Kentucky Housing Corporation, Frankfort, KY

HUD's Loss Mitigation Program for FHA-Insured Loans

Office of Audit, Region 4
Atlanta, GA

Audit Report Number: 2016-AT-1015
September 30, 2016

To:	Robert E. Mulderig, Acting Deputy Assistant Secretary for Single Family Housing, HU
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From:	Nikita N. Irons, Regional Inspector General for Audit, 4AGA
Subject:	The Kentucky Housing Corporation Did Not Always Accurately Report on FHA-Insured Loans to HUD

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Kentucky Housing Corporation's administration of HUD's Loss Mitigation program for loans insured by the Federal Housing Administration.

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 (404)-331-3369.

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The Kentucky Housing Corporation Did Not Always Accurately Report on FHA-Insured Loans to HUD

Highlights

What We Audited and Why

We audited the Kentucky Housing Corporation's administration 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 selected the Corporation based on our analysis of risk factors of single-family loan servicers in Region 4's jurisdiction.[1] Our audit objective was to determine whether the Corporation accurately reported the default status and reason codes and the delinquency status of FHA-insured loans to HUD.

What We Found

The Corporation did not always accurately report the default status and reason codes and the delinquency status of FHA-insured loans in HUD's system. This condition occurred because the Corporation staff lacked adequate training. As a result, HUD did not always have complete and accurate information to (1) properly assess the performance of FHA-insured loans and (2) effectively monitor the Corporation's loss mitigation efforts.

What We Recommend

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing require the Corporation to provide adequate training to staff responsible for making entries to ensure accurate reporting in HUD's system. The training should include but not be limited to ensuring that its staff understands all of HUD's reporting requirements.

[1] The region includes eight States and two U.S. territories: Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee, Puerto Rico, and the Virgin Islands.

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Background and Objective

The Kentucky Housing Corporation was created by the 1972 General Assembly as a public corporation of the Commonwealth of Kentucky and is governed by a 15-member board of directors. In 1989, the Corporation created its in-house loan servicing program to include the servicing[2] of loans insured by the Federal Housing Administration (FHA). In addition, the Corporation is a lender[2] that provides mortgage financing.

The FHA Loss Mitigation program delegates to lenders both the authority and the responsibility to use certain actions and strategies to assist borrowers in default or imminent default to retain their homes or reduce losses to the insurance fund that result from mortgage foreclosures. Lenders may use any of several loss mitigation options that lead to home retention, including the FHA-Home Affordable Modification program, long-term special forbearance,[3] mortgage modification, and partial claim. If the borrower is unable or unwilling to support the mortgage debt, servicers must consider use of other loss mitigation tools, including a preforeclosure sale or a deed in lieu of foreclosure,[4] before initiating legal action to foreclose on the mortgage.

The U.S. Department of Housing and Urban Development (HUD) encourages lenders to use loss mitigation by reimbursing administrative costs involved in these actions and by paying financial incentives. Although lenders have flexibility in selecting the loss mitigation strategy appropriate for each borrower, participation in the Loss Mitigation program is not optional. Before initiation of foreclosure, lenders are required to evaluate all defaulted borrowers for loss mitigation options eligibility, quickly activate appropriate loss mitigation options, provide housing counseling availability information, consider all reasonable means to assist the borrower in addressing the delinquency, and retain written documentation of compliance with loss mitigation requirements. Failure to comply may result in the loss of incentive compensation, interest curtailment, and other financial and administrative sanctions, including withdrawal of HUD's approval of a lender.

HUD's Single Family Default Monitoring System and Single Family Data Warehouse are two different systems used for tracking and monitoring FHA loans. While the Warehouse stores information on all FHA loans, the Monitoring System tracks only those loans that become delinquent. More specifically, HUD's Monitoring System is a tool used to keep track of the default and delinquency status of HUD's portfolio of FHA loans. The Monitoring System provides data to allow HUD to assess the performance of FHA-insured loans and to monitor loss mitigation efforts on those loans that need it. In part, HUD uses the Monitoring System to

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[2] A mortgage lender loans money for a home to borrowers. A loan servicer handles the daily functions of mortgages (for example, accepting and applying mortgage payments). The Corporation services all mortgages it issues. Therefore, we use the term lender and servicer interchangeably.
[3] A special forbearance, which is available only to borrowers who are unemployed, is a written agreement between a lender and borrower to reduce or suspend mortgage payments.
[4] A deed-in-lieu of foreclosure is for borrowers in default of their FHA loans who do not qualify for any other HUD loss mitigation program. In essence, deed-in-lieu results in the borrower signing back the home to the mortgage company to avoid foreclosure.

generate month end reports, which it uses to review the percentage of loans in foreclosure, delinquency, and loss mitigation. Beginning November 1, 2006, HUD required[5] reporting on all FHA mortgages that were 30 or more days delinquent and announced[6] updated default status codes and claim filing assistance for loss mitigation claims in October 2009. The default status codes for trial payment plans for loan modification and partial claims were updated in August 2011[7] and in May 2013.[8]

The warehouse is a collection of database tables 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. The Monitoring System among other HUD systems feeds data into the warehouse.

Our audit objective was to determine whether the Corporation accurately reported the default status and reason codes and the delinquency status of FHA-insured loans to HUD.

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[5] Mortgagee Letter 06-15, dated June 8, 2006
[6] Mortgagee Letter 09-39, dated October 9, 2009
[7] Mortgagee Letter 11-28, dated August 15, 2011
[8] Mortgagee Letter 13-15, dated May 9, 2013

Results of Audit

Finding: The Corporation Did Not Always Accurately Report on FHA-Insured Loans to HUD

The Corporation did not always accurately report on FHA-insured loans to HUD. Specifically, it did not always accurately report the default[9] status and reason codes and the delinquency[9] status of FHA-insured loans in HUD's Monitoring System and Warehouse. This condition occurred because the Corporation's staff lacked adequate training to ensure that it accurately reported the default status and reason codes and the delinquency status of FHA-insured loans to HUD. As a result, HUD did not always have complete and accurate information to (1) properly assess the performance of FHA-insured loans and (2) effectively monitor the Corporation's loss mitigation efforts.

Default Status and Reason Codes Not Always Reported Accurately

The Corporation did not accurately report the default status and default reason codes in HUD's system for 8 of the 14 (57 percent) loans reviewed. According to HUD's reporting requirements,[10] a lender must report the correct default status code reflecting the status of the mortgage, and the lender must determine and report the specific reason for the delinquency. We identified two instances in which the Corporation used incorrect default status codes and six instances in which the Corporation used incorrect default reason codes. For example, the Corporation entered code 031 (unable to contact borrower) for reporting the default reason on multiple occasions, which was incorrect based on the Corporation's records indicating multiple instances of borrower contact with an explanation of why the loan was delinquent. The table below identifies the loans with incorrect default status and reason codes.

Table 1: Incorrect default status and reason code reported in HUD's Monitoring System

Loan number	Incorrect default status code	Incorrect default reason code
201-5154567		X
201-4957269	X	
201-5553122		X
201-5348478	X	
201-5614772		X
201-4876591		X

[9] According to 24 CFR (Code of Federal Regulations) 203.466, a mortgage account is delinquent any time a payment is due and not paid. A mortgage is in default, as described by 24 CFR 203.331, when the borrower fails to make any payment or to perform any other obligation under the mortgage for a period of 30 days.

[10] Mortgagee Letter 06-15, dated June 8, 2006, item 4 and 5

Loan number	Incorrect default status code	Incorrect default reason code
201-5510986		X
201-5195923		X

Delinquency Status Not Always Reported Accurately

The Corporation did not always accurately report the delinquency status to HUD. We compared data for all 130 foreclosed on loans as of March 2016 to the loss mitigation table in HUD's Warehouse. The comparison showed six loans reported as not having loss mitigation pursued[11] and another six loans not reported as 90 days delinquent before being reported as foreclosed on.[12] However, based on a review of the Corporation's system and notes maintained, we determined that (1) loss mitigation action was attempted by issuing letters for all six loans that were reported as having no loss mitigation action attempts and (2) the other six loans were 90 days delinquent but the Corporation failed to report the information correctly to HUD. The table below lists the 12 loans by deficiency type.

Table 2: Incorrect reporting on loss mitigation action and 90-day delinquency in HUD's Warehouse

Loan number	Attempt at loss mitigation not reported accurately	90-day delinquency not reported
201-4820172	X	
201-4917037	X	
201-5119390	X	
201-5285428	X	
201-5346897	X	
201-5396018	X	
201-4518958		X
201-4783533		X
201-4846851		X
201-4968958		X
201-4975204		X

[11] Mortgagee Letter 13-32, dated September 20, 2013, states, before four full monthly installments due on the mortgage are unpaid, the lender must evaluate a borrower's financial situation on a monthly basis to determine the appropriate loss mitigation option when the mortgage is in default or imminent default. In addition, HUD provides codes for the Monitoring System that indicate different loss mitigation actions initiated.

[12] According to HUD's frequently asked questions regarding reporting requirements in the Monitoring System, the lender must report the delinquency and default status codes that accurately reflect the stage of delinquency or lender action. Each month, the lender must report delinquent servicing activities for all mortgages that are 30, 60, and 90 days or more delinquent as of the last day of the month. As explained in the Background and Objective section of this report, data from the Monitoring System feeds in HUD's Warehouse. In addition, regulations at 24 CFR 203.606(a) state that the lender may not begin foreclosure for a monetary default unless at least three full monthly installments due under the mortgage are unpaid.

Loan number	Attempt at loss mitigation not reported accurately	90-day delinquency not reported
201-5066065		X

Corporation Staff Not Adequately Trained

The reporting deficiency occurred because the Corporation staff lacked adequate training to ensure that the default status and reason codes and the delinquency status of FHA-insured loans were accurately reported to HUD. Specifically, during our review, we noted that in 2012, HUD's Quality Assurance Division cited the Corporation staff as not having servicing training in compliance with HUD's requirements that would help to minimize loss to the FHA fund. The Division stated that it is important that staff be sufficiently trained in all aspects of mortgage servicing, including field collection, counseling activities, and loss mitigation, to have a positive impact on the default and claim rates. The Division recommended immediate training for all employees in the Servicing and Collection department, which includes the Corporation's loss mitigation activities. When asked whether this training had taken place and whether certificates had been issued, the managing director of Loan Servicing explained that the training had taken place but only one of the current loss mitigation staff was employed at the time of the training and that employee could not find any certificates for the training.

One of the loss mitigation staff members interviewed stated that she did not recall having received formal training and mostly received on-the-job training.

We noted that the Corporation's Internal Audit department, which administered the Corporation's quality control program, also identified an instance of loss mitigation staff not correctly entering the default status and reason codes into HUD's system during a quality control review performed during May 2015. We discussed the deficiency with Corporation management. Management agreed that additional training should help address the reporting weaknesses.

Conclusion

The Corporation did not always accurately report to HUD on FHA-insured loans. This condition occurred because Corporation staff lacked adequate training to ensure that it accurately reported the default status and reason codes and the delinquency status of FHA-insured loans in HUD's system. As a result, HUD did not always have complete and accurate information to (1) properly assess the performance of FHA-insured loans and (2) effectively monitor the Corporation's loss mitigation efforts.

Recommendations

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family require the Corporation to

1A. Provide adequate training to staff responsible for making entries to ensure accurate reporting in HUD's system. The training should include but not be limited to ensuring that its staff understands all of HUD's reporting requirements.

Scope and Methodology

We performed our audit work between April and June 2016 at the Corporation's office located at 1231 Louisville Road, Frankfort, KY. The audit generally covered the period January 1, 2011, through December 31, 2015, but we expanded the period as necessary.

To accomplish our objective, we reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to HUD's Loss Mitigation program. Further, we reviewed the Corporation's servicing policies and procedures, quality control plan, and quality control documentation. We also reviewed the Corporation's electronic and hardcopy loan servicing files.

Using data maintained in HUD's Warehouse, we statistically selected a sample of 80 loans from an audit universe consisting of 867 loans that the Corporation serviced, which met the following criteria: (1) an endorsement date on or after January 1, 2011, (2) reported as having a default episode, and (3) FHA insurance on the loan not terminated as of the time of the sample selection. We reviewed 14 of the 80 loans for the survey phase and did not review the remaining 66 loans based on the 57 (8 of 14) percent error rate discovered in the review of 14 files. We deemed this error rate to be adequate to indicate there was a condition with the default reporting and further review of the remaining loans was not necessary.

For the 14 loans reviewed, we determined whether the Corporation (1) approved and rejected borrowers for HUD's Loss Mitigation program, (2) consistently and appropriately applied loss mitigation options for eligible borrowers, (3) maintained documentation to support adequate attempts at loss mitigation as required, and (4) accurately reported the default and delinquency status to HUD. The conclusions in this audit report are limited to the 14 loans reviewed and cannot be projected.

We reviewed data for all 130 loans as of March 2016, identified as foreclosures during our audit period, to determine whether the Corporation adequately reported loss mitigation actions and the 90-day default status.

We relied on information maintained in HUD's Monitoring System and Warehouse for informational and sampling purposes only. We also relied on data maintained in the Corporation's servicing system, such as electronic loan files. 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 adequately reliable for our purposes. The testing consisted of comparing data in the electronic files to information from HUD's systems. The audit results were based on our review of electronic and supporting hardcopy documentation maintained by the Corporation.

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 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,
- Relevance and reliability of information, 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 objective:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Relevance and reliability of information– Policies and procedures that management has implemented to reasonably ensure that operational and financial information used for decision making and reporting externally is relevant, reliable, and fairly disclosed in reports.
- Compliance with applicable 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 objectives 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 Corporation's internal controls.

Appendix

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments**

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Ms. Nikita N. Irons
Regional Inspector General for Audit
U.S. Department of Housing & Urban Development
Office of the Audit (Region IV)
75 Spring Street, SW, Rm 330
Atlanta, GA 30303-3388

Dear Ms. Irons:

Thank you for this opportunity to comment on the findings in your draft audit report of your review of Kentucky Housing Corporation's (KHC) Loss Mitigation program. KHC strives to be the premier provider of affordable housing financing to the citizens of Kentucky and values our partnership with FHA to accomplish that goal. Our primary focus during the recession and the years since has been to afford borrowers in financial difficulty every opportunity available to assist them in preserving their home. We are proud that there were no instances found during your review of any borrower who was not offered a loss mitigation solution.

Comment 1

We acknowledge the importance of timely, accurate information reporting through HUD's Single Family Default Monitoring System (SFDMS) so that the Insurance Fund can be properly managed by FHA. While we have strived to be completely accurate in our reporting, we acknowledge that there have been lapses in such reporting. While some inaccuracies can be attributed to system difficulties, most can be traced, as you have noted in your report, to inadequate training of staff. We have determined that our heretofore method of informal training has been insufficient and have already implemented a more formalized training regimen and have held training sessions, not just with loss mitigation staff but with all staff involved with SFDMS reporting, to strengthen our SFDMS reporting. Special attention will be given to ensuring that staff turnover does not create issues with future reporting. This is receiving the attention of senior management down to the clerical staff level.

We are happy to furnish new training documentation should you desire to see it at this time. Again, we appreciate the opportunity to comment on the report and express our commitment to improved reporting going forward.

Sincerely,

J. Kathryn Peters
Executive Director

c: [redacted] Assistant Regional Inspector General for Audit, by email
[redacted] Senior Auditor, U.S. Department of Housing & Urban Development, Office of Inspector General, by email
[redacted] Chief Financial Officer
[redacted] Managing Director, Loan Servicing

OIG Evaluation of Auditee Comments

Comment 1 The Corporation agreed with the deficiencies identified in the report and stated that it has implemented formalized training for all staff responsible for reporting to HUD. We commend the Corporation for initiating action to address the deficiencies and improve the accuracy of its reporting to HUD. The corporation should communicate with HUD and provide any supporting information necessary to successfully satisfy the audit recommendation during the audit resolution process.