



Member First Mortgage, LLC, Grand Rapids, MI

HUD's Loss Mitigation Program for FHA-Insured Loans



To: Kathleen Zadareky, Deputy Assistant Secretary for Single Family Housing, HU

//signed//

From: Kelly Anderson, Regional Inspector General for Audit, Chicago Region, 5AGA

Subject: Member First Mortgage, LLC, Grand Rapids, MI, Generally Implemented Its Loss Mitigation and Quality Control Programs in Accordance With HUD's Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) results of our review of Member First Mortgage's Loss Mitigation and quality control programs for Federal Housing Administration-insured loans.

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 8M, 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 312-353-7832.



Audit Report Number: 2015-CH-1005
Date: September 10, 2015

Member First Mortgage, LLC, Grand Rapids, MI, Generally Implemented Its Loss Mitigation and Quality Control Programs in Accordance With HUD's Requirements

Highlights

What We Audited and Why

We audited Member First Mortgage, Limited Liability Company, a Federal Housing Administration (FHA) nonsupervised servicer as part of the activities in our fiscal year 2015 annual audit plan. We selected Member First based upon our analysis of risk factors for single-family servicing lenders in Region 5's jurisdiction.¹ Our audit objectives were to determine whether (1) Member First complied with the U.S. Department of Housing and Urban Development's (HUD) loss mitigation requirements for servicing FHA-insured loans and (2) Member First's quality control plan, as implemented, met HUD's requirements.

What We Found

Member First generally complied with HUD's requirements for loss mitigation and the quality control program with the exception of the frequency of its quality control reviews of nonperforming FHA-insured loans. Specifically, for the 15 FHA loans reviewed, it maintained adequate documentation of its attempts to contact borrowers to mitigate loan delinquencies. It also appropriately determined borrowers' (1) eligibility for loss mitigation and (2) loss mitigation options. However, Member First did not perform or ensure that its contractor performed monthly quality control servicing reviews of its nonperforming loans. As a result of this weakness, HUD and Member First lacked assurance that potential servicing deficiencies were identified and mitigated in a timely manner, potentially resulting in an increased risk to FHA's Mutual Mortgage Insurance Fund.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Member First to implement adequate procedures and controls to ensure that Member First and its contractor perform quality control servicing reviews of FHA-insured loans in accordance with HUD's requirements.

¹ The region contains six States: Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.

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Background and Objectives

Member First Mortgage, Limited Liability Company, a nonsupervised lender,² received approval as a Federal Housing Administration (FHA) lender on January 11, 1995. On April 21, 2008, Member First became an unconditional direct endorsement lender, which also originates and services government, conventional, and credit union portfolio loan products.

The National Housing Act, as amended, established FHA, an organizational unit within the U.S. Department of Housing and Urban Development (HUD). FHA provides insurance to private lenders against loss on mortgages financing homes. The basic home mortgage insurance program is authorized under Title II, section 203(b), of the National Housing Act and governed by regulations in 24 CFR (Code of Federal Regulations) Part 203.

HUD established the Loss Mitigation program in 1996 to ensure that distressed FHA-insured borrowers would have opportunities to keep their homes and reduce losses to FHA's insurance fund. Loan servicers must offer loss mitigation options to borrowers in distress based on the borrower's financial circumstances and the status of the loan. The program consists of reinstatement options to promote retention of borrowers' homes and disposition options, which assist borrowers in disposing of their homes.

The reinstatement options are special forbearance, partial claim, loan modification, and the Home Affordable Modification Program. A special forbearance is a written repayment agreement between a loan servicer and borrower, containing a plan to reinstate a delinquent loan. A partial claim consists of an interest-free loan to the borrower in the amount needed to reinstate the mortgage, thereby becoming a subordinate mortgage payable to HUD. FHA's Home Affordable Modification Program loss mitigation option, which became effective August 15, 2009, combines the loan modification and partial claim loss mitigation options.

The disposition options are preforeclosure sale and deed in lieu of foreclosure. The preforeclosure sale option allows the defaulted borrower to sell his or her home and use the sales proceeds to satisfy the mortgage debt even if the proceeds are less than the amount owed. A deed in lieu of foreclosure allows a borrower to hand over his or her home to HUD in exchange for a release from all mortgage obligations.

Our objectives were to determine whether (1) Member First complied with HUD's loss mitigation requirements for servicing FHA-insured loans and (2) Member First's quality control plan, as implemented, met HUD's requirements.

² A nonsupervised lender is an FHA-approved lending institution, the principal activity of which involves lending or investing funds in real estate mortgages.

Results of Audit

Finding: Member First Generally Implemented Its Loss Mitigation and Quality Control Programs in Accordance With HUD's Requirements

Member First generally complied with HUD's requirements for loss mitigation and the quality control program with the exception of the frequency of its quality control reviews of nonperforming FHA-insured loans. Specifically, for the 15 FHA loans reviewed, it maintained adequate documentation of its attempts to contact borrowers to mitigate loan delinquencies. It also appropriately determined borrowers' (1) eligibility for loss mitigation and (2) loss mitigation options. However, Member First did not perform or ensure that its contractor performed monthly quality control servicing reviews of its nonperforming loans. As a result of this weakness, HUD and Member First lacked assurance that potential servicing deficiencies were identified and mitigated in a timely manner, potentially resulting in an increased risk to FHA's Mutual Mortgage Insurance Fund.

Member First Generally Implemented Its Loss Mitigation Program

We reviewed 15 loans to determine whether Member First complied with HUD's requirements for loss mitigation. For all 15 loans reviewed, when applicable, Member First generally

- Maintained documentation to support its (1) attempts to contact the borrowers before it initiated the first legal action to foreclose and (2) determination of borrowers' eligibility for loss mitigation,
- Evaluated borrowers' financial situation to determine the most viable loss mitigation options that would generate the smallest financial loss to the FHA insurance fund, and
- Initiated the selected loss mitigation option or foreclosure process in a timely manner.

Member First Did Not Perform Monthly Quality Control Reviews

Member First did not perform or ensure that its contractor performed monthly quality control servicing reviews of the loans (1) for borrowers who were delinquent in their mortgage payments, (2) that resulted in an insurance claim, or (3) for properties that were in the foreclosure process or had been foreclosed upon. Instead, its contractor performed quarterly quality control reviews. According to HUD's requirements,³ due to the importance of these aspects of servicing, lenders must perform monthly reviews of delinquent loans, claims, and foreclosures.

³ HUD Handbook 4060.1, REV-2, paragraph 7-10(B)

Member First Lacked Adequate Oversight of Its Contractor

The weakness described above occurred because Member First relied on its contractor to perform its quality control servicing reviews. However, Member First did not monitor its contractor to ensure that it complied with HUD's requirements. HUD Handbook 4060.1, REV-2, paragraph 7-3(B)(2), states that lenders contracting out any part of their quality control function are responsible for ensuring that the outside source meets HUD's requirements. This requirement for monthly quality control reviews was also included in the contractor's written agreement with Member First.

In May 2014, Member First began performing monthly quality control servicing reviews of its servicing loan portfolio. However, these reviews were separate from the quality control reviews required by HUD. According to Member First, its review was more of an internal risk assessment. As a result of our audit, Member First contacted its quality control contractor to discuss performing quality control reviews of delinquent loans monthly. Member First's vice president of compliance said that he expected these monthly reviews to be implemented during the second quarter of 2015. As of July 16, 2015, Member First's compliance manager stated that its quality control contractor had begun performing the quality control review for June 2015.

Conclusion

Member First lacked adequate oversight of its quality control contractor to ensure that loans (1) for borrowers who were delinquent in their mortgage payments, (2) that resulted in an insurance claim, or (3) for properties that were in the foreclosure process or had been foreclosed upon were reviewed monthly in accordance with HUD's requirements. As a result, HUD and Member First lacked assurance that potential servicing deficiencies were identified and mitigated in a timely manner, potentially resulting in an increased risk to FHA's Mutual Mortgage Insurance Fund.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Member First to

- 1A. Implement adequate procedures and controls to ensure that Member First and its contractor performs quality control servicing reviews of FHA-insured loans in accordance with HUD's requirements.

Scope and Methodology

We performed our audit work from December 2014 through April 2015 at Member First's office in Grand Rapids, MI, and our offices located in Chicago, IL, Detroit, MI, and Columbus, OH. The audit covered the period December 1, 2012, through November 1, 2014, and was adjusted as necessary.

To accomplish our objectives, we reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to HUD's Loss Mitigation program. Further, we reviewed Member First's servicing policies and procedures, quality control plan, and quality control documentation. We also reviewed Member First's electronic or hardcopy loan servicing files. We interviewed Member First's employees and HUD's National Servicing Center's staff.

We also selected the following samples to test the implementation of Member First's loss mitigation program.

Loss Mitigation Review

Using data maintained in HUD's Single Family Data Warehouse system,⁴ we determined that Member First had serviced 1,408 loans as of November 15, 2014. Of the 1,408 loans, we excluded 201 that were no longer FHA insured. Of the remaining 1,207 loans (1,408 - 201), 18 were identified as loans for which HUD paid a conveyance claim during our audit period. In addition, HUD's Quality Assurance Division reviewed 3 of the 18 loans, reducing our universe to 15. We randomly selected 5 of the 15 loans to review.

Further, using data maintained in HUD's system, we also identified 264 loans, the borrowers of which were delinquent with their mortgage payments from December 1, 2012, through November 1, 2014. Of the 264 loans, the borrowers of 21 loans were 90 days or more delinquent with their mortgage payments. HUD paid loss mitigation incentive claims on 1 of the 21 loans; thus, we excluded that loan since it was part of the loss mitigation universe (above). Therefore, we randomly selected 5 of the 20 (21-1) loans to review.

In addition using data maintained in HUD's system, as of January 3, 2015, we had identified 14 loans for which HUD paid a loss mitigation incentive claim⁵ from December 1, 2012, through November 1, 2014. We randomly selected 5 of the 14 loans to review. In combining our sampling results, we reviewed a total of 15 loans (5+5+5) to determine whether Member First complied with HUD's requirements for loss mitigation.

⁴ HUD's Single Family Data Warehouse is a collection of database tables structured to provide HUD users easy and efficient access to single-family housing case-level data on properties and associated loans, insurance, claims, defaults, and demographics.

⁵ Fees lenders received based on the loss mitigation option used to cure the default.

The conclusion in this audit report is limited to the 15 loans reviewed. We did not include Member First's compliance with HUD's loss mitigation requirements for its entire servicing loan portfolio.

Quality Control Review

We reviewed Member First's contractors' quality control review reports for its second and third quarters of 2014. We reviewed the results of the reviews to determine whether Member First complied with HUD regulations for performing quality control servicing reviews.

We relied on information maintained in HUD's Neighborhood Watch⁶ and Single Family Data Warehouse systems for information and sampling purposes only. We also relied on data maintained in Member First's servicing system, such as electronic loan files. 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 adequately reliable for our purposes. The testing consisted of comparing data in the electronic files to information from HUD's systems. The audit results were based on our review of electronic and supporting hardcopy documentation maintained by Member First.

We provided the results of our review to Member First and HUD's staff during the audit. We asked Member First's vice president of compliance to provide written comments on our discussion draft audit report by July 27, 2015. Member First's vice president of compliance opted to not comment 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(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁶ Neighborhood Watch refers to a Web-based software application that displays loan performance data for lenders and appraisers using FHA-insured single-family loan information. The system is designed to highlight exceptions so that potential problems are readily identifiable.

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 objectives:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with 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.

We evaluated internal controls related to the audit objectives in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of Member First's internal controls.