Issue Date April 30, 2009	
Audit Report Number 2009-BO-1007	

TO: Brian Montgomery, Assistant Secretary for Housing - Federal Housing Commissioner, H

FROM: John Dvorak, Regional Inspector General for Audit, Boston Region, 1AGA

SUBJECT: GMAC Mortgage, Fort Washington, Pennsylvania, Allowed Borrowers to Receive Cash Back In Excess of Their Cash Investment at Closing on FHA Loans with Secondary Financing from the Connecticut Housing Finance Authority

HIGHLIGHTS

What We Audited and Why

We reviewed lenders in the State of Connecticut that had Federal Housing Administration (FHA) loans with secondary financing from the Connecticut Housing Finance Authority as part of our annual audit plan. The objective was to determine whether the lenders inappropriately gave borrowers using secondary financing from the Connecticut Housing Finance Authority cash back at closing in excess of their total cash deposit and other closing costs paid outside of closing.

What We Found

In general, the lenders reviewed, with one exception, did not give borrowers using secondary financing from the Connecticut Housing Finance Authority cash back at closing in excess of their total cash deposit and other costs paid outside of closing. However, we did find seven loans originated by GMAC Mortgage in which the borrowers received excess cash back at closing totaling $1,471. This practice resulted in the U.S. Department of Housing and Urban Development's (HUD) over insuring the loans.

What We Recommend

We recommend that HUD's Assistant Secretary for Housing - Federal Housing Commissioner require GMAC Mortgage to pay down the principal balances of the over insured loans by the amounts of excess cash back paid to the borrowers at closing. We also recommend that GMAC Mortgage implement controls in its loan closing policies and procedures to ensure that it follows HUD's requirements regarding cash back to the borrower.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided GMAC Mortgage officials draft finding details throughout the course of the audit. We also provided GMAC Mortgage officials with a draft audit report on April 15, 2009. We discussed the draft report at an exit conference on April 23, 2009, and received their written comments on April 27, 2009. GMAC Mortgage generally agreed with the facts, conclusions, and recommendations in this report.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

The National Housing Act, as amended, established the Federal Housing Administration (FHA), an organizational unit within the U.S. Department of Housing and Urban Development (HUD). FHA[1] provides insurance to private lenders against losses on mortgages financing homes. The basic single-family mortgage insurance program is authorized under Title II, Section 203(b) of the National Housing Act and is governed by regulations in 24 CFR [*Code of Federal Regulations*] Part 203. The single-family programs are generally limited to dwellings with one- to four-family units. HUD handbooks and mortgagee letters provide detailed processing instructions and advise the mortgage industry of major changes to FHA programs and procedures.

During a recent audit of two lender branch offices of Countrywide Bank, FSB, we found that the lender allowed some borrowers using secondary financing from the Connecticut Housing Finance Authority, acting as an instrumentality of government, to incorrectly receive cash back at closing in excess of their total cash deposit (Office of Inspector General (OIG) Audit Report Number 2008-BO-1007). Therefore, these borrowers had no financial investment in the property, and the loans were over insured. Borrowers may use secondary financing to finance the down payment and all of their closing costs. Secondary financing from the Connecticut Housing Finance Authority can only be used in conjunction with a first mortgage from the Connecticut Housing Finance Authority (assigned to the Connecticut Housing Finance Authority from the various lenders participating in the program), which carries a below-market interest rate.

According to our analysis, loans with secondary financing from federal, state, and local government agencies, as well as nonprofit agencies considered instrumentalities of government, had a higher early payment default percentage than loans without this type of secondary financing. This analysis included loans originated in the state of Connecticut with beginning amortization dates between January 1, 2006, and July 31, 2008. The percentage of originations with the secondary financing that had first defaults (i.e., became 90 days delinquent) during this period was 6.43 percent. The percentage of originations without the secondary financing that had first defaults during this period was 4.17 percent.

The audit objective was to determine whether the lenders acted in a prudent manner and complied with HUD regulations, procedures, and instructions in the origination of FHA-insured single-family mortgages. Specifically, we wanted to determine whether lenders allowed borrowers using secondary financing from the Connecticut Housing Finance Authority to receive cash back at closing in excess of their total cash deposit and other costs paid outside of closing.

[1] The acronyms HUD and FHA are often used interchangeably.

RESULTS OF AUDIT

Finding: Borrowers Received Cash Back In Excess of Their Cash Investment at Closing on FHA Loans

We found seven loans in which the borrowers received excess cash back from GMAC Mortgage at closing totaling $1,471. Federal, state, and local government agencies, as well as nonprofit agencies considered instrumentalities of government, may provide secondary financing for the borrower's entire cash investment. However, FHA-insured first mortgage rules prohibit excess cash back to the borrower. The borrowers received excess cash back because GMAC Mortgage did not ensure that FHA loan closing guidelines governing the use of secondary financing from an agency acting as an instrumentality of government were followed. Borrowers receiving this excess cash resulted in HUD over insuring the loans.

Borrowers Received Cash Back In Excess of Their Cash Investment

Federal, state, and local government agencies, as well as nonprofit agencies considered instrumentalities of government, may provide secondary financing for the borrower's entire cash investment in the FHA-insured property so long as it does not result in excess cash back to the borrower.[2] From our sample of FHA loans with secondary financing from Connecticut Housing Finance Authority, we determined that GMAC Mortgage originated loans in which the borrowers received cash back at closing in excess of their earnest money deposit or other upfront costs paid outside of closing. Based on the results of the review, we expanded our scope to review all loans originated by GMAC Mortgage during our audit period that had secondary financing from Connecticut Housing Finance Authority. GMAC Mortgage originated 566 of 3,315 (17 percent) loans with secondary financing from Connecticut Housing Finance Authority, more than any other lender, representing the greatest risk to the FHA insurance fund.

Our review identified seven instances in which the HUD-1 settlement statements indicated that the borrowers received cash back at closing in excess of their earnest money deposit and/or other upfront costs paid outside of closing. These borrowers had received down payment assistance from the Connecticut Housing Finance Authority, which is considered an instrumentality of government. As a result, these borrowers had no financial investment in the property, and the loans were over insured. The total cash incorrectly received by the seven borrowers totaled $1,471

[2] HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans," chapter 1, section 5.

(see appendix C). This condition occurred because GMAC Mortgage did not ensure that FHA loan closing guidelines were followed.

Conclusion

Borrowers incorrectly received cash back at closing, resulting in over insured FHA loans. This condition occurred because the lender did not follow prudent FHA loan closing responsibilities. Although GMAC Mortgage did not follow proper FHA loan closing guidelines, there was no indication of an egregious pattern of noncompliance. Nonetheless, HUD over insured the seven loans by a total of $1,471, representing increased risk to the FHA insurance fund, and GMAC Mortgage needs to be more vigilant with its loan closing responsibilites.

Recommendations

We recommend that HUD's Assistant Secretary for Housing - Federal Housing Commissioner require GMAC Mortgage

1A. To pay down the principal balances of the over insured loans by the amount of excess cash back paid to the borrowers at closing totaling $1,471 (see appendix C). If HUD has paid a claim on any of these loans, the lender should remit the payment to HUD.

1B. To implement controls in its loan closing policies and procedures to ensure that it follows HUD's requirements regarding cash back to the borrower.

SCOPE AND METHODOLOGY

Our audit generally covered the period January 1, 2006, through July 31, 2008. We conducted our audit work from September 2008 through March 2009. We primarily carried out our audit work at the HUD field office in Hartford, Connecticut. We focused the audit on the lenders' loan origination, underwriting, and quality control operations.

To achieve our objectives, we identified, obtained, and reviewed relevant rules, regulations, and guidance pertaining to the origination of single-family mortgages, including the *Code of Federal Regulations*, HUD handbooks, mortgagee letters, and the *United States Code*. We also obtained and analyzed critical documents from the loan origination files maintained by selected lenders and HUD. We interviewed appropriate lenders, the Connecticut Housing Finance Authority, and HUD officials as necessary. In addition, we obtained an understanding of controls significant to the audit objective and considered whether the lender had designed specific control procedures and placed them into operation.

We relied on information from systems used by HUD and the Connecticut Housing Finance Authority. Other evidence supported the information obtained; therefore, we determined that the data were sufficiently reliable for our purposes. The corroborating evidence independently supports our conclusions.

We initially selected during our survey a statistical sample of 162 FHA-insured loans from various lenders that had secondary financing from the Connecticut Housing Finance Authority, and were originated during our audit period. There were 3,315 FHA loans originated during our audit period that had secondary financing from Connecticut Housing Finance Authority. We obtained the sample based on a confidence level of 95 percent, a precision range of 10 percent, and an anticipated error rate of 11 percent. Based on the results of the survey, we then selected 100 percent of the loans originated by GMAC Mortgage (566 loans) during the audit verification that had secondary financing from the Connecticut Housing Finance Authority. The results of our detailed testing only relate to the loans reviewed. This sampling method allowed us to focus on loans that had a greater inherent risk to the FHA insurance fund and/or of noncompliance or abuse.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following controls are achieved:

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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:

- Controls over program operations - Policies and procedures that management has implemented to reasonably ensure that the HUD single-family insurance programs meet their objectives and that unintended actions do not result.
- Controls over the validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data (including computer-processed data) are obtained, maintained, and fairly disclosed in reports and HUD computer systems.
- Controls over compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that the implementation of the HUD single-family programs is consistent with laws, regulations, and provisions of contracts or grant agreements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

GMAC Mortgage allowed borrowers with secondary financing from the Connecticut Housing Finance Authority to receive cash back in excess of their own cash investment in seven cases. However, we do not believe this condition to be a significant control weakness because there was no indication of an egregious pattern of noncompliance.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	$1,471

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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

GMAC ResCap

U.S. Residential Finance Group

April 27, 2009

John A. Dvorak, Regional Inspector General for Audit
U.S. Department of HUD-Office of Inspector General for Audit
10 Causeway Street, Room 370
Boston, MA 02222-1092

RE: OIG Audit – Loans with Secondary Financing from Connecticut Housing Finance Agency

Dear Mr. Dvorak:

Comment 1

GMAC ResCap wishes to clarify that the errors identified by the audit occurred at the time the loans were closed and funded, not as part of the underwriting process. GMAC ResCap's process flow requires the underwriter to place a condition on the loan approval that the borrower is not to receive excessive cash back from closing. The next step of the process is for GMAC ResCap's Consumer Lending channel to require the closing associates in the loan centers to review the final version of the HUD-1 before disbursing funds; this is to assure that the borrower meets the minimum cash investment requirements, no unallowable fees are charged and that the borrower does not receive excess cash from closing. Lastly, the Government Insuring Team then reviews the HUD-1 again before submitting the loan for insurance endorsement.

After researching the OIG's findings, it is agreed that the borrowers received excessive funds at closing on 7 transactions. Of the 7 loans identified, 5 loans funded in 2006, 1 in 2007 and 1 in 2008. The errors were the result of human error and are not indicative of a systemic issue. We arrived at this conclusion given the de minimis findings rate of 1.2% (7 loans with findings out of 566 reviewed).

Comment 2

In 2008, the Consumer lending channel implemented the use of a pre-funding checklist which is completed by the funder and includes a review of the HUD-1. The checklist requires the funder to review the HUD-1 to confirm that the borrower did not receive excess cash back at closing.

The Government Insuring Team uses the HUD Pre-Endorsement Checklist when reviewing loans prior to endorsement. That review includes an evaluation of the HUD-1. Exceptions identified are required to be resolved prior to endorsement.

Comment 3

The curtailments required as a result of th OIG'S audit report have been requested and GMAC ResCap will confirm that the funds have been applied . Once that is completed for the seven loans a confirmation will be sent to the OIG.

Please advise if you have any questions or require additional information.

Sincerely,

Will Thompson
Director, Quality Contol

WT/jaw/bq

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OIG Evaluation of Auditee Comments

Comment 1 We agree that the errors identified during our audit occurred at the time the lender closed the loans and it does not necessarily indicate underwriting deficiencies, and made changes in the report to say that the errors occurred during the loan closing process.

Comment 2 The use of a pre-funding checklist that includes a review to ensure that a borrower does not receive excess cash back at closing is appropriate. However, HUD has to review the lender's implementation in regards to recommendation 1B.

Comment 3 We acknowledge the lender's action to initiate the curtailments on the loans in question. HUD will have to verify the curtailments.

Appendix C

SCHEDULE OF LOANS WITH EXCESS CASH BACK TO BORROWERS

#	Lender	FHA case number	Cash paid to borrower at closing	Deposit or earnest money	Appraisal (POC)[3]	Credit report (POC)	Hazard/flood insurance premium (POC)	Home inspection (POC)	Adjustments for items unpaid by seller/aggregate escrow account adjustments	Excess cash back to borrower
1	GMAC Mortgage	061-2923174	$ 3,346.15	$ (2,000.00)	$ (350.00)	$ (48.00)	$ (509.00)	-	-	$ 439.15
2	GMAC Mortgage	061-2927334	$ 436.35	-	$ (350.00)	$ (48.00)	-	-	-	$ 38.35
3	GMAC Mortgage	061-2941546	$ 1,051.68	-	$ (250.00)	-	$ (368.00)	-	$ (92.02)	$ 341.66
4	GMAC Mortgage	061-2954300	$ 2,036.00	$ (1,000.00)	$ (400.00)	-	-	$ (250.00)	-	$ 386.00
5	GMAC Mortgage	061-2970066	$ 1,481.02	$ (1,000.00)	$ (375.00)	$ (23.00)	-	-	-	$ 83.02
6	GMAC Mortgage	061-3028186	$ 430.81	-	$ (400.00)	-	-	-	-	$ 30.81
7	GMAC Mortgage	061-3194032	$ 3,488.86	$ (500.00)	$ (400.00)	-	$ (501.00)	-	$ (1,935.86)	$ 152.00
									Total excess cash back:	**$ 1,470.99**

[3] POC – paid outside of closing.