



Issue Date January 12, 2012

Audit Report Number 2012-PH-0003

TO: Daniel J. Sullivan, Acting Director, Office of Multifamily Housing Development, HTDP
//signed//

FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

SUBJECT: HUD Approved Multifamily Accelerated Processing Program Lenders as Required but Did Not Adequately Select Lenders to Monitor

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) monitoring of its Multifamily Accelerated Processing program lenders. The audit was performed based on a hotline complaint and the Office of Inspector General's annual audit and strategic plan to help HUD improve its fiscal responsibilities. The objective of the audit was to determine whether HUD adequately approved and selected program lenders to monitor.

What We Found

HUD generally approved program lenders as required but did not adequately select lenders to monitor. The audit showed that 5 of 51 program lenders¹ with loan originations totaling almost \$88 million had not been monitored. HUD had developed improved procedures for selecting lenders to monitor, but it had yet to complete or implement the new procedures.

¹ An additional 39 approved lenders had not originated any loans.

What We Recommend

We recommend that HUD complete and fully implement its new procedures for selecting lenders to monitor. We also recommend that it immediately classify its approved lenders as low-, moderate-, or high-volume lenders in accordance with its updated policy. After it appropriately classifies its lenders, we recommend that HUD prepare and implement a monitoring schedule based on the number and type of monitoring reviews it will perform for each lender.

For each recommendation in the body of the report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a discussion draft audit report to HUD on December 16, 2011, and discussed it with HUD officials during the audit and at an exit conference on December 22, 2011. HUD provided written comments to our draft audit report on January 3, 2012. It generally agreed with the conclusions in the report. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVE

Since 1937, the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) multifamily mortgage insurance has been a major source of financing for affordable housing. Each year, FHA insures billions of dollars in multifamily housing mortgage loans to facilitate the construction, substantial rehabilitation, purchase, and refinancing of apartments and health care facilities. FHA mortgage insurance protects lenders against financial losses stemming from a borrower's default. When default occurs, a lender may elect to assign the mortgage to HUD and file an insurance claim with HUD for the unpaid principal balance. HUD processes multifamily loan insurance applications through its multifamily hubs and program centers throughout the United States.

In May 2000, HUD implemented multifamily accelerated processing procedures to establish a national "fast-track" process to reduce the amount of HUD review time and ensure an acceptable level of risk for HUD's multifamily mortgage insurance programs. A key feature of multifamily accelerated processing allows lenders to conduct the underwriting of the loan and submit a package directly to the hub or program center for mortgage insurance. The hub or program center reviews the lender's underwriting and decides whether to provide mortgage insurance for the loan. The multifamily accelerated processing method may be used for refinancing or processing new construction or substantial rehabilitation of multifamily developments including apartments, health care facilities, and apartments in urban renewal areas.

Prior to using multifamily accelerated processing, a lender must first submit an application packet to HUD's Lender Qualification and Monitoring Division. The division currently has 11 staff persons that are responsible for reviewing applications, monitoring lenders and providing general oversight of the approved lenders and performance. The division reviews the application packet to determine if the lender meets its qualification requirements. The lender's application packet must provide evidence that it is an FHA-approved multifamily mortgagee, financially sound, and maintains employees that have met multifamily training and underwriting experience. The lender must also provide evidence supporting satisfactory multifamily loan processing.

Once the lender is approved to participate in the program, the division is required to monitor the lender's performance to ensure loans processed using the multifamily accelerated processing method comply with FHA underwriting standards. There are 90 lenders approved to submit and process loan applications for multifamily mortgage insurance using the multifamily accelerated processing method.

The objective of the audit was to determine whether HUD adequately approved and selected program lenders to monitor.

RESULTS OF AUDIT

Finding: HUD Did Not Adequately Select Lenders to Monitor

HUD generally approved program lenders as required but needed to make sure that all of its program lenders were monitored according to its policy. The audit showed that 5 of 51 program lenders with loan originations totaling almost \$88 million had not been monitored as recommended by its written policy. This occurred because HUD did not ensure all lenders were monitored and its existing policy failed to define which lenders should be classified as low-, moderate-, or high-volume lenders. Although HUD began reevaluating its monitoring processes and procedures in November 2008, it had yet to complete its reevaluation or complete the update to its policy. HUD needed to immediately classify its approved lenders as low-, moderate-, or high-volume lenders as described in its draft policy and implement a monitoring schedule which should help to mitigate the risk to the FHA insurance fund.

HUD Generally Approved Program Lenders as Required

According to chapter 2 of HUD's lender qualification multifamily accelerated processing procedures, lenders are required to meet several qualification standards prior to participating in the program. Specifically, a lender must provide evidence that it is an FHA-approved multifamily mortgagee, financially sound, and maintains employees that have met multifamily training and underwriting experience requirements. The lender must also provide evidence supporting satisfactory multifamily loan processing.

We reviewed 11 lender applications to determine if approved lenders met qualification requirements. HUD generally ensured that the 11 lenders met qualification standards. Specifically, documentation was generally available showing that the approved lenders were FHA-approved multifamily mortgagees, financially sound, employed multifamily staff that met training and underwriting requirements, and provided evidence showing satisfactory multifamily loan processing.

Lenders Were Not Selected for Monitoring According to HUD's Policy

Section 4-3 of HUD's internal operating guide required that HUD monitor its program lenders by conducting a project review, quality control review, or lender

review. The reviews were to be conducted on a regular basis. High-volume lenders were to be reviewed annually. Program lenders that were not categorized as high-volume were to be reviewed once every 3 years. As shown in appendix B, 5 of 51 program lenders with loan originations totaling almost \$88 million had not been monitored in violation of HUD's policy.

HUD Needs To Implement Its New Policy and Procedures

HUD acknowledged that it did not always monitor its approved lenders as recommended by its own policy and procedures. HUD began reevaluating its monitoring processes and procedures in November 2008, but as of December 2011 it had yet to complete its reevaluation or update its procedures. A major problem with its existing procedures was that they failed to define what lenders should be classified as low-, moderate-, or high-volume lenders. Under its new procedures, high-volume lenders will be defined as lenders with 20 or more originations (defined as issued commitments) per year over the previous 4 years. HUD will classify lenders as moderate-volume if the lenders originate 10 or more loans per year. All other lenders that originate less than 10 loans per year will be classified as low-volume lenders. The additional controls should assist HUD in determining which high-volume lenders to monitor annually to ensure compliance with underwriting requirements. The new procedures will also require HUD to assign numerical points for rejected applications, early defaults, early claims, or other material violations noted during its review. Based on the total amount of numerical points received, lenders may be placed on probation, suspension, or termination from being approved to process loans using the multifamily accelerated processing method. The additional controls should help HUD to mitigate the risk to the FHA insurance fund.

Recommendations

We recommend that HUD's Acting Director, Office of Multifamily Housing Development

- 1A. Complete and fully implement HUD's updated procedures for selecting lenders to monitor.
- 1B. Immediately classify HUD's approved program lenders as low-, moderate-, or high-volume lenders in accordance with its new updated policy.
- 1C. Immediately prepare and implement a monitoring schedule based on the number and type of monitoring reviews to be performed for each lender.

SCOPE AND METHODOLOGY

We conducted the audit from April to October 2011 at HUD's Office of Multifamily Housing Development, Lender Qualification and Monitoring Division, located in Washington, DC, and our offices located in Richmond, VA. The audit covered the period January 2005 through October 2011. We relied in part on computer-processed data. Although we did not perform a detailed assessment of the reliability of data, we performed a minimal level of testing and found the data to be adequate for our purposes. To accomplish our objective, we

- Interviewed HUD's multifamily staff responsible for approving lender applications and monitoring lender performance.
- Reviewed applications of lenders approved to underwrite multifamily loans using the multifamily accelerated processing method.
- Analyzed HUD's automated data and hard copy files related to 123 project monitoring reviews and 39 lender reviews performed from 2005 through 2011.

HUD had 90 approved program lenders as of April 2011. Of the 90 approved lenders, 51 lenders had originated loans during the audit period. The FHA-insured loan portfolio of the 51 approved lenders since its approval to participate in the program totaled more than \$12.9 billion.

We reviewed the project, quality control plan, and lender reviews performed for the 51 lenders that had originated loans during our audit period to determine whether HUD monitored its program lenders at least once during a 3-year period, or annually for high-volume lenders as required by its existing written internal operating procedures.

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

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- 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:

- Program operations – Policies and procedures that management implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

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

- HUD did not make sure that all of its program lenders were monitored and had not completed nor implemented its updated policy.

APPENDIXES

Appendix A

AUDITEE COMMENTS

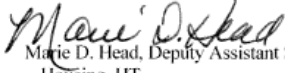


U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

January 3, 2012

MEMORANDUM FOR: John P. Buck, Regional Inspector General for Audit, Philadelphia
Region, 3AGA

FROM: 
Marie D. Head, Deputy Assistant Secretary, Office of Multifamily
Housing, IHT

SUBJECT: Response to Audit Report of Lenders Qualification and Monitoring
Division Activity

This is a follow-up to the exit conference held December 22, 2011, and in response to the draft Audit Report finding and recommendations.

OIG Finding: HUD Did Not Adequately Select Lenders to Monitor.

Housing's Response: We concur with the finding; five lenders were not reviewed within the 3 year period. Given we are in the process of revoking one of the lender's authority to originate MAP loans, and the other four lenders were responsible for less than 1 percent of originations during the period, this finding represents a technical deficiency but is not material.

OIG Recommendation 1A: Complete and fully implement HUD's updated procedures for selecting lenders to monitor.

Housing's Response: We concur with the recommendation. The LQMD Draft "Internal Operating Guide" will be updated by September 30, 2012.

OIG Recommendation 1B: Immediately classify HUD's approved program lenders a low-, moderate-, or high volume lenders in accordance with its new updated policy.

Housing's Response: We concur with this recommendation. The list of low-, moderate-, and high-volume lenders, based on Fiscal Year 2011 production is attached.

OIG Recommendation 1C: Immediately prepare and implement a monitoring schedule based on the number and type of monitoring reviews to be performed for each lender.

Housing's Response: We concur with the recommendation to prepare and implement a monitoring schedule and will do so in conjunction with the updated LQMD Internal Operating Guide reference in Recommendation 1A. All of the high-volume lenders listed in the attachment will be reviewed in FY 2012, as well as all of the low- and moderate-volume lenders which did not receive a review in FY 2010 or FY 2011.

Thank you for your recommendations and the opportunity to respond. We appreciate the professionalism and courtesy extended by the Office of Inspector General's staff. Please contact Dan Sullivan at (202) 402-6130 if you or your staff has any questions about our response.

Attachment

www.hud.gov

espanol.hud.gov

Lenders at FIRM	Volume	Lenders at FIRM	Volume
RED MORTGAGE CAPITAL	High	GREYSTONE FUNDING CORP	Low
BERKADIA COMMERCIAL MTG	High	HFC FUNDING	Low
LANCASTER POLLARD MTGE	High	ARMSTRONG MORTGAGE	Low
P/R MTGE & INVEST CORP	High	CENTURY HEALTH CAPITAL	Low
GREYSTONE SERVICING	High	PHARES CO	Low
PRUDENTIAL HUNTOON PAIGE	High	METROPOLITAN FUNDING CORP	Low
LOVE FUNDING CORP	High	D. ANSLEY	Low
OPPENHEIMER MF HSG & HCAR	High	ARBOR COMMERCIAL MTGE	Low
CWCAPITAL LLC	High	FOREST CITY CAPITAL CORP	Low
ROCKPORT	High	COLUMBIA NATL REAL ESTATE	Low
CAPITAL FUNDING LLC	High	LAY MORTGAGE	Low
GERSHMAN INVESTMENT	High	REDSTONE AGENCY LENDING	Low
WELLS FARGO BANK NA	High	GREAT LAKES FINANCIAL GRP	Low
WALKER AND DUNLOP LLC	High	ZIEGLER FINANCING CORP	Low
DOUGHERTY MORTGAGE LLC	High	EASTERN BANK	Low
CAMBRIDGE REALTY CAPITAL	High	FIRST HSG DEVMT CORP OF F	Low
HOUSING & HEALTHCARE FINC	High	ROCKHALL FUNDING CORP	Low
DEUTSCHE BANK BERKSHIRE M	High	JS FUNDING	Low
OAK GROVE COMMERCIAL MTG	High	LINKS MORTGAGE CORP	Low
CENTENNIAL MORTGAGE	Moderate	BEDFORD LENDING CORP	Low
DRAPER AND KRAMER COMMERCIAL MORTGAGE	Moderate	NICHOLS FINANCIAL SERVICES	Low
ST JAMES CAPITAL LLC	Moderate	SECORE	Low
GRANDBRIDGE REAL ESTATE C	Moderate	CHAMBERS BANK	Low
M & T REALTY CORP	Moderate	TAVERNIER CAPITAL FUNDING	Low
DAVIS-PENN MTGE	Moderate	FIRST AMERICAN CAPITAL GR	Low
HUNTOON HASTINGS INC	Moderate	NORTH STAR MORTGAGE	Low
KEYCORP REAL ESTATE CAP MARKETS	Moderate	NORTHPOINT CAPITAL LLC	Low
AGM FINANCIAL SERVICES, INC.	Moderate	WYATT FUNDING CORP	Low
AMERISPHERE MTG FDNANCE L	Moderate	BONNEVILLE MORTGAGE Co	Low
DEVELOPERS MORTGAGE	Moderate	CRAIN MORTGAGE GROUP	Low
PARAGON	Moderate	AMERISOUTH FINANCIAL	Low
BELLWETHER REAL EST CAPT	Moderate	NY URBAN	Low
CBRE HMF INC	Moderate	ARLINGTON TRUST	Low
SIMS MORTGAGE	Moderate	BANKERS MTGE & INVMT	Low
PNC BANK NA	Moderate	BEECH STREET CAPITAL	Low
ENTERPRISE COMMUNITY INVM	Moderate	CENTERLINE MTGE CAPITAL	Low
		CENTRAL BANK AND TRUST	Low
		MASS HFA	Low
		PACIFIC COMMONWEALTH	Low
		SUNWEST	Low
		BANK OF MONTANA	Low
		BEACON HILL MORTGAGE CORP	Low
		FUNDING INC.	Low
		HUNTINGTON MORTGAGE CAPITAL	Low
		ILLINOIS HOUSING DEVELOPMENT	Low
		PENNSYLVANIA HFA	Low
		PUERTO RICO HFA	Low
		STIFEL BANK	Low
		STONEARCH MORTGAGE CORP.	Low
		NEW TIER	Low

Appendix B

PROGRAM LENDERS NOT MONITORED

Lenders	Number of insured loans	Value of insured loans
Great Lakes Financial Group, LP	6	\$30,157,800
Phares Company	13	23,378,300
American Mortgage Solutions, LLC	1	15,006,200
Red Stone Agency Lending, LLC	2	14,306,700
Beacon Hill Mortgage Corporation	2	4,939,000
Totals	24	\$87,788,000