OFFICE OF AUDIT
REGION 3
PHILADELPHIA, PA

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

Home Equity Conversion Mortgage Program

2014-PH-0001

SEPTEMBER 30, 2014

Issue Date: September 30, 2014

Audit Report Number: 2014-PH-0001

TO: Kathleen A. Zadareky, Deputy Assistant Secretary for Single Family Housing, HU

//signed//

FROM: David E. Kasperowicz, Regional Inspector General for Audit, Philadelphia Region, 3AGA

SUBJECT: HUD Policies Did Not Always Ensure That HECM Borrowers Complied With 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 (HECM) program.

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 215-430-6730.

September 30, 2014

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

Highlights

Audit Report 2014-PH-0001

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 (HECM) program based on our strategic goal to improve the integrity of HUD's single-family insurance programs and because of residency issues identified in prior audits of the HECM program. Our objective was to determine whether HUD's Office of Single Family Housing had effective controls to ensure that HECM loan borrowers complied with residency requirements when concurrently participating in the Housing Choice Voucher (Voucher) program.

What We Recommend

We recommend that HUD (1) direct the applicable lenders to verify borrowers' compliance with the residency requirement or, for each noncompliant borrower, declare the loan due and payable, thereby putting about $3.4 million to better use; (2) implement controls to prevent or mitigate instances of borrowers violating residency requirements by concurrently participating in the Voucher program; and 3) update its guidance to detail the steps that servicing lenders should take for borrowers who fail to certify to residency.

What We Found

HUD policies did not always ensure that HECM borrowers complied with residency requirements. The audit showed that as many as 136 out of 159 borrowers reviewed were not living in the properties associated with their loans because they were receiving rental assistance under the Voucher program for a different address at the same time. This condition occurred because HUD's Office of Single Family Housing did not have controls to prevent or mitigate the problem. The loans for 15 of the 136 borrowers were independently terminated by the servicing lenders during the audit. The remaining 121 insured loans had current balances totaling more than $15.6 million and maximum claim amounts totaling more than $19 million. As a result, 121 insured loans should be declared in default and due and payable to reduce the potential risk of loss of about $3.4 million 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. The HECM program enables elderly homeowners to obtain income by accessing the equity in their homes. To be eligible for a loan, the homeowner must be 62 years of age or older, have significant equity in their home, occupy the property as a principal residence, not be delinquent on any Federal debt, and participate in HUD-approved reverse mortgage counseling.

The borrower is not required to repay the loan as long as they continue to occupy the home as a principal residence, maintain the property, and pay the property taxes and the mortgage insurance premiums. The loan agreement defines "principal residence" as the dwelling where the borrower maintains their 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 HECM program requirements, including the annual certification of principal residency. The mortgage note contains a clause stating 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 Housing Choice Voucher (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. Each agency's administrative plan must include a policy limiting the number of consecutive days a family may be absent from the unit to a maximum of 180 days. Agencies may terminate assistance if the family violates its policy on absence from a unit.

Our audit objective was to determine whether HUD's Office of Single Family Housing had effective controls to ensure that HECM loan borrowers complied with residency requirements when concurrently participating in the Voucher program.

RESULTS OF AUDIT

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

HECM borrowers did not always comply with residency requirements. Contrary to requirements, as many as 136 out of 159 borrowers reviewed were not living in the properties associated with their loans because they were receiving rental assistance under the Voucher program for a different address at the same time. This condition occurred because HUD's Office of Single Family Housing did not have controls to prevent or mitigate the problem. The loans for 15 of the 136 borrowers were independently terminated by the servicing lenders during the audit. The remaining 121 insured loans had current balances totaling more than $15.6 million and maximum claim amounts totaling more than $19 million. As a result, 121 insured loans were potentially ineligible and should be declared in default and due and payable to reduce the potential risk of loss of about $3.4 million to the Federal Housing Administration (FHA) insurance fund.

Borrowers Violated HECM Program Residency Requirements

Contrary to requirements, as many as 136 borrowers were not living in the properties for which they obtained HECM loans. According to 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 159 loan borrowers that were possibly violating HECM program residency requirements by concurrently participating in the Voucher program. Based on reviews of documents obtained from servicing lenders and public housing agencies, there was substantial evidence indicating that as many as 136 borrowers were not living in the

[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.

properties associated with their loans because they were receiving rental assistance under the Voucher program for a different address at the same time. The documented overlap of the loan and the borrower's participation in the Voucher program ranged from 2 to 36 months.[3] The borrowers for 113 of the loans were listed as heads-of-households in the Voucher program. The remaining borrowers were listed as spouses and other adults.

Of the 136 borrowers that may have violated HECM program residency requirements:

- 46 borrowers certified that they occupied the properties associated with their loans as their principal residence during the overlap of participation in the Voucher program,
- 80 borrowers did not provide occupancy certifications during the overlap[4] of participation in the Voucher program, and
- 10 borrowers certified that they did not occupy the properties associated with their loans during the overlap of participation in the Voucher program.

HUD Lacked Adequate Controls To Prevent or Mitigate The Problem

HUD did not have control policies or procedures to prevent or mitigate instances of borrowers violating HECM program residency requirements by concurrently participating in the Voucher program. The loans for 15 of the 136 borrowers were independently terminated[5] by the servicing lenders during the audit. The remaining 121 insured loans had current balances totaling more than $15.6 million and maximum claim amounts totaling more than $19 million. HUD risks loss to its FHA insurance fund for the current balances, which include loan advances and accrued interest, servicing fees, and mortgage insurance premiums. Further, HUD risks up to $3.4 million in potential future claim liabilities[6] for undisbursed loan amounts and continued accrual of interest, servicing fees, and mortgage insurance premiums.

[3] The audit covered the period April 2011 through March 2014.
[4] In 29 of the 80 cases, the documented overlap was less than 12 months. Therefore, occupancy certifications may not have been due during the overlap.
[5] The 15 loans were terminated for a variety of reasons including occupancy issues and failure to pay property taxes and insurance. Further, at least one loan was paid in full by the borrower.
[6] The $3.4 million risk for potential loss was calculated by deducting the $15.6 million total current loan balances from the $19 million total maximum claim amounts for the 121 loans. This difference accounts for undisbursed loan amounts as well as the potential for continued accrual of interest and fees on the outstanding loan balances.

HUD's Office of Single Family Housing needs to quickly work with the applicable servicing lenders to verify documentation of the borrowers' compliance with residency requirements for each of the 121 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 as well as continued accrual of interest, servicing fees, and mortgage insurance premiums.

The Office of Single Family Housing can prevent or mitigate instances of borrowers violating residency requirements by concurrently participating in the Voucher program by periodically coordinating with the Office of Public and Indian Housing to compare data in their respective systems. This measure will allow HUD to identify potential violators of the residency requirements and work with applicable servicing lenders to take steps to verify borrowers' residency or otherwise declare loans in default and due and payable as appropriate. HUD should also update its guidance to provide servicing lenders steps to take when borrowers fail to provide annual certifications.

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 121 cases or for each noncompliant borrower, declare the loan in default and due and payable, thereby putting approximately $3,362,055 to better use.

1B. Implement controls to prevent or mitigate instances of borrowers violating HECM program residency requirements by concurrently participating in the Voucher program, including policies and procedures to at least annually coordinate with HUD's Office of Public Housing to match borrower data in the Single Family Data Warehouse to member data in the Public Housing Information Center.

1C. Update its guidance to detail the steps that servicing lenders should take for borrowers who fail to certify at least annually that the property associated with the loan is their principal residence. This includes borrowers who do not provide a certification, those who do not provide the certification in a timely manner, and those who certify that they no longer occupy the property.

SCOPE AND METHODOLOGY

We conducted the audit from March to August 2014 at our office in Philadelphia, PA. The audit covered the period April 2011 through March 2014 but was expanded as necessary to accomplish our objective.

To accomplish our objective, we reviewed

- Relevant background information on the loans and applicable regulations,
- HECM program requirements,
- Information in HUD's Single Family Data Warehouse,
- Information in HUD's Public and Indian Housing Information Center,
- Accurint[7] information on the borrowers and the properties associated with the loans,
- Loan documentation provided by the servicing lenders, and
- Voucher program documentation provided by public housing agencies.

We interviewed staff from HUD's Office of Single Family Housing.

We obtained loan-level data from HUD's Single Family Data Warehouse System as of February 28, 2014. Additionally, we obtained information on Voucher program participants from HUD's Public and Indian Housing Information Center as of February 21, 2014. These data included borrower information for 627,479 insured loans and information for 4.8 million household members participating in the Voucher program. We matched the data from the 2 systems and identified 172 potential matches. We further analyzed the data and eliminated 13 of the matches because the detailed borrower data did not match the detailed Voucher program member data. For the remaining 159 matches, we requested loan documents from the servicing lenders and Voucher program documents from the public housing agencies for the period covering April 2011 through March 2014.

We reviewed the documents outlined above to determine whether borrowers were potentially violating HECM program residency requirements by concurrently participating in the Voucher program. Specifically, we reviewed loan applications, counseling letters, appraisals, loan agreements, settlement statements, deeds of trust, and annual recertification documents for each loan. For the Voucher program, we reviewed HUD-50058 forms[8] covering the audit period along with inspection and landlord information. Based on this review, as many as 136 borrowers were not living in the properties associated with their loans because they were receiving rental assistance under the Voucher program for a different address at the same time. Of the remaining 23 borrowers, 19 borrowers were live-in aides for a family participating in the Voucher program, 3 borrowers received voucher assistance at the properties associated with their loans, and 1 borrower did not participate in the Voucher program.

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[7] Accurint is a public records search tool that includes more than 37 billion public records.
[8] Form HUD-50058 is used by HUD's Office of Public and Indian Housing to collect data on the people who participate in subsidized housing programs.

For the 136 borrowers that were potentially out of compliance with HECM program requirements, we obtained updated loan information from HUD's Single Family Data Warehouse and from HUD's National Servicing Center in Oklahoma City, OK. Since the beginning of our audit, 15 of the 136 loans cited had been independently terminated by the servicing lenders. As of July 29, 2014, $12.7 million had been advanced to the borrowers on the remaining 121 loans and $128,159 was available for disbursement. As of August 1, 2014, these loans had current balances totaling $15.6 million and maximum claim amounts totaling $19 million. HUD risks loss to its FHA insurance fund for the current balances, which include loan advances and accrued interest, servicing fees, and mortgage insurance premiums. Further, HUD risks up to $3.4 million in potential future claim liabilities for undisbursed loan amounts and continued accrual of interest on the outstanding balance, servicing fees, and mortgage insurance premiums. The $3.4 million risk for potential loss was calculated by deducting the $15.6 million total current loan balances from the $19 million total maximum claim amounts for the 121 loans. While some of the 121 loans are currently in default, these loans represent an ongoing risk to HUD because interest, servicing fees, and mortgage insurance premiums continue to accrue until the loans are terminated. Also, because it is possible that the defaults on these loans may be cured, the borrowers may have future access to additional undisbursed funds unless HUD ensures that the servicing lenders continue to pursue the defaults.

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 documents provided by servicing lenders and public housing agencies.

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 control was relevant to our audit objective:

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that the use of resources is consistent with laws and regulations.

We assessed the relevant control 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 Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- HUD lacked adequate control policies or procedures to prevent or mitigate instances of borrowers violating program residency requirements by concurrently participating in the Voucher program.

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$3,362,055

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 direct the applicable servicing lenders to verify and provide documentation of the borrowers' compliance with the residency requirement or for each noncompliant borrower, declare the loan 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 undisbursed loan amounts and continued accrual of interest, servicing fees, and mortgage insurance premiums.

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 25, 2014

MEMORANDUM FOR: David E. Kasperowicz, Regional Inspector General for Audit, Philadelphia 3AGA

FROM: Kathleen A. Zadareky, Deputy Assistant Secretary for Single Family Housing, HU

SUBJECT: Auditee Response
HUD Policies Did Not Always Ensure That HECM Borrowers Complied With Residency Requirements
Audit No: 2014-PH-XXXX

The Office of Housing has received the Home Equity Conversion Mortgage Program (HECM) draft report from the Office of Inspector General (OIG). OIG performed this audit based on their strategic goal to improve the integrity of HUD's single-family insurance programs and because residency issues identified in prior audits of HECM programs. OIG's objective was to determine whether HUD's Office of Single Family Housing had effective controls to ensure that HECM loan borrowers complied with residency requirements when concurrently participating in the Housing Choice Voucher program.

Recommendation 1A:

Comment 1

Direct the applicable servicing lenders to verify and provide documentation of the borrowers' compliance with the residency requirement for each of the 122 cases or for each noncompliant borrower, declare the loan in default and due and payable, thereby putting approximately $3,394,206 to better use.

Single Family Housing's Response:

The Office of Single Family Asset Management will contact the servicing lenders for the 122 loans within 120 days to obtain occupancy certification that at least one borrower resides in the property, as their primary residence. Where it is determined that no borrower resides in the property, the servicing lender will be instructed to submit a due and payable request.

Recommendation 1B:

Implement controls to prevent or mitigate instances of borrowers violating HECM program residency requirements by concurrently participating in the Voucher program, including policies and procedures to at least annually coordinate with HUD's Office of Public Housing to match

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borrower data in the Single Family Data Warehouse to member data in the Public Housing Information Center.

Single Family Housing's Response:

The Office of Single Family Asset Management will work with the Office of Public Housing to determine the best way to cross-check our respective tracking systems to identify HECM borrowers receiving Section 8 vouchers.

Recommendation 1C:

Update its guidance to detail the steps that servicing lenders should take for borrowers who fail to certify at least annually that the property associated with the loan is their principal residence. This includes borrowers who do not provide a certification, those who do not provide the certification in a timely manner, and those who certify that they no longer occupy the property.

Single Family Housing's Response:

Comment 2

The Office of Single Family Asset Management plans to issue a Mortgagee Letter in FY 2015 which will provide guidance for loans that become due and payable for failure to comply with the terms of the mortgage.

OIG Evaluation of Auditee Comments

Comment 1 As a result of our final reporting review procedures, we adjusted the 122 cases cited in the draft report down to 121 cases. Accordingly, we also adjusted the funds to be put to better use of $3,394,206 down to $3,362,055.

Comment 2 HUD's planned actions meet the intent of our three audit recommendations.