

Legal Update

Impact of Climate Change on US Residential Mortgage Servicing

Whether or not climate change is real and represents an existential threat and, if so, regardless of the reasons for it, the number and severity of domestic natural disasters appear to be on the rise. And, if you are a mortgage servicer dealing with disaster-related damage to mortgaged properties and the related mortgagor defaults, it probably does not matter why. What matters the most is whether the servicer bears the risk of loss resulting from borrower defaults arising out of natural disasters and that exceed property insurance proceeds, even though the servicer has no beneficial ownership interest in the loan.

As we detail below, the credit risk of loss following a mortgagor default resulting from a natural disaster rests in part with the servicer when the loan is pooled to back securities guaranteed by the Government National Mortgage Association (“Ginnie Mae”)—the most common form of ownership of government-insured or -guaranteed loans. And the servicer morphs into the actual holder of the loan following an early pool buy-out. If the frequency and severity of natural disasters continue to increase due to climate change or mere random acts and property-related insurance proves to be insufficient to cover the costs of property repair and rebuilding, the appetite of servicers to service government-insured or -guaranteed loans and acquire the related servicing rights could well be materially diminished. A reasonably likely consequence of this diminished appetite could be lessened availability or increased costs of government-insured or -guaranteed residential mortgage loans.

Impact of Climate Change on Financial Services

The US government has investigated and reported on the risks climate change poses to financial services. Most recently, the Commodity Futures Trading Commission (“CFTC”) issued a report documenting these risks and how to manage them.¹ The CFTC found that “[c]limate change poses a major risk to the stability of the US financial system and to its ability to sustain the American economy” and that such impacts are already occurring.² Specifically, the CFTC identified risks that included disorderly price adjustments in various asset classes, the potential inability of market participants to adapt to rapid changes in policy that will be necessary for a large-scale transition to a net-zero emissions economy, and limitations in the availability of credit and financial products.³

With regard to real estate, the CFTC noted that climate change is already affecting and will likely continue to have an increasing impact on real estate values.⁴ The Commission cited several studies showing depressions in certain housing markets because of flooding and wildfire risks.⁵ Flooding, wildfires, or other natural disasters in a large region could result in a swift increase in mortgage delinquency and prepayment rates, similar to the current impact of the COVID-19 pandemic.⁶ Recent studies suggest that lenders are passing along riskier mortgages to government-sponsored entities in order to reduce the risk on their own books.⁷ The US government, and accordingly US taxpayers, will ultimately have to pay if these risky mortgages default.⁸ The CFTC identified several financial assets that have significant exposure to climate change impacts, including: mortgages, mortgage-backed securities, government-sponsored enterprise credit risk transfer securities, and real estate investment trusts, among other assets.⁹ Further, estimates place more than half of mortgaged properties at risk of climate-change exacerbated flooding outside of current recognized flood zones, meaning that these properties are at a higher risk of being underinsured and accordingly at higher risk of default.¹⁰

State governments are also considering the impacts of climate change on the financial industry. On October 29, 2020, New York's Department of Financial Services ("DFS") issued guidance providing background information on climate risks and outlining DFS's expectations for regulated financial institutions in New York to manage financial risks from climate change.¹¹ The letter notes that residential homes in New York City with \$334 billion of reconstruction value are at high risk of storm surges. In addition, the letter cites a study finding that current climate data show 70% more (14.6 million) properties in the United States are at substantial risk of flooding than the current Federal Emergency Management Agency classification of 8.7 million properties, indicating that these additional properties could have insufficient flood insurance.¹² In response to these impacts, among others, DFS now expects all regulated banking organizations to start integrating the financial risks from climate change into their governance frameworks, risk management processes, and business strategies and to start developing their approach to climate-related financial risk disclosure.¹³ DFS also expects all regulated non-depository financial institutions to conduct a risk assessment of the physical and transition risks of climate change and to start developing strategic plans to mitigate such risks.¹⁴ The agency also noted that it is planning on issuing further guidance on this issue, including integrating climate-related risks into its supervisory process.¹⁵

Mortgage issuers and insurance companies have already started changing their lending and insurance practices regarding environmentally risky properties as a result of these risks. Lenders have virtually refused to mortgage environmentally risky properties worth too much for federal mortgage backers to accept, but have continued making loans secured by similar, lower-priced homes that meet the requirements of government insurers.¹⁶ Lenders then quickly pass the loans, along with their risks of damage, to federal mortgage backers. Similarly, insurers have raised rates or outright refused to provide insurance for properties at high risk for natural disasters.¹⁷ Despite attempts to withdraw policies and raise rates, however, some states have enacted laws and regulations that either subsidize the cost of affordable insurance or provide a state option, called Fair Access to Insurance Requirements Plans.¹⁸ Yet even if there is hazard or flood insurance, it may be insufficient in amount or claims may be rejected or delayed if there are questions of what actually caused the damage during a natural disaster.

Losses Borne by Servicers Resulting from Mortgagor Defaults Caused by Natural Disasters

In what ways would a loan servicer, which generally does not own a loan secured by a damaged mortgaged property, bear the risk of loss resulting from natural disasters for loans that default? In the first instance, we want to distinguish between two different types of losses related to property damage caused by natural disasters. First is the cost borne by the mortgagor to repair damage to the mortgaged property and that in the ordinary course is covered in whole or in part by hazard insurance, flood insurance, or other types of property-related insurance. Second is the loss borne by the servicer or holder of the loan if a mortgagor defaults on a loan because in part property-related insurance is insufficient or unavailable to cover the cost to repair extensive damage to the property resulting from a natural disaster. This Legal Update focuses on the latter scenario where a mortgagor essentially abandons a damaged mortgaged property and defaults on the related mortgage loan rather than go out-of-pocket to cover the cost of uninsured, substantial repair or rebuilding of the mortgagor's home. This may not be a typical scenario right now, but it does occur from time to time in response to major natural disasters and could well occur with much greater frequency in the future. Would the servicer bear the risk of loss in this latter scenario?

Servicers, of course, bear certain risks of loss on defaulted loans, regardless of the cause of the default. First, servicers do not receive servicing fees on non-performing loans, generally regardless of the reason for default. Second, at least in the case of servicing loans pooled in mortgage-backed securities, the servicer may have to advance to the securities holders regularly scheduled monthly mortgage payments of principal and interest. Whether the loans are serviced as whole loans or securitized loans, servicers also generally have to advance taxes, insurance, repair and preservation expenses, and foreclosure costs. In both cases, servicers generally have a right to reimbursement for these advances, but when and how much they are reimbursed differ based on the investor or insurer. In neither case does the servicer receive its cost of funds for such advances, including if the servicer self-funds or obtains third-party financing. Increased operational costs is a third type of loss realized by loan servicers dealing with defaulted loans secured by damaged properties. And, of course, servicers are required to service in accordance with applicable investor and insurer standards and they bear the risk of loss resulting from their own neglect in the monitoring of mortgaged properties in accordance with these standards.

Credit losses are the biggest potential risk of loss if a mortgagor defaults as a result of uninsured damage to the mortgaged property resulting from natural disaster. Except for a servicer's failure to service in accordance with applicable law and investor/insurer requirements, servicers generally do not bear the credit risk of loss for mortgagor defaults resulting from natural disasters damaging their homes. That makes sense. While servicers may bear the economic consequences noted above, they merely are service providers to loan holders. Consistent with the benefits and burdens of ownership, logically, the loan holders or insurers or guarantors, not the servicers, ultimately should be responsible for credit-related losses on defaulted loans resulting from natural disasters.

But government-insured or -guaranteed loans are another story, in large measure because of the way they are held. Residential mortgage loans insured by the Federal Housing Administration ("FHA") or guaranteed by the Department of Veterans Affairs ("VA") or the Rural Housing Service of the Department of Agriculture ("RHS") typically are pooled to back securities guaranteed by Ginnie Mae. While the loans are pooled, the servicer, known as the "issuer," retains legal title to the pooled loan. It

is obligated to advance regularly scheduled payments of principal and interest, without regard to whether the related mortgagors make those payments themselves or, if not, why not. This advance obligation survives for so long as the delinquent loan is in the Ginnie Mae pool. Ginnie Mae guidelines permit a servicer to repurchase a pooled loan when the loan reaches a certain level of delinquency and require a servicer to repurchase a pooled loan at par in order to modify the loan in accordance with agency requirements. At the point of repurchase of the pooled loan, the servicer also becomes the holder of the beneficial interest in the loan. Whether the loan remains pooled or subsequently is repurchased from the pool, if the mortgagor default arose out of insufficient insurance to restore natural disaster-damaged mortgaged properties, FHA, VA, and RHS look to the servicer or holder to bear this cost.

Impact of Damage to Mortgaged Properties Due to Natural Disasters on Claims for FHA Insurance and VA/RHS Guarantees

Mortgage insurance is designed to protect a loan holder against the risk of credit loss due to a borrower default. Unlike hazard insurance or flood insurance, it is not designed to protect against damage to property due to hazard events or floods. And unlike title insurance, mortgage insurance is not designed to protect against liens or encumbrances on a mortgaged property. Rather, it is designed to pay for losses resulting from a mortgagor's failure to pay his or her loan, after accounting for actual or potential recoveries from the sale of the underlying mortgaged properties and receipt of applicable insurance proceeds.

In the case of government-insured and -guaranteed loans, the mortgagee (typically the servicer) bears at least part of the cost of the resulting property damage. While the costs may be mitigated by private insurance policies, in some circumstances the mortgagee bears the risk for costs in excess of the insurance coverage and in the event the property is not sufficiently insured against the damage incurred. Federal government insurers/guarantors, such as the FHA, VA, and RHS, require mortgagees to repair damages caused by natural disasters (without reimbursement) or deduct the value of necessary repairs when submitting a defaulted loan for claim.

FHA-Insured Loans

The beauty of FHA insurance is that it covers a full one hundred percent of the outstanding principal balance of an insured loan, regardless of the value of the underlying mortgaged property. But realizing on that insurance is not absolute. When a mortgage insurance claim is filed, the mortgagee is responsible for the cost of surchargeable damage to a mortgaged property, which includes damage caused by fire, flood, earthquake, or tornado.¹⁹ The mortgagee is not responsible for property damage that exceeds the amount of its mortgage insurance claim as to a particular property, but the servicer's mortgage insurance claim is reduced by estimated costs to repair such damage.²⁰ Below, we lay out how property damage caused by natural disasters impacts the claims process for these loans.²¹ As a threshold matter, we note that, presently, the vast majority of unreimbursed surchargeable damage is based on mortgagee neglect, which is an extremely subjective standard. But, for purposes of this Legal Update, we assume mortgagee neglect is not an issue.

PRE-FORECLOSURE SALES

If a mortgagee seeks to enter into a pre-foreclosure sale agreement with a borrower and the mortgaged property has surchargeable damage, i.e., damage caused by natural disasters or

mortgagee neglect, the mortgagee is responsible for the cost of the damage and must obtain an estimate of the cost to repair the damage from HUD and then receive HUD approval of the proposed sale agreement.²² Alternatively, if the property is being sold “as is” subject to the damage, the mortgagee must deduct the government’s repair cost estimate of the damage from its pre-foreclosure sale claim.²³ If the property is being sold “as repaired” and funds for the surchargeable repairs will not be escrowed or provided as a credit to the borrower at closing, the mortgagee must not include in its net sale proceeds calculation the amount of the repair escrow or repair credit.²⁴ In contrast, if the damage is not considered surchargeable, the mortgagee is not required to obtain prior approval for the pre-foreclosure sale agreement.²⁵ Where applicable, the mortgagee must work with the borrower to file a hazard insurance claim and either use the proceeds to repair the property or adjust the pre-foreclosure sale claim by the amount of the insurance settlement or the government’s repair cost estimate.²⁶ If the mortgagee becomes aware that the property has sustained significant damage after a borrower has received approval to participate in a pre-foreclosure program, the mortgagee must re-evaluate the property to determine if it continues to qualify for the program or terminate participation if the extent of the damage changes the fair market value.²⁷

CONVEYANCE TO HUD

A mortgagee must receive prior approval to convey a property to HUD if it is damaged by fire, flood, earthquake, hurricane, tornado, or mortgagee neglect.²⁸ We understand that HUD rarely approves the conveyance of damaged properties, but we describe the rules nevertheless. In a request to convey damaged property, the mortgagee must provide documentation evidencing the damage and any repairs, including a detailed repair estimate of the damages and a detailed estimate of the cost to repair the property.²⁹ If the mortgagee fails to provide adequate documentation, HUD will attribute the damage to the mortgagee. In addition, if the mortgagee fails to obtain prior approval, HUD may reconvey the property to the mortgagee or require a reduction to the claim for insurance benefits.³⁰ If a property is reconveyed because of damage, the mortgagee must withdraw its claim for insurance benefits and reimburse HUD for property expenditures.³¹

When a property is substantially damaged such that the cost of restoring the structure to its before-damaged condition would equal or exceed 50% of the market value before the damage occurred, the mortgagee must ensure repairs comply with the federal building elevation standards and any higher applicable standards adopted by state or local governments.³²

In cases of surchargeable damage, the mortgagee must repair the property before conveyance unless prior approval is received from HUD.³³ The mortgagee cannot request reimbursement for such repairs.³⁴ If HUD does not require the mortgagee to make repairs, HUD will deduct from the mortgage insurance benefits the greater of any insurance recovery received by the mortgagee or HUD’s estimate of the cost to repair the property.³⁵ In the event the mortgagee has not received the hazard insurance proceeds by the time the mortgagee submits the claim, the mortgagee may estimate recovery.³⁶ If the actual recovery amount is less than the amount estimated, the mortgagee may request reimbursement of the difference between the expected amount of proceeds and the proceeds received if both are greater than HUD’s estimate of the damage.³⁷ The mortgagee is not entitled to reimbursement if it would reduce the deduction in insurance benefits to less than HUD’s estimate of the damage.³⁸

If a mortgagee seeks to convey a property damaged by a fire that was not covered by fire insurance at the time of the damage, or the amount of insurance coverage was inadequate to fully repair the damage, the mortgagee must complete a certification in order to limit the deduction from insurance

benefits to the amount of insurance recovery received by the mortgagee, if any.³⁹ The certification must include the following statements: at the time the mortgage was insured, the property was covered by fire insurance in an amount equal to the lesser of 100% of the insurable value of the improvements or the principal balance of the mortgage; the insurer later canceled this coverage or refused to renew it for reasons other than nonpayment of premium; the mortgagee made diligent efforts within 30 days of cancellation or non-renewal, and at least annually thereafter, to secure other coverage or coverage under a Fair Access to Insurance Requirements Plan to the extent such coverage was available at a reasonable rate; and that the mortgagee performed all required property preservation and protection actions.⁴⁰

CLAIMS WITHOUT CONVEYANCE OF TITLE

Instead of conveying a property secured by a delinquent mortgage to HUD, a mortgagee can secure a third-party purchaser for the property and submit a claim without conveyance of title (“CWCOT”) to HUD in order to receive mortgage insurance benefits.⁴¹ *A property with surchargeable damage is not eligible for the CWCOT process.*⁴² If surchargeable damage occurs after the required appraisal under the CWCOT process, the mortgagee must submit a variance to HUD and the Department will provide additional instructions as appropriate.⁴³

When a third party is the successful bidder at the foreclosure sale or the mortgagee elects to retain the property and file a CWCOT claim, the mortgagee may claim reimbursement for property preservation and protection costs incurred before the foreclosure sale.⁴⁴ If the property is sold as part of a post-foreclosure sales effort, the mortgagee may claim reimbursement for property preservation and protection costs incurred before the closing date.⁴⁵ HUD will not reimburse the mortgagee for any hazard insurance premiums allocated to the period after acquisition of title by the mortgagee or a third party.⁴⁶

VA-Guaranteed Mortgage Loans

Unlike an FHA-insured loan, a VA guaranty of a mortgage loan does not cover one hundred percent of the outstanding principal balance of the loan. Rather, the amount of the guarantee is based on a specified percentage of the original principal amount of the loan, with a minimum percentage of 25% but subject to other adjustments. Without going into the same level of detail that we provide above for FHA-insured loans, claims under VA mortgage guaranty policies generally proceed in one of two ways. One way calls for the holder to retain a property acquired by foreclosure or otherwise and the other calls for the holder to convey the property to the VA. Both ways result in the holder bearing the credit risk of loss for uninsured damages to mortgaged properties resulting from natural disasters.

The claims based on the holder’s retention of the acquired property rely on the applicable percentage of the guarantee in determining claims proceeds.⁴⁷ First, one takes the percentage of the loan originally guaranteed (as may have been adjusted in the case of a prior modification) and applies this percentage to the sum of the outstanding principal as of the date of the “liquidation sale” plus allowable expenses and permitted interest.⁴⁸ Against that sum is credited proceeds from the liquidation sale, and the amount of the claim may not exceed either the remaining balance of the “indebtedness” or the amount originally guaranteed.⁴⁹ So how does property damage fit into that equation? In cases where the holder does not convey the property to the VA, one will not find a specific reference to property damages in the statutory and regulatory calculation of the payable

claim. Rather, it will be reflected in the liquidation proceeds where one would expect a purchaser to take the damage into consideration when placing a purchase bid.

But, before carrying out a liquidation of the mortgaged property, the holder must notify the VA of the proposed sale, at which point the VA determines the “net value” of the property and the amount of the “total indebtedness” and notifies the holder of the VA’s determination of such net value.⁵⁰ For this purpose, the term “net value” means the amount equal to the fair market value minus the total of the amounts that the VA estimates it would incur if the VA were to acquire and dispose of the property (including property maintenance and property improvement).⁵¹ Presumably, repair of damage or related rebuilding resulting from natural disasters would reduce the “net value” of the property based on estimated property maintenance and property improvements.

What comes next depends on whether the net value of the property securing a defaulted loan exceeds the amount of the total indebtedness under the loan minus the guaranteed amount. If so, the holder may convey the property to the VA in return for a claims payment by VA of an amount equal to the lesser of such net value or total indebtedness.⁵² If not, the VA may not accept conveyance of the property.⁵³ In other words, the VA will accept conveyance of the property if VA determines that it is not likely to lose money if it pays more than it might otherwise pay without a conveyance of the property. In this regard, the holder may reduce or waive a portion of the indebtedness of the mortgage loan, such as a reduction of the principal, in order to reduce the “total indebtedness” calculation and thereby result in the VA accepting the conveyance of the property.⁵⁴

Holders of VA-guaranteed loans bear responsibility for any loss due to damage or destruction of the property sustained from the time the mortgagee acquires the property until the property is transferred to the VA.⁵⁵ Holders are required to ensure the property is insured in an amount sufficient to protect the property against potential risks or hazards customary in the locality.⁵⁶ In the event of a natural disaster, the VA expects holders to ensure appropriate action is taken to secure the property and ensure the borrower files a claim for the damage with the insurance carrier.⁵⁷ If the borrower fails to submit a claim or if the holder has acquired the property, the mortgagee must file a claim under the mortgagee clause.⁵⁸ The holder must also ensure that proceeds from the property damage claim are applied to the restoration of the security or to the loan balance.⁵⁹ If a holder fails to obtain and apply an adequate hazard insurance loss settlement in a timely manner, the holder’s VA claim may be reduced.⁶⁰ The VA regulations and guidance do not specify under what circumstances and by what amount the claim will be reduced. If the property is damaged by fire, earthquake, windstorm, or flooding, the holder must either repair the property or obtain prior approval from the VA before conveying the property to the VA.⁶¹

RHS-Guaranteed Loans

The claims process for RHS loans is similar to the process for VA loans, and the holder of the loan similarly bears the risk of loss from natural disasters. For single-family home mortgages, RHS guarantees up to 90% of the outstanding principal balance of the loan.⁶² The loss claim payment a holder can receive is equal to the difference between the total indebtedness on the loan and the net recovery value.⁶³ The net recovery value of the property is determined differently depending on whether the holder has sold the property at the time the claim is filed.⁶⁴ For a property that has been sold, the net recovery value is calculated by subtracting the amount of reasonable liquidation and disposition costs from the total amount recovered, including proceeds from the sale.⁶⁵ For a property that the holder has acquired, the net recovery value is based on an estimated property sale value that

is calculated using a predictive model that considers market value appraisal along with estimated management and acquisition costs and offsetting the total principal, interest, and marketing period expenses.⁶⁶ In addition, the predictive model accounts for historical loss claim data, loan characteristics at the time of default, and best practices from comparable models. The holder is required to submit the loss claim package, including the market value appraisal, to RHS within 60 days of the foreclosure sale, acquisition, or possession of the property.⁶⁷

Just as with VA-guaranteed loans, a property damaged by a natural disaster will have a lower net recovery value, and accordingly, the holder will receive a lower loss claim payment. In addition, if RHS determines that the amount of the loss was increased due to the holder's failure to comply with the conditions of the mortgage guarantee, RHS may reduce or deny any loss claim by the portion of the loss determined to have been caused by the holder's action or failure to act.⁶⁸ Properties that have sustained serious damage from natural disasters should not be considered for pre-foreclosure sale or deed-in-lieu of foreclosure if the cost of repair exceeds 10% of the "as repaired" appraised value until all insurance claims are resolved.⁶⁹

Conclusion

Absent a change in law or policy, increases in the severity and number of natural disasters will continue to heighten risks to servicers of mortgage loans pooled to back securities guaranteed by Ginnie Mae to the extent such damage is not sufficiently covered by hazard insurance, flood insurance, or other property-related insurance policies. The above provisions limit the amount a holder of an FHA-insured or VA- or RHS-guaranteed loan can recover after a property has suffered damage from natural disasters and insurance is insufficient to repair or rebuild; they essentially allocate that risk of loss to the servicer or holder. Those losses may be insubstantial presently, except in the case of really extreme natural disasters. But if the number and severity of natural disasters increase and property-related insurance increasingly is unavailable, unaffordable or insufficient, servicers may become more reluctant to assume this risk of loss. The natural consequence of the increase in the number and severity of natural disasters could well be an unwillingness of lenders to participate at the same scale in making, servicing, purchasing, and pooling government-insured or -guaranteed lending and servicing, as well as in purchases of the related servicing rights. The result would be decreased access of consumers to such loan programs or increased costs to obtain insured or guaranteed loans.

For more information about the topics raised in this Legal Update, please contact either of the following lawyers.

Laurence E. Platt

+1 202 263 3407

lplatt@mayerbrown.com

Kerri Elizabeth Webb

+1 202 263 3252

kwebb@mayerbrown.com

Endnotes

- ¹ CFTC, “Managing Climate Risk in the U.S. Financial System” (Sept. 9, 2020), <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>.
- ² *Id.* at i.
- ³ *Id.*
- ⁴ *Id.* at 16-17.
- ⁵ *Id.*
- ⁶ *Id.* at 31.
- ⁷ *Id.*
- ⁸ *Id.*
- ⁹ *Id.*
- ¹⁰ *Id.* at 36.
- ¹¹ Letter from Linda A. Lacewell, Superintendent, DFS, to the Chief Executive Officers or Equivalents of New York State Regulated Financial Institutions (Oct. 29, 2020), https://www.dfs.ny.gov/industry_guidance/industry_letters/il20201029_climate_change_financial_risks.
- ¹² *Id.*
- ¹³ *Id.*
- ¹⁴ *Id.*
- ¹⁵ *Id.*
- ¹⁶ Jesse M. Keenan & Jacob T. Bradt, “Underwaterwriting: from theory to empiricism in regional mortgage markets in the U.S.,” *Climatic Change* (June 2020).
- ¹⁷ Abrahm Lustgarten, “How Climate Migration Will Reshape America,” *New York Times* (Sept. 17, 2020).
- ¹⁸ *Id.* In some instances, state governments have also mandated that residential insurance companies provide relief to policyholders for damages caused by natural disasters. See, e.g., our October 2, 2020, blog post *CA Department of Insurance Asks Residential Insurers to Provide Relief to Policyholders Who Suffered Loss in Wildfires* authored by Kara Baysinger, Stephanie Duchene, and Philip A. Goldstein, available at <https://www.mayerbrown.com/en/perspectives-events/publications/2020/10/ca-department-of-insurance-asks-residential-insurers-to-provide-relief-to-policyholders-who-suffered-loss-in-wildfires>.
- ¹⁹ 24 CFR § 203.378(c); HUD Single Family Housing Policy Handbook 4000.1 (“HUD Handbook”) § III.A.2.I.ii.B.4.a.2.ii.
- ²⁰ 24 CFR § 203.378(d).
- ²¹ We do not address partial claims here, including those made in Presidentially-Declared Major Disaster Areas, because deductions for property damage are not made during the partial claims process. A subsequent claim on the property due to default on the loan, however, would undergo the standard claim requirements described below, including consideration of the condition of the property.
- ²² HUD Handbook § III.A.2.I.ii.B.4.a.2.iii.
- ²³ *Id.* § III.A.2.I.ii.B.4.a.2.iv.
- ²⁴ *Id.* § III.A.2.I.ii.B.4.a.2.v.
- ²⁵ *Id.* § III.A.2.I.ii.B.4.b.
- ²⁶ *Id.* § III.A.2.I.ii.B.4.c.
- ²⁷ *Id.* § III.A.2.I.ii.B.4.d.
- ²⁸ 24 CFR § 206.142(a); HUD Handbook § III.A.2.t.ii.A.
- ²⁹ HUD Handbook § III.A.2.t.ii.D.2.b.
- ³⁰ 24 CFR §§ 203.379(c); HUD Handbook § III.A.2.t.ii.D.3.
- ³¹ HUD Handbook § IV.A.4.F.1.
- ³² *Id.* § III.A.3.c.iii.
- ³³ 24 CFR § 206.142(a). This requirement also applies to multifamily units. *Id.* § 234.270(a)(2).
- ³⁴ HUD Handbook § IV.A.2.a.ii.A.2.a.
- ³⁵ 24 CFR § 206.142(a)(1); HUD Handbook § IV.A.2.a.ii.A.2.b. For multifamily units, FHA will deduct from the insurance benefits the greater of either its estimate of the decrease in value of the family unit or the amount of any insurance recovery received by the mortgagee. 24 CFR § 234.270(a)(2).

- ³⁶ HUD Handbook § IV.A.2.a.ii.A.2.c.
- ³⁷ *Id.* § IV.A.2.a.ii.A.2.d.
- ³⁸ *Id.*
- ³⁹ 24 CFR § 206.142(a)(2); HUD Handbook § IV.A.2.a.ii.A.2.e. A certification is not required for multifamily properties, but the properties must meet substantially similar requirements. 24 CFR § 234.270(b).
- ⁴⁰ 24 CFR § 206.142(a)(2); HUD Handbook § IV.A.2.a.ii.A.2.e.
- ⁴¹ HUD Handbook § III.A.2.p.i.
- ⁴² *Id.* § III.A.2.p.ii; HUD Handbook Claim Filing Technical Guide § 5.a.24.
- ⁴³ HUD Handbook § III.A.2.p.iii.C.
- ⁴⁴ *Id.* § IV.A.2.d.iii.B.
- ⁴⁵ *Id.*
- ⁴⁶ HUD Handbook § IV.A.2.d.iii.C.
- ⁴⁷ 38 USC § 3732(a)(1).
- ⁴⁸ *Id.* § 3732(c).
- ⁴⁹ *Id.*
- ⁵⁰ 38 CFR 36.4323(a).
- ⁵¹ 38 USC § 3732(c)(1)(C).
- ⁵² *Id.* § 3732(c).
- ⁵³ *Id.* § 3732(c)(8).
- ⁵⁴ 38 CFR 36.4323(b).
- ⁵⁵ 38 CFR § 36.4323.
- ⁵⁶ *Id.* § 36.4329.
- ⁵⁷ VA Servicer Handbook M26-4, Ch. 4.18.
- ⁵⁸ *Id.*
- ⁵⁹ *Id.*
- ⁶⁰ *Id.*
- ⁶¹ 38 CFR § 36.4323(11).
- ⁶² 7 CFR § 3555.351(b). Specifically, the lesser of 90% of the outstanding principal balance or 100% of any loss equal to or less than 35% of the original loan amount plus 85% of any remaining loss up to 65% of the original loan amount. SFH Guaranteed Loan Program Technical Handbook, HB-1-3555 § 19.2.A.
- ⁶³ 7 CFR § 3555.352.
- ⁶⁴ *Id.* § 3555.353.
- ⁶⁵ *Id.* § 3555.353.
- ⁶⁶ *Id.* § 3555.353(b).
- ⁶⁷ *Id.* § 3555.306(f).
- ⁶⁸ *Id.* § 3555.355(a).
- ⁶⁹ *Id.* Appendix 8.10.

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Any tax advice expressed above by Mayer Brown LLP was not intended or written to be used, and cannot be used, by any taxpayer to avoid U.S. federal tax penalties. If such advice was written or used to support the promotion or marketing of the matter addressed above, then each offeree should seek advice from an independent tax advisor.

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website.

"Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown.

© 2020 Mayer Brown. All rights reserved.