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TO: Phillip Murray, Deputy Assistant Secretary for Single Family Housing, HU

FROM: 
John Dvorak, Regional Inspector General for Audit, Boston Region, IAGA

SUBJECT: James B. Nutter and Company, Kansas City, Missouri, Complied with HUD's Regulations, Procedures, and Instructions for the Underwriting and Closing of FHA-Insured HECM Loans Originated by First Call Mortgage Company

HIGHLIGHTS

What We Audited and Why

We reviewed Federal Housing Administration (FHA)-insured home equity conversion mortgage (HECM) loans originated by First Call Mortgage Company (First Call) and sponsored by James B. Nutter & Company (J.B. Nutter) during the period of January 2007 to December 2008. We reviewed these loans because in September 2008 state banking regulators from New Hampshire and Massachusetts found that First Call used deceptive business practices and did not have the proper state licensing to originate reverse mortgages. As a result, we wanted to determine if any FHA HECM loans originated by First Call were adversely affected.

The primary purpose of our review was to determine whether J.B. Nutter acted in a prudent manner and complied with the U.S. Department of Housing and Urban Development's (HUD) regulations, procedures, and instructions for the underwriting and closing of FHA-insured HECM loans.

What We Found

J. B. Nutter acted in a prudent manner and complied with HUD's regulations, procedures, and instructions for the underwriting and closing of FHA-insured HECM loans selected for review.

What We Recommend

This report contains no formal recommendations, and no further action is necessary.

Auditee's Response

An exit conference was held on September 24, 2009, with lender officials from J.B. Nutter. The report did not require a response from the auditee and no formal comments were provided.

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BACKGROUND AND OBJECTIVE

The National Housing Act, as amended, established the Federal Housing Administration (FHA), an organizational unit within the U.S. Department of Housing and Urban Development (HUD). The Housing and Community Development Act of 1987 established a federal mortgage insurance program, Section 255 of the National Housing Act, to insure home equity conversion mortgages (HECM). FHA¹ provides insurance to private lenders against losses on mortgages financing homes.

The objective of the HECM program is to enable elderly homeowners to convert equity in their homes, generally limited to dwellings with one- to four-family units, to monthly streams of income or lines of credit. These loans are also known as reverse mortgages. Borrowers, aged 62 and older, may use the equity to supplement their lifestyle, pay off bills, or make needed repairs to the home. Lenders offer borrowers a range of payment plan options as well as varying interest rates depending on the plan chosen. The borrower retains ownership of the property and may sell the home and move at any time, keeping the sales proceeds in excess of the mortgage balance. Lenders cannot force the borrower to sell the home to pay off the mortgage, even if the mortgage balance grows to exceed the value of the property. A borrower does not have to repay an FHA-insured reverse mortgage until the borrower moves, sells, or dies. When the loan is due and payable, if the loan exceeds the value of the property, the borrower (or the heirs) will owe no more than the value of the property. In order to be qualified for a HECM loan, the homeowners must attend HECM counseling from a HUD approved counseling agency, and requires a counseling certificate before a HECM approved lender can originate such loan.

HECM is a unique loan product because the risk cannot be measured by a standard mortgage default rate. Risk to FHA is mitigated by proper origination and servicing by the lender. HUD handbooks and mortgagee letters provide detailed processing instructions and advise the mortgage industry of major changes to FHA programs and procedures, and there continues to be congressional interest in audits of the HECM program.

First Call Mortgage Company (First Call) was a mortgage company that received approval from HUD to originate FHA single-family insured loans, including HECM loans, in February 2004. Its home office was located in Andover, Massachusetts, with a branch office in Portsmouth, New Hampshire. First Call originated 234 HECM loans between January 2007 and December 2008. Five different HECM lenders sponsored these loans. Sponsors are responsible for the proper underwriting and closing of the loans originated by lenders, such as First Call, on behalf of the sponsor. James B. Nutter and Company (J.B. Nutter) based in Kansas City, Missouri, sponsored 204 (or 87 percent) of the 234 loans originated by First Call. J.B. Nutter was incorporated in 1955 and became an approved FHA lender in 1957.

In September 2008, state banking regulators from Massachusetts and New Hampshire issued orders for First Call to cease and desist because of deceptive business practices. The reverse mortgage concerns cited by the bank examiners were primarily consumer disclosure issues,

¹ The acronyms HUD and FHA are often used interchangeably.

missing counseling certificates, and making reverse loans without explicit state approval². First Call no longer exists, and the assets of the company were purchased by Direct Finance Corporation, Hanover, Massachusetts (another FHA-approved lender), in October 2008.

The primary purpose of our review was to determine whether the sponsoring lender, J.B. Nutter, acted in a prudent manner and complied with HUD's regulations, procedures, and instructions for the underwriting and closing of FHA-insured HECM loans.

² Massachusetts law requires lenders intending to make reverse mortgage loans to submit for the Division's approval, a program that meets specific criteria set forth in Massachusetts General Laws Chapter 167E, section 7, and made applicable to lenders through Massachusetts General Laws chapter 183, section 67.

RESULTS OF AUDIT

J.B. Nutter acted in a prudent manner and complied with HUD's regulations, procedures, and instructions for the underwriting and closing of FHA-insured HECM loans selected for review. Specifically, no significant deficiencies were identified from a review of a random sample of 30 loans with regard to the critical origination or closing loan documents. We also verified that the information submitted to HUD was consistent with the information in the lender's own file with no exceptions noted. In addition, we analyzed the information from the 30 loans further with additional investigative tools, and no exceptions were found regarding the borrowers' residency, age, Social Security number validity, deed record, and property assessed values (see Appendix). Finally, J.B. Nutter had not filed a claim on any of the loans in our sample as of August 5, 2009.

Conclusion

The review of the 30 loans did not identify any reportable deficiencies. The review showed that J.B. Nutter acted in a prudent manner and complied with HUD's regulations, procedures, and instructions for the underwriting and closing of the 30 FHA-insured HECM loans selected for review.

Based on our audit, we did not identify any reportable conditions or deficiencies (see also Appendix). Therefore, we are not making any recommendations.

SCOPE AND METHODOLOGY

Our review generally covered the period January 1, 2007, through December 31, 2008. We conducted our work from May through August 2009. We primarily carried out our work at the HUD Office of Inspector General (OIG) field office in Hartford, Connecticut. We focused the audit on the lenders' loan origination, underwriting, and quality control operations.

To achieve our objectives, we

- Identified, obtained, and reviewed relevant regulations pertaining to the origination of single-family home equity conversion mortgages, including the *Code of Federal Regulations*, HUD handbooks, mortgagee letters, and the *United States Code*.
- Interviewed appropriate lender and HUD officials as necessary.
- Selected a sample of 30 FHA-insured HECM loans.
- Obtained and analyzed critical documents from the loan origination files maintained by HUD and J.B. Nutter (see Appendix).
- Verified that the information submitted to HUD was consistent with the information in the lender's own file.
- Used other investigative tools and methods to verify borrowers' residency, age, Social Security number validity, deed record, and property assessed values.

We randomly selected a nonstatistical random sample of 30 FHA-insured loans for review out of 199 that were originated by First Call and sponsored by J.B. Nutter. For surveying purposes, we determined it to be appropriate to use a nonstatistical random sample, which assisted the auditor in determining whether any errors could be significant to the audit objective. First Call originated 234 HECM loans during the audit period. J.B. Nutter sponsored 204 (87 percent) of these loans. However, only 199 of the 204 loans had active FHA insurance when we began the audit. Therefore, the 30 loans selected were from the universe of 199 loans sponsored by J.B. Nutter that had active FHA insurance when audit began. The sample was randomly drawn using auditing computer software.

We relied on information from systems used by HUD (including Single Family Neighborhood Watch and Single Family Housing Enterprise Data Warehouse),³ verified that the information submitted to HUD was consistent with the information in the lender's own file, and used LexisNexis Investigative Portal to verify borrowers' residency, age, Social Security number validity, deed record, and property assessed values. LexisNexis is a web-based search tool that

³ The Single Family Neighborhood Watch system is a web-based comprehensive data processing, automated querying, reporting and analysis system designed to highlight exceptions to lending practices to high-risk mortgages, so that potential problems that may arise are readily identifiable. The Single Family Housing Enterprise Data Warehouse is a large and extensive collection of database tables organized and dedicated to support the analysis, verification, and publication of single-family housing data. The data is 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.

provides access to billions of public records, news, businesses, legal records, and other types of information, which helps locate individuals, businesses, and assets. Other evidence supported the information obtained; therefore, we determined that the data were sufficiently reliable for our purposes. The corroborating evidence independently supports our conclusions.

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 an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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:

- Controls over program operations.
- Controls over the validity and reliability of data.
- Controls over compliance with laws and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

We found no significant internal control weaknesses within the scope of our audit.

FOLLOW-UP ON PRIOR AUDITS

James B. Nutter Did Not Meet HUD's or Its Own Quality Control Requirements Regarding the Number of Loans to Review; Audit Report No. 2008-KC-1005

OIG previously reviewed J.B. Nutter's quality control program and issued an audit report in September 2008 (see OIG Audit Report No. 2008-KC-1005). We concluded that for six months in 2007 and 2008, J.B. Nutter did not meet HUD's or its own quality control requirements regarding the number of loans to review. We recommended that HUD ensure that J.B. Nutter follows HUD requirements regarding the minimum number of endorsed loans to be reviewed for quality control purposes. The corrective action was pending as of September 2, 2009.

APPENDIX

ANALYSIS OF CRITICAL DOCUMENTS FROM THE LOAN ORIGINATION FILES

For the sample of 30 FHA-insured HECM loans, we obtained and analyzed critical documents from the loan origination files maintained by HUD and J.B. Nutter. The descriptions that follow are not intended to be comprehensive but serve as a guide to key issues regarding each loan. Below is a summary of our review of the loans as follows:

- Residential loan application for reverse mortgages (Federal National Mortgage Association (FNMA) form 1009) – Verified the borrowers’ date of birth and type of property for program eligibility. The youngest borrower shall be 62 years of age or older at the time the lender submits the application for insurance. Confirmed borrower’s request for a face-to-face interview and/or telephone interview for completing the loan application. No exceptions noted.
- Property appraisal – Ensured that the condition of the property met HUD/FHA minimum property standards for existing properties and was completed in a prudent manner. Reviewed information on the appraisal to ensure that the data on the form were consistent with the loan. No exceptions noted.
- Certificate of HECM counseling – The lender must explain to a potential HECM borrower that the HECM program requires counseling and refer the client to a list of HUD-approved entities eligible to provide HECM counseling. Reviewed the acceptable listing of entities eligible to provide HECM counseling and permissible types of counseling acceptable. Reviewed and verified (1) the dates when the counseling took place, (2) acceptable means of documenting that the potential HECM borrower received counseling, and (3) whether the lender charged the borrower any fees before receiving the required HECM counseling certificate. Reviewed the method of counseling and confirmed the borrower’s request for a face-to-face and/or telephone interview with the counseling entity. No exceptions noted.
- Waiver to HECM counseling requirement – HUD may waive the HECM counseling requirement for HECM borrowers who are refinancing into a new HECM mortgage and choose not to receive counseling. Reviewed the uniform residential loan application or FNMA form 1009 to verify whether the HECM was a refinance. Verified written documentation of the required conditions if the HECM borrowers chose to waive the HECM counseling. Documentation must ensure that all of the following conditions were met: (1) the HECM borrower received the antichurning disclosure form required by law, (2) the increase in the borrower’s principal limit exceeds the total cost of the refinancing

by five times, and (3) the timing between the closing on the original HECM loan and the date of the application for refinancing does not exceed five years. No exceptions noted.

- Interest rate lock provision – The expected rate lock provision for HECMs is 120 days. The expected interest rate is used to calculate the principal limit for HECMs and is established based upon the date in which the initial loan application is signed by the borrower. No exceptions noted.
- Source of funds for closing – The lender must document the borrower’s source of funds in accordance with established guidelines. With the exception of the origination fee, the borrower is allowed to finance 100 percent of the closing costs. No exceptions noted.
- HECM loan agreement and related exhibits – Reviewed loan agreement and payment history to confirm that the payment method elected by the borrower was consistent with the lender’s disbursement schedule. The five HECM payment options available to the borrower are (1) tenure, (2) term, (3) line of credit, (4) modified tenure, and (5) modified term⁴. Reviewed type of interest rate selected (fixed or adjustable), assignment option, and mortgage insurance option elected. No exceptions noted.
- Evidence of calculations for principal limit and monthly payment amount – Reviewed calculations based on borrower’s age, appraised value of the property, expected interest rate, loan costs and fees, and maximum claim amount. Examined the maximum mortgage worksheet, HECM loan agreement, disbursement history, draw requests, repair rider, and allowable fees. No exceptions noted.
- Credit reports – Verified borrowers’ birth date and age. The youngest borrower(s) must be 62 years of age or older. No exceptions noted.
- Compliance inspection report – Reviewed report for completion of all required repairs with appropriate supporting documentation. No exceptions noted.
- HUD 1 settlement sheet – Checked for disallowable fees or charges to the borrower. Origination fee limited to the greater of \$2,000 or 2 percent of the maximum claim

⁴ Under tenure payment plan, the borrower will receive equal monthly payments from the lender for as long as the borrower lives and continues to occupy the property as a principal residence. Under the term payment plan, the borrower will receive equal monthly payments from the lender for a fixed period of months selected by the borrower. Under the line of credit payment plan, the borrower will receive the mortgage proceeds in unscheduled payments or in installments, at times and in amounts of the borrower’s choosing, until the line of credit is exhausted. Under the modified tenure payment plan, the borrower may combine a line of credit with monthly payments for life, or for as long as the borrower continues to live in the home as a principal residence. In exchange for reduced monthly payments, the borrower will set aside a specified amount of money for a line of credit, on which he or she can draw until the line of credit is exhausted. Under the modified term payment plan, the borrower may combine a line of credit with monthly payments for a fixed period of months selected by the borrower. In exchange for reduced monthly payments, the borrower will set aside a specified amount of money for a line of credit, on which he or she can draw until the line of credit is exhausted.

amount⁵. For repairs required to be completed after closing, the lender shall set aside a portion of the principal limit equal to 150 percent of the estimated cost of repairs, plus the repair administration fee. Calculated the amount of funds set aside for repairs. If requested by borrower, reviewed the portion of the principal limit set aside for the payment of taxes, ground rents, flood and hazard insurance premiums, and assessments. Checked the initial disbursement date of mortgage proceeds. Mortgage proceeds may not be disbursed until the expiration of the three-day rescission period (certain fees or charges may be exceptions). Checked the title insurance commitment reported on the HUD-1 to ensure that it was at least equal to the maximum claim amount. No exceptions noted.

- Security instrument(s), mortgage(s), note(s), and repair rider – HECMs are nonrecourse loans. Validity and enforceability of the mortgage and note will depend on compliance with state law. Reviewed state requirements. Compared legal documents to form HUD-92900-A, Direct Endorsement Approval for a HUD/FHA –Insured Mortgage, for the proper interest rate. Real property secured by HECMs in Texas must use the Texas-approved documents as outlined in Mortgage Letter 00-34. Examined the repair rider to ensure that all repairs and disbursements were completed as outlined in the rider. No exceptions noted.
- Miscellaneous fees – Reviewed lender fees for a plan type change, term change, unscheduled lump sum payment, or suspension of a payment. These fees are limited to \$20 per occurrence. Looked at the servicing fees charged by the lender for annually adjusting interest (\$30 per month maximum fee) or monthly adjusting interest (\$35 per month maximum fee) fees charged for servicing. Servicing fees were taken from the principal limit and set aside in a lump sum at closing, then taken from the set-aside every month and added to the loan balance. No exceptions noted.
- Disclosures – Form HUD-92901, Anti-Churning Disclosure, must be provided to all HECM borrowers seeking to refinance an existing HECM⁶. The required information to be disclosed includes the total cost of the new mortgage, based on the projected future loan balance; all fees and charges associated with the refinanced HECM; a new maximum mortgage limit; and the new funding that will be available to the borrower. Reviewed information included in the HUD-92901, the Real Estate Settlement Procedures Act, the Truth in Lending Act, the good faith estimate, and Regulation Z requirements (lender must determine whether the HECM loan is open-end or closed-end line of credit). No exceptions noted.

⁵ The maximum claim amount is the lesser of the appraised value of the property or the maximum mortgage amount for a one-family residence that HUD will insure in an area under Section 203(b)(2) of the National Housing Act. The maximum claim amount is established when the Conditional Commitment is issued and represents the maximum amount that HUD will pay on a claim for insurance benefits.

⁶ This disclosure is designed to prevent “churning,” an irresponsible lending practice whereby lenders engage in multiple refinancing to generate additional profit from loan fees and charges. The “churned” mortgages are not made in the interest of the borrower and provide no financial benefit to the borrower.

- Checked the type of HECM selected by the borrower – Regulation Z requires accurate disclosure statements for open-end credit. If the borrower chooses an adjustable interest rate HECM, the lender must provide an adjustable-rate mortgage disclosure statement to the borrower. Examined the right of rescission disclosure for proper timing allowed for cancellation. This form allows the borrower the right to cancel the HECM loan within three business days of closing. No exceptions noted.
- Mortgage insurance premium options – One of two options must be chosen before requesting endorsement for insurance. The assignment option allows the lender to assign the mortgage to HUD when the outstanding balance is equal to or greater than 98 percent of the maximum claim amount or when a request for a line of credit draw will cause the outstanding balance to equal or exceed 98 percent of the maximum claim amount. The lender must be current with all payments owed to the homeowner. The shared premium option allows the lender to hold the loan for its entire term and retain a portion of the monthly premium. If the outstanding balance exceeds the property value at the time that the mortgage is due and payable, the lender receives insurance benefits up to the maximum claim amount and compensates for any losses with retained mortgage insurance premiums. No exceptions noted.
- Deed to property – Reviewed current deed to property and title commitment report to ensure that all owners with an interest in the property will be included on the HECM mortgage(s). Failure to include all owners on the mortgage may compromise the security interest in the property at time of transfer, assignment, or foreclosure. No exceptions noted.

The information analyzed from the 30 loans resulted in no exceptions being found regarding the critical documents from the loan origination files maintained by HUD and J.B. Nutter or the borrowers' residency, age, Social Security number validity, deed record, and property assessed values.