Virginia Housing Development Authority, Richmond, VA

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-1007
September 30, 2015

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: The Virginia Housing Development Authority, Richmond, VA, Did Not Always Accurately Report Its Servicing Actions in HUD's Single Family Default Monitoring System

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 Virginia Housing Development Authority's implementation of HUD's Loss Mitigation program 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 215-430-6730.

Audit Report Number: 2015-PH-1007
Date: September 30, 2015

The Virginia Housing Development Authority, Richmond, VA, Did Not Always Accurately Report Its Servicing Actions in HUD's Single Family Default Monitoring System

Highlights

What We Audited and Why

We audited the Virginia Housing Development Authority'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 Authority had the largest active portfolio and the largest number of delinquent loans for servicers located in Virginia as of October 31, 2014. Our objectives were to determine whether the Authority (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 Authority did not always accurately report its servicing actions in HUD's Single Family Default Monitoring system.[1] Of the 26 loans reviewed, 10 contained an improper status code. This condition occurred because the Authority's automated system was incorrectly programed, which triggered the inaccurate status code. The Authority also lacked a control to ensure that accurate status codes were reported in HUD's system. As a result, HUD was unable to assess the effectiveness of the Authority's servicing activities and the potential risk to the FHA insurance fund. The Authority initiated corrective action during the audit to address this problem. It replaced its automated system and implemented an additional control.

Additionally, the Authority properly implemented HUD's Loss Mitigation program and properly initiated foreclosures without using loss mitigation for the 26 loans reviewed, and it generally developed and implemented a quality control program in accordance with HUD requirements.

What We Recommend

We recommend that HUD require the Authority to provide verification that it has taken appropriate action to correct its erroneous reporting of the "loss mitigation option failure" status code in HUD's Single Family Default Monitoring system.

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

Table of Contents

Background and Objectives

The Virginia Housing Development Authority is an approved Federal Housing Administration (FHA) loan servicer located in Richmond, VA. It services more than 22,000 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[2] 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

[2] 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.

mortgage debt, although the proceeds may be less than the amount owed. A deed in lieu of 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 Authority (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 Authority Did Not Always Accurately Report Its Servicing Actions in HUD's Single Family Default Monitoring System

The Authority did not always accurately report status codes when reporting its servicing actions to HUD for 10 of the 26 loans reviewed. This condition occurred because the Authority's automated system was incorrectly programed, which triggered an inaccurate status code. The Authority also lacked a control to ensure that accurate status codes were reported in HUD's system. As a result, HUD was unable to assess the effectiveness of the Authority's servicing activities and the potential risk to the FHA insurance fund. The Authority initiated corrective action during the audit to address this problem. It replaced its automated system and implemented an additional control. Additionally, the Authority properly implemented HUD's Loss Mitigation program and properly initiated foreclosures without using loss mitigation for the 26 loans reviewed, and it generally developed and implemented a quality control program in accordance with HUD requirements.

The Authority Reported Inaccurate Status Codes in HUD's Single Family Default Monitoring System

The Authority used inaccurate status codes when reporting its servicing actions in HUD's Single Family Default Monitoring system for 10 of the 26 loans reviewed. HUD required the Authority to promptly and accurately report an up-to-date account of the status and trends of FHA-insured mortgages.[3] For the 10 loans, the Authority used the "loss mitigation option failure" status code in HUD's system. The Authority should have used this status code when a borrower had failed to perform under the terms of a loss mitigation tool.[4] However, the files did not contain evidence that the Authority used a loss mitigation tool and that the borrowers failed to perform under the terms of a loss mitigation tool. For the 10 loans reviewed, the files contained consolidated notes logs[5] to show that the Authority should have coded 9 of the loans as "delinquent" and one of the loans as the "borrower's financial information was under review." This condition occurred because the Authority's automated system was incorrectly programed, which triggered the inaccurate status code. Specifically, its automated system was programed to report a broken "promise to pay" in the same manner as a broken "repayment" plan. The Authority also lacked a control to ensure that accurate status codes were reported in HUD's system. As a result, HUD was unable to assess the effectiveness of the Authority's servicing activities and the potential risk to the FHA insurance fund.

---

[3] HUD Handbook 4330.1, REV-5, paragraph 7-8(A)
[4] Mortgagee Letter 2013-15
[5] The consolidated notes log is a record of the Authority's servicing actions on a loan.

The Authority initiated action to correct the flaw in June 2015 by replacing its automated system. In July 2015, it also created and implemented an additional control to identify erroneous "loss mitigation option failure" status codes that it reported in HUD's system. The control tasked the Authority's internal audit division to review a report of all loans with the status code "loss mitigation option failure" on a monthly basis and select a sample of loans to verify that the status codes were accurate. The internal audit division implemented this control for the first time in September 2015.

The Authority Properly Implemented the Program

The Authority properly implemented HUD's Loss Mitigation program for 12 FHA-insured loans reviewed. For each of the 12 loans, the Authority requested financial information from the borrowers to evaluate all loss mitigation options before three full monthly installments were due and unpaid as required.[6] 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 Authority Properly Initiated Foreclosures Without Using Loss Mitigation

The Authority properly initiated foreclosures without using loss migitation 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.[7] The Authority repeatedly made phone calls or sent letters to the borrowers to inform them of loss mitigation options before three full monthly installements 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 Authority's repeated efforts to inform them of loss mitigation, (3) passed away before loss mitigation could be completed and there were no co-borrowers on the mortgage, (4) decided to walk away from his or her home because they could no longer afford the property, (5) had income that created a monthly deficit, (6) defaulted on the mortgage, or (7) failed to satisfy excessive judgments. Appendix B provides details on our file reviews.

The Authority Developed and Implemented a Quality Control Plan as Required

The Authority developed and implemented a quality control plan in accordance with HUD requirements.[8] 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 pursed in a timely fashion; and (4) borrower information was reported to credit bureaus. Based on the quality control reports reviewed, the Authority generally followed its plan when conducting quality control reviews.

[6] Mortgagee Letters 2000-05, 2012-22, and 2013-32
[7] Regulations at 24 CFR (Code of Federal Regulations) 203.606(a) and Mortgagee Letter 2000-05
[8] HUD Handbook 4060.1 REV-2, chapter 7

Conclusion

The Authority did not always accurately report its servicing actions to HUD as required. This condition occurred because the Authority's automated system was incorrectly programed, which triggered an inaccurate status code. The Authority also lacked a control to ensure that accurate status codes were reported in HUD's system. As a result, HUD was unable to assess the effectiveness of the Authority's servicing activities and the potential risk to the FHA insurance fund. The Authority initiated corrective action during the audit to address this problem.

Recommendations

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

1A. Provide verification that it has taken appropriate action to correct its erroneous reporting of the "loss mitigation option failure" status code in HUD's Single Family Default Monitoring system.

Scope and Methodology

We conducted the audit from February through September 2015 at the Authority's servicing office located at 4224 Cox Road, Glen Allen, VA, and our office located in Richmond, VA. 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 Authority's servicing, collection, and quality control programs;
- The Authority's organizational charts;
- The Authority's servicing, collection, and quality control files; and
- HUD's report of its monitoring of the Authority's procedures for servicing FHA-insured loans, performed the week of January 9, 2012.

We interviewed responsible Authority 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[9] and Single Family Data Warehouse[10] 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 Authority serviced more than 22,000 FHA-insured loans. Of those loans, 3,490 were listed as delinquent in Neighborhood Watch. For the loss mitigation actions used most by the Authority, we sorted the data in descending order by unpaid principal balance and selected loans with the largest unpaid principal balance. We selected and reviewed a sample of 12 loans with a total unpaid principal balance of about $3.7 million, based on loss mitigation actions coded in Neighborhood Watch, to determine whether the Authority properly implemented the program. The 12 loans had the following codes in Neighborhood Watch:

- 4 were coded as "loss mitigation option failure,"

---

[9] 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.
[10] HUD's Single Family Data Warehouse system provides case-level data on single-family properties and associated loans, claims, and defaults.

- 3 were coded as “FHA-HAMP,”
- 2 were coded as “borrower’s financial information was under review,”
- 2 were coded as “forbearance,” and
- 1 was coded as “ineligible for loss mitigation.”

As of February 2015, data in HUD’s Single Family Data Warehouse showed 1,309 loans that went into foreclosure with no loss mitigation for the period January 2008 to January 2015. From the universe of 1,309 loans, we initially identified a stratified, systematic, statistical sample of 95 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 95 loans, with total claims paid of more than $1.9 million, to determine whether the Authority 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 26 FHA-insured loans selected for review to determine whether the Authority complied with HUD reporting requirements. We also reviewed reports for the quality control reviews that the Authority performed on its FHA-insured loans between November 2012 and October 2014 and the Authority’s quality control plan to determine whether the Authority 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.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The Authority lacked a control to ensure that servicing actions were accurately reported in HUD’s Single Family Default Monitoring system.

Appendixes

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

VHDA

September 24, 2015

Mr. David Kasperowicz
HUD Office of the Inspector General
100 Penn Square East
Suite 10205
Philadelphia, PA 19107

RE: HUD OIG Discussion Draft Report –
Review of Virginia Housing
Development Authority Loss
Mitigation Program

Dear Mr. Kasperowicz,

In response to Mr. Ronald Lloyd's email of September 24, 2015, below you will find my written comments to the updated discussion draft report:

Comment 1

As noted in the report, the system causing the incorrect codes was replaced in June of 2015 and an additional monitoring control was added to the existing controls. The Authority provided evidence to the OIG staff of the replacement of the system as well as resulting test work from the additional monitoring control noted in the report.

Please contact me if you have any questions.

Regards,

Susan F. Dewey

Susan F. Dewey

Cc: Mr. Ronald J. Lloyd
Ms. Julie A. Camus
Ms. Janet Wiglesworth

VIRGINIA HOUSING DEVELOPMENT AUTHORITY
601 SOUTH BELVIDERE STREET | RICHMOND, VIRGINIA 23220 | PHONE: 877/VHDA123 | TDD: 804/783-6705 | WWW.VHDA.COM

OIG Evaluation of Auditee Comments

Comment 1 The Authority noted that it replaced the system causing the incorrect codes, added an additional monitoring control to its existing controls, and provided evidence to support these actions. After the exit conference, the Authority provided additional documentation to show that it replaced the system causing the incorrect codes and added an additional monitoring control to its existing controls. The Authority tasked its internal audit division to review a sample of loans with the "loss mitigation option failure" status code on a monthly basis to verify that the status codes were accurate. It conducted its initial test in September 2015, and the results of the initial test showed that not all of the "loss mitigation option failure" codes were accurate. Therefore, as part of the audit resolution process, the Authority needs to provide HUD verification that it has taken appropriate action to correct its erroneous reporting of the "loss mitigation option failure" status code in HUD's system.

Appendix B

File Review Details

The following paragraphs provide details on our review of the 12 sample delinquent loans with a total unpaid principal balance of about $3.7 million.

- For the four loss mitigation option failure loans, the files contained consolidated notes logs[11] to show that the Authority requested financial information from the borrower to evaluate all loss mitigation options within the required timeframe. The consolidated notes logs for the four files showed that the Authority contacted the borrowers and accepted their promises to make a one-time payment to bring the loan current. However, the borrowers did not make the payments at that time.

- For the three FHA-HAMP loans, the files contained consolidated notes logs to show that the Authority requested financial information from the borrower to evaluate all loss mitigation options within the required timeframe. In addition, the files contained a completed FHA loss mitigation retention priority order (waterfall) form and the borrower's financial information to show that the Authority selected the appropriate reinstatement option, a combination of a loan modification, and a partial claim under FHA-HAMP and it followed the requirements for implementing that option.

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

- For the two loans in forbearance, the files contained consolidated notes logs to show that the Authority requested financial information from the borrowers to evaluate all loss mitigation options within the required timeframes. The files contained evidence that the Authority reviewed unemployment insurance documents and letters from their employers to determine that the borrowers experienced a loss of income due to unemployment. The Authority executed written agreements with the borrowers for a special forbearance to suspend mortgage payments as required.

[11] The consolidated notes log is a record of the Authority's servicing actions on a loan.

- For the ineligible for loss mitigation loan, the file contained evidence that the Authority reviewed documentation, such as a credit report, pay stubs, monthly expenses, bank statements, a hardship letter, and tax returns, to determine that the borrower had a monthly deficit of more than $1,600.

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 $1.9 million.

- For seven loans, the consolidated notes logs showed that the Authority initiated foreclosures because the borrowers did not respond to the Authority's repeated efforts to inform them of loss mitigation.

- For two loans, the consolidated notes logs, foreclosure recommendations,[12] and inspection reports showed that the Authority initiated foreclosures because the properties were either abandoned or vacant for more than 60 days.

- For one loan, the consolidated notes log and a foreclosure recommendation showed that the Authority initiated foreclosure because the borrower passed away before loss mitigation could be completed and there were no coborrowers on the mortgage.

- For one loan, the consolidated notes log and a written letter from the borrower showed that the Authority initiated foreclosure because the borrower decided to walk away from the home because the borrower could no longer afford the property.

- For one loan, the consolidated notes log and a foreclosure recommendation showed that the Authority initiated the foreclosure because the borrower's income created a monthly deficit, which made the borrower ineligible for loss mitigation. Specifically, the file contained evidence that the Authority reviewed pay stubs, monthly expenses, bank statements, and a credit report to determine that the borrower had a monthly deficit of more than $1,700.

- For one loan, the consolidated notes log and a foreclosure recommendation showed that the Authority initiated foreclosure because the borrower defaulted on the mortgage. The file contained evidence that the Authority offered the borrower a 3-month forbearance plan. However, during the forbearance period, the borrower made only one payment and filed for bankruptcy. During the bankruptcy, the borrower continued to default on the mortgage, and the Authority initiated foreclosure once the bankruptcy stay was lifted.

- For one loan, the consolidated notes log showed that the Authority initiated foreclosure because there were excessive judgments against the borrower, which the borrower was unable to satisfy.

[12] A foreclosure recommendation contains the Authority's recommendation to initiate foreclosure on a loan.