OFFICE OF AUDIT
REGION 3
PHILADELPHIA, PA

# U.S. Department of Housing and Urban Development, Washington, DC

# Home Equity Conversion Mortgage Program

2013-PH-0002 DECEMBER 20, 2012

Issue Date: December 20, 2012

Audit Report Number: 2013-PH-0002

TO: Charles Coulter, Deputy Assistant Secretary for Single Family Housing, HU

**//signed//**

FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

SUBJECT: HUD Policies Did Not Always Ensure That Borrowers Complied With Program Residency Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG), final results of our review of HUD's oversight of the Home Equity Conversion Mortgage Program II.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 215-430-6729.

December 20, 2012

**HUD Policies Did Not Always Ensure That Borrowers Complied With Program Residency Requirements**

# Highlights

**Audit Report 2013-PH-0002**

## What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) oversight of its Home Equity Conversion Mortgage Program based on our annual audit plan and our strategic goal to improve the integrity of HUD's single-family insurance programs. This is the second of two reports that we issued on HUD's oversight of the Program. Our objective was to determine whether HUD controls prevented borrowers from renting their properties to Section 8 Housing Choice Voucher program participants.

## What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing (1) direct the applicable lenders to verify and provide documentation of the borrowers' compliance with the Program residency requirement or for each noncompliant borrower, declare the loan due and payable, thereby putting about $525,000 to better use, and (2) implement control policies or procedures to at least annually coordinate with HUD's Office of Public and Indian Housing to match borrowers' information with Section 8 voucher participant data to prevent or mitigate instances of borrowers renting out their properties to Section 8 voucher participants.

## What We Found

HUD policies did not always ensure that borrowers complied with Program residency requirements. The audit showed that 37 out of 174 borrowers reviewed were not living in the property associated with the loan and were renting the property to Section 8 voucher participants contrary to residency requirements. This condition occurred because HUD's Office of Single Family Housing did not have control policies or procedures in place to prevent or mitigate the problem. As a result, 37 insured loans were ineligible and should be declared in default and due and payable to reduce the potential risk of loss of about $525,000 to HUD's insurance fund.

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# BACKGROUND AND OBJECTIVE

The U.S. Department of Housing and Urban Development (HUD) provides reverse mortgage insurance through the Home Equity Conversion Mortgage (HECM) Program.

Loans insured under the Program enable elderly homeowners to convert the equity in their homes to monthly streams of income or credit lines. To be eligible for a loan, the borrower must be 62 years of age or older, own the property outright or have a small mortgage balance, occupy the property as a principal residence, not be delinquent on any Federal debt, and participate in a consumer information session given by a HUD-approved Program counselor. The maximum amount (principal limit) the borrower or borrowers may receive is based on the age of the youngest borrower, interest rate, mortgage insurance premium, and value of the home or HECM FHA mortgage limits, whichever is less. The loan is secured by the home's equity. Eligible properties include single-family homes or one-to-four-unit homes with one unit occupied by the borrower, HUD-approved condominiums, and manufactured homes that meet Federal Housing Administration (FHA) requirements. The borrower is not required to repay the loan as long as he or she continues to occupy the home as a principal residence, maintains the property, and pays the property taxes and the mortgage insurance premiums. The loan agreement defines "principal residence" as the dwelling where the borrower maintains his or her permanent place of abode and typically spends the majority of the calendar year. A person may have only one principal residence at any one time. The borrower must certify to principal residency initially at closing and annually thereafter.

Servicing lenders are responsible for ensuring that borrowers meet the Program requirements, including the annual certification of principal residency. The mortgage note contains a clause stipulating that the lender may require immediate payment in full of all outstanding principal and accrued interest, upon approval of an authorized representative of the HUD Secretary, if the property ceases to be the principal residence of the borrower for reasons other than death and the property is not the principal residence of at least one other borrower.

HUD's Section 8 Housing Choice Voucher program provides Federal funds to assist very low-income families, the elderly, and the disabled to afford decent, safe, and sanitary housing in the private market. The funds are made available to public housing agencies through HUD's Office of Public and Indian Housing, and the housing choice vouchers are administered locally by public housing agencies.

Our objective was to determine whether HUD's controls prevented borrowers from renting their properties to Section 8 voucher participants.

# RESULTS OF AUDIT

## Finding: HUD Policies Did Not Always Ensure That Borrowers Complied With Program Residency Requirements

Borrowers did not always comply with Program residency requirements. Contrary to Program residency requirements, 37 borrowers were not living in the properties associated with their loans and were renting the properties to Section 8 voucher participants. This condition occurred because HUD lacked adequate control policies or procedures to prevent or mitigate instances of borrowers violating Program residency requirements by renting their properties to Section 8 voucher participants. As a result, 37 loans valued at about $5.8 million were ineligible, and approximately $525,000 in undisbursed loan funds remained available to the borrowers, thereby presenting a potential risk to the FHA insurance fund.

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**37 Borrowers Violated Program Residency Requirements**

Contrary to Program requirements, 37 borrowers were not living in the properties for which they obtained home equity conversion mortgage loans. According to Program regulations at 24 CFR (Code of Federal Regulations) 206.39, the property associated with the loan must be the principal residence of each borrower at closing. Also, regulations at 24 CFR 206.211 require servicing lenders to at least annually determine whether the property associated with a loan is the principal residence of at least one borrower and require borrowers to certify that the property associated with the loan is their principal residence. Further, regulations at 24 CFR 206.27 state that the mortgage balance will be due and payable in full if the property ceases to be the principal residence of a borrower for reasons other than death and the property is not the principal residence of at least one other borrower.

We analyzed data in HUD's Single Family Data Warehouse[1] and its Public Housing Information Center[2] and identified 174 loan borrowers that were possibly violating Program residency requirements by renting their properties to Section 8 voucher participants. Based on reviews of documents obtained from public housing agencies, servicing lenders, and public data sources, there was substantial evidence indicating that 37 borrowers were not living in the property

[1] HUD's Single Family Data Warehouse system contains case-level information covering all the processes in the mortgage insurance life cycle of FHA-insured loans.
[2] HUD uses its Public Housing Information Center database to manage its public housing programs.

associated with their loan and were renting the property to Section 8 participants. In 35 of the 37 cases, the borrowers provided annual certifications[3] indicating that the underlying property for the mortgage was their principal residence. Regarding the other two cases, in one case, the lender did not provide annual occupancy certifications; and in the other case, the lender did not obtain annual occupancy certifications because the loan is suspended for repairs. Given the audit evidence, 37 borrowers violated Program residency requirements, and of them 35 falsely certified to compliance; therefore, the related loans were ineligible. The breakdown for the remaining 137 loans reviewed is as follows:

- 123 borrowers were living in the property associated with their loan but had either rented a unit or room in the property to a Section 8 voucher participant.

- 2 borrowers were not living in their properties and had rented them out to Section 8 voucher participants; however, the loans had been terminated.

- For the remaining 12 borrowers, the property addresses were different from the Section 8 voucher participants' addresses. Therefore, we found no evidence to confirm that the borrowers had violated the residency requirements.

## HUD Lacked Adequate Controls To Prevent or Mitigate the Problem

HUD did not have control policies or procedures in place to prevent or mitigate instances of borrowers renting out their properties to Section 8 voucher participants. The 37 borrowers identified had been advanced about $5.8 million, and approximately $525,000 remained to be disbursed. However, 17 of the borrowers had been advanced the full amount of their loans; therefore, there were no funds left to be disbursed or drawn on those loans. HUD risks loss to its FHA insurance fund for the loan advances made on the 37 loans.

HUD's Office of Single Family Housing needs to quickly work with the applicable servicing lenders to verify and obtain documentation of the borrowers' compliance with Program residency requirements for each of the 37 cases identified or for each noncompliant borrower, declare the loan in default and due and payable. Doing so would reduce the risk of loss to the FHA insurance fund because HUD would be relieved of potential future claim liabilities related to the undisbursed loan amounts. Also, the Office of Single Family Housing can prevent or mitigate instances of borrowers improperly renting out their properties

[3] We requested the borrowers' annual certifications for the last 3 years from the applicable servicing lenders.

to Section 8 voucher participants by periodically coordinating with the Office of Public and Indian Housing to compare data in their respective systems. This measure will allow the Office of Single Family Housing to identify potential violators of the residency requirements and work with applicable lenders to take steps to verify borrowers' residency or otherwise declare loans in default and due and payable as appropriate.

## Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

1A. Direct the applicable servicing lenders to verify and provide documentation of the borrowers' compliance with the residency requirement for each of the 37 cases or for each noncompliant borrower, declare the loan in default and due and payable, thereby putting approximately $524,993 to better use.

1B. Implement control policies or procedures to at least annually coordinate with HUD's Office of Public Housing to match data in the Single Family Data Warehouse to data in the Public Housing Information Center to prevent or mitigate instances of borrowers violating Program residency requirements by renting their properties to Section 8 voucher participants.

# SCOPE AND METHODOLOGY

We conducted the audit from February to October 2012 at our office in Richmond, VA. The audit covered the period January 2001 through December 2010 but was expanded as necessary to accomplish our objective. We relied in part on computer-processed data in HUD's Single Family Date Warehouse and Public and Indian Housing Information Center. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes. The testing entailed matching information obtained from the Single Family Data Warehouse and the Public and Indian Housing Information Center to hardcopy documents provided by servicing lenders and public housing agencies.

To accomplish our objective, we reviewed

- Relevant background information on the loans and applicable regulations,
- Program requirements,
- Loan information on the borrowers provided by the servicing lenders,
- Lexis Nexis[4] information on the borrowers,
- Information in HUD's Single Family Data Warehouse,
- Information in HUD's Public and Indian Housing Information Center,
- Information on Zillow.com,[5] and
- Information from Google Maps.[6]

We interviewed staff from HUD's Office of Single Family Housing, including loan servicing personnel, and public housing officials.

We obtained loan-level data from HUD's Single Family Data Warehouse System as of February 2011. Additionally, we obtained information on Section 8 voucher rental assistance participants from HUD's Public and Indian Housing Information Center. The Single Family Data Warehouse contained information on 515,000 loans, and the Public and Indian Housing Information Center contained records on 1.9 million Section 8 voucher participants. We matched the data from the two systems and identified 174 borrowers that were possibly renting their properties to Section 8 voucher participants. We then requested loan documents and Section 8 Voucher Program records to determine whether the borrowers had violated Program residency requirements by renting out their properties to Section Voucher Program participants.

A review of these documents and documentation from other information sources as outlined in the bulleted list above disclosed substantial evidence that 37 borrowers were not living in the properties associated with their loans and were renting them to Section 8 voucher participants. As of September 1, 2012, the balance of advances to the borrowers was about $5.8 million, and

[4] The LexisNexis database is an online resource that provides information on legal and public records.
[5] Zillow.com is an online real estate database founded in 2005.
[6] Google Maps is a map and directions Web site from Google offering photographic views, showing real streets and surroundings.

approximately $525,000 was still available for disbursement. Unless HUD obtains and provides evidence to the contrary, the 37 loans were ineligible and should be declared in default and due and payable. Doing so would reduce the risk of loss to HUD's FHA insurance fund because HUD would be relieved of potential future claim liabilities related to undisbursed loan amounts. We estimated this savings to HUD (funds to be put to better use) to be about $525,000. We calculated the estimated savings by obtaining and totaling the net funds available for disbursement as reflected in HUD's Insurance Accounting Collection System[7] for each of the 37 borrowers. A breakdown of the 37 loans questioned is provided in appendix C of this report.

On December 3, 2012, HUD said that it agreed with the audit finding and recommendations, and had no comments on the draft report.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

[7] The Insurance Accounting Collection System was developed to handle the collection of financial data that are unique to the Program.

# INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that the Program meets its objectives.

- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports for the Program.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that Program participants comply with Program laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD lacked adequate control policies or procedures to prevent or mitigate instances of borrowers renting their properties to Section 8 voucher participants.

# APPENDIXES

## Appendix A

## SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

| Recommendation number | Funds to be put to better use 1/ |
|---|---|
| 1A | $524,993 |

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, implementation of our recommendation to declare ineligible loans in default and due and payable would reduce the risk of loss to the FHA insurance fund because HUD would be relieved of potential future claim liabilities related to the undisbursed loan amounts.

# Appendix B

## BREAKDOWN OF ESTIMATED FUNDS TO BE PUT TO BETTER USE

| # | FHA case number | Loan funds advanced as of September 1, 2012 | Net funds available for disbursement as of September 1, 2012 |
|---|---|---|---|
| 1 | 045-6452081 | $167,830 | $0 |
| 2 | 042-8186147 | 77,161 | 63,447 |
| 3 | 044-4312843 | 279,049 | 0 |
| 4 | 048-4384208 | 216,092 | 279 |
| 5 | 048-4557624 | 188,062 | 72 |
| 6 | 052-1895949 | 111,440 | 0 |
| 7 | 052-5909929 | 241,860 | 66 |
| 8 | 095-1283740 | 192,110 | 944 |
| 9 | 137-3989613 | 113,584 | 0 |
| 10 | 141-1386280 | 171,917 | 0 |
| 11 | *141-1450314 | 216,055 | 63,276 |
| 12 | 141-1463432 | 107,452 | 0 |
| 13 | 141-1476097 | 142,624 | 0 |
| 14 | 251-3688423 | 173,563 | 0 |
| 15 | 197-1892090 | 80,906 | 36,906 |
| 16 | 197-3575300 | 192,939 | 0 |
| 17 | 221-4164492 | 51,343 | 6,608 |
| 18 | *222-1758094 | 22,633 | 0 |
| 19 | 251-4062830 | 65,921 | 0 |
| 20 | 277-0475188 | 93,451 | 467 |
| 21 | 292-4679516 | 82,097 | 0 |
| 22 | 351-5618547 | 172,686 | 31,017 |
| 23 | 352-5550092 | 282,526 | 0 |
| 24 | 352-5717108 | 140,428 | 131,710 |
| 25 | 352-5952203 | 222,040 | 138,159 |
| 26 | 372-2958653 | 123,786 | 0 |
| 27 | 374-4627465 | 226,184 | 5,814 |
| 28 | 374-4880984 | 212,602 | 39,047 |
| 29 | 374-5379653 | 311,084 | 446 |
| 30 | 374-5555800 | 218,050 | 437 |
| 31 | 381-8780466 | 116,793 | 0 |
| 32 | 412-5537024 | 63,236 | 0 |
| 33 | 441-7851523 | 139,832 | 4,903 |
| 34 | 451-0917670 | 225,659 | 0 |
| 35 | 461-5122105 | 62,010 | 267 |
| 36 | 511-0090413 | 27,208 | 166 |
| 37 | 374-5767426 | 222,530 | 962 |
| **Total** | | **$5,754,743** | **$524,993** |

*Annual occupancy certifications not provided.