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

September 30, 2014

MEMORANDUM NO:
2014-KC-0801

Memorandum

TO: Carol Galante
FHA Commissioner-Assistant Secretary, Office of Housing, H

//**signed**//
FROM: Ronald J. Hosking
Regional Inspector General for Audit, Denver Region, 8AGA

SUBJECT: Memorandum Report on the Office of Inspector General's Internal Audit of HUD's Single Family Seven-Loan Limit

INTRODUCTION

The Office of Inspector General (OIG) conducted an audit of HUD's Single Family seven-loan limit. We initiated this review based on issues identified in an audit of the Wyoming Housing Opportunities Association in memorandum 2013-DE-1801. Our objective was to determine the impact of investor loan properties on the FHA fund.

METHODOLOGY AND SCOPE

We used FHA's Single Family Housing Enterprise Data Warehouse to identify borrowers who had greater than seven active single-family FHA mortgage loans. The system query generated 37 individual investors that held 622 active FHA loans. We analyzed the data to determine whether the loans closed prior to Mortgagee Letter 96-59; dated October 29, 1996, which put a moratorium on investor 203k (rehabilitation) loans. We determined the loans in our review closed prior to the moratorium and therefore, are eligible under HUD's current rules and regulations.

Next, we narrowed our review by selecting 8 of the 37 investors who had greater than 20 active FHA loans. For these 8 investors, we reviewed the data to determine whether their loan eligibility and housing standards were putting a negative impact on the FHA fund. We selected the two investors where the properties were in closest geographic proximity to each other and conducted on-site reviews to evaluate the condition of the properties.

We then analyzed 4 investors that had more than 20 FHA single family mortgages where the properties were located in the same geographic area. The 4 investors in our sample held 177 active FHA mortgages. The table below shows the location of the 4 properties, total number of loans, original mortgage amounts, and current unpaid principal balance.

Borrower ID	Location	Total loans	Original mortgage amount	Unpaid balance
9095	Humacao, PR	91	$ 2,665,445	$ 962,758
5798	Baltimore, MD	33	$ 1,370,852	$ 1,144,905
8342	Columbus, OH	27	$ 986,327	$ 446,020
4481	Memphis, TN	26	$ 1,103,140	$ 389,503
	Total:	**177**	**$ 6,125,764**	**$ 2,943,186**

BACKGROUND

The Federal Housing Administration (FHA) provides mortgage insurance for loans made by FHA-approved lenders throughout the United States and its territories. FHA insures mortgages on single family and multifamily homes including manufactured homes and hospitals. It is the largest insurer of mortgages in the world, insuring over 34 million properties since its inception in 1934.

The seven-unit limitation prohibits any borrower, including non-profit organizations, State and local government agencies, and private investors, from obtaining FHA-insured financing for a property that may be rented if the borrower has, or will have, a financial interest in more than seven rental units (regardless of financing type) in a contiguous area. This is generally defined as within a two-block radius. FHA designed the regulation to limit its insurance exposure on multiple mortgages to any one borrower in any one area. The seven-unit limitation appears in 24 CFR 203.42(a), paragraph 3-9 of HUD Handbook 4155.1 Rev-4, Change 1 and, specifically for the Section 203(k) program, in paragraph 4-6 of HUD Handbook 4240.2 Rev-2.

In 1996, HUD issued Mortgagee Letter 96-59 that placed a moratorium on all investor loans. That moratorium is still in effect.

The seven-loan limit and the investor loan moratorium do not apply to FHA Streamline Refinance loans. Specifically, HUD Handbook 4155.1 6.C.3.e, states an eligible investor that has a financial interest in more than seven rental units, as described in 24 CFR 203.42, may only refinance without appraisals. We reviewed the loans in our analysis and determined that of the 177 loans above, 16 loans were not Streamline Refinance loans. The 16 loans closed prior to the 1996 investor loan moratorium; therefore, those loans were eligible under the previous criteria.

RESULTS OF REVIEW

We found multiple instances of investors deferring maintenance on their investment property. Since there is no policy for periodic evaluation of property conditions or appraisals in the case of refinancing, this might put undue risk on the FHA insurance fund.

We conducted onsite visits of the Baltimore, MD, and Columbus, OH, properties to determine whether the borrowers maintained the properties similar to HUD's Housing Quality Standards. Additionally, we wanted to ensure the properties were not in such disrepair they would decrease the property's value and place the FHA insurance fund at risk. We determined that multiple homes had deferred maintenance, including cracked or boarded up windows, exposed wiring, loose or missing railing, leaking plumbing, missing entry stairs, etc.

We believe the deferred maintenance issues existed because there is no policy for FHA or its approved lenders to conduct periodic evaluations of property conditions for properties with single-family mortgage insurance, as there would be if these properties had mortgages with multi-family mortgage insurance. We also believe the issues also exist because the investors can refinance their mortgages without obtaining an appraisal, which could disclose significant deferred maintenance.

The properties we inspected contained multiple deficiencies that might decrease their property value, putting risk on the FHA insurance fund. If the above-mentioned properties were insured under multifamily mortgage insurance programs, some would not meet HUD's Housing Quality Standards. Furthermore, some of the homes we inspected had deferred maintenance that may have decreased the insured value of the home. See appendix A for various pictures of our onsite visits.

The 33 active mortgages for the Baltimore, MD investment properties have all been refinanced without appraisals. The amounts of the original mortgages were more than $1.3 million and the current mortgages still have outstanding principal balances of more than $1.1 million. The original mortgage closing dates ranges are 1991 – 1996 with refinance loan dates of 1997 – 2004. This investor has had conveyance claims filed against two additional properties totaling more than $96,000. The remaining properties are in deteriorated condition but the mortgage balances are only about 16% less than they were around 20 years ago.

These properties function much like multifamily properties, but FHA does not have the protections for single family properties that are in its multifamily insurance programs. These loans pose a greater risk to the insurance fund than ordinary single family loans because they are greater in number, are all on properties being rented out, and are managed and maintained similarly. If the borrower stops making payments on one loan, they could stop making payments on all their loans, possibly at a significant cost to the insurance fund. This happened recently with an investor who held 51 mortgages in Cheyenne, WY as identified in our audit memorandum 2013-DE-1801. Therefore, FHA should consider developing additional protections, like requiring appraisals on refinanced investor loans and, if FHA reinstates the investor loan program, consider other changes to the insurance requirements for investor loans that will better protect the insurance fund.

RECOMMENDATION

We recommend that the FHA Commissioner-Assistant Secretary, Office of Housing

1A. Perform a study of the risks involved with deteriorating property conditions related to investor loans and evaluate whether changes are needed, such as requiring appraisals on refinanced investor loans and making changes to the insurance requirements for investor loans.

Appendix A

The pictures below are from various Baltimore, MD properties.

Broken window

Boarded up egress window

Broken exposed external wirings

Damaged stairs with no railing

The pictures below are from various Columbus, OH properties.

Missing window

Leaking plumbing and no cabinet doors

Appendix B

AUDITEE COMMENTS

HUD chose not to provide comments to this report.