds the value of their house. Nearly all (98.6%) mortgage borrowers who indicated they had concerns or difficulties making their mortgage payments and defaulted reported that one or more of the shocks in Table 1 contributed to their inability to pay their mortgage. If

nearly all borrowers who default identify a liquidity shock as a trigger, then negative equity alone is not driving mortgage defaults.[18]

Additional studies examine the relationship between income loss and mortgage default and note that the connection holds regardless of traditional measures of "affordability." In other words, mortgage default closely follows an income loss regardless of whether the borrower's debt-to-income (DTI) ratio at origination was above or below 43%.[19]

As is evident from Table 1, the financial hardships that trigger mortgage default can be temporary or ongoing. Mortgage default triggers can range in duration from a month or two (illness) to the remainder of the loan term (loss of a spouse). Thus, in developing the most appropriate countermeasures for mortgage default, the GSEs and FHA have included solutions that can address a temporary hardship as well as solutions that address a permanent change in financial status.

Best Practice 3: Agencies must deploy a range of solutions to minimize credit losses, including: temporary suspension of monthly payments, deferral of repayment, and, if necessary, payment reduction.

The experience of the post-Great Recession period provided significant evidence regarding the most effective countermeasures to prevent mortgage defaults from transitioning to disposition. Similarly, the economic stress created by the COVID-19 pandemic provided an additional opportunity to improve existing home retention programs. In response to the evidence, government housing agencies have further refined home retention programs to reduce disposition-related losses. The resulting GSE and FHA home retention programs have incorporated the following:

> **Best Practice 3a: Mortgage forbearance, when used judiciously, can be an effective early intervention tool but must be followed by suitable, permanent home retention alternatives.**

Through forbearance, the guarantor suspends monthly payments, with the expectation that the borrower will reperform when the financial hardship is resolved. Prior to the COVID-19 pandemic, forbearance was primarily provided to borrowers living or working in an area affected by a natural disaster or who became unemployed.

Use of forbearance became more widespread during the COVID-19 pandemic due to actions taken by the housing agencies and the CARES Act. Borrowers with federally-backed mortgages were permitted to request up to 12 months of payment forbearance by attesting

[18] In What Triggers Mortgage Default? New Evidence from Linked Administrative and Survey Data by David Low :: SSRN, the author finds that at most 4% of all defaults are strategic, which reinforces the finding in WHY DO BORROWERS DEFAULT ON MORTGAGES?* that 6% of defaults were caused by negative equity alone.

[19] Source: Falling Behind: Bank Data on the Role of Income and Savings in Mortgage Default.

to a financial hardship caused directly or indirectly by the pandemic.[20] Unlike traditional forbearance programs, the CARES Act included a provision that missed payments while in forbearance would not be reported as delinquent to the credit bureaus, and therefore payments missed while in forbearance would not reduce a borrower's credit score.

Given the temporary nature of the economic uncertainty and volatility associated with the pandemic, forbearance was an effective and appropriate form of assistance. Studies suggest that CARES Act forbearance, *followed by streamlined home retention tools*, prevented or postponed somewhere between hundreds of thousands and millions of dispositions during the pandemic, as borrowers were permitted to pause this monthly expense for a period and then resume making mortgage payments without negative consequences.[21] Further analysis suggests that, during the pandemic, the broad availability of forbearance, *coupled with permanent home retention programs*, may have reduced the probability of home disposition after default by 46%.[22]

It is important to note, however, that the pandemic period was marked by sizeable fiscal stimulus and other government assistance, and these steps undoubtedly also helped reduce mortgage defaults. In addition, the foreclosure moratorium in place during the pandemic paused nearly all disposition activity. Regardless, forbearance gave a temporary reprieve and when followed by a resolution of the delinquency, did help to keep borrowers in their homes during the pandemic. Post-pandemic, forbearance will continue to serve as a useful early intervention tool that assists borrowers with temporary hardship.

That said, forbearance offers a unique form of relief that must be used judiciously. There are three critical considerations when using forbearance. First, **forbearance must be followed by a home retention tool** that allows the borrower to cure their delinquency and remain in their home. Mortgage **forbearance itself is not a home retention tool, because it cannot resolve the borrower's resulting delinquency**. While forbearance forestalls disposition and buys the borrower time to assess and resolve their hardship, it does not forgive missed payments. Unless the borrower can afford to repay the delinquent amount in a lump-sum or by increasing their mortgage payments over a short period of time, they will still need a home retention solution to resolve the delinquency and the accrued missed payments. In other words, forbearance alone does not cure mortgage default or prevent disposition.

Second, while temporary forbearance is effective as a temporary intervention, to the extent that forbearance prolongs delinquency, it will also increase the cost of the eventual resolution. Missed payments during forbearance must be resolved, and every additional

[20] See https://www.congress.gov/116/plaws/publ136/PLAW-116publ136.pdf. Forbearance periods were later extended beyond 12 months for borrowers in need.
[21] Sources: Normalizing Forbearance.pdf, Message from ATTOM, and How Many Mortgage Foreclosures Is Forbearance Preventing? | St. Louis Fed.
[22] See Loss Mitigation.

missed payment increases the cost to the guarantor of providing a home retention alternative to resolve the delinquency.

Therefore, the term of permissible forbearance should be managed carefully, and not every borrower who defaults should enter forbearance. Forbearance should be a short-term measure and end as soon as the borrower no longer needs it. Forbearance should also end when it becomes clear that the borrower needs a payment reduction to create an affordable payment or will be unable to retain the home and should be evaluated for home disposition. Forbearance should be avoided entirely if there is no prospect of home retention.

Third, borrower engagement with their servicer regarding repayment options is critical. Forbearance has a significant advantage over delinquency outside of forbearance because initiating forbearance requires borrower engagement. Analysis of borrower responses to the 2020 American Survey of Mortgage Borrowers indicates that, among borrowers who had mortgage or other credit delinquencies yet did not enter forbearance, 29% cited uncertainty about a lump-sum payment at the end of forbearance and 20% cited uncertainty regarding how missed payments would be repaid as the reason they did not enter forbearance.[23] This information was readily available to borrowers who contacted their servicers and therefore, based on the pandemic experience, it is critical that borrowers communicate with their servicers to receive accurate information on post-forbearance workout options.

When applied with the above considerations in place, forbearance can continue to be an effective early intervention tool against temporary financial hardships.

> **Best Practice 3b: Deferring arrearages to the end of the loan, which can allow the loan to remain in the mortgage-backed security and retain its note rate, is an effective home retention alternative for borrowers who have resolved a temporary hardship.**

The GSE payment deferral and the FHA Standalone Partial Claim (PC) (together, "payment deferral") allow a borrower who has overcome a temporary hardship to repay missed payments as a single payment due at the end of their mortgage, whether that be the final maturity or an early payoff due to a refinance or house sale.[24] In the meantime, the payment deferral cures the borrower's delinquency so they can resume making their original monthly payment. Payment deferral is well-suited to borrowers who can afford to resume their original monthly payment but cannot afford to repay their missed payments as a lump sum or through a short-term repayment plan with an increased monthly payment.

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[23] See Individual Borrower Motivations Surrounding Mortgage Forbearance Take-up and Exit.

[24] The GSE payment deferral is described in Payment Deferral | Fannie Mae and FHA's Standalone Partial Claim is described in hud.gov/sites/dfiles/OCHCO/documents/40001-hsgh-update16.pdf.

Payment deferrals were both popular and effective for borrowers who fell behind during the pandemic. For example, as of November 2024, borrowers with a GSE-backed loan who completed a home retention alternative in 2020 or later were about 16 times more likely to use payment deferral as compared to a repayment plan.[25] Redefault rates as of February 2025 for GSE payment deferral recipients were significantly lower (18%) than redefault rates for repayment plan recipients (43%).[26] For FHA borrowers, the redefault rate difference was similarly stark—40% of Standalone PC recipients had redefaulted compared to 59% of repayment plan recipients.[27]

It is important to note that the higher redefault rate for the FHA Standalone PC compared to the GSE payment deferral is likely driven by 2 factors. First, the credit quality of GSE borrowers is higher than that of FHA borrowers, and this increases both FHA default rates and FHA's post-intervention redefault rates. Second, the sharp increase in mortgage rates in the second half of 2022 made FHA's modifications, which must adopt market interest rates, ineffective at delivering payment relief. In contrast, the GSE Flex Mod allows borrowers to keep their lower interest rates and thereby retained its effectiveness at providing payment relief. As a result, many FHA borrowers who needed a payment reduction accepted a Standalone PC instead of a modification that would increase their monthly payment. In other words, borrowers who could not afford an increase, let alone their existing payment level, took the better of the two options, but were at higher risk of redefault. As a result, FHA experienced higher Standalone PC redefault rates. FHA closed this gap in their home retention alternatives in mid-2024 by adding the Payment Supplement PC program, which provides payment relief in the current interest rate environment, returning the Standalone PC to serve borrowers who need help resolving arrearages only. We discuss these home retention alternatives in more detail in the Appendix.

Payment deferral is a remarkably cost-effective method for guarantors to cure delinquencies caused by a temporary hardship. Because it does not require that delinquent loans be bought out of the mortgage-backed security (MBS), payment deferral allows the guarantor to bring the loan current and postpone collection of the accumulated missed payments until payoff of the loan. This approach works well in all interest rate environments. The efficiency of this approach, combined with low redefault rates, makes payment deferral a relatively inexpensive home retention alternative. Our analysis indicates that the expected cost of providing payment deferral for the average SDQ GSE loan is just 37% of the expected cost of disposition.[28]

[25] Sources: Foreclosure Prevention & Refinance Report - April 2021 and Foreclosure Prevention, Refinance, and FPM Report - November 2024.
[26] Source: Mortgage Bankers Association Monthly Loan Monitoring Survey, March 2025.
[27] Ibid.
[28] See HPC Educational Resources: *Quantifying the Savings from the GSEs' Home Retention Programs*.

However, payment deferrals and Standalone PCs should be limited to borrowers who have overcome a temporary hardship and can resume making their original monthly payment, not targeted toward borrowers with an ongoing hardship. This is illustrated by the higher redefault rates for those FHA Standalone PCs provided to borrowers who in fact needed a payment reduction.

Best Practice 3c: Reducing the monthly payments of borrowers who are facing ongoing financial hardships is the most efficient way to generate loan reperformance, but must be cost-effective in all interest rate environments.

If mortgage defaults are caused by a liquidity shock such as a permanent loss of income or unexpected expense that is ongoing, intuition suggests that a reduction in the monthly mortgage payment will be an effective method to produce an affordable payment that the borrower can sustain. Research provides compelling evidence to support this intuition: a 25% reduction in a borrower's monthly principal and interest (P&I) payment reduced subsequent 5-year redefault rates by 36% relative to no payment reduction.[29] In addition, the reduction in P&I was more effective at reducing redefaults than meeting a pre-set affordability measure such as PTI (payment-to-income) or DTI (debt-to-income) or an equity threshold based on a loan-to-value (LTV) ratio.[30] Modifications that provided delinquent borrowers with a modified mortgage payment that reduced their PTI to 31% but provided less payment relief had higher redefault rates than modifications that resulted in a higher PTI but provided more substantial payment reduction.[31]

In general, increasing the amount of P&I reduction delivered increases the cost of providing the home retention alternative. Therefore, it is important to find the optimal balance between the cost of providing payment reduction and post-intervention redefault rates. Analysis suggests that payment reductions of between 20% and 30% are optimal—payment reductions of less than 20% are often insufficient to reduce redefault rates, while payment reductions beyond 30% have little marginal impact on redefault rates. Specifically, research using GSE loan performance data shows that payment reductions of less than 10% actually *increased* default probability.[32] Moreover, 2-year cumulative default rates suggest a large improvement in loan performance can be achieved by increasing payment reduction from between 10% and 20% (50.3% redefault rate) to between 20% and

[29] Source: the causal effect of P&I reduction on default is derived from the Replication Kit provided for Liquidity Versus Wealth in Household Debt Obligations: Evidence from Housing Policy in the Great Recession, American Economic Review, 110(10): 3100-3138 (2020) available at GitHub - ganong-noel/mtg_mods_public: Repkit for Liquidity vs. Wealth in Household Debt Obligations: Evidence from Housing Policy in the Great Recession.
[30] Source: Liquidity versus Wealth in Household Debt Obligations: Evidence from Housing Policy in the Great Recession.
[31] Ibid.
[32] See Figure 8 in Assessing the effectiveness of payment reduction on preventing borrower re-default for mortgages.

30% (43.2% redefault rate), but no improvement is achieved by increasing payment reduction to between 40% and 50% (43.7% redefault rate).[33]

It is critical for guarantors to offer at least one home retention alternative that can provide payment reduction in a cost-effective manner in all interest rate environments. Payment reduction is typically provided by modifying the terms of the mortgage, but the cost of mortgage modifications for guarantors increases when prevailing mortgage rates are higher than the note rate.

The GSE program that achieves this objective when market rates are higher than the note rate is the Flex Mod and for FHA, it is the Payment Supplement program, both described in the Appendix.[34] Without such alternatives, mortgage guarantors are left with market-rate modifications that may raise the borrower's monthly payment when mortgage rates rise, thus defeating the purpose of the modification.

When the prevailing mortgage rate is well above the note rate on most existing loans, as is the case today, market-rate modifications such as FHA's Standalone Loan Modification and its Combination Loan Modification and Partial Claim (described in the Appendix) that set the modified note rate to the prevailing mortgage rate become less effective or even ineffective.[35]

To complete a market-rate modification, delinquent loans are purchased out of the MBS pool at par, arrearages are added to the loan balance, and the loan is modified by setting the note rate to the prevailing mortgage rate and extending the term to 30 or 40 years.[36] The modified loan is then sold for securitization at par (or slightly above par). Today, with the mortgage rate above 6.50% and 72% of outstanding GSE and FHA loans having a note rate below 5.25%, very few loans will get a lower payment from market-rate modifications, much less reach a target payment reduction of 20% or 25% of P&I.[37] Instead, the increase in note rate offsets some or all of the effect of term extension and principal deferment, and the modification is likely to increase the borrower's P&I payment rather than creating a more affordable payment. As would be expected, modifications that result in modified monthly payments that are *higher* than pre-modification monthly payment typically have high redefault and disposition rates. While market-rate modifications are ineffective in the

[33] Ibid, see Figure 6 and Figure 12, which show loan performance results by P&I reduction are similar within credit score bins.
[34] GSE payment deferral is described in Payment Deferral | Fannie Mae and FHA's Payment Supplement is described in hud.gov/sites/dfiles/OCHCO/documents/40001-hsgh-update16.pdf.
[35] The Combination Loan Modification and Partial Claim goes beyond a traditional market-rate modification by deferring principal, but today, this additional step still does not reach the target payment reduction for most FHA loans. FHA modifications are described in hud.gov/sites/dfiles/OCHCO/documents/40001-hsgh-update16.pdf.
[36] Mortgage loans with similar note rates and maturities are pooled and securitized into MBS and sold to investors. Each MBS has a weighted-average coupon (WAC), which is the average note rate of the loans pooled in the MBS, weighted by UPB. After securitization, the price of MBS will vary as the prevailing mortgage rate increases or decreases each day. Typically, MBS with a WAC above the prevailing mortgage rate will have a market price above "par" or 100% of the UPB of the pooled loans. Conversely, MBS with a WAC below the prevailing mortgage rate will have a market price below par. Today, with the mortgage rate around 7.00%, MBS with a WAC of 4.00% have a market price of 85%, whereas MBS with a WAC of 8.00% have a market price of 104%.
[37] Mortgage rate is from Mortgage Rates - Freddie Mac as of March 7, 2025. Data on GSE and FHA note rates as of February 2025 provided by Recursion.

current environment (where the interest rate spread is significant), as we discuss in the Appendix, market-rate modifications do provide cost-effective payment relief when the prevailing mortgage rate is at or below the note rate.

The GSEs, with their government-supported balance sheet, are also able to offer lower-of-rate modifications that they hold, rather than re-pool into MBS. The primary home retention modification for the GSEs, Flex Mod, permits the new note rate to be set to the lower of the existing note rate and the prevailing mortgage rate (a **lower-of-rate modification**). As a result, the payment reduction delivered by the modification will not be attenuated by an increase in interest rate and the guarantor will retain the benefit of strong post-modification loan reperformance. However, when the prevailing market rate is well above existing note rates, before the consideration of loan reperformance, a lower-of-rate modification is more costly to provide than a market-rate modification; if and when the modified loan is sold for securitization, the sale price reflects the below-market note rate.[38] For a 4.00% loan, the original loan would be bought out of the MBS pool at par but, based on a market price for MBS with a 4.00% WAC, the modified loan would be sold at 85%, creating a loss of 15% of UPB.

It is critical to note that, even in the current interest rate environment, we estimate that, on average, providing the Flex Mod still generates savings for the GSEs relative to disposition and a market-rate modification because the Flex Mod generates significantly better loan reperformance.[39] Moreover, should mortgage rates fall, the cost advantage of the Flex Mod will increase. Unlike a market-rate modification, the Flex Mod only reduces the modified interest rate to reach the 20% payment reduction target. To the extent that the modified interest rate is above the prevailing mortgage rate, the GSEs will be able to sell reperforming loans above par, potentially resulting in a profit.

FHA does not have a portfolio to hold modified loans, so a lower-of-rate modification is not practicable. Therefore, given the above dynamics and current mortgage rates, FHA needs a home retention alternative that resolves the borrower's delinquency and provides payment relief without requiring the delinquent loan to be purchased out of the MBS pool. FHA's Payment Supplement fills this gap by using the Partial Claim to reduce the borrower's monthly P&I payment by 25% for three years. Conversely, when the prevailing mortgage rate is below the note rate on delinquent loans, FHA uses the Standalone Loan Modification and Combination Loan Modification and Partial Claim to provide the same 25% P&I reduction permanently at a lower cost for FHA.

By meeting the standards set in Best Practice 3b and 3c, the GSE and FHA home retention programs include alternatives that collectively generate reperformance in a cost-effective

[38] For GSE loans, the GSEs absorb this cost in the Flex Mod. For FHA loans, the servicer performs the modification and if FHA were to require lower-of-rate modifications, mortgage servicers would absorb a substantial loss (10% to 20% of UPB) on each modification provided. For this reason, FHA mainly makes use of market-rate modifications, with the addition of principal deferment.
[39] See HPC Educational Resources: *Quantifying the Savings from the GSEs' Home Retention Programs*.

manner in all interest-rate environments, regardless of the relationship between note rates on delinquent loans and the prevailing mortgage rate or the nature of the hardship (temporary or ongoing). In addition, once home retention programs are calibrated to work effectively in different rate environments, they can remain stable over time, minimizing implementation costs for the guarantor and mortgage servicers.

Best Practice 4: Streamlined assessment practices are necessary to resolve delinquencies quickly and efficiently and are cost-effective for the guarantor.

Requiring borrowers to provide documentation to access home retention programs leads to fallout, delays resolution of the delinquency, increases the cost of home retention, and may result in otherwise preventable dispositions. In contrast, removing documentation requirements increases take up rates and overall program benefits. Streamlined assessments have been used successfully for years. In fact, research suggests that, between 2012 and 2015, streamlining a GSE modification program increased borrower take-up by 45% and increased the net benefit to the GSEs by 34% relative to a modification program with documentation requirements.[40]

The benefits of streamlined assessments became further evident during the COVID-19 pandemic, when their use was standard practice. Of note, both forbearance and permanent home retention solutions were made available with simplified procedures that did not require the collection of financial information from the borrower. Given the high volume of cases that needed to be handled quickly, the streamlined programs were successful at achieving a very high level of loan reperformance.

In addition, concerns regarding the moral hazard that could come from the provision of assistance without proof of hardship did not materialize. Through the CARES Act, borrowers could assert a pandemic-related hardship and request mortgage forbearance without documenting their hardship in an application or any other paperwork. Some raised concerns that borrowers would stop making mortgage payments without an actual hardship and use the cash for other purposes with no adverse consequences to their credit, because missed payments under CARES Act forbearance were not reported to the credit bureaus.

But research shows otherwise. One study finds little-to-no strategic use of CARES Act forbearance among new homebuyers, borrowers who refinanced, or borrowers who took forbearance to the maximum term.[41] A second analysis finds forbearance reached the intended recipients: borrowers who missed payments while in forbearance showed income

[40] Source: How Beneficial Are Streamlined Modifications (urban.org). The streamlined program studied made automatic modification offers to delinquent borrowers. Even if removing the automatic feature cuts the benefits of streamlining in half, the resulting benefits would still be substantial.

[41] See Mortgage Borrowers' Use of COVID-19 Forbearance Programs.

declines similar to borrowers delinquent outside of forbearance, larger income declines compared to homeowners who stayed current, and were more likely to have received unemployment insurance compared to borrowers who remained current.[42] Some borrowers took forbearance during the pandemic as a precautionary measure and did not miss any payments, but these borrowers gained no benefit and created no cost for government guarantors, as there was no delinquency to cure.

Today, the theoretical moral hazard and resulting need to collect hardship documentation from borrowers is minimized by the negative impact of missed payments on a borrower's credit score. The current rules require that missed mortgage payments, including during a forbearance period, are reported and result in a meaningful drop in the borrower's credit score. So, any incentive a borrower might have to purposely miss payments just to receive forbearance or a home retention alternative would be offset by the degradation of their credit standing. FICO suggests that a homeowner who misses three mortgage payments would, depending on their initial credit score, experience a drop in credit score of between 59 and 133 points.[43] Given the negative consequences on their ability to access credit and a higher cost charged on credit they can obtain, few borrowers would be expected to request forbearance or a retention option without a hardship.

Moreover, the analysis of post-Great Recession modifications discussed in Best Practice 3c concluded that the efficacy of home retention alternatives that provide payment relief is driven by the amount of payment reduction delivered rather than reaching an affordability measure based on documented income. As a result, home retention tools now target a specific payment reduction amount rather than a particular ratio of payment amount to income, rendering income documentation collection unnecessary. For this reason, well before the pandemic, the GSEs offered a streamlined Flex Mod for borrowers who had missed three or more payments. Given the effectiveness of this streamlined program, the GSEs' pandemic home retention programs similarly did not require borrowers who had missed three or more payments to provide income or asset documentation.[44]

Most home retention alternatives today employ a trial payment plan (TPP) of three months to demonstrate that the new, lower payment is affordable for the borrower before making the home retention alternative permanent. Rather than assuming that meeting a single ratio of debt- or mortgage payment-to-income will signal affordability for all borrowers who

[42] See Did Mortgage Forbearance Reach the Right Homeowners?. Given the ease of access to CARES Act forbearance, many more borrowers could have acted in a strategic manner but did not. At the peak of CARES Act forbearance use, just 6% of borrowers were in forbearance and missed at least one payment; 94% of borrowers who could continue to make on-time payments continued to do so.
[43] Source: FICO_Consumer_Credit_Activity_Infographic.pdf.
[44] The GSEs' Flex Mod, FHA's COVID-19 Recovery Modification, and VA's COVID-19 Refund Modification did not require borrowers to provide income or asset documentation. However, borrowers with a GSE-backed loan who have missed less than three payments and therefore have not borne the adverse credit consequences of three missed payments can access the GSEs' Flex Mod but must demonstrate need by completing a borrower response package (BRP). Sources: F-1-27: Processing a Fannie Mae Flex Modification (05/10/2023), Guide Section 9206.10 (freddiemac.com), FHA Single Family Housing Policy Handbook (hud.gov), and Circular 26-24-2 (va.gov).

need financial relief, a TPP tests the affordability of the retention option directly for each individual borrower.

Finally, and perhaps most importantly, streamlined home retention alternatives minimize missed payments and are therefore less costly than fully documented solutions. Collecting borrower documentation increases the time required to process a delinquent loan, which in turn allows arrearages to build. Larger arrearages increase the cost of providing a home retention alternative and may decrease the amount of payment reduction provided, leading to a higher redefault rate.[45] By contrast, streamlined home retention alternatives are faster to process, leading to fewer missed payments and cheaper resolutions.

Section III: Conclusion

Dispositions are costly for the government housing agencies that hold the risk of loss from loan defaults. Using the experiences gained from the post-Great Recession and COVID-19 pandemic periods, the GSEs and FHA enhanced their loss mitigation solutions to make them more cost-effective.

The GSE and FHA home retention programs reflect the collective best practices described herein: judicious use of mortgage forbearance for temporary hardships; deferral of accrued missed payments for borrowers who can resume payments at the previous level; carefully calibrated payment relief, offered in a cost-effective manner under a variety of interest rate scenarios (rather than more costly interventions to reach a pre-determined affordability target); and streamlined access to assistance programs to effect quick resolution and minimize arrearages.

Moreover, the GSE and FHA home retention programs have been optimized on cost and must be applied by the mortgage servicer in order from least costly to most costly, to identify and offer the alternative that resolves the borrower's delinquency at the lowest expected cost for the guarantor. In doing so, home retention alternatives result in reperformance by delinquent borrowers and avoid the high cost of dispositions for the guarantor.

While some baseline level of dispositions cannot be avoided, the GSE and FHA home retention alternatives have proven to reduce government losses. There is clear and compelling evidence that home retention programs more than pay for themselves and are a win-win: government agencies save billions, the many borrowers who use home retention programs keep their homes, and society avoids substantial foreclosure-related deadweight losses.

[45] See the analysis in: Analysis and Evaluation of Loss Mitigation Efforts Draft Report (huduser.gov).

Appendix: The Current GSE and FHA Home Retention Programs Reflect Best Practices and are Effective

The GSE and FHA home retention programs have helped the agencies successfully avoid the high costs associated with dispositions. That success has improved over the years due to their adoption of the best practices described above. The GSE and FHA programs include: an option that allows borrowers who have overcome a temporary hardship to resolve their delinquency and resume making their original payments; an option to help borrowers who are facing an ongoing hardship achieve a payment reduction; and options that allow for the loan to remain in the MBS pool. The programs are streamlined and rely on three missed payments as a sufficient and necessary indicator of financial distress, and several include a three-month TPP to test affordability.

The GSEs' Current Early Intervention and Home Retention Alternatives

The impact of the GSE home retention programs is compelling—despite a severe pandemic-induced economic contraction, a sharp rise in unemployment, and a spike in inflation, rates of serious delinquency and foreclosure among GSE borrowers in 2023 and 2024 remained below 2019 levels.[46]

As mentioned above, the GSEs use **early interventions** such as forbearance, which can be followed by a repayment plan. Forbearance is simply the suspension of monthly payments (P&I, as well as escrow payments for taxes and insurance, or T&I) for up to a maximum of 12 months, including any pre-forbearance delinquency.[47] Financial documentation is not required, but the borrower must specify a hardship. Eligible hardships are listed on the Mortgage Assistance Application (Form 710) and include unemployment; reduction in income; increase in housing-related expenses; disaster impacting the property or the borrower's place of employment; long-term or permanent disability or serious illness of a borrower, co-borrower, or dependent family member; divorce or legal separation; separation of borrowers unrelated by marriage or civil union; death of borrower or primary or secondary wage earner; or distant employment relocation; or "other" with a required explanation.[48]

Borrowers who receive forbearance can repay the missed payments in a lump-sum and resume their previous monthly payments or can repay the full amount of missed payments over a period of up to five years, adding a small amount to every monthly mortgage payment. Or, a borrower may pursue a home retention program that doesn't require either of these shorter-term repayment alternatives.

[46] See FPRR-3Q2024.pdf.
[47] Source: Forbearance Plan | Fannie Mae.
[48] See https://guide.freddiemac.com/app/guide/form/710. Note that the borrower is not required to fill out Form 710.

The GSEs' **home retention** alternatives include:

Payment Deferral: resolves the delinquency of borrowers who have recovered from a temporary hardship and can resume making their originally scheduled monthly payment amount but cannot afford to repay their arrearages in a lump sum or a repayment plan.[49] Between two and six months of delinquent payments (P&I, T&I, and servicer corporate advances) can be deferred as a non-interest-bearing amount, which is due at loan maturity or payoff. No borrower-provided documentation is required.

A loan may have more than one payment deferral but no more than 12 months of cumulative past-due P&I payments from a payment deferral may be deferred over the life of the loan. The limit may be exceeded in cases where the borrower also received a disaster payment deferral.

Note that while forbearance followed by payment deferral has been described as a "loan cancellation," this term is a misnomer and mischaracterizes the borrower's obligation.[50] Any payments missed during forbearance that are resolved with a payment deferral *must* be repaid at the end of the loan, whether that be final maturity or a payoff due to a home sale or refinance. The borrower is *not* absolved of this debt and the delinquent amounts are not forgiven; only the timing of the payments has changed.

Flex Mod: provides borrowers facing an ongoing hardship with a 20% reduction in their monthly P&I payment.[51] To be eligible for a Flex Mod without providing documentation, a borrower must have missed three or more payments. A borrower who is in imminent default or has missed two or fewer payments must provide evidence of financial need by completing a borrower response package, in order to qualify for a Flex Mod. The GSEs require documentation to demonstrate hardship, because the borrower has not missed three payments nor borne the negative credit repercussions of delinquency.

The Flex Mod is a lower-of-rate modification and targets a 20% reduction in the borrower's P&I payment through a series of steps, summarized as follows:

1) Capitalize arrearages.
2) Determine the post-modification mark-to-market loan-to-value ratio (MTMLTV), which is the UPB after capitalization of arrearages divided by the estimated current value of the property.
3) If the MTMLTV is greater than or equal to 50% and the contractual interest rate is greater than the official modification interest rate,[52] reduce the rate in 0.125% increments until the target P&I reduction is achieved or the modification interest rate is reached.

[49] See Payment Deferral | Fannie Mae for a complete description of the program and eligibility requirements.
[50] For Example, see Slide 24 in AEI Housing Market Indicators, June 2024 | American Enterprise Institute - AEI.
[51] See Updates to Determining the Flex Modification Terms, Fannie Mae Flex Modification | Fannie Mae for a complete description of the Flex Mod.
[52] The Modification Interest Rate (Freddie Mac Modification Interest Rate - Freddie Mac Single-Family) is set monthly and typically tracks the Freddie Mac Primary Market Mortgage Survey rate (https://www.freddiemac.com/pmms).

4) Extend the mortgage term in monthly increments until the target P&I reduction is achieved or the term reaches 480 months.
5) If the MTMLTV is greater than 50%, defer principal in an amount needed to achieve a 20% reduction in P&I, where the deferred principal cannot exceed an amount that would create a post-modification MTMLTV = 50% using the interest-bearing principal balance and 30% of the gross post-modification UPB of the mortgage.

Note that the flexibility to use the lower of the contractual note rate and the prevailing interest rate in Step 3 improves the cost-effectiveness of the Flex Mod. If the contractual note rate is already less than the modification interest rate, then the note rate does not change as part of the modification, thus the "lower-of-rate" designation for the Flex Mod. However, if the contractual note rate is greater than the modification interest rate, the Flex Mod generates payment reduction in Step 3 by reducing the note rate on the modified loan until either the P&I reduction target is reached or the modification interest rate is reached, whichever comes first. Under these circumstances, the GSEs purchase the delinquent loan out of the MBS pool at par and can sell the re-performing loan for securitization at or above par, thereby reducing the cost of providing the Flex Mod relative to a market-rate modification.[53]

Should the GSEs wish to reduce the cost of the Flex Mod, they could consider putting term extension (Step 4) before interest rate reduction (Step 3), since term extension has little to no cost to the GSEs.[54] Today, such a move would have little impact—based on our representative SDQ GSE portfolio, less than 4% of loans, weighted by current UPB, have a note rate above the modification interest rate and would be eligible for interest rate reduction. However, as the GSE portfolio turns over or if the mortgage rate falls, the GSEs should consider this approach to reduce the cost of the Flex Mod by positioning term extension before interest rate reduction.

If the steps of the Flex Mod are exhausted without reaching the target payment reduction, the borrower is offered the Flex Mod as long as it doesn't result in an increase in their P&I payment. To test affordability, the Flex Mod has a TPP during which the borrower must make on-time payments, before the modification is made permanent. The TPP has a three-month term unless the borrower was current at evaluation for the Flex Mod, in which case it has a four-month term.

The GSE home retention alternatives largely reflect the best practices discussed in Section II. The solutions described above are streamlined for quick resolution and are ordered from least costly to most costly for the GSEs and, save for term extension, the steps of the Flex Mod are also ordered optimally.

[53] For a more detailed discussion of the cost drivers of the Flex Mod, see HPC Educational Resources: *Quantifying the Savings from the GSEs' Home Retention Programs*.
[54] For a detailed discussion of the relative cost of each step in a modification, see ssrn_id3849054_code2699240.pdf.

FHA's Current Early Intervention and Home Retention Alternatives

FHA's current home retention programs also reflect the best practices described above. It is notable that, in early 2024, in response to the post-pandemic spike in inflation and mortgage rates, FHA installed the FHA Payment Supplement solution. In order to generate loan reperformance and maintain the cost-effectiveness of their home retention program, FHA needed a home retention alternative that provided payment reduction without removing the loan from the MBS pool. Payment Supplement meets this need, as it can generate loan reperformance that would not have been possible with market-rate modifications that result in payment increases and high redefault rates.

Our analysis is based on the FHA home retention alternatives that are scheduled to take effect September 30, 2025.[55]

Like the GSEs, FHA also uses **early intervention** tools, including forbearance that can be followed by a repayment plan.[56] Forbearance suspends monthly payments (P&I and T&I) for an initial period of one to three months, up to a maximum of 12 months, including any pre-forbearance delinquency. No borrower-provided documentation is required.

Borrowers who receive forbearance can repay the missed payments in a lump-sum and resume their previous monthly payments or use an FHA Repayment Plan, which establishes an increased monthly payment for a fixed period to repay missed payments for borrowers who can afford the payment increase. Repayment plans are typically limited to a maximum of four missed payments and a 24-month term.

FHA's **home retention** alternatives rely on one set of eligibility requirements, designed to resolve the delinquency quickly, to reduce the costs to FHA:

- No documentation requirements when borrowers are three or more payments behind; attestation that the default is due to financial hardship and indication of payment capacity (can resume original payment or require a payment reduction).
- If the loan is current but the borrower is at risk of imminent default, FHA requires a certification of status *and* hardship documentation.
- All FHA home retention alternatives require a demonstration that the loan will reperform, as the borrower must complete a 3-month TPP before the home retention alternative is made permanent.

FHA has several home retention alternatives:

Standalone Partial Claim (PC): like the GSE payment deferral, the Standalone PC resolves the delinquency when a borrower can resume making their originally scheduled monthly payments but cannot afford to repay their arrearages in a lump sum or a repayment plan.

[55] Unlike the FHA home retention program that takes effect in September 2025, the COVID-19 Recovery Options do not include TPPs.
[56] For a description of all FHA home retention options, see Updates to Servicing, Loss Mitigation, and Claims.

The size of the subordinate lien associated with the PC is limited by statute—the outstanding, cumulative balance on all PCs is limited to 30% of UPB as of the date of default. Like the payment deferral, the Standalone PC is a non-interest-bearing loan due at loan maturity or payoff.

Because the Standalone PC is more costly to FHA than a Standalone Loan Modification (described below), the Standalone Loan Modification is deployed prior to a Standalone PC, if a Standalone Modification provides at least a $1 reduction in the borrower's monthly payment.

Like GSE forbearance and payment deferral, FHA forbearance followed by a Standalone PC has also been mischaracterized as a loan cancellation, but again, any payments missed during forbearance that are resolved with a Standalone PC must be repaid at the end of the loan, whether that be final maturity or a payoff due to a home sale or refinance. The borrower is not absolved of this debt and the delinquent amounts are not forgiven; only the timing of the payments has changed. FHA absorbs the interest cost of the delayed repayment; the borrower is not charged interest on the Standalone PC amount.

Standalone Loan Modification: the Standalone Loan Modification is a market-rate modification that capitalizes arrearages and then targets a 25% P&I reduction. If a 30-year loan at PMMS + 0.25% can reach the target, it is offered to the borrower. If not, if and 40-year loan at PMMS + 0.50% can reach the target, it is offered to the borrower. If not, the borrower is evaluated for a Combination Loan Modification and PC.

Combination Loan Modification and Partial Claim: is also a market-rate modification that targets a 25% reduction in P&I, but the Combination Modification uses the PC to defer principal up to the 30% of UPB statutory limit. Arrearages are capitalized and, if the 25% P&I reduction target can be reached with a 30-year Combination Modification at PMMS + 0.25%, it is offered. If not, a 40-year Combination Modification at PMMS + 0.50% is used, as long as it can reduce P&I by at least 15%.

It is important to acknowledge that, historically, the Standalone Loan Modification and the Combination Loan Modification and Partial Claim have been much more cost-effective at avoiding preventable dispositions than they are today. Mortgage defaults tend to increase during economic downturns, and economic downturns are typically accompanied by falling interest rates. As long as the prevailing mortgage rate is at or below the existing note rate on an SDQ loan, these FHA modifications can reach a 25% P&I reduction. This condition has not been the market experience for the last several years, which is why FHA introduced the Payment Supplement PC program.

Payment Supplement: uses the same PC approach and therefore provides the same cost-saving to the FHA, to temporarily reduce the borrower's monthly payment by up to 25% for three years. Because the Payment Supplement only provides temporary payment relief, whereas a loan modification provides permanent payment relief, the borrower is offered a

40-year Combination Modification if it can provide the borrower with a lower monthly payment than the Payment Supplement.

The FHA home retention alternatives are also broadly consistent with the best practices outlined in Section II. The steps are ordered from least costly to most costly for FHA. Among home retention alternatives, when a 30-year Standalone Loan Modification provides a payment reduction, it is offered in lieu of a Standalone PC because it is cheaper for FHA. The Standalone Loan Modification is offered before the Combination Loan Modification and Partial Claim because the latter defers principal when necessary to reach the target payment and therefore can be more expensive for FHA. When FHA's market-rate modifications cannot deliver sufficient payment reduction to generate loan reperformance because note rates are lower than the prevailing market rate, FHA uses the Payment Supplement instead, allowing the loan to remain in the MBS pool and providing a cost-effective resolution for FHA.