Pennsylvania Housing Finance Agency, Harrisburg, PA

HUD's Loss Mitigation Program for Loans Insured by the Federal Housing Administration

Office of Audit, Region 3
Philadelphia, PA

Audit Report Number: 2015-PH-1006
September 28, 2015

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

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

Subject: The Pennsylvania Housing Finance Agency, Harrisburg, PA, Properly Implemented HUD's Loss Mitigation Requirements for Servicing Loans Insured by the Federal Housing Administration

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final report of our review of the Pennsylvania Housing Finance Agency's implementation of HUD's Loss Mitigation program for Federal Housing Administration-insured loans.

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.

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The Pennsylvania Housing Finance Agency, Harrisburg, PA, Properly Implemented HUD's Loss Mitigation Requirements for Servicing Loans Insured by the Federal Housing Administration

Highlights

What We Audited and Why

We audited the Pennsylvania Housing Finance Agency's implementation of the U.S. Department of Housing and Urban Development's (HUD) Loss Mitigation program for loans insured by the Federal Housing Administration (FHA). We conducted the audit because the Agency had the largest active portfolio and the largest number of delinquent loans for servicers located in Pennsylvania as of October 2014. Our objectives were to determine whether the Agency (1) properly implemented HUD's Loss Mitigation program, (2) properly initiated foreclosures without using loss mitigation, (3) complied with HUD reporting requirements, and (4) developed and implemented its quality control program in accordance with HUD requirements.

What We Found

The Agency properly implemented HUD's Loss Mitigation program and initiated foreclosures without using loss mitigation for the FHA-insured loans reviewed. It also complied with HUD reporting requirements and developed and implemented a quality control plan in accordance with HUD requirements.

What We Recommend

This report contains no recommendations.

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Background and Objectives

The Pennsylvania Housing Finance Agency is an approved Federal Housing Administration (FHA) loan servicer located in Harrisburg, PA. It services more than 29,000 FHA-insured loans.

The U.S. Department of Housing and Urban Development (HUD) established the Loss Mitigation program in 1996 to ensure that distressed FHA-insured borrowers would have opportunities to retain their homes and reduce losses to FHA's insurance fund. Loss mitigation is considered critical to FHA because it fulfills the goal of helping borrowers in default retain home ownership while reducing, or mitigating, the economic impact on the insurance fund.

The Loss Mitigation program gives lenders responsibility for managing loan defaults and provides financial incentives to recognize them for their efforts. Lenders have a responsibility to compare the loss mitigation options and take appropriate actions that can generate the smallest financial loss to HUD. The program consists of reinstatement options to allow borrowers to keep their homes and disposition options that assist them in the disposing of their homes. The lender must evaluate the borrower for both informal and formal forbearance plans[1] before considering one of FHA's loss mitigation home retention options. These forbearance plans are the only options available for delinquent borrowers without verifiable losses of income or increases in living expenses. Mortgage forbearance is an agreement made between a mortgage lender and delinquent borrower, in which the lender agrees to not foreclose on a mortgage and the borrower agrees to a mortgage plan that will, over a certain period, bring the borrower current on his or her payments. A forbearance agreement, however, is not a long-term solution for delinquent borrowers. It is designed for borrowers who have temporary financial problems caused by unforeseen problems, such as temporary unemployment or health problems.

Once forbearance plans are considered, the loss mitigation home retention options must be considered in the following order: (1) special forbearances, (2) loan modifications, and (3) FHA's Home Affordable Modification Program (HAMP). A special forbearance is a written agreement between a lender and borrower to reduce or suspend mortgage payments. This option is available only to borrowers who are unemployed. A loan modification is a permanent change to the terms of a borrower's loan. FHA-HAMP typically involves the combination of a loan modification and a partial claim, which may include an amount needed to cover arrears in loan payments and an additional amount for principal deferment. However, it may now involve the use of one or both of the loss mitigation options.

The disposition options are preforeclosure and deed in lieu of foreclosure. The preforeclosure option allows the defaulted borrower to sell his or her house and use the sales proceeds to satisfy the mortgage debt, although the proceeds may be less than the amount owed. A deed in lieu of

[1] Informal forbearance plans are oral agreements relating to a period of 3 months or less. Formal forbearance plans are written agreements relating to a period of greater than 3 months and less than 6 months.

foreclosure allows a borrower to turn his or her home over to HUD in exchange for a release from all mortgage obligations.

Our objectives were to determine whether the Agency (1) properly implemented HUD's Loss Mitigation program, (2) properly initiated foreclosures without using loss mitigation, (3) complied with HUD reporting requirements, and (4) developed and implemented its quality control program in accordance with HUD requirements.

Results of Audit

Finding: The Agency Properly Implemented HUD's Loss Mitigation Requirements for Servicing FHA-Insured Loans

The Agency properly implemented HUD's Loss Mitigation program for 8 FHA-insured loans reviewed and initiated foreclosures without using loss mitigation for 14 FHA-insured loans reviewed. It also complied with reporting requirements and developed and implemented a quality control plan in accordance with HUD requirements.

The Agency Properly Implemented the Program

The Agency properly implemented HUD's Loss Mitigation program for eight FHA-insured loans reviewed. For each of the eight loans, the Agency requested financial information from the borrowers to evaluate all loss mitigation options before three full monthly installments were due and unpaid as required.[2] It properly determined whether the borrowers were either eligible or ineligible for the program in accordance with applicable requirements. Appendix B provides details on our file reviews.

The Agency Properly Initiated Foreclosures Without Using Loss Mitigation

The Agency properly initiated foreclosures without using loss mitigation for 14 FHA-insured loans reviewed. For each of the 14 loans, it made an effort to consider all loss mitigation options before initiating foreclosures as required.[3] The Agency repeatedly made phone calls or sent letters to the borrowers to inform them of loss mitigation options before three full monthly installments were due and unpaid as required. It properly initiated foreclosures without using loss mitigation because the borrowers (1) abandoned or vacated their property, (2) failed to respond to the Agency's repeated efforts to inform them of loss mitigation, or (3) rejected the Agency's loss mitigation offer. Appendix B provides details on our file reviews.

The Agency Complied With HUD's Reporting Requirements

For the 22 loans reviewed, the Agency generally complied with HUD's reporting requirements. It promptly and accurately reported an up-to-date account of the status and trends of the FHA-insured loans reviewed in HUD's Single Family Default Monitoring system[4] in accordance with applicable requirements.[5]

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[2] Mortgagee Letters 2000-05, 2012-22, and 2013-32

[3] Regulations at 24 CFR (Code of Federal Regulations) 203.606(a) and Mortgagee Letter 2000-05

[4] HUD's Single Family Default Monitoring system tracks data on delinquent loans until a delinquency is cured or a claim is submitted.

[5] HUD Handbook 4330.1, REV-5, paragraph 7-8(A)

The Agency Developed and Implemented a Quality Control Plan as Required

The Agency developed and implemented a quality control plan in accordance with HUD requirements.[6] Its quality control plan contained the required elements, such as determining whether (1) all appropriate loss mitigation tools had been considered and documented and that borrowers were provided every reasonable opportunity to remedy a delinquency or default before the decision to foreclose, (2) accurate documentation of collection efforts was maintained, (3) effective collection activities were pursued in a timely fashion; and (4) borrower information was reported to credit reporting bureaus. Based on the quality control reports reviewed, the Agency generally followed its plan when conducting quality control reviews.

Conclusion

The Agency properly implemented HUD's Loss Mitigation program and initiated foreclosures without using loss mitigation for the FHA-insured loans reviewed. It also complied with reporting requirements and implemented a quality control plan in accordance with HUD requirements.

[6] HUD Handbook 4060.1, REV-2, chapter 7

Scope and Methodology

We conducted the audit from January through September 2015 at the Agency's servicing office located at 211 North Front Street, Harrisburg, PA, and our office located in Philadelphia, PA. The audit covered the period January 2008 through January 2015.

To accomplish our objectives, we reviewed

- Relevant background information;
- Applicable regulations, HUD handbooks, and mortgagee letters;
- Applicable policies and procedures related to the Agency's servicing, collection, and quality control programs;
- The Agency's organizational charts;
- The Agency's servicing, collection, and quality control files; and
- HUD's report of its monitoring of the Agency's procedures for servicing FHA-insured loans, performed the week of June 25, 2012.

We interviewed responsible Agency employees and HUD officials located in Washington, DC, and Philadelphia, PA.

To achieve our audit objectives, we relied in part on computer-processed data in HUD's Neighborhood Watch[7] and Single Family Data Warehouse[8] systems, which contain data from HUD's Single Family Default Monitoring system. 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.

As of December 2014, the Agency serviced more than 29,000 FHA-insured loans. Of those loans, 7,844 were listed as delinquent in Neighborhood Watch. We selected and reviewed a sample of eight loans, with a total unpaid principal balance of more than $2.4 million, based on loss mitigation actions coded in Neighborhood Watch to determine whether the Agency properly implemented the program. The eight loans had the following codes in Neighborhood Watch:

- Two were coded as "seriously delinquent but not in loss mitigation,"
- Two were coded as "borrower's financial information was under review,"
- One was coded as "ineligible for loss mitigation,"
- One was coded as "forbearance,"

[7] Neighborhood Watch is a secure Web-based application designed to provide comprehensive data querying, reporting, and analysis capabilities for tracking the performance of loans originated, underwritten, and serviced by FHA-approved lending institutions.
[8] HUD's Single Family Data Warehouse system provides case-level data on single-family properties and associated loans, claims, defaults.

- One was coded as “FHA-HAMP,” and
- One was coded as “pre-foreclosure.”

As of February 2015, data in HUD’s Single Family Data Warehouse showed 414 loans that went into foreclosure with no loss mitigation for the period January 2008 to January 2015. From the universe of 414 loans, we initially identified a stratified, systematic, statistical sample of 90 loans. The universe was divided into six strata according to claim amount to control for variance. We used a systematic sample within each stratum to control for differences in the payment problems associated with each loan. After strata boundaries were determined, the data were sorted and sampled using a computer program written in SAS, using the survey select procedure with a random-number seed value of 7. We reviewed 14 of the 90 loans, with total claims paid of more than $1.5 million, to determine whether the Agency considered all loss mitigation options before initiating foreclosures.

We compared data reported in HUD’s Single Family Default Monitoring system to supporting documents for each of the 22 FHA-insured loans selected for review to determine whether the Agency complied with HUD reporting requirements. We also reviewed reports for the quality control reviews that the Agency performed on its FHA-insured loans between November 2012 and October 2014 and the Agency’s quality control plan to determine whether it complied with HUD requirements.

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.

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:

- Validity and reliability of data – 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 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 objective 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 the Agency's internal control.

Appendixes

Appendix A

Auditee Comments

The Agency chose not to provide written comments for this audit report.

Appendix B

File Review Details

The following paragraphs provide details on our review of the eight sample delinquent loans with a total unpaid principal balance of more than $2.4 million.

- For three of the loans (the two that were coded as seriously delinquent and the one that was coded as ineligible for loss mitigation), the files contained collection histories[9] to show that the Agency made an effort to evaluate and consider all loss mitigation techniques within the required timeframe. The Agency requested financial information from the borrowers, but the borrowers did not return the financial information to the Agency for review.

- For the two loans in which the borrower's financial information was under review, the files contained collection histories to show that the Agency requested financial information from the borrowers to evaluate all loss mitigation options within the required timeframe. The files contained evidence that the Agency reviewed documentation, such as pay stubs, monthly expenses, profit and loss statement, bank statements, hardship letters, and tax returns, to evaluate the borrower's financial condition.

- For the loan in forbearance, the file contained a collection history to show that the Agency requested financial information from the borrower to evaluate all loss mitigation options within the required timeframe. According to the collection history, the borrower promised to make a payment on the loan to bring it current. The borrower made the payment in June 2014.

- For the FHA-HAMP loan, the file contained a collection history to show that the Agency requested financial information from the borrower to evaluate all loss mitigation options within the required timeframe. In addition, the file contained a completed FHA Loss Mitigation Retention Priority Order (Waterfall) form and the borrower's financial information to show that the Agency selected the appropriate reinstatement option, loan modification under FHA-HAMP, and it followed the requirements for implementing that option.

- For the preforeclosure loan, the file contained a collection history to show that the Agency requested financial information from the borrower to evaluate all loss mitigation options within the required timeframe. The collection history also showed that the

[9] The collection history is a record of the Agency's servicing actions on a loan.

borrower contacted the Agency before the loan became delinquent to request a deed in lieu of foreclosure. In addition, the file contained evidence that the Agency reviewed bank statements, the most recent tax return, unemployment benefits, monthly expenses, and an appraisal report to show that it properly evaluated the borrower for preforeclosure.

The following paragraphs provide details on our review of the 14 sample loans that went into foreclosure with no loss mitigation with total claims paid of more than $ 1.5 million.

- For seven loans, the collection histories showed that the Agency initiated foreclosures because the borrowers did not respond to the Agency's repeated efforts to inform them of loss mitigation.

- For six loans, collection histories, review committee reports,[10] or inspection reports showed that the Agency initiated foreclosures because the properties were either abandoned or vacant for more than 60 days.

- For one loan, the collection history showed that the Agency initiated foreclosure because the borrower rejected the Agency's special forbearance offer.

[10] A review committee report contains the Agency's recommendation to initiate foreclosure on a loan.