OFFICE OF AUDIT
REGION 7
KANSAS CITY, KS

OFFICE of INSPECTOR GENERAL

UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

U.S. Department of Housing and Urban Development, Office of Single Family Housing

Lender Servicing of Claims With Coborrowers

2013-KC-0004 **SEPTEMBER 18, 2013**

U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

Issue Date: September 18, 2013

Audit Report Number: 2013-KC-0004

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

//**signed**//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: HUD Paid Claims That Lacked Contact or Collection Activities With Coborrowers

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Federal Housing Administration (FHA) claims with coborrowers.

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 913-551-5870.

Office of Audit Region 7
400 State Avenue, Suite 501, Kansas City, KS 66101
Phone (913) 551-5870, Fax (913) 551-5877
Visit the Office of Inspector General Web site at www.hudoig.gov.

September 18, 2013

HUD Paid Claims That Lacked Contact or Collection Activities With Coborrowers

Highlights

Audit Report 2013-KC-0004

What We Audited and Why

We reviewed the U.S. Department of Housing and Urban Development (HUD), Office of Single Family Housing, to determine whether lenders contacted all borrowers on each Federal Housing Administration (FHA) loan before proceeding to claim. We initiated this nationwide audit because we noted instances in which the lender collected financial information from only one of the borrowers and showed no efforts to contact other borrowers.

What We Recommend

We recommend that HUD (1) strengthen monitoring to check for proper contact with each borrower during loan servicing, (2) enhance data collection to begin collecting information on whether each coborrower will occupy the subject property as well as the addresses and phone numbers of each coborrower, and (3) educate lenders and remind them of their responsibility to contact all borrowers during servicing.

What We Found

HUD paid claims on approximately 2,109 FHA loans when the lenders did not contact, attempt collection from, or otherwise include all borrowers during the loss mitigation process. The lenders did not communicate with all borrowers, and sometimes the lenders did not send credit information to credit reporting bureaus. Some of the coborrowers were nonoccupying coborrowers, who were added to the loans during underwriting so the loans would meet FHA underwriting standards. Other coborrowers were originally cooccupants, but during servicing, it was revealed that one or more borrowers no longer lived in the subject property. However, the lenders showed no attempt to contact all of the borrowers regarding the mortgage debt.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVE

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories, enabling those lenders to provide credit to borrowers who might otherwise be unable to access the capital markets to purchase or refinance a property. It is the largest insurer of mortgages in the world, having insured more than 40 million properties since its inception in 1934. FHA mortgage insurance provides lenders with protection against losses as a result of homeowners' defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet certain requirements established by FHA to qualify for insurance.

The U.S. Department of Housing and Urban Development's Office of Single Family Housing is responsible for the overall management and administration of the FHA single family mortgage insurance programs. The National Servicing Center works with FHA homeowners and their lenders to find creative solutions to avoid foreclosure. Its staff provides direction and training to mortgage lenders. The Quality Assurance Division works to ensure the highest possible degree of compliance by lenders with origination and servicing requirements. Its staff prepares lender targeting plans and performs reviews of approved lenders.

Each lender is responsible for giving notice to each borrower in default in accordance with 24 CFR (Code of Federal Regulations) 203.602. In addition, HUD Handbook 4330.1 REV-5, section 7-12, requires that all coborrowers be advised of a default in an attempt to avoid foreclosure. HUD considers it prudent servicing that a notification of default be sent to coborrowers so they may have the opportunity to salvage the mortgage. Lastly, Mortgagee Letter 98-18 says it is mandatory that all borrowers with FHA-insured mortgages, regardless of risk ranking, be considered for each of FHA's loss mitigation programs before foreclosure is initiated. HUD Handbook 4330.1 REV-5, section 9-2 C, also requires lenders to ensure that the account has been accurately reported to the national credit information repositories.

Our audit objective was to determine whether FHA lenders contacted all borrowers on each FHA loan before proceeding to claim.

RESULTS OF AUDIT

Finding: HUD Paid Claims on Approximately 2,109 FHA Loans When the Lenders Did Not Contact All Borrowers

HUD paid claims on approximately 2,109 FHA loans when the lenders did not contact, attempt collection from, or otherwise include all borrowers during the loss mitigation process. HUD's monitoring procedures did not include detailed steps to check for proper contact, and its data systems did not include the necessary information to facilitate that check. As a result, HUD could not ensure that the FHA insurance fund paid proper claims.

Coborrowers Not Contacted

In total, FHA paid claims on more than 160,000 loans from March 1, 2012, through February 28, 2013. To conduct this audit, we narrowed the universe to 15,762 claims with coborrowers submitted by the 9 largest lenders, from which we selected a statistical sample of 95 claims (see Scope and Methodology for details of our universe and sample selection). Of the 95 claims reviewed, 19, or 20 percent, were ineligible because the lender did not contact all of the borrowers. This number statistically projects to approximately 2,109 claims on which the lender did not contact, attempt collection from, or otherwise include all borrowers during the loss mitigation process.

In some instances, the lender did not document letters or phone calls with all borrowers, and sometimes the lender did not send credit information to credit reporting bureaus. For example, in one sample item, there were three borrowers who declared at origination that they all planned to live in the subject property. The borrowers were a married couple and a brother of the husband; the brother had owned an additional home in the same State for the past 10 months. During loan servicing, the lender did not contact the brother at either the subject property or his other property address or via phone. This loan ended in a preforeclosure sale, and the lender again did not reach out to the brother and based the financial analysis for the preforeclosure sale only on the other borrowers. In addition, the lender neglected to send credit reporting information to the credit reporting agencies for the brother.

Some of the coborrowers were nonoccupying coborrowers, who were added to the loan during underwriting so the loan would meet FHA underwriting standards. For example, in one loan file reviewed, the borrower was a married woman, who was not working and had no income, and she could not put her husband on the loan because of bad credit. To obtain the loan, she had her nonoccupying mother cosign for her. When the lender was processing the foreclosure, the daughter was not working, her husband had left her, and the lender did not contact her mother before the claim was filed.

In other instances, the coborrowers were originally cooccupants, but during servicing, it was revealed that not all of the borrowers lived in the subject property. However, the lender showed no attempt to contact both borrowers regarding the mortgage debt. For example, one loan file indicated that two unmarried people both planned to live in the subject property as their primary residence; however, during loan servicing, the lender became aware that one of the borrowers had moved out of the property. The lender had an updated credit report in its file identifying two new addresses for him, yet the lender did not try to contact him at these addresses to attempt collection, gather financial information for the preforeclosure sale, or obtain his signature for the preforeclosure sale.

Inadequate Information in HUD's Systems

During its servicing reviews, HUD's Quality Assurance Division checked only that lenders sent notices to the borrower(s) at the property address, not necessarily to all borrowers on the loan. These reviews examined selected lenders for compliance with HUD-FHA requirements, the lender's standard servicing procedures, and its loss mitigation practices. In the Division's quality control plan checklist for loan servicing, one of the items checked for was whether "Effective collection activities are pursued in a timely fashion. Contact is attempted with all co-mortgagors, co-signers and former mortgagors, as appropriate." In addition, the Division's case review sheet checked a sample of loans to see whether contact attempts were adequate, including contacts with coborrowers and former borrowers. These review procedures did not explicitly require the Division's reviewer to determine whether all borrowers lived in the subject property and whether all individuals were contacted.

HUD's Single Family Data Warehouse did not identify when a coborrower was nonoccupying or list the address or telephone number of the coborrower in such a case. Therefore, the Division stated that it was difficult to determine whether a coborrower was a nonoccupant as such information was contained only in the origination file, which the Division did not examine during a servicing review. The Division agreed that without using the origination file, it could not ensure that all borrowers were contacted during servicing. The Division also agreed that if the lenders' notes documented a nonoccupant coborrower, the lender should attempt contact with all borrowers.

Improper FHA Insurance Fund Claims

HUD could not ensure that the FHA insurance fund paid proper claims when the coborrower was not appropriately contacted. If the coborrowers had been contacted, some of them might have been able to cure the loan and prevent the claim. The loans for which coborrowers were not contacted did not qualify for a claim since the lender did not perform proper servicing.

Using statistical sampling procedures to project the ineligible claims to the universe of 15,762 claims, we estimated that the FHA insurance fund paid claims on 2,109 loans, with an estimated value of $191 million, when the coborrower was not appropriately contacted.

Conclusion

Lenders did not always contact all borrowers on each loan before proceeding to claim. Of the statistically selected claims, 20 percent were ineligible because the lender did not have contact with all of the borrowers. HUD could not ensure that the FHA insurance fund paid proper claims when the coborrower was not appropriately contacted. HUD needs to strengthen monitoring to check for proper contact with each borrower during loan servicing and enhance data collection to begin collecting nonoccupying coborrowers' addresses and phone numbers.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

1A. Strengthen monitoring to check for proper contact with each borrower during loan servicing to put $191 million to better use.

1B. Enhance data collection to begin collecting information on whether each coborrower will occupy the subject property as well as the addresses and phone numbers of each coborrower.

1C. Educate lenders and remind them of their responsibility to contact all borrowers during servicing.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Interviewed HUD and industry management and staff;
- Reviewed Federal regulations, HUD handbooks, and mortgagee letters;
- Reviewed the Quality Assurance Division 2009 Guidebook along with Servicing Review Standard Forms and Paragraphs and Quality Assurance Division servicing codes;
- Reviewed Federal Registers showing Mortgagee Review Board actions; and
- Selected and reviewed a statistical sample of claims.

We performed our audit work between March and August 2013. We conducted audit fieldwork at HUD's National Servicing Center in Oklahoma City, OK, and at lenders in Oklahoma City, OK, Des Moines, IA, and O'Fallon, MO. Our audit generally covered the period March 1, 2012, through February 28, 2013.

Using HUD's Single Family Data Warehouse, we identified 163,223 loans with a claim processed between March 1, 2012, and February 28, 2013. Of these, 68,935 loans had one or more coborrowers. We used the following criteria to identify loans in which the coborrowers may not have occupied the property.

- Loans with two or more coborrowers,
- Loans in which the primary borrower was not classified as married, and
- Loans with the highest age difference between the borrower and the first coborrower.

Of the 68,935 loans with coborrowers, 18,391 met the criteria described above. We then limited our sample universe to the 15,762 loans that were serviced by the 9 lenders with the highest volume of loans.

We used a seven-strata sample design to account for fluctuations in low-end and high-end amounts that would be expected to cause large variance estimates. The variable used to stratify the sample was the profit-loss amount for each loan. For many loans, this amount was calculated in HUD's system, representing the original insurance payment to the bank for the unpaid balance, holding costs, earnings from resale of the property, and relevant administrative transactions associated with the failure of the loan. In cases in which a profit-loss amount had not been calculated by HUD, a typical amount was estimated for the purposes of stratification, based on the average percentage of the unpaid balance that was lost for other loans the bank had issued in that month.

We found a sample size of 95 to be the best size for providing meaningful audit results without an unnecessary risk of spurious error. We used replicated sampling to proof-test the sample design and model the true sampling distribution, thereby confirming the performance of the sample design. To control for the possibility that FHA loans were adversely affected differently across lenders, each strata was sorted by the lending institution. The sample design was stratified as shown in the below table.

Strata design					
Strata (based on loss amount)	Quantity in universe	Quantity in sample	Profit-loss range	Probability of selection	Sampling weight
Net gain	24	2	$148 - $50,691	0.08333	12.0
0 – 10 percent loss	1,573	9	$0 - $46,869	0.00572	174.8
10 - 30 percent loss	3,149	19	$46,870 - $71,221	0.00603	165.7
30 - 50 percent loss	3,147	19	$71,222 - $92,803	0.00604	165.6
50 – 70 percent loss	3,149	19	$92,804 - $120,101	0.00603	165.7
70 - 90 percent loss	3,146	18	$120,102 - $170,775	0.00572	174.8
90 - 100 percent loss	1,574	9	> $170,776	0.00572	174.9
Total	15,762	95	n/a	n/a	n/a

We reviewed the statistical sample of claims to evaluate whether the lender contacted, attempted to collect from, or otherwise included all borrowers during the loss mitigation process. For the purposes of our review, we obtained both the origination and servicing files from the lenders to review for contact with all borrowers. We used the origination file to determine whether all borrowers planned to occupy the property. We then used the servicing files provided to determine whether all borrowers had been contacted either by mail, email, or telephone before the claim was filed.

We determined that for 19 of the 95 sampled loans, or 20 percent, the lender did not have contact with all of the borrowers. We considered these claims to be ineligible. These loans amounted to an average of $19,667 per loan in our universe. Deducting for statistical variance, we can say with a one-sided confidence interval of 95 percent that improper payments amounted to $12,142 per loan. Extending this to our sample universe of 15,762 loans, we can say with a one-sided confidence of 95 percent that lenders did not contact all borrowers for at least 2,109 loans and $191 million in claims. In projecting the findings to a dollar amount, we used the actual costs to HUD for each loan claim, as indicated in the Single Family Data Warehouse system, effective June, 2013. We revalidated the performance of the sample design by using the actual cost of the claims and verified that the sample would perform as stated with no additional modifications.

We relied in part on data maintained by HUD in its Single Family Data Warehouse database. Specifically, we relied on the data to identify loans that resulted in claims during our audit period and met the criteria described below. We also relied on the associated claim amounts for these loans. Although we did not perform a detailed assessment of the reliability of the data, we corroborated the fields used to determine our sample universe against documentary evidence supplied by the lenders for our 95 sample loans. We found that that 10 of the 95 loans in our sample had incorrect information in the database that would have caused the loans not to be included in our universe. In each of these cases, the marital status was incorrect when compared against the loan origination file. However, we do not consider this issue to be significant because the lenders contacted all borrowers in each case and the loans were projected against the universe, which lowered the projected loss to HUD. As described above, we also performed testing on each sampled loan to determine whether lenders contacted all borrowers before proceeding to claim. Based on the work performed, we determined that the computer-processed data were sufficiently reliable for the purposes of this 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.

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:

- Policies and procedures to ensure that lenders contact all borrowers on each FHA loan before proceeding to claim.

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's monitoring procedures did not include detailed steps to check for proper contact, and its data systems did not include the necessary information to facilitate that check (see finding).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$191,000,000

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, if HUD implements our recommendations, it will ensure that claims are paid only for qualifying borrowers to lenders that have followed all of the program requirements. It will no longer pay claims for borrowers who have not been properly contacted during loan servicing.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

September 11, 2013

MEMORANDUM FOR: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

FROM: Charles S. Coulter, Deputy Assistant Secretary for Single Family Housing, HU

SUBJECT: Auditee Response
HUD Paid Claims That Lacked Contact or Collection Activities with Coborrowers
Audit No: 2013-KC-000X

The Office of Inspector General (OIG) reviewed the U.S. Department of Housing and Urban Development (HUD), Office of Single Family Housing, to determine whether lenders contacted all borrowers on each Federal Housing Administration (FHA) loan before proceeding to claim. The OIG initiated this nationwide audit because they noted instances in which the lender collected financial information from only one of the borrowers and showed no efforts to contact other borrowers when a mortgage became delinquent.

Comment 1

The Office of Single Family Housing agrees with the OIG's recommendations in principle and will implement its recommendations by publishing a Mortgage Letter (ML) entitled, Methods of Borrower Communication. This ML reminds servicers to attempt to contact all borrowers and to document their servicing files of their efforts to do so. The ML is expected to be published in October 2013.

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OIG Evaluation of Auditee Comments

Comment 1 OIG will consider this to be a management decision relating to recommendation 1C. Single Family must fully implement all recommendations in this report to ensure all borrowers are contacted on each FHA loan before going to claim.