

CHAPTER 5: SPECIAL SERVICING

5.1 OVERVIEW OF SPECIAL SERVICING [7 CFR 3550.201]

The majority of Agency borrowers repay their loans without the need for special servicing. However, some borrowers will encounter financial or personal problems that make it difficult or impossible for them to meet the terms and conditions of the loan. Other borrowers may prove unwilling to do so. In either case, the Agency's response begins with special servicing activities that are designed to help the borrower become current and succeed in repaying the loan. Exhibit 5-1 summarizes the special servicing tools that can be used to help a borrower succeed in repaying a loan. Each of these tools is discussed in detail in this chapter. If, even with the special servicing assistance the Agency can offer, the borrower is unable or unwilling to continue with the loan, the Agency must take action to liquidate the loan in the most cost-effective manner.

A. Time Frame for Servicing Action [7 CFR 3550.202]

An account is considered past due if the scheduled payment has not been received by the due date. A late fee will be assessed if the scheduled payment is not received by the 15th day after the due date. Monthly-pay accounts may be liquidated without further servicing when:

- An amount equal to three scheduled payments is past due; or
- An amount equal to two scheduled payments has been past due for at least 3 consecutive months.

Exhibit 5-2 illustrates these time frames.

For annual-pay borrowers, the account may be accelerated without further servicing when at least three-twelfths of one scheduled payment has not been received by its due date.

B. Identifying Special Servicing Accounts

Accounts that require special servicing should be identified well before either of these thresholds has been reached. In some instances, the borrower may notify the Centralized Servicing Center (CSC) of a problem, such as the loss of employment, even before a single payment has been missed. In other cases, CSC will initiate regular followup and counseling with the borrower because of past due amounts. Generally, any borrower with past due amounts equal to two scheduled payments should be referred to a counselor for special servicing.

Exhibit 5-1

Special Servicing Tools



General Servicing

- Regular followup and counseling for delinquent accounts.
- Conversion of delinquent annual-pay borrowers to monthly payments.



Delinquency Workout Agreements

- Through delinquency workout agreements of up to 2 years, borrowers agree to make the required monthly payment plus an amount that will bring the account current.



Protective Advances

- Most commonly used to pay taxes and insurance and initial contributions to a newly established escrow account.
- May also be used to provide funds for repairs to the security property if the borrower cannot qualify for a subsequent loan.
- Advances are repaid through a lump sum, payment schedule consistent with the borrower's ability to pay, or by reamortizing the loan.



Payment Assistance

- Payment assistance to reduce the borrower's required payment may be made available to eligible borrowers living in eligible units.
- Borrowers with program loans made before August 1, 1968, and nonprogram borrowers may be able to refinance in order to receive payment assistance.



Moratoriums

- A moratorium "stops the clock" on payments for up to 2 years to enable the borrower to recover from losses of income or unexpected expenses.
- Amounts that accrue during the moratorium are repaid in a lump sum or by reamortizing the loan and including the amounts accrued in the outstanding balance.

Exhibit 5-2

Illustration of Past Due Time Frames

Scheduled payment due is \$400 (principal and interest portion equals \$325; taxes and insurance portion equals \$75.)

Example 1: An amount equal to 3 scheduled payments is past due.

	<u>Account Balance Due</u>
April 1: No payment is received.	\$400
April 2: <i>This account is past due.</i>	
April 16: A late fee will be assessed.	\$413
May 1: No payment is received.	\$813
May 16: A second late fee will be assessed.	\$826
June 1: No payment is received.	\$1,226
June 2: An amount equal to 3 scheduled payments is past due.	\$1,226

Example 2: An amount equal to 2 scheduled payments is past due for at least 3 consecutive months.

	<u>Account Balance Due</u>
April 1: No payment is received.	\$400
April 2: <i>This account is past due.</i>	
April 16: A late fee will be assessed.	\$413
May 1: Borrower pays \$200.	\$613
May 16: A late fee will be assessed.	\$626
June 1: No payment is received.	\$1,026
June 2: <i>An amount equal to 2 scheduled payments is past due - first month.</i>	
June 16: A late fee is assessed.	\$1,039
July 1: Borrower pays \$300.	\$1,139
July 2: <i>An amount equal to 2 scheduled payments is past due - second month.</i>	
July 16: A late fee is assessed.	\$1,152
August 1: Borrower pays \$400.	\$1,152
August 2: <i>An amount equal to 2 scheduled payments is past due -- third month.</i>	

NOTE: These examples are presented to illustrate the time frame in which the Agency could initiate liquidation without further servicing. **But** in practice, the Agency should intervene with other servicing actions well before the date that liquidation is permitted.

C. Developing a Servicing Strategy

The circumstances of each borrower are unique, and the servicing strategy for each should be tailored to the individual circumstances. The special servicing tools in this chapter often may be used in combination.

For each special servicing account, CSC must work with the borrower to develop a reasonable servicing strategy with the borrower. Servicers must carefully document the strategy and each contact with the borrower.



Example - Combining Special Servicing Tools

A borrower who loses employment may become delinquent before contacting CSC for assistance. Such a borrower may be eligible for new or increased payment subsidies or be eligible for a moratorium. Alternatively, the borrower may require a delinquency workout agreement to correct the past due amount.

A borrower may need a moratorium on payments in the case of a serious illness of a household member. The borrower may also need to reamortize the loan at the end of the moratorium period.

D. Borrowers Who Have Filed for Bankruptcy

All servicing actions connected with a borrower who has filed for bankruptcy protection under any Chapter of the Bankruptcy Code should be handled on a case-by-case basis, with advice from the Office of General Counsel (OGC). This paragraph summarizes the key concepts surrounding the types of bankruptcies that most frequently affect Agency servicing actions.

When a borrower files a petition under the Bankruptcy Code, the court initially prohibits further collection actions by creditors by entering a stay. If CSC receives the petition, it should be forwarded to OGC with any supporting materials. When a borrower has filed for bankruptcy protection, CSC should obtain a Notice of Commencement of Bankruptcy from the bankruptcy court to document the bankruptcy activity for the borrower's file.

CSC should continue to send monthly statements to borrowers who have filed for bankruptcy unless notified by OGC to stop sending statements to borrowers in a particular jurisdiction. All other collection actions must be discontinued until approved by OGC. Payments made voluntarily by the borrower should be accepted.



Cease Collections

CSC must not pursue collection activities for borrowers who have filed for bankruptcy.

The Agency does not need to attend bankruptcy proceedings unless OGC advises it. If an Agency presence is required, Field Staff should be asked to attend the proceedings.

1. Proof of Claim

Official Bankruptcy Form 10, Proof of Claim is used to itemize the Agency's claims against the borrower for the bankruptcy court. It must be filed within 180 days after the date the bankruptcy was filed, unless the date is changed by the bankruptcy court. No *Proof of Claim* needs to be submitted for Chapter 7 no-asset cases or in cases where OGC determines that the Agency's claim, exclusive of recapture, is fully secured.

2. Chapter 13 Cases

Under a Chapter 13 bankruptcy plan, the borrower will continue to make scheduled monthly payments during the life of the plan. If the borrower was in default on an Agency debt at the time the plan was developed, the plan should specify a schedule under which the borrower will repay the delinquent amount during the term of the plan

CSC may use special servicing actions, such as granting payment assistance or a moratorium, to help the borrower make scheduled monthly payments. If a borrower does not make scheduled payments according to the plan, CSC should request OGC guidance in working with the bankruptcy court to resolve the problem. The Agency is not permitted to accelerate the account without the consent of the bankruptcy court, even if the borrower meets the Agency's criteria for liquidation.

Normal servicing may be resumed when the stay is terminated and the trustee has released any interest in the Agency's security. This will automatically occur when the bankruptcy case is dismissed and closed or the plan is complete and the case is closed.

3. Chapter 7 Cases

Under Chapter 7 bankruptcy, the borrower is given the option to liquidate property that he or she can no longer financially retain which may include the Agency's security property. The Agency is not permitted to accelerate the account without the consent of the bankruptcy court, even if the borrower meets the Agency's criteria for liquidation, until the property is no longer property of the bankruptcy estate. Property will cease to be part of the bankruptcy estate if the property is abandoned by the bankruptcy trustee and the borrower receives a discharge or, if the property has not been abandoned, on the earliest to occur of: (1) the date the case is closed; (2) the date the bankruptcy is dismissed; or (3) the date the debtor receives a discharge.

If the borrower will retain the security property, CSC should request that the borrower execute a “reaffirmation agreement.” Under this agreement, the borrower promises to resume payments to the Agency once the bankruptcy case is discharged and would again be personally liable for the debt. If the borrower does not execute a reaffirmation agreement before discharge, *Handbook Letter 102(3550), Continuation with Unreaffirmed Debt After Discharge in Bankruptcy*, must be sent to the borrower after discharge. CSC should resume normal servicing procedures for borrowers who have received discharges under Chapter 7, and who have executed a reaffirmation agreement or who have received *Handbook Letter 102(3550)*. A borrower who is discharged under Chapter 7 of the Bankruptcy Code and has not signed a reaffirmation agreement is no longer personally liable for the debt.

E. Developing a Problem Case Report

When special servicing is required, the borrower’s case will typically be referred to a Servicer who specializes in counseling. In order to become familiar with the case, the Counselor should review the borrower’s information and begin a problem case report.

The problem case report is an automated screen that consolidates basic information about the loan and borrower. While some information may not be available when the problem case report is started, all information should be provided before a recommendation for liquidation is made. The problem case report:

- Summarizes the status of the loan and the servicing actions taken or considered;
- Identifies delinquent taxes and other liens against the security, all borrowers and cosigners, and any others who may have an interest in the property;
- Provides information on borrower income and assets and the value of the security property;
- Makes recommendations regarding foreclosure and how other lien holders will be handled.

The problem case report is a living document. It should be updated at key points in the servicing process to summarize all servicing actions that are taken. In this way, the problem case report can serve as an organized reference to the status of the account -- making it easy for the Counselor to review the case and discuss it with supervisors. When the Counselor determines that the borrower cannot be successful or if the borrower fails to cooperate by refusing: (1) to

provide information; (2) to agree to a reasonable repayment schedule for the deficiency; or (3) to meet the terms of the agreed upon delinquency workout agreement, the Counselor will complete the problem case report and make a recommendation for liquidation when it is in the best interest of the Government. The problem case report will be submitted to the Counselor's supervisor for review and approval.

5.2 DELINQUENCY WORKOUT AGREEMENTS [7 CFR 3550.205]


Delinquency workout agreements permit borrowers to stop liquidation action by agreeing to pay, in addition to the scheduled payment, an extra amount that will bring the account current within 2 years or the remaining term of the loan, whichever is shorter.

A. Eligibility

Delinquent borrowers with either program or nonprogram loans may be eligible for a delinquency workout agreement. However, a Servicer cannot approve more than one agreement with a particular borrower within a 2-year period without approval from a supervisor. As a condition for approval of a delinquency workout agreement, monthly pay borrowers must be on escrow and annual-pay borrowers with monthly income must convert to a monthly payment schedule and be on escrow.

B. Related Servicing Actions

Before proceeding with a delinquency workout agreement, it is important to understand the reasons for the delinquency. If the borrower has had difficulty making regular payments because the borrower lost income or had unexpected expenses, a delinquency workout agreement alone will not solve the problem. In such cases a moratorium, rather than a delinquency workout agreement, may be the appropriate servicing strategy. For eligible borrowers, new or additional payment subsidy also may be needed.



Realistic Promises to Pay

An important aspect of a Servicer's counseling role is to help borrowers avoid entering into unrealistic delinquency workout agreements. Delinquency workout agreements should not be used unless available information supports the borrower's promise to pay.

C. Processing Delinquency Workout Agreements

1. Determining a Reasonable Payment

Any time a borrower requires over 60 days to repay a delinquency, CSC conducts an analysis of the borrower's financial circumstances based upon necessary and essential

family expenses to determine a reasonable monthly payment amount and repayment term (not to exceed 24 months). The borrower should provide to CSC the necessary information for the analysis. To determine an amount for the delinquency workout agreement, a ratio of 41 percent of annual income will be used. After determining 41 percent of the borrower's annual income, subtract the annual amount for principal, interest, real estate taxes, and insurance, child support payments, and installments on consumer and medical debts which will require longer than 6 months to repay. The amount remaining will be used to establish a delinquency workout agreement. In situations where the balance will not pay off the delinquency within 24 months, or there is a negative balance, a delinquency workout agreement will not be established, unless the borrower firmly asserts that they can repay the delinquency within 24 months.

2. Confirming the Agreement

For borrowers who agree to pay delinquent amounts within 30 days, the reaffirmation agreement must be documented. Borrowers who need more than 30 days to repay a delinquency must be sent a letter confirming the repayment agreement. Borrowers who require a formal delinquency workout agreement (any agreement that exceeds 60 days) will receive an adjusted billing statement that itemizes the additional amount to be paid.



3. Late Fees on Delinquency Workout Agreements

Late fees accrued during the term of the agreement will be waived for months in which the borrower pays according to the agreement.

4. Borrower Failure to Pay

If a borrower required to make payments under a delinquency workout agreement is more than 30 days past due, the agreement is automatically canceled. If the borrower's failure to comply with the terms of the agreement is the result of additional financial problems, additional servicing options may be considered. If the borrower is unwilling to comply with the agreement or if, even with all available servicing options, the account cannot be brought current, the loan should be liquidated.

5. Bringing the Account Current Through Reamortization

Borrowers who have been successfully paying the amounts due under a delinquency workout agreement may be offered the opportunity to have the outstanding balance

Paragraph 5.2 Delinquency Workout Agreements [7 CFR 3550.205]

reamortized over the remaining term of the loan. To be eligible for reamortization: (1) the remaining term of the delinquency workout agreement must be at least 12 months; and (2) the borrower must have been making full payments without incurring any late fees for at least 6 months.

As a condition of reamortization, annual-pay borrowers with monthly income must convert to a monthly payment schedule, and the borrower must agree to the establishment of an escrow account for taxes, insurance, and related costs. Annual-pay borrowers without monthly income will be encouraged to convert to a monthly payment schedule, but are not required to convert to a monthly schedule or establish an escrow.

5.3 USING PAYMENT ASSISTANCE AS A SPECIAL SERVICING ACTION *[7 CFR 3550.204]*

Payment assistance is offered as part of a special servicing strategy to help prevent future delinquent payments by adjusting the monthly payment to an amount the borrower can afford. However, providing payment assistance alone will not cure a delinquency. Therefore, payment assistance must be used in conjunction with either a delinquency workout agreement or a moratorium. Detailed instructions for processing payment assistance are provided in Chapter 4.

A. Refinancing Loans to Permit Payment Assistance

Payment assistance cannot be provided in conjunction with loans made before August 1, 1968, or with loans made on above-moderate or nonprogram terms. However, borrowers who are in danger of losing their homes due to circumstances beyond their control may be permitted to refinance their loans to enable them to obtain payment assistance. Before proposing that a loan be refinanced, the Servicer should consider whether other servicing actions can solve the problem without payment assistance. If not, the Servicer must consider whether the payment assistance that will be provided, plus any other available servicing actions, will be sufficient to remedy the delinquency and place the borrower in a position to remain current on the new loan. To do so, the Servicer should:

- Confirm that the borrower would be income-eligible for payment assistance following the procedures in Chapter 4; and
- Use FASTeller to estimate the borrower's monthly payments if the loan were refinanced.

If refinancing the loan appears feasible, CSC should request that the appropriate Field Office originate the new loan. No additional servicing actions are taken on the account until the Field Office makes a determination about refinancing the loan.

B. Servicing Actions While the Request for Payment Subsidies Is Processed

During the time that it takes to receive and verify income data and determine that the family is eligible for payment assistance, the account continues to accrue late fees.

5.4 PROTECTIVE ADVANCES [7 CFR 3550.206]

The Agency may advance funds to pay for fees and services that are needed to protect the Government's interest in either program or nonprogram property. Protective advances are generally only considered when the Agency cannot provide a subsequent loan for such purpose to the borrower. This could occur because the borrower does not meet current eligibility requirements, a lack of funds, or an unwillingness of the borrower to cooperate. When CSC becomes aware that a borrower may need a subsequent loan or protective advance, they will refer the case to the Field Office, and cue the Field Office accordingly. The Agency recovers the amounts advanced by charging the borrower's account. Amounts advanced are due with the next scheduled payment. If the borrower is unable to repay the advance in a lump sum, the Field Office may request that CSC schedule repayment consistent with the borrower's ability to pay or reamortize the loan.

A. Advances for Property Repairs

Protective advances for property repairs are made only to protect the Government's interest in the security property and should be considered only if the repairs cannot be financed through a subsequent loan. Advances will bear interest at the promissory note rate of the loan against which they are charged. Advances for borrowers with multiple loans secured by the same property should be charged against the largest loan.

1. Determining the Need for Repairs

The need for repairs may be identified by either the borrower, Field Office, or CSC. Field Offices are responsible for completing an inspection of the property, an environmental review, developing a description of the work required, preparing a cost estimate, and approving the protective advance.

Paragraph 5.4 Protective Advances [7 CFR 3550.206]

2. *Alternative Sources of Funding*

Before processing the advance, the Field Office must first determine whether it appears that the borrower qualifies for a subsequent loan. If a subsequent loan appears feasible, the Field Office will process a loan application immediately. If the need for a protective advance is so urgent or if it is clearly apparent that the borrower would not qualify for a loan, is uncooperative, or that a protective advance is more appropriate, the Field Office may proceed immediately with an advance.

B. Advances for Other Purposes

In order to protect the Government's interest, protective advances also may be used for other purposes. These types of advances will be processed and approved by Field Offices or CSC, as appropriate. Field Staff will coordinate efforts with CSC for any loan which is still under the jurisdiction of CSC. Protective advances for other purposes include such items as:

- Paying off a senior lien holder who intends to foreclose in cases where the Agency is a junior lien holder;
- Paying taxes or insurance premiums that are past due; or
- Paying for local assessments.

5.5 MORATORIUMS [7 CFR 3550.207]

A moratorium is an agreement between the Agency and a program borrower to suspend the requirement for the borrower to make payments for up to a 2-year period. A moratorium is intended to help a borrower who is experiencing *temporary* financial difficulties avoid foreclosure. Before considering a moratorium, a borrower must first be considered for payment subsidy, or if currently receiving a payment subsidy, an increase in such assistance. A nonprogram borrower is not eligible for a moratorium.

A. Eligibility

For a borrower to be eligible for a moratorium, all of the following conditions must be met:

- Due to circumstances beyond the borrower's control, the borrower is temporarily unable to continue to make scheduled payments because:
 - ◇ The borrower's repayment income fell by at least 20 percent within the past 12 months. The change in repayment income is based only on the income of parties to the note who are living in the household, or
 - ◇ The borrower must pay unexpected and unreimbursed expenses resulting from the illness, injury, or death of the borrower or a family member, or
 - ◇ The borrower must pay unexpected and unreimbursed expenses resulting from damage to the security property in cases where adequate hazard insurance was not available or was prohibitively expensive.
- The borrower occupies the dwelling, unless RHS determines that it is uninhabitable or the borrower may be temporarily absent, and
- The borrower's account is not currently accelerated, and
- The loan was written on program terms.



Multiple Moratoriums

A borrower may be eligible for more than 1 moratorium over the life of the loan. No waiting period between moratoriums is required *if* new circumstances qualify the borrower for a new moratorium at the end of a moratorium.


B. Initiating the Request for a Moratorium

Although some borrowers may be knowledgeable enough to request a moratorium, more typically CSC will recognize that a borrower is a candidate for a moratorium and propose it to the borrower. Regardless of which party initiates the discussion, the borrower must request the moratorium and provide financial information to enable CSC to determine whether the borrower's new financial circumstances support the request for a moratorium. The Servicer should carefully document the request. Moratoriums are not available to nonprogram borrowers.



C. Evaluating and Acting on the Request

A moratorium is not an appropriate servicing tool for borrowers whose circumstances have changed in such a way that it is unrealistic to anticipate recovery within the maximum moratorium period. Both the borrower’s plans and the Servicer’s judgment enter into this decision. To evaluate the situation, the Servicer must:



Three Key Steps In Evaluating a Moratorium Request

- Confirm the facts of the case.
- Determine whether a moratorium is the appropriate remedy.
- Determine an appropriate monitoring schedule.

- Determine whether the borrower may be eligible for payment assistance or, if already on a payment subsidy, for an increase in such assistance.
- If it is determined that the borrower cannot make the scheduled payments, determine whether the cause is due to reasons beyond the borrower’s control;
- Conduct a financial analysis to determine whether, given the new circumstances, the borrower is unable to make the scheduled payment;
- Determine whether there is reason to believe that the borrower’s financial problems are temporary -- that is, can be sufficiently resolved within 2 years to enable the borrower to resume making scheduled payments; and
- If the borrower’s request is approved, notify the borrower in writing; or
- If the borrower’s request is rejected, notify the borrower and provide information about the appeal process described in Paragraph 1.9.

D. Monitoring Borrower Accounts During the Moratorium

Moratoriums are permitted only for as long as the borrower’s circumstances prevent repayment of the loan. Borrowers are required to report changes in the circumstances on which the moratorium is based. For example, if a moratorium is granted because a borrower loses a job, the Agency must be notified when the borrower finds employment.

Borrower eligibility for a continuation of the moratorium should be reviewed at least once every 6 months. The precise schedule should be worked out based on the borrower’s individual situation. For borrowers who receive payment subsidy, one of the semiannual reviews should be conducted simultaneously with the annual income re-examination.

When the moratorium is linked to unexpected expenses, the borrower periodically must submit evidence to document that those debts are being paid. Acceptable forms of documentation include certifications from the payee, copies of paid receipts, or canceled checks or money orders.

E. Cancellation of a Moratorium

CSC should cancel the moratorium if:

- The borrower does not respond to a request for financial information;
- The Agency receives information indicating that the moratorium is no longer required; or
- The moratorium was granted due to unexpected and unreimbursed expenses, and the borrower cannot show that an amount at least equal to the deferred payments has been applied toward the expenses.

If a cancellation is required, CSC must notify the borrower. If a borrower provides the information necessary to justify continuance of the moratorium within 30 days of the notification, CSC should continue the moratorium.

F. Resumption of Payments

At least 60 days before the moratorium is scheduled to expire, CSC should review the borrower's account to determine whether the borrower is able to resume making scheduled monthly payments. Unless current income data is available, the borrower must provide updated financial information.

1. Reamortization

When the borrower is able to resume scheduled payments, but is unable to bring the account current immediately, the loan will be reamortized to include the amount deferred during the moratorium. As a condition of reamortization, monthly payment borrowers not currently on escrow and annual-pay borrowers with monthly income must convert to a monthly payment schedule. They must also agree to the establishment of an escrow account.

2. Forgiving Interest

If the new monthly payment, after consideration of the maximum amount of payment subsidy available to the borrower, exceeds the borrower's repayment ability, interest accrued during the moratorium period may be forgiven. The amount of interest to be forgiven is limited to the amount required to demonstrate repayment ability.

3. Borrowers Unable to Resume Payments

If, after the approved moratorium period, the borrower is unable to resume payments, the account must be liquidated, as described in Chapter 6.

5.6 THE LIQUIDATION RECOMMENDATION

At any point during the special servicing process, it may become clear that the borrower will be unable to succeed and that liquidation is appropriate. The Servicer should discuss this issue openly with the borrower and encourage the borrower to consider voluntary liquidation.

After discussing the situation with the borrower, the Servicer should use the problem case report to recommend liquidation and submit it to a supervisor for approval. Chapter 6 describes the various methods of liquidation that are available. The problem case report should document that the Counselor has pursued all appropriate servicing actions and summarize the reasons for the liquidation recommendation.

