



# U.S. Department of Housing and Urban Development, Office of Single Family Housing

## Partial Claims Loss Mitigation Option



**To:** Robert Mulderig, Acting Deputy Assistant Secretary for  
Single Family Housing, HU

*//signed//*

**From:** Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

**Subject:** HUD Did Not Collect an Estimated 1,361 Partial Claims Upon Termination of  
Their Related FHA-Insured Mortgages

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 collection of partial claims upon termination of Federal Housing Administration (FHA)-insured mortgages.

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 913-551-5870.



**Audit Report Number: 2016-KC-0001**

**Date: August 17, 2016**

**HUD Did Not Collect an Estimated 1,361 Partial Claims Upon Termination of Their Related FHA-Insured Mortgages**

## Highlights

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### What We Audited and Why

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We audited the U.S. Department of Housing and Urban Development (HUD) to determine whether it collected partial claims upon termination of their related Federal Housing Administration (FHA)-insured mortgages. We initiated this audit because of our concern that FHA partial claims could go uncollected.

### What We Found

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HUD did not collect an estimated 1,361 partial claims that became due in fiscal year 2015. As a result, partial claims totaling approximately \$21.5 million were not returned to the FHA insurance fund.

### What We Recommend

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We recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing (1) require HUD's loan servicing contractor to complete the necessary debt collection efforts for an estimated \$21.5 million in uncollected partial claims that became due during fiscal year 2015, (2) add a performance requirement measuring partial claims collection to HUD's contractor's performance work statement to put more than \$21.5 million to better use, and (3) strengthen procedures to better identify and resolve all due and payable partial claims.

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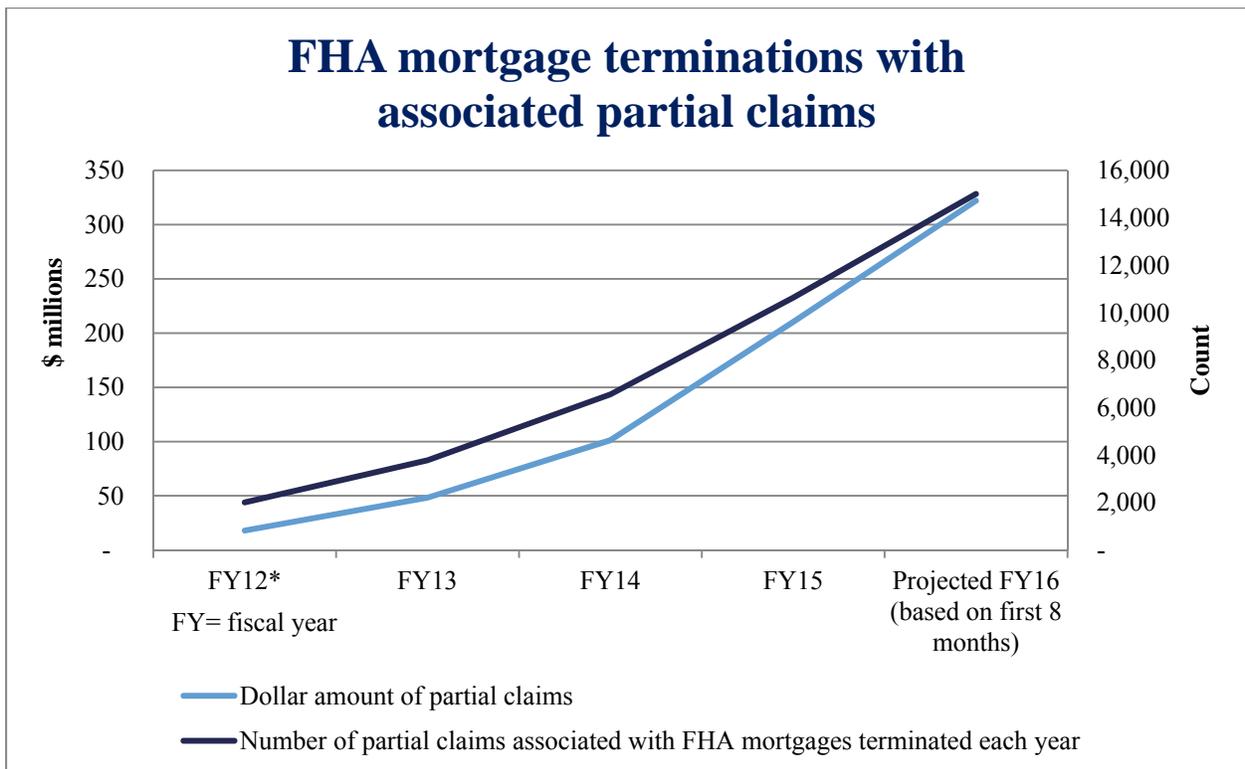
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# Background and Objective

The Federal Housing Administration (FHA) provides mortgage insurance for loans made by FHA-approved lenders throughout the United States and its territories. FHA mortgage insurance protects lenders against losses from homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender if a homeowner defaults on his or her loan. Loss mitigation is critical to FHA because it helps borrowers in default keep their homes while reducing the economic impact on the insurance fund.

The FHA partial claim is a loss mitigation tool that helps borrowers keep their homes by advancing funds on behalf of the borrowers to reinstate delinquent FHA-insured mortgages. The borrowers execute promissory notes and mortgages payable to the U.S. Department of Housing and Urban Development (HUD) when they accept the advances. A partial claim note does not accrue interest and is not due and payable until the related first mortgage has been paid off, has matured, or has been refinanced with a non-FHA-insured mortgage or the borrower sells the property. HUD paid more than 500,000 partial claims since the program began in 1997. During the last 5 years, the number of terminated FHA-insured mortgages with associated partial claims had increased.



Source: Single Family Data Warehouse

HUD's National Servicing Center helps FHA homeowners by working with lenders to administer the Loss Mitigation program. The National Servicing Center contracts the servicing, collecting, and managing of partial claims to its national loan servicing contractor. Partial claim notes become due and payable when their related FHA-insured mortgages are terminated. In some cases, a lender or title company remits a portion of the proceeds from the sale or refinance of the property to the loan servicing contractor to pay off the partial claim. In other cases, the contractor transfers the unpaid partial claim debt to HUD's Financial Operations Center to take collection action against the borrower. This action includes referring the delinquent debts to the U.S. Department of the Treasury. HUD's Financial Operations Center is responsible for servicing and collecting a variety of debts and receivables that are transferred from other organizations with HUD. Federal agencies are required to aggressively collect all debts arising from activities of that agency. This requirement mandates that debt collection actions be taken promptly once it is determined that a debt is owed.

Our objective was to determine whether HUD collected FHA partial claims upon termination of their related FHA-insured mortgages.

# Results of Audit

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## **Finding 1: HUD Did Not Always Collect Partial Claims**

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HUD did not collect an estimated 1,361 partial claims that became due in fiscal year 2015. This condition occurred because HUD did not include strong performance requirements in its loan servicing contract and did not always identify and resolve all partial claims that the contractor needed to collect. As a result, uncollected partial claims totaling \$21.5 million were not returned to the FHA insurance fund.

### **Partial Claims Not Collected**

HUD did not collect an estimated 1,361 partial claims that became due in fiscal year 2015. We reviewed a statistical sample of 135 of 10,561 partial claims associated with FHA-insured mortgages that terminated in fiscal year 2015. HUD had not collected 36 of the claims that should have been collected. We used this result to project that a total of 1,361 partial claims were not collected.

A partial claim becomes due and payable when the borrower either pays off the related FHA-insured first mortgage or no longer owns the property, except for a streamlined refinance when the partial claim note is subordinated to a new FHA first mortgage. When a partial claim note is paid off soon after becoming due, such as through the proceeds from a property sale closing, HUD's loan servicing contractor receives the partial claim payoff, deposits the funds in the bank, and notes in HUD's loan servicing system that the claim has been collected. When the note is not paid off soon after becoming due, the contractor notes that it is due and payable in HUD's loan servicing system and transfers the unpaid note to HUD's Financial Operations Center. The Financial Operations Center then issues demand letters to the borrowers and collects the partial claims, along with interest on the unpaid balance assessed from the date of the demand letter until the time of payment. Various HUD criteria provide the requirements for collecting partial claims (appendix D).

Of the 36 uncollected partial claims in our sample, the contractor had entered only 4 into HUD's loan servicing system as due and payable. The contractor had not referred any of the claims to the Financial Operations Center for collection. HUD, therefore, had not issued demand letters to start collection in any of the 36 cases.

### **Contract and Monitoring Weaknesses**

HUD did not include strong partial claims collection performance requirements in the loan servicing contractor's contract and did not always identify and resolve all partial claims that the contractor needed to collect.

HUD's contract for its national loan servicing contractor states that the contractor is responsible for collecting the partial claim note when the first mortgage is terminated. However, the contract does not set standards for expected timeframes and performance levels for partial claims

collection. These standards are necessary for HUD to effectively hold the contractor to an acceptable level of performance.

HUD did not always identify and resolve all due and payable partial claims. HUD's National Servicing Center conducted monitoring reviews based on its quality assurance surveillance plan. The plan required the government technical monitor to check for errors in the partial claims that were proposed to be transferred from the contractor to the Financial Operations Center each month. It did not, however, require the government technical monitor to determine whether any eligible partial claims were missing. In addition, HUD did not adequately follow up on the problems it found. HUD noted partial claims collection issues in two of its four quarterly monitoring reviews during fiscal year 2015. HUD's first quarter monitoring review noted 308 cases in which FHA mortgages were terminated but the partial claims were not reviewed for collection. We reviewed 5 of these 308 cases as part of our audit sample and found that 3 of them had not been transferred to the Financial Operations Center for collection more than a year later. The fourth quarter monitoring review noted that necessary debt collection efforts were not completed but did not state the number of problem cases. Of the 36 uncollected partial claims identified in our sample, 11 became due during that fourth quarter. The contractor did not make the necessary debt collection efforts until March 2016, after we requested documentation for those cases.

### **FHA Fund Reduced**

The FHA insurance fund was reduced because an estimated \$21.5 million in uncollected partial claims was not returned to the fund. When partial claims are returned, the fund's economic value increases. In addition, because HUD did not start collections in a timely manner, it forfeited interest that would have accrued on the debt beginning on the date of the demand letter. The forfeited interest would have also helped improve the fund's value.

HUD failed to collect \$625,399 for 36 of the partial claims in our sample. Using statistical sampling procedures to project the uncollected claims to the universe of 10,561 partial claims, we estimated that HUD failed to collect at least \$21.5 million in partial claims that became due during fiscal year 2015. During the most recent 5-year period, the volume of FHA mortgage terminations with outstanding partial claims had increased significantly. As a result, HUD's failure to collect partial claims could result in an even greater loss of revenue.

### **Conclusion**

HUD failed to collect an estimated \$21.5 million in FHA partial claims that became due last fiscal year. HUD's contract with its national loan servicing contractor lacked a performance requirement measuring partial claims collection. In addition, HUD's monitoring reviews of the contractor did not improve the contractor's performance in collecting partial claims. HUD should require the contractor to identify all partial claims that were due and payable, prepare the paperwork needed for debt collection, and transfer the claims to the Financial Operations Center. The Financial Operations Center should collect the \$21.5 million in uncollected partial claims from fiscal year 2015 from the borrowers, or if it is not possible to collect from the borrowers due to lender error, it should collect those funds from the lender. HUD also needs to strengthen the contract and monitoring review procedures to ensure that partial claims are properly collected.

## **Recommendations**

We recommend that the Deputy Assistant Secretary for Single Family Housing

- 1A. Require the contractor to complete the necessary debt collection efforts for \$21,526,130 in uncollected partial claims associated with FHA mortgages terminated during fiscal year 2015.
- 1B. Add a performance requirement measuring partial claims collection to the contractor's performance work statement to effectively hold the contractor to an acceptable level of performance to put more than \$21,526,130 to better use.
- 1C. Strengthen procedures to better identify and resolve all due and payable partial claims.

# Scope and Methodology

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Our audit covered the period October 2014 through September 2015. We performed our audit work between October 2015 and June 2016. We conducted onsite work at HUD's national loan servicing contractor's office at 2401 Northwest 23rd Street, Suite 1A1, Oklahoma City, OK.

To accomplish our objective, we

- Reviewed relevant laws, regulations, and HUD guidance;
- Reviewed HUD monitoring reviews of the loan servicing contractor;
- Reviewed HUD and loan servicing contractor policies and procedures;
- Interviewed HUD and loan servicing contractor personnel; and
- Selected and reviewed a statistical sample of partial claims.

We relied in part on data maintained by HUD in its Single Family Data Warehouse, HUD's key source for Single Family data. We also relied on HUD's Single-Family Mortgage Asset Recovery Technology System, HUD's comprehensive loan servicing system used for analyzing, processing, and tracking of FHA-insured mortgage loan servicing functions. Finally, we relied on HUD's Debt Collection and Asset Management System, which collects and maintains data needed to support activities related to the collection and servicing of various HUD and FHA debts.

Specifically, we relied on the systems to identify the universe of partial claims for which HUD should have made collection efforts. Although we did not perform a detailed assessment of the reliability of the data, we determined that the data were sufficiently reliable for the purposes of our review because the data in the sampled items were corroborated by supporting documentation supplied by HUD's national loan servicing contractor.

Our audit universe consisted of 10,625 partial claims, valued at more than \$211.5 million. The 10,625 partial claims were associated with FHA mortgages that terminated during fiscal year 2015 due to refinance, nonconveyance claim, voluntary termination of mortgage insurance, or full repayment of the loan. This universe included mortgages terminated with nonconveyance foreclosures for which the partial claim balances were written off. It also included streamline refinances with partial claim balances subordinated to the new FHA mortgage, which did not need to be paid off. It did not include partial claims associated with FHA mortgages that were terminated in conveyance claims or assignments. To ensure a more accurate projection, the universe excluded as outliers 64 partial claims, each exceeding \$120,000, leaving 10,561 partial claims valued at more than \$202.3 million.

HUD provided a list of collected partial claims, which indicated it had collected 5,952 of the 10,561 partial claims in our universe. To control for variance, we stratified the universe based on whether a partial claim was on HUD's list of collected partial claims. To control for the range of amounts in partial claims, the claims were sorted and ranked by dollar value and then stratified into eight groups according to percentile points along this continuum. This process

yielded 16 strata ( $2 \times 8$ ). Within each stratum, we sorted by the type of termination and age of the loan and then sampled systematically across that continuum to control for influence from those elements.

We validated the sample design using replicated sampling (computer simulations) across several audit scenarios, based on a variety of scenarios, both similar to and different from conditions found during the audit. We found a sample size of 135 to be sufficient. We found that an additional 35 samples would be required if the exception rate was very low, but they were not needed in this case.

Based on the design, we selected a statistical sample and reviewed documentation from HUD to determine whether HUD properly collected the sampled partial claims. Percentages, counts, and average dollar amounts were estimated and projected to the universe as a whole. Because all randomly selected samples are subject to “the luck of the draw,” we calculated a margin of error for each type of measure and made a final projection on that basis. Variances were calculated using a Taylor series. We used the traditional formulas (Cochran 1977, Wayne W. Daniel 1983) for estimating the lower bounds (LCL) of counts and dollar amounts.

We reviewed the statistical sample to determine whether HUD properly collected the partial claims. For each sampled partial claim we reviewed, as applicable, the

- Partial claim subordinate note,
- Partial claim subordinate mortgage,
- Partial claim payoff instructions,
- Partial claim subordination agreement,
- Neighborhood Watch case details,
- Evidence supporting partial claim collection,
- Single-Family Mortgage Asset Recovery Technology System notes, and
- Debt Collection and Asset Management System notes.

Our audit testing found that HUD failed to collect 36 of the 135 partial claims totaling \$625,399. We projected the sample results to the universe of 10,561 partial claims with a one-sided confidence interval of 95 percent. We projected that HUD failed to collect at least \$21.5 million in partial claims that became due during our audit period. We also projected that even after deducting a margin of error, these problems affected at least 1,361 partial claims and the actual number could be substantially more.

Calculations below:

$(16.38\% - 1.6577 \times 2.11\%) \times N = 12.9\% \times N \approx 1,361$  uncollected partial claims

$(2878.8 - 1.6577 \times 507.03) \times N = 2038.3 \times N \approx \$21,526,130$  uncollected partial claim amounts

Because our audit period covered an entire year, these findings represent \$21.5 million per year that will be uncollected if HUD does not improve controls over partial claims collections.

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

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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 objective:

- Policies and procedures that have been implemented to reasonably ensure that the partial claims were properly collected.

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:

- HUD did not include strong performance requirements in its national loan servicing contract (see finding).
- HUD did not have procedures to always identify and resolve all due and payable partial claims (see finding).

# Appendixes

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## Appendix A

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**Schedule of Questioned Costs and Funds To Be Put to Better Use**

<b>Recommendation number</b>	<b>Ineligible 1/</b>	<b>Funds to be put to better use 2/</b>
1A	\$21,526,130	
1B		\$21,526,130
<b>Totals</b>	<b>21,526,130</b>	<b>21,526,130</b>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ 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 case, if HUD implements our recommendations, it will ensure that partial claims are properly collected upon termination of the FHA mortgage. Our estimate reflects only the initial year of this benefit. These amounts do not include potential offsetting costs incurred by HUD to implement our recommendations to strengthen controls.

# 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

August 4, 2016

MEMORANDUM FOR: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

*R. E. Mulderig*

FROM: Robert E. Mulderig, Acting Deputy Assistant Secretary for Single Family Housing, HUD

SUBJECT: Auditee Response  
HUD Did Not Collect an Estimated 1,361 Partial Claims upon Termination of their Related FHA-Insured Mortgages  
Audit No: 2016-XX-XXXX

The Office of Inspector General (OIG) audited the U.S. Department of Housing and Urban Development (HUD) to determine whether HUD collected partial claims upon the termination of related Federal Housing Administration (FHA)-insured mortgages. The OIG found that HUD did not collect an estimated 1,361 partial claims that became due in fiscal year 2015. As a result, partial claims totaling approximately \$21.5 million were not returned to the FHA insurance fund.

The Office of Single Family Housing (Housing) greatly appreciates the OIG's collaboration on this audit. As we have advised you, staff within the National Servicing Center (NSC) have worked tirelessly during the past two years to address the unsatisfactory level of performance of NOVAD, the vendor under contract to perform the function which is the subject of the audit report. As such, we appreciate your engaging us in a discussion about the audit as it relates to the challenges we face with NOVAD, which include the acquisition strategy for FHA's loan servicing contract in general, especially going forward.

Overall, Housing agrees with the recommendations included in the audit. However, we do believe that your audit report did not take fully into consideration certain aspects of our oversight of the subject contractor, specifically:

- We believe it is important to highlight that the existing loan servicing contract indeed includes a requirement for the contractor to pursue collections monthly. Unfortunately, although this requirement is delineated in the contract, the contract does not include an associated remedy if the contractor fails to perform this task. The NSC contract monitoring team has worked closely with the Office of the Chief Procurement Officer (OCPO) to address the contractor's performance, including but not limited to its failure to pursue collections timely. Our efforts are expected to result in the Contracting Officer's incorporating language that will include specific consequences

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Comment 1

**Ref to OIG  
Evaluation**

**Auditee Comments**

Comment 2

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in the next option/contract year that will assist Housing in enforcing timely collection activities, in accordance with the Fair Debt Collection Act.

- Housing has a remaining concern about internal control deficiencies included in the audit report, even though you have assured us that these will not have any bearing in FHA's Annual Financial Statements for FY 2016. In your noting a "Significant Deficiency," Housing believes that your conclusion does not fully reflect the procedures that Housing currently has in effect to identify all due and payable partial claims correctly. (Reference NSC Secretary-held Training Guide, dated June 2014<sup>1</sup> and version 2.0 of the NOVAD Loan Servicing Guide, dated July 8, 2015<sup>2</sup>.) Specifically, the complete list of due and payable partial claims is delivered to the loan servicing contractor by the NSC's monitoring team (consisting of the contractor's Government Technical Monitor and other NSC subject matter experts) on a monthly basis.

Thank you again for collaborating with Single Family Housing staff in the development of this audit report, as well as for the constructive dialogue we have had on your conclusions; we greatly appreciate the support we have received from your office.

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<sup>1</sup> See pages 99-100 of the NSC Sec-Held Training Guide, dated June 2014.

<sup>2</sup> See pages 69-70 of the Novad Loan Servicing Guide Version 2.0, dated July 8, 2015

## OIG Evaluation of Auditee Comments

- Comment 1 The scope of work provided to OIG during the audit stated “servicing tasks are generally limited to collection of the note when the first mortgage is terminated through payoff of sale of the property” but did not include any specific timeframes or performance levels for partial claims collection. Incorporating language into the loan servicing contract for specific, measurable timeframes and performance levels for partial claims collections and specific consequences for failure to adequately pursue partial claims collection will adequately address recommendation 1B in this report. The incorporated language will need to be reviewed during the audit resolution process to determine if it satisfies the recommendation.
- Comment 2 Our concern was not with NSC’s delivery of the termination report to the loan servicing contractor, but rather was with NSC’s ability to identify and resolve its contractor’s performance problems. The contractor did not always note the partial claims as due and payable in the SMART system and then make the appropriate referral to the Financial Operations Center. Some of NSC’s quarterly monitoring reports on the contractor did not identify this problem with partial claims collection activities. Those reports that did identify uncollected partial claims did not always result in the specific uncollected cases being resolved. As stated in recommendation 1C, HUD needs to strengthen procedures to better identify and resolve all due and payable partial claims.

## Appendix C

### Sample Results

Control number	Termination processed date	Termination type	Date noted as due and payable*	Days between processed date and due and payable	Date noted as eligible for transfer to Financial Operations Center*	Partial note amount
65	10/25/2014	Matured	1/7/2015	74	3/5/2016	\$ 2,382.90
170	10/28/2014	Refinanced	1/8/2015	72		4,350.00
11	11/7/2014	Paid in full	6/1/2015	206		13,010.76
150	12/23/2014	Paid in full	9/11/2015	262		4,025.96
81	2/17/2015	Paid in full	11/17/2015	273		5,274.69
93	3/27/2015	Paid in full	1/6/2016	285	1/6/2016	2,801.19
13	3/17/2015	Paid in full	1/9/2016	298	1/14/2016	92,561.82
149	3/17/2015	Paid in full	1/12/2016	301	3/7/2016	23,910.98
4	4/13/2015	Refinanced	1/20/2016	282		34,193.70
128	3/13/2015	Paid in full	1/20/2016	313	3/7/2016	66,500.00
52	4/23/2015	Refinanced	1/21/2016	273	3/22/2016	2,940.88
109	2/5/2015	Paid in full	1/22/2016	351	3/7/2016	4,370.42
8	2/4/2015	Paid in full	1/22/2016	352	3/4/2016	29,142.42
122	4/10/2015	Paid in full	2/2/2016	298	2/18/2016	27,548.06
107	4/29/2015	Paid in full	2/6/2016	283		2,562.90
129	6/1/2015	Matured	2/10/2016	254		4,524.20
30	5/11/2015	Paid in full	2/22/2016	287	3/1/2016	8,515.91
51	9/3/2015	Paid in full	3/3/2016	182	3/5/2016	3,058.61
100	10/6/2014	Paid in full	3/3/2016	514	3/7/2016	2,514.10
1	8/6/2015	Refinanced	3/3/2016	210		4,688.44
2	8/4/2015	Paid in full	3/3/2016	212	3/5/2016	4,149.91
125	8/4/2015	Paid in full	3/3/2016	212		3,770.07
126	7/13/2015	Paid in full	3/3/2016	234		4,779.00
161	6/30/2015	Paid in full	3/3/2016	247	3/7/2016	3,438.68
114	9/29/2015	Refinanced	3/3/2016	156		6,032.19
119	6/29/2015	Paid in full	3/3/2016	248	3/7/2016	6,439.51
147	12/19/2014	Paid in full	3/3/2016	440	3/10/2016	5,915.20
22	9/21/2015	Paid in full	3/3/2016	164	3/7/2016	13,007.78
23	7/6/2015	Paid in full	3/3/2016	241	3/4/2016	13,962.16
34	8/10/2015	Paid in full	3/3/2016	206	3/5/2016	10,654.36
82	5/14/2015	Paid in full	3/3/2016	294	3/5/2016	11,523.56
40	7/16/2015	Refinanced	3/3/2016	231		16,561.56
141	6/9/2015	Paid in full	3/3/2016	268	3/7/2016	19,859.92
154	6/24/2015	Refinanced	3/3/2016	253		33,470.66
104	6/5/2015	Paid in full	3/3/2016	272	3/7/2016	42,376.78
84	9/1/2015	Refinanced	3/3/2016	184		90,580.35
<b>Total</b>						<b>\$ 625,399.63</b>

\* Date the contractor noted each event in HUD's Single-Family Mortgage Asset Recovery Technology System

## Appendix D

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### Criteria

#### 24 CFR (Code of Federal Regulations) 203.371, Partial claim

(c) Repayment of the subordinate lien.

The mortgagor [borrower] must execute a mortgage in favor of HUD with terms and conditions acceptable to HUD for the amount of the partial claim under §203.414(a). HUD may require the mortgagee [lender] to be responsible for servicing the subordinate mortgage on behalf of HUD.

#### Mortgagee Letter 2003-19 (November 20, 2003)

##### **Subject: Partial Claims: Program Changes and Updates**

Under the partial claim option, a mortgagee will advance funds on behalf of a mortgagor in an amount necessary to reinstate a delinquent loan (not to exceed the equivalent of 12 months' worth of principal, interest, taxes, and insurance). The mortgagor, upon acceptance of the advance, will execute a promissory note and subordinate mortgage payable to HUD. Currently, these promissory or "partial claim" notes carry no interest and are not due and payable until the mortgagor either pays off the first mortgage or no longer owns the property.

#### **G. Repayment Terms**

The partial claim advance will be secured by a note and subordinate mortgage with the following repayment terms:

- The note is interest free. (The [HUD] Secretary reserves the right to assess interest on partial claim notes originated in the future.);
- No monthly or periodic payments are required, however, mortgagors may voluntarily submit partial payments;
- The note is due at the earlier of 1) the payoff of the first mortgage, or 2) when the mortgagor no longer owns the property;
- There is no prepayment penalty;
- A mortgagor is only eligible to apply for a mortgage insurance premium (MIP) refund when the partial claim note has been paid in full;
- The Partial Claim Note and security documents must be payable to HUD;
- Voluntary payments or prepayments should be delivered via a cashier's check or other certified funds to the Department's servicing contractor.

#### **H. Required Documentation**

A promissory note must be executed in the name of the Secretary and a subordinate mortgage must be obtained and recorded. The mortgagee must include the provisions of HUD's model

form of note and subordinate mortgage (as provided in ML [Mortgage Letter] 97-17) and make any amendments required by state laws. While HUD does not endorse the products or services of vendors, the Department is aware that state specific documents are commercially available. Mortgagees who take advantage of the convenience of purchasing these documents should review them prior to use.

### **K. Loan Payoff or Refinance - Mortgagee Responsibilities**

Mortgagees will be responsible for notifying HUD when the first mortgage is being paid in full or refinanced in order for HUD to provide a payoff figure on the Partial Claim. HUD's Servicing Contractor, identified in Section G of this mortgagee letter, should be contacted to request a payoff quote on the outstanding Partial Claim. The purpose of this requirement is to ensure that no partial claim is overlooked when preparations are made to pay the first mortgage in full.

#### **Mortgagee Letter 2013-16 (May 14, 2013)**

##### **Subject: Subordination of Partial Claim Liens Associated with Federal Housing Administration (FHA) Streamlined Refinances**

FHA will accept subordination of Partial Claim promissory notes, provided that the current lien position for those notes remains the same. Partial Claims do not have to be paid off at the time of a FHA Streamlined Refinance transaction.

Subordination documents are to be sent to HUD's Secretary-Held Portfolio Servicing Contractor.

#### **Mortgagee Letter 2013-19 (May 31, 2013)**

##### **Subject: Partial Claim Documentation and Delivery Requirements**

###### **Required Documentation for Partial Claims**

A promissory note must be executed in the name of the Secretary, and a partial claim mortgage must be obtained and recorded. The partial claim note and mortgage must include:

- The provisions of HUD's model partial claim note (Attachment 1) and partial claim mortgage (Attachment 2), and
- Any amendments as required by state laws.

While HUD provides a model partial claim mortgage and note, mortgagees are encouraged to review these documents, make modifications as needed to comply with applicable state and local requirements, and have their counsel review these documents for legal sufficiency.

#### **Attachment 1**

Model Subordinate Note Form

FHA Case No. \_\_\_\_\_

## PROMISSORY NOTE

[Date]

[Property Address]

### 1. PARTIES

“Borrower” means each person signing at the end of this Note, and the person’s successors and assigns. “Secretary” or “Lender” means the Secretary of Housing and Urban Development and its successors and assigns.

### 2. BORROWER’S PROMISE TO PAY

In return for a loan received from Lender, Borrower promises to pay the principal sum of \_\_\_\_\_ Dollars (U.S. \$ \_\_\_\_\_), to the order of the Lender.

### 3. PROMISE TO PAY SECURED

Borrower’s promise to pay is secured by a mortgage, deed of trust or similar security instrument that is dated the same date as this Note and called the “Security Instrument.” The Security Instrument protects the Lender from losses, which might result if Borrower defaults under this Note.

### 4. MANNER OF PAYMENT

#### (A) Time

On, [insert maturity date of insured primary mortgage] or, if earlier, when the first of the following events occurs:

- (i) Borrower has paid in full all amounts due under the primary Note and related mortgage, deed of trust or similar Security Instruments insured by the Secretary, or
- (ii) The maturity date of the primary Note has been accelerated, or
- (iii) The primary Note and related mortgage, deed of trust or similar Security Instrument are no longer insured by the Secretary, or
- (iv) The property is not occupied by the purchaser as his or her principal residence.

#### (B) Place

Payment shall be made at the Office of Housing FHA-Comptroller, Director of Mortgage Insurance Accounting and Servicing, 451 Seventh Street, SW, Washington, DC 20410 or any such other place as Lender may designate in writing by notice to Borrower.

### 5. BORROWER’S RIGHT TO REPAY

Borrower has the right to pay the debt evidenced by this Note, in whole or in part, without charge or penalty. If Borrower makes a partial prepayment, there will be no changes in the due date or in the amount of the monthly payment unless Lender agrees in writing to those changes.

### 6. WAIVERS

Borrower and any other person who has obligations under this Note waive the rights or presentment and notice of dishonor. “Presentment” means the right to require Lender to demand payment of amounts due. “Notice of dishonor” means the right to require Lender to give notice to other persons that amounts due have not been paid.

## 7. OBLIGATIONS OF PERSONS UNDER THIS NOTE

If more than one person signs this Note, each person is fully and personally obligated to keep all of the promises made in this Note, including the promise to pay the full amount owed. Any person who is a guarantor, surety or endorser of this Note is also obligated to do these things. Any person who takes over these obligations, including the obligations of a guarantor, surety or endorser of this Note, is also obligated to keep all of the promises made in this Note. Lender may enforce its rights under this Note against each person individually or against all signatories together. Any one person signing this Note may be required to pay all the amounts owed under this Note.

BY SIGNING BELOW, Borrower accepts and agrees to the terms and covenants contained in this Note.

\_\_\_\_\_(SEAL)  
Borrower  
\_\_\_\_\_(SEAL)  
Borrower

### **HUD Handbook 4740.2, REV-3 – Title I and Other Debt Collection Guidance**

Single Family Partial Claims. These consumer debts originate as part of Housing’s loss mitigation program. Under the loss mitigation “partial claim” option, a mortgagee will advance funds on behalf of a mortgagor in an amount necessary to reinstate a delinquent loan (not to exceed the equivalent of 12 monthly payments). The mortgagee then files a claim with HUD for the funds advanced. In exchange for HUD’s payment, the mortgagor is required to execute a promissory note and subordinate mortgage payable to HUD. No payment is due until a callable event occurs (usually a sale or refinance of the mortgaged property.) Once the note becomes due and payable, Housing’s Oklahoma City National Servicing Center’s contractor issues a demand letter. Interest begins to accrue on the debt from the date of this letter. If the borrower fails to pay, the debt can be referred to the FOC [Financial Operations Center] for appropriate collection action. The referral package must include supporting documentation including a copy of the note and lien.

#### **Partial Claim Frequently Asked Questions**

**Question 8:** What is the collection process on a Partial Claim that is not collected from the Borrower at the time the Borrower pays off their FHA first mortgage?

**Answer:** For a Partial Claim that is left unpaid at the time the Borrower pays off their FHA first mortgage, the Department bills the Borrower directly. The Partial Claim debt is not forgiven and the Borrower is required to make a lump sum payoff.

**Question 9:** At what point does the Lender’s responsibility for a Partial Claim end?

**Answer:** The Lender’s responsibility for a Partial Claim ends when the following two events occur: (a.) HUD receives the executed Subordinate Mortgage and (b.) When any requests for

payoff of the first lien occur, the Lender is obligated to notify HUD to obtain full payoff amount of the Partial Claim and supply that information to the Borrower.

**Is a partial claim paid off at the time of an FHA Streamline Refinance transaction?**

An FHA-insured loan with a Partial Claim (as evidenced by a second lien) may be eligible for an FHA streamline refinance transaction because FHA will accept subordination of Partial Claim promissory notes, provided that the current lien position for those notes remains the same.

Partial Claims do not have to be paid off at the time of an FHA Streamline Refinance transaction. (See Mortgagee Letter 2013-16)