Issue Date
August 25, 2010
Audit Report Number
2010-FW-0003

TO: Vicki B. Bott, Deputy Assistant Secretary for Single Family Housing, HU

//signed//
FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: HUD Was Not Tracking Almost 13,000 Defaulted HECM Loans With Maximum Claim Amounts of Potentially More Than $2.5 Billion

HIGHLIGHTS

What We Audited and Why

We performed an internal audit of the U. S. Department of Housing and Urban Development's (HUD) Home Equity Conversion Mortgage (HECM) program because we found that an increasing number of borrowers had not paid taxes or homeowners insurance premiums as required, thus placing the loan in default[1]. Also, we noted that HUD had granted foreclosure deferrals routinely on defaulted loans, but it had no formal procedures. Our audit objective was to determine whether HUD's adoption and reversal of an informal foreclosure deferral policy for HECM loans that defaulted due to nonpayment of taxes and insurance had a negative effect on the HECM program.

What We Found

HUD's informal foreclosure deferral policy and its reversal had a negative effect on the universe of HECM loans and loan servicers (servicers). After cancelling

1 HECM program regulations do not use the term "default." However, HUD used the term to describe 7,673 loans where the borrowers had not paid their taxes and insurance in accordance with their mortgages' provisions. Thus, we used the term to describe all of the loans where the borrowers did not pay their taxes and insurance. "Default" is defined as failure to meet the terms of the loan agreement.

its informal policy, HUD did not issue guidance to servicers advising them of what actions to take regarding defaulted loans. Thus, servicers continued to service the loans and paid the taxes and insurance for the borrowers, but they did not notify HUD. As a result, four servicers contacted were holding almost 13,000 defaulted loans with a maximum claim amount of more than $2.5 billion, and two of the four servicers said they were awaiting HUD guidance on how to handle them. Further, the servicers had paid taxes and insurance premiums totaling more than $35 million for these 12,958 borrowers and, if HUD does not take action, additional payments will occur in the next 12 months.

HUD also could not identify the deferred or defaulted loans in the Single Family Data Warehouse and did not track the number of borrowers who were unable to pay their property taxes or insurance premiums. As a result, HUD did not know how many loans had principal amounts increasing because the servicer had added payments for taxes and insurance to the loan amount. Since unreported defaulted loans were only obtained from 4 of a total of 16 HECM servicers nationwide, more defaulted loans may exist. Further, as HUD could not track these loans, it did not know the potential claim amount. In the event of foreclosure of the 7,673 loans for which HUD was aware and 12,958 loans of which it was not aware, HUD could lose an estimated $1.4 billion upon sale of the properties.

What We Recommend

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing (1) discontinue the practice of deferring foreclosure due to nonpayment of taxes and insurance which will result in an estimated $35 million in funds being put to better use; (2) issue formal guidance to servicers regarding loans currently in default due to nonpayment of property taxes and insurance, including requiring the servicers to foreclose if the borrowers do not pay the delinquent taxes and insurance; (3) develop and implement a plan to minimize the risk of future defaults due to nonpayment of taxes and insurance; and (4) develop a tracking and reporting system, including making modifications to the Single Family Data Warehouse, to ensure that HUD can track the defaulted loans and the amounts paid for the borrowers.

Auditee's Response

We provided a draft report to HUD on July 6, 2010, and requested its written comments by August 5, 2010. We held an exit conference with HUD on July 20, 2010 and HUD requested an extension to respond until August 12, 2010. On August 17, 2010, we received HUD's written response which generally agreed with the finding. The complete text of the response, along with our evaluation of it, can be found in appendix B. HUD also provided a presentation from servicer training as an attachment. As it was not formal HUD policy, we have not included this report, but a copy is available upon request.

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BACKGROUND AND OBJECTIVE

The U. S. Department of Housing and Urban Development (HUD) provides reverse mortgage insurance through the Home Equity Conversion Mortgage (HECM) program. Before fiscal year 2009, the HECM program was part of the General Insurance Fund. The Federal Housing Administration (FHA) Modernization Act within the Housing and Economic Recovery Act of 2008 moved all new HECM program endorsements to the Mutual Mortgage Insurance Fund[2], effective in fiscal year 2009. For fiscal year 2010, HUD's request for $800 million in additional funding for the HECM program was denied by Congress. HUD responded by decreasing the principal loan limits for borrowers by 10 percent. For fiscal year 2011, HUD requested an additional $250 million.

The HECM program enables homeowners to obtain income by accessing the equity in their homes. To be eligible for a HECM, homeowners must be 62 years of age or older, have significant equity in their home, and have received HUD-approved reverse mortgage counseling to learn about the program. There are no minimum income or credit requirements. A HECM loan provides homeowners with cash payments or credit lines. The maximum amount they can receive is determined by the borrowers' age, interest rate, and value of their home or HUD's loan limits, whichever is less. The loan is secured by the home's equity. Borrowers are not required to repay the loans as long as the borrower continues to live in the home, maintains the property, and pays the property taxes and homeowners insurance premiums. The HECM loan servicer (servicer)[3] is required to ensure that the borrower continues to meet the requirements.

In the event that the borrower fails to pay property taxes, to prevent a tax foreclosure, the servicer will pay the property tax and add the amount to the loan principal. The servicer will also pay for property insurance if the borrower fails to pay to keep the property insured.[4] If the borrower's principal has not reached the principal limit,[5] the amount of the tax and insurance payment is considered a distribution of the loan amount. If payments of property taxes or insurance result in the loan balance exceeding the principal limit, the borrower is in default of the mortgage terms. During fiscal year 2009, approximately 83 percent of HECM borrowers withdrew their credit line as a lump sum at loan closing; thus, the borrowers had no additional funds available to draw on in future years and payment of taxes and insurance by the servicer would cause the loans to immediately exceed the principal limit and be in default.

Servicers may assign HECM loans to HUD when the principal, interest, and servicing fees for the loan reaches 98 percent of the maximum claim amount. At that time, HUD pays the servicer for the

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2 The Mutual Mortgage Insurance Fund was authorized by Section 203(b) of the National Housing Act of 1934. Borrowers who obtain FHA insured mortgages on their single-family homes pay premiums into the fund. Deposits into the fund are then used to pay claims to lenders if borrowers default on their FHA insured mortgages.

3 The originating lender may or may not service the loan after closing.

4 24 CFR (Code of Federal Regulations) 206.205(c). If the mortgagor fails to pay the property charges in a timely manner and has not elected to have the mortgagee make the payments, the mortgagee may make the payment for the mortgagor and charge the mortgagor's account.

5 Principal limit is the maximum amount that can be advanced to the borrower based on the borrower's age and the value of the house.

loan out of the appropriate insurance fund, and HUD takes over servicing the loan. The mortgage terms also require that the mortgage be due and payable, upon approval of the HUD Secretary, if the borrower does not pay the taxes and insurance. HECM regulations require the servicers to notify HUD whenever the mortgage is due and payable due to a tax and insurance default.[6] The servicer can also assign a mortgage to FHA when the borrower requested a payment which exceeded the difference between the maximum claim amount and the loan balance. However, the servicer may not assign such a loan to FHA if the loan is due and payable. However, assignment can occur if the servicer has not informed FHA of a taxes and insurance default or if FHA has been informed but denied approval for the loan to be due and payable.

Our audit objective was to determine whether HUD's adoption and reversal of an informal foreclosure deferral policy for HECM loans that defaulted due to nonpayment of taxes and insurance had a negative effect on the HECM program.

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[6] 24 CFR 206.125. The mortgagee shall notify the Secretary whenever the mortgage is due and payable under the conditions stated in Sec. 206.27(c)(1), or one of the conditions stated in Sec. 206.27(c)(2) has occurred. 24CFR 206.27(c)(2) states the mortgage shall state that the mortgage balance shall be due and payable in full, upon approval of the Secretary, if …an obligation of the mortgagor under the mortgage is not performed.

RESULTS OF AUDIT

Finding: HUD Was Not Tracking Almost 13,000 Defaulted HECM Loans with Maximum Claim Amounts of Potentially More Than $2.5 Billion

HUD's informal foreclosure deferral policy and its reversal had a negative effect on the universe of HECM loans and the servicers. After cancelling its informal policy, HUD did not issue guidance to HECM loan servicers advising them of what actions to take regarding loans in default due to nonpayment of taxes and insurance.[7] Thus, the servicers continued to service the loans and paid the taxes and insurance for the borrowers but did not notify HUD. As a result, four servicers contacted indicated that they were holding almost 13,000 of these defaulted loans with a maximum claim amount of more than $2.5 billion, and two of the four servicers said they were awaiting HUD guidance on how to handle them. Further, the servicers had paid taxes and insurance premiums totaling more than $35 million for these 12,958 borrowers, and if HUD does not take action, additional payments will occur in the next 12 months.

Additionally, since HUD lacked critical information, it could not track or assist troubled borrowers who had not gone into default, and it did not know the extent of those borrowers who had gone into default.

HUD Previously Allowed Deferrals for Tax and Insurance Defaults

Before April 30, 2009, to preserve the property from tax foreclosure, the HECM servicer paid the taxes and added the tax payment to the principal amount above the borrowers' principal limit. The servicer notified HUD that the loan was due and payable, and HUD granted a deferral[8] rather than foreclose. HUD routinely deferred foreclosure through an informal policy[9] because it indicated that it was unwilling to foreclose on senior citizen borrowers. HUD tracked these loans outside the Single Family Data Warehouse. As of April 30, 2009, HUD was tracking 7,673 loans[10] with a maximum claim amount of approximately $1.1 billion.

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7 HECM borrowers agreed to pay taxes and insurance on their properties, and if they are not paid, the borrower has not met the terms of the mortgage provisions. 24 CFR 206.27

8 Due and payable loans are subject to foreclosure. HUD gives the servicer permission to not foreclose or foreclosure is deferred.

9 HUD's policy was issued via e-mail. HUD was unable to provide a copy.

10 The Single Family Data Warehouse does not currently track these loans. The database maintained by HUD was an Excel spreadsheet outside HUD systems, based on loans reported to HUD by the servicers.

HUD Stopped Deferring Foreclosure for Tax and Insurance Default

On May 20, 2009, HUD sent HECM servicers an e-mail informing them that HUD would not accept foreclosure deferral requests after April 30, 2009, for loans in default due to nonpayment of taxes and insurance. Although the servicers are required to report the defaulted loans, HUD's unclear direction was apparently interpreted by servicers as waiving this reporting requirement. While HUD claimed that it was developing policy, it had not given the servicers procedures for handling these loans.

Servicers Were Holding Defaulted Loans

We contacted four servicers and obtained lists of loans in default due to unpaid property taxes and insurance. The four servicers reported that they were holding almost 13,000 loans with a maximum claim amount of more than $2.5 billion. For these 13,000 loans, the servicers paid the taxes and insurance and added that amount to the principal balance. For all of these loans, the borrower's failure to pay the taxes and insurance placed the loan in default as the mortgage provisions had not been met. Since the loans were in default, the servicers were required to report the defaults to HUD and with HUD's approval proceed to foreclosure. As previously stated, HUD had not provided guidance, and the servicers indicated that they were awaiting further instruction from HUD. HUD was not aware of these loans, but upon our advising it of the loans, a HUD supervisor stated that she was not surprised by the number of defaulted loans being held by servicers due to nonpayment of taxes and insurance.

Unpaid Tax and Insurance Amounts Exceeded $35 million

Since the borrowers did not pay their taxes and insurance as required, the four servicers of the more than 13,000 loans paid more than $35 million from May 2009 through March 2010 to cover unpaid amounts. Payment of the taxes and insurance by the servicers ultimately increases the potential claims that HUD will have to pay. The number of deferred loans grew 173[11] percent from May 2009 to March 2010. If the trend continues, the number of deferred foreclosures due to nonpayment of taxes and insurance, the amount of tax and insurance payments

[11] Before May 2009, the four servicers contacted had reported 7,509 of the total of 7,673 defaulted loans reported to HUD; however, they had not reported 12,958 defaulted loans during the period May 2009 to March 2010. Thus, they had a total of 20,467 deferred loans (12,958+7,509=20,467) which represented a 173 percent increase for the period (20,467 / 7,509=2.725 - 1= 1.725 or 173 percent).

made by servicers, and the corresponding risk to the Mutual Mortgage Insurance Fund should be expected to similarly increase. It is imperative that HUD promptly issue guidance to the servicers including directing them to foreclose, if necessary, to avoid payment of an additional $35 million in property taxes and insurance by servicers in the next year.

Cost to HUD Could Not Be Measured as HUD Had No Tracking Mechanism

HUD could not easily track the number of loans on which the borrowers had not paid their property taxes and insurance. Specifically, HUD could not identify deferred or defaulted loans in the Single Family Data Warehouse, did not track the number of borrowers who were unable to pay their property taxes or insurance premiums, and did not know how many loans had principal amounts increasing because payments for taxes and insurance had been added to the loan amount. Unless the Single Family Data Warehouse or other appropriate single family data base is modified to adapt unused data fields to accommodate HECM-specific data, HUD cannot track the deferred or defaulted loans. Further, HUD could not track or assist troubled borrowers whose loans had property tax or insurance paid for them. In addition, HUD did not have the information it needed for its evaluations, forecasts, or projections for future program needs. If HUD had this data, it might be able to improve the program to ensure that borrowers have the ability to pay their taxes and insurance and better evaluate the program. If not addressed, the problem will increase as the HECM program grows.

HUD Was Aware of the Issue and Was Concerned

HUD obtained an actuarial analysis of the HECM loans in the Mutual Mortgage Insurance Fund for fiscal year 2009.[12] The report, dated October 12, 2009, concluded that there were sufficient capital resources to meet the anticipated liabilities associated with the HECM portion of the Mutual Mortgage Insurance Fund. To assess the adequacy of the current and future capital resources needed to meet estimated cash outflow requirements, the contractor used historical HECM loan data reported by HUD through June 30, 2009. However, the analysis did not include the loans on which HUD had deferred foreclosure due to nonpayment of taxes or insurance or the 12,958 defaulted loans of which HUD was not aware. While some of the 12,958 loans were not in default at the time of the analysis, at least the 7,673 that HUD was tracking as of April 30, 2009, were in default but were not included in the analysis. It is unknown what effect these loans would have had

[12] "An Actuarial Analysis of FHA Home Equity Conversion Mortgage Loans In the Mutual Mortgage Insurance Fund Fiscal Year 2009"

on the outcome of the analysis, but given the rate of increase of the defaults, the conclusion of the analysis at this point may be questionable.

HUD was concerned by the defaults as expressed by HUD's Deputy Assistant Secretary for Single Family Housing as recently as May 2010. In reference to HUD's request for $250 million to support the HECM program for fiscal year 2011, she noted that "the program was designed to be self-sustaining without congressional appropriations, and that is proving untenable."[13] She further stated that without the appropriation, HUD will have to look at ways to make the program self-sustaining while at the same time exploring ways to resolve longstanding problems such as nonpayment of taxes and insurance. Regarding the taxes and insurance, she stated, "I think there's a balance [needed] to give seniors enough time to figure out how to pay or sell the property and find alternative living arrangements," adding that "hopefully within 30 days we can talk more specifically" about the government's intent. She further stated, "Some finite amount of time will be set [after which] someone has to take the financial risk."

A June 19, 2010 article in The Washington Post stated that the Deputy Assistant Secretary said that, ". . . new guidance this summer will emphasize a 'curative approach' that allows seniors to 'develop a plan to repay past tax and insurance delinquencies.'"

HUD's Director of Portfolio Analysis, Office of Evaluation, stated that his office had previously prepared an analysis of the tax and insurance issue.[14] The analysis identified several concerns, including

- "Adding T & I [taxes and insurance] to the loan balance after reaching the principal limit will significantly reduce recoveries and increase total losses."
- "Allowing deferrals will create an incentive to other borrowers not to pay the T & I [taxes and insurance], which will further increase HUD's risk exposure."
- "The current additional cost associated with the deferral of calling a loan due and payable and adding the tax and insurance to the loan balance is not captured in the audited HECM cash-flow model. As more deferrals occur, the total loss will quickly become material."

The analysis included a detailed risk analysis that considered the overall loss associated with the deferral of tax and insurance payments, using various models to obtain the net present value of future claims and premiums and their impact on the cash-flow model. The risk was measured in terms of the additional claim and premium amounts from deferrals. The analysis was based on 11,272 loans. Since

[13] Reverse Mortgage Daily May, 18, 2010

[14] We did not verify the accuracy of the analysis, and HUD was unable to confirm the source of the data used in the analysis.

the number of loans is now more than 20,000, the estimated losses would be significantly higher if current data were used. The analysis concluded that

1. In cases in which the property value exceeds the loan balance at the time of property disposition (114 loans), there is no net loss when deferring and calling the loan due and payable and allowing the servicers to add tax and insurance payments to the loan balance.

2. In cases in which a loss occurs if the decision to call the loan due and payable is deferred (293 loans), the net loss is approximately $3 million.

3. In cases in which a loss occurs regardless of calling the loan due and payable, but the amount of loss is significantly greater at the time of loan termination (10,865 loans), the net loss is $60 million.

In addition, the Office of the Comptroller of the Currency[15] was also concerned about this growing area and believed that particular attention needed to be paid to whether to impose additional requirements with respect to escrows of taxes and insurance.

Although HUD was not aware of how many loans the four servicers were holding, it was not surprised and anticipated that more loans will go into default for nonpayment of taxes and insurance. In May 2009, HUD stated that it was working on policy with the National Reverse Lenders Mortgage Association.[16] HUD stated that the policy discussed various ways to address this issue, including possibly establishing a minimum income or credit level to ensure that the borrowers have the funds for house expenses or setting aside funds at loan origination for these expenses. However, more than a year later, HUD had not issued formal policy.

HUD May Lose an Estimated $1.47 Billion on the 20,631 Defaulted Loans

Given that the portfolio of defaulted loans had increased significantly, coupled with the rapid rise in the number of new HECM loans, it is crucial that HUD act swiftly to issue guidance on how to resolve the loans currently in default and implement policies to reduce or prevent future occurrences. Unfortunately, implementation of future policies will not resolve the pending claims that may have to be paid on the loans currently in default. The maximum claim amount for the 20,631 loans that defaulted for nonpayment of taxes and insurance was more than $3.68 billion. Using HUD's 2009 fiscal year-to-date loss severity rate of 60

[15] The Comptroller of the Currency is a bureau of the U. S. Department of the Treasury.

[16] According to the National Reverse Lenders Mortgage Association, it serves as an educational resource, policy advocate and public affairs center for reverse mortgage lenders and related professionals.

percent, supported by the Actuarial Review of the FHA Mutual Mortgage Fund for Fiscal Year 2009, the estimated loss on the loans is $2.21 billion. However, using the more conservative average loss amount per home of $71,536[17] on the sale of HECM foreclosed-upon properties from October 1, 2008, to February 22, 2010, HUD can expect to lose at least $1.47 billion in the event of foreclosure. Of further concern is that since the payment of taxes and insurance by the servicers causes the loans to reach the maximum principal balance faster, coupled with the increase in the number of new HECM loans, the number of defaulted loans could increase significantly.

Conclusion

Because HUD did not issue guidance to HECM loan servicers, the servicers continued to pay the taxes and insurance for the borrowers. As a result, four servicers contacted indicated that they were holding almost 13,000 of these defaulted loans, of which HUD was not aware, with a maximum claim amount of more than $2.5 billion. Since the borrowers did not pay more than $35 million in taxes and property insurance for these loans as specified in the mortgages, the 12,958 loans were in default. Further, since HUD lacked critical information, it could not track or assist troubled borrowers who had not gone into default, and it did not know the extent of those borrowers who had gone into default.

Although HUD expressed concern about the defaults and the extent of the problems, it had not yet issued any formal guidance to servicers directing them how to address the nonpayment of taxes and insurance or implemented procedures to minimize the risk of future occurrences. It is imperative that HUD take prompt actions to resolve these matters in order to avoid payment of an additional $35 million in property taxes and insurance by servicers in the next year, and to reduce the potential claims that may have to be paid from the Mutual Mortgage Insurance Fund, which could be at least $1.47 billion for the 20,631 loans that were in default as of March 2010.

Recommendations

We recommend that HUD’s Deputy Assistant Secretary for Single Family Housing

1A. Inform the servicers to discontinue the practice of holding the loans and continuing to pay the taxes and insurance which will result in an estimated $35,494,896 in funds being put to better use during the next 12 months.

[17] According to HUD, $71,536 is the average loss from property sells of foreclosed HECM loans from October 1, 2008, through February 22, 2010.

1B. Issue formal guidance to servicers regarding loans currently due and payable as a result of nonpayment of property taxes and insurance, including requiring the servicers to foreclose.

1C. Develop and implement a plan to minimize the risk of future defaults due to nonpayment of taxes and insurance.

1D. Develop a tracking and reporting system, including making modifications to the Single Family Data Warehouse or other appropriate data base, to ensure that HUD can track the deferred and defaulted loans and the amounts the servicers paid for taxes and insurance on these loans.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Obtained and reviewed background information on HECM loans, applicable regulations, and legal documents.
- Interviewed HUD single-family program staff and various individuals at four HECM servicers.
- Obtained, reviewed, and analyzed reports and other documents to determine existing treatment of HECM loans by servicers and HUD.
- Obtained from HUD an electronic file of deferred HECM loans previously reported to HUD as of April 30, 2009. Tested the reliability of data by matching the loan number to HUD's Single Family Data Warehouse to ensure that they were FHA HECM loans. A match was also performed on Social Security numbers to ensure that they were valid numbers. The HECM loan number data in the file was determined to be generally reliable. We did not perform reliability tests on the data in the Single Family Data Warehouse.
- Obtained separate electronic data listings from four servicers of HECM loans in default due to nonpayment of taxes and insurance that had not been reported to HUD from May 1, 2009, to March 3, 2010. The servicers' data also provided the amount that they had paid in taxes and insurance for each defaulted loan. A match was performed to the Single Family Data Warehouse to ensure that these were FHA HECM loans. The HECM loan account number information was determined to be generally reliable. We did not test the reliability of the tax and insurance amounts the servicers paid because HUD does not have a system to track the tax and insurance amounts and no single system existed to allow tracking of these individual payment amounts.

We conducted our audit from December 2009 through April 2010 at our office in Fort Worth, TX, and at various homes in the general Dallas/Fort Worth, TX, area. Our audit period was January 1, 2007, through December 31, 2008. We expanded the scope as necessary to accomplish our objective.

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 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:

- HECM program operations, policy, and procedures;
- Relevance and reliability of HECM information; and
- Compliance with applicable HECM laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal controls 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 Weaknesses

Based on our review, we believe that the following items are significant deficiencies:

- HUD had not issued formal policy to the servicers regarding procedures for HECM loans in default due to unpaid property taxes and insurance (finding).
- HUD (1) could not identify deferred loans in the Single Family Data Warehouse or other appropriate system, (2) did not track the number of borrowers who were unable to pay their property taxes or insurance

premiums, and (3) did not know how many loans had principal amounts increasing because payments for taxes and insurance had been added to the loan (finding).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$35,494,896

1/ 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 instance, the amount represents what was paid in taxes and insurance on the 12,958 HECM loans reported by the four servicers from May 1, 2009 to March 3, 2010. These are loans that the servicers had been holding since HUD reversed its informal deferral policy, almost 1 year ago. If HUD takes action on these loans by issuing policies and procedures and foreclosing on the loans, the servicers will avoid paying at least $35,494,896 in taxes and/or insurance in the next 12 months.

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

AUG 17 2010

MEMORANDUM FOR: Gerald R. Kirkland, Regional Inspector General for Audit, 6AGA

FROM: Vicki B. Bott, Deputy Assistant Secretary for Single Family Housing, HU

SUBJECT: Discussion Draft-Audit Report
HUD Was Not Aware of Almost 13,000 Defaulted HECM Loans with Maximum Claim Amounts of Potentially More than $2.5 Billion
Issue Date: July 6, 2010

The Office of Inspector General (OIG) performed the subject audit of the U.S. Department of Housing and Urban Development's (HUD) Home Equity Conversion Mortgage (HECM) Program to determine whether HUD's adoption and reversal of an informal foreclosure deferral policy for HECM loans that defaulted, due to nonpayment of taxes and insurance, had a negative effect on the HECM program. During the course of the audit, OIG concluded that after HUD cancelled its informal foreclosure deferral policy, formal policy guidance advising servicers of what actions to take regarding loans in default was not issued. Thus, servicers continued to advance tax and insurance payments without notifying HUD. The Office of Single Family Housing's (Single Family) response to the audit results is as follows:

OIG's Determination:

The report states that HUD was aware and concerned about the issue, but had not issued formal policy guidance to servicers regarding procedures for HECM loans in default due to unpaid property taxes and insurance.

Single Family's Response:

Comment 1
Comment 2

Single Family requests that the audit title be revised to state, "Defaulted HECM Loans." Single Family staff was aware that a small percentage of the active loans were in default for the nonpayment of taxes and insurance and the draft report supports this acknowledgment. Once the informal deferral program ended, servicers received subsequent guidance for handling loans that remained in a non-compliance state. Said guidance was presented to servicers who directly contacted HUD; and information was presented at the 2009 HECM Servicer Training held in Tulsa, Oklahoma. All training attendees received an Agenda Book that contained this information. See attached copy.

OIG's Determination:

www.hud.gov espanol.hud.gov

Comment 3

Comment 4

Comment 5

OIG's Determination:

The report states, HUD could not identify deferred loans in the Single Family Data Warehouse.

Single Family's Response:

HUD tracks and monitors loans that receive approval for deferral in the Single-Family Mortgage Asset Recovery Technology (SMART) system. Loans approved for deferral and presented for assignment to HUD are validated against notes entered in SMART to ensure the mortgagor repaid the full amount advanced on their behalf. The Single Family Data Warehouse does not have this information because the two systems do not interface with one another.

Single Family is developing formal policy guidance that addresses the prevention of future defaults and the actions servicers must take to address the current population of loans that are out of compliance with the terms of the mortgage. Single Family started the "rulemaking" process to amend the HECM regulations to provide mortgagees with options for ensuring the mortgagor will be able to pay property charges to keep the HECM in compliance with the mortgage terms, and regulations. In addition, Single Family is drafting instructions to servicers on the actions that must be taken to address the existing portfolio of defaulted or deferral loans.

Description of Planned Actions:

To further address the audit, Single Family will take the following actions.

- Provide an alternative to OIG's recommendation to end the payment of taxes and insurance premiums which is currently allowed by the HECM regulations. This information will be communicated in the Final Management Decision.
- Issue formal policy guidance to servicers instructing them to notify the mortgagor of the default and require specific actions to be taken to bring the loan into compliance with the terms of the mortgage or request due and payable approval from the Secretary.
- Take the necessary actions to modify existing systems or procure a system that will enable HUD staff to track and monitor defaulted loans where the mortgagee is advancing funds for payment of property charges when the mortgagor fails to do so.
- Complete the "rulemaking" process needed to amend the HECM regulations to address future defaults.

Attachment

2

OIG Evaluation of Auditee Comments

Comment 1
HUD requested we change the title of the report. We did not change it to HUD's language, but we did make a minor modification.

Comment 2
HUD stated it was aware of a small percentage of loans in default but that it had provided guidance to servicers who directly contacted it or who attended servicer training in June 2009. Although HUD stated there is only a small percentage loans in default, the loans held by the 4 of the 16 servicers nationwide totaled more than $2.5 billion. Having those loans go to claim will have a negative impact on the applicable insurance fund and they may even impact the program's ability to be self sustaining. Further, HUD may have been aware that servicers were holding loans, but it did not know how many loans the servicers were holding. Finally, HUD's method of providing guidance was not formal and was not effective as the servicers indicated they were holding loans because HUD had not provided guidance.

Comment 3
HUD stated it was tracking loans approved for deferral through SMART, but HUD's response did not address the 13,000 loans that had not been reported to it by the servicers. HUD also did not address whether or not it can track loans of troubled borrowers or determine the amount that servicers have advanced for taxes and insurance payments.

Comment 4
HUD stated it was developing formal policy to prevent future defaults and to provide direction to servicers concerning these types of defaulted loans. We acknowledge HUD's actions; however, as HUD has been developing policy for more than a year, HUD needs to expedite this policy to prevent this issue from continuing.

Comment 5
HUD provided a list of planned action it would take, but HUD stated that it would not end the payment of taxes and insurance recommended by OIG. We did not recommend that servicers discontinue the payment of taxes and insurance. Rather, we recommended that HUD inform the servicers to discontinue the practice of holding loans and continuing to pay taxes and insurance, which would result in the payment taxes and insurance several years after default. We acknowledge HUD's other proposed actions as they address the recommendations.