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BY THE COMPTROLLER GENERAL



# Report To The Congress

OF THE UNITED STATES

## Weaknesses In Servicing And Accounting For Home Mortgages Held By HUD

The Department of Housing and Urban Development services and accounts for mortgages valued at over \$151 million. These mortgages were either bought from commercial lenders to prevent foreclosure on defaulted mortgagors experiencing temporary financial problems or resulted from the Department selling property it had previously acquired.

The Department does not provide adequate incentives to encourage these mortgagors to pay off their debts. Rather than helping them eliminate or reduce their delinquencies, the Department has allowed many mortgagors to fall so far behind that repayment may be impossible.

During GAO's review, the Department made a number of changes to improve its accounting and servicing activities. Additional changes are needed, however, to reduce the delinquency rate and to promptly collect funds due the Government.



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WASHINGTON, D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report deals with a program under which the Department of Housing and Urban Development is the mortgagee on home mortgages valued at over \$151 million. These mortgages were either acquired from commercial lenders because insured mortgagors defaulted on their payments or resulted from the Department selling property it had previously acquired.

The report shows that as of January 31, 1979, over \$17 million was already delinquent under the terms of the mortgages. Many homeowners were so delinquent that it may be impossible for the Department to induce them to repay overdue amounts. This situation costs the Government and is unfair to the majority of insured mortgagors who have not defaulted on their insured mortgages. The report discusses the system weaknesses that allow the deficiencies to occur and recommends specific ways to correct the weaknesses.

We are sending the report to the Acting Secretary of Housing and Urban Development and to the Director, Office of Management and Budget.

Sincerely yours,

  
ACTING Comptroller General  
of the United States

D I G E S T

The Department of Housing and Urban Development has not properly serviced or accounted for single-family home mortgages valued at over \$151 million. As a result:

--As of January 31, 1979, over \$17 million in delinquent mortgage payments had not been collected. (See p. 13.)

--Interest-free escrow advances amounting to almost \$2.7 million were outstanding as of May 31, 1978. (See p. 6.)

--From the date the Department assumed management of the mortgages through December 31, 1977, delinquent mortgagors have been over- or undercharged as much as \$3 million for such items as interest and tax penalties. (See p. 3.)

HUD's policy is to avoid acquiring property if default on the insured mortgage is due to temporary circumstances beyond the mortgagor's control and the mortgagor can reasonably be expected to complete the mortgage payments. In such cases, HUD pays the insurance claims of the commercial lenders and assumes management of the delinquent mortgages. It also manages purchase money mortgages which result from the sale of property the Department had previously acquired. (See pp. 1-2.)

The number and value of mortgages held by the Department increased from 8,103, valued at about \$117 million on September 30, 1977, to 10,022, valued at over \$151 million on January 31, 1979. The Department did not have adequate plans for such a sizable workload increase and, consequently, the program has been hampered by accounting and mortgage servicing problems.

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A/C 3/23*

*NO L/P  
Mortgage program  
Escrow accounts  
Accounting systems  
Loan defaults  
Loan repayment*

## ACCOUNTING CONTROL WEAKNESSES

GAO estimates that the method of accounting for home mortgages held by HUD resulted in 65 percent of the mortgagors being undercharged and 35 percent being overcharged. From the date HUD assumed management of the mortgages until December 31, 1977, GAO estimates that the total under- and overcharges were as much as \$2.7 million and \$658,000, respectively. (See pp. 10-11.)

Part of the undercharge resulted from problems with the design of HUD's computerized mortgage notes accounting system. The system was not designed to accrue interest on missed payments. Instead, it provided for the mortgagors to be charged the same dollar amount of interest on delinquent payments that would be charged if payments were received on time. In addition, the Department did not assess late payment penalties. Consequently, as a mortgagor's delinquency increased, the effective interest rate charged on the mortgage decreased. (See pp. 3-6.)

HUD's method of computing monthly escrow requirements also contributed to the undercharges because it resulted in insufficient balances being available to pay taxes when due. Therefore, the Department advanced the necessary funds to pay the property taxes. As of May 31, 1978, over 57 percent of all mortgagors had outstanding interest-free advances, and almost \$2.7 million was owed to the Government. (See pp. 6-7.)

On the other hand, homeowners were overcharged because the Department did not promptly post payments, often charged tax penalties to the mortgagors, and did not reduce interest charges for prepayments. At the time of GAO's audit, collections and disbursements totaling almost \$500,000 were not posted to the individual mortgagors' accounts. This resulted in incorrect mortgage accounting records and erroneous delinquency data being reported to the field offices. (See p. 7.)

## MORTGAGE SERVICING WEAKNESSES

Besides accounting problems, the Department's mortgage servicing efforts have been hampered by outdated procedures and ineffective collection practices, such as untimely foreclosure actions. GAO believes that these conditions contribute to the high volume of delinquent mortgage payments which, as of January 31, 1979, amounted to over \$17 million. Since the Department's headquarters had not provided adequate accounting information or developed current servicing and foreclosure guidance, the Department's field offices had to maintain duplicate collection records and did not undertake effective collection procedures. Timely foreclosure recommendations were often not made by field offices when repayment appeared doubtful. (See pp. 13-15.)

## CONCLUSIONS

Due to accounting and servicing weaknesses, delinquent mortgagors have little incentive to pay off their mortgages. During GAO's review, the Department made a number of changes to improve its accounting and servicing activities. However, GAO believes that additional changes are needed to reduce the mortgage payment delinquency rate and to promptly collect funds due the Government.

## RECOMMENDATIONS

We recommend that the Secretary of HUD direct the Assistant Secretary for Administration to incorporate procedures in the accounting system that will:

- Accrue interest on delinquent principal balances and assess penalties for late payments.
- Calculate realistic escrow requirements, charge interest on escrow advances, and collect escrow advances from payments before reducing the mortgage balance.

- Promptly and accurately post all collections and disbursements to the individual mortgagors' accounts.
- Provide adequate accounting data for field offices to properly monitor mortgages and thereby eliminate the need for duplicate collection records.
- Promptly reconcile differences disclosed by the semi-annual inventories of Secretary-held mortgages.

We also recommend that the Secretary of HUD improve the Department's mortgage servicing efforts by requiring the Assistant Secretary for Housing to:

- Issue new guidelines and procedures for the servicing of Secretary-held mortgages. The new guidelines should emphasize the need to take effective action to collect mortgage payments when due or, when appropriate, to promptly recommend foreclosure.
- Develop a monitoring system that will ensure that HUD field offices comply with the servicing guidelines to assure prompt payments.
- Assume the servicing and collection activity currently performed by the Office of General Counsel so that the General Counsel can promptly initiate foreclosure on cases recommended by the field offices.

Finally, GAO recommends that the Secretary have the Inspector General review changes to improve the accounting and mortgage servicing systems to ensure that they are adequate, promptly completed, and closely followed.

#### AGENCY COMMENTS

The Department agreed with GAO's findings and recommendations and agreed to take corrective actions. (See app. I.)

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## CHAPTER 1

### INTRODUCTION

This report presents the results of our review of single family mortgages valued at over \$151 million, as of January 1979, for which the Department of Housing and Urban Development has servicing responsibility.

As authorized by the National Housing Act of 1934, as amended, the Department of Housing and Urban Development has various mortgage insurance programs to assist home buyers in the purchase of new or existing housing. Under these programs, lending institutions provide money for mortgages and the Department insures the lender, or mortgagee, against default by the mortgagor.

Traditionally, when a mortgagor failed to make required mortgage payments, the mortgagee would foreclose on the defaulted mortgage, evict the homeowner, and return the title of the vacant property to HUD. In mid-1974 and early 1975, when interest rates were high and mortgages were difficult to obtain, HUD sold many of these properties and retained the mortgage, thereby becoming the mortgagee. These HUD-held mortgages were called "purchase money mortgages."

In May 1976, HUD announced a liberalized policy of accepting "assignment of" defaulted mortgages. The default had to be caused by temporary financial problems beyond the mortgagor's control and there had to be a reasonable prospect that the mortgagor would be able to resume full mortgage payments after a forbearance period of reduced or suspended payments. In accepting assignments, HUD would buy the mortgage from the original mortgagee and work with the mortgagor to alleviate the delinquency. These HUD-held mortgages are called "assigned mortgages."

Between September 30, 1977, and January 31, 1979, the number and dollar value of home mortgages held by HUD increased from 8,103 mortgages, valued at about \$117 million, to 10,022 mortgages, valued at over \$151 million. The Department did not have adequate plans for such a sizable increase in workload and, consequently, the program has been hampered by accounting and mortgage servicing problems. Together, the purchase money mortgages and assigned mortgages are referred to as single-family, "Secretary-held mortgages."

HUD is responsible for providing all services to the mortgagor that were previously supplied by the original mortgagee. These duties have been delegated within HUD as follows:



- The Assistant Secretary for Administration's Office of Finance and Accounting maintains the computerized financial records on Secretary-held mortgages, computes monthly tax escrow requirements, and provides field offices with management information on delinquent mortgagors.
- The HUD field office directors perform most servicing functions, including personal contacts with mortgagors, negotiations of special forbearance agreements, referrals of mortgagors to HUD-approved counseling services, and efforts to induce mortgagors to make payments. They recommend foreclosure actions when payment appears hopeless.
- The Assistant Secretary for Housing develops the policies and procedures for servicing Secretary-held mortgages and provides technical advice and guidance to the field offices.
- The General Counsel initiates foreclosure action after receiving notice from the field offices to foreclose.

#### SCOPE OF REVIEW

We reviewed HUD's policies and procedures in accounting for and servicing single-family, Secretary-held mortgages. This review was primarily directed at reviewing HUD's single-family mortgage accounting system. It was performed at HUD headquarters in Washington, D.C., and at HUD field offices in Philadelphia, St. Louis, and San Francisco. These sites were selected because of their potential accounting problems rather than present servicing problems.

We are currently undertaking a comprehensive review of mortgage servicing at several agencies, including HUD. The results of that review will be furnished in a separate report.

## CHAPTER 2

### ACCOUNTING SYSTEM FOR SECRETARY-HELD

#### HOME MORTGAGES NEEDS IMPROVEMENT

HUD's centralized accounting system for Secretary-held home mortgages was designed to handle mortgages for which periodic payments were normally made when due. Consequently, the system did not include features required to process data in a format that would effectively manage and account for delinquent mortgages. As a result, GAO estimates that from the time HUD assumed management of the mortgages until December 31, 1977, total over- and undercharges to mortgagors for such items as interest and tax penalties were as high as \$3 million.

#### DESIGN FEATURES CAUSED PROBLEMS IN HANDLING DELINQUENT MORTGAGES

HUD's accounting system for Secretary-held home mortgages was designed with features to handle purchase money mortgages on which monthly payments were generally received when due. However, the mortgage workload consisted primarily of delinquent mortgages for which irregular payments were received in amounts differing from the terms of the mortgage. These payments created unique processing problems that HUD's system could not properly or effectively handle. We noted among the problems that the system:

- Failed to adequately recognize special payment agreements, partial payments, prepayments, or late payments.
- Did not provide adequate accounting information to servicing personnel in HUD's field offices.
- Contained improper procedures for allocating payments between interest and principal.
- Used an incorrect approach to compute escrow requirements to pay property taxes.

#### System design inappropriate for type of payments received

HUD's accounting system was designed to handle mortgage payments made on the due date. It was not designed to handle reduced or increased payments received on delinquent mortgages under the terms of special payment agreements. As a result

- HUD field offices maintained duplicate collection records to properly service delinquent mortgages.
- Late charges were not assessed against mortgagors even though the mortgage documents, depending on the date of the mortgage, called for a 2- or 4-percent penalty for late payments.
- Monthly mortgage payments were not applied to the individual accounts in accordance with the terms of the mortgage instrument or the "U. S. Rule" which governs payments received on debts owed to the Government.

#### Duplicate collection records

HUD's centralized accounting system did not provide adequate accounting information to servicing personnel in the field offices. As a result, field offices had to maintain manual records of information that should have been provided by the computerized system.

When a HUD field office accepts a mortgage assignment, a special payment agreement, called a "forbearance agreement," is required to be negotiated with the mortgagor. Forbearance agreements can provide temporary financial relief to a delinquent mortgagor by suspending or lowering the monthly payment amount called for in the mortgage. For delinquency reporting purposes, however, HUD's accounting system did not recognize the existence of these forbearance agreements and reported in a delinquent status many mortgagors who were meeting the terms of their forbearance agreements. To adequately service the delinquent mortgages, field office personnel must know the delinquency status of the mortgages under the terms of the forbearance agreements. Since the accounting system did not report delinquencies based on the terms of these agreements, field office personnel were required to maintain duplicate collection records to identify those mortgagors who were actually delinquent.

Before October 1978, when new procedures were established, field offices were authorized to accept monthly mortgage payments until HUD headquarters established the mortgages in the master file. Subsequently, mortgagors sent all payments directly to HUD headquarters. Under the new procedures, field offices receive and deposit locally all payments and must manually maintain informal collection records, thus making better collection data available to field office personnel. However, the new procedure places a manual record-keeping responsibility on field offices so they can have access to accurate delinquency information which should be provided by a mechanized accounting system.

Inadequate accounting procedures  
for irregular payments

Frequently HUD received prepayments, late payments, or partial payments on delinquent mortgages. Because these payments were not properly accounted for by HUD's accounting system and late charges were not assessed for late payments, as a mortgagor became more delinquent, the effective interest rate charged on the mortgage decreased.

HUD's computer was programmed to process only full monthly payments in accordance with the original mortgage amortization schedule, and to consider that each payment received from the mortgagor was paid on the date due regardless of the date received. Any money received by HUD which did not equal one full payment was placed in the mortgagor's account as unapplied funds. When sufficient unapplied funds accumulated to make one full payment, the computer processed the next payment due in accordance with the original amortization schedule. Since the computer did not recognize when a payment was actually received, but only when the payment was originally scheduled to be received,

--no reduction in interest charges could be given to mortgagors who were prepaying their mortgages and

--no additional interest could be assessed against mortgagors who paid late.

In addition, HUD did not assess late payment penalties of 2 or 4 percent of the payment as provided for in the mortgage. A delinquent mortgagor, therefore, had little incentive to keep his mortgage payments current.

Improper procedures to allocate payments  
to service charges, principal, and interest

When a mortgage loan is made, an amortization schedule is prepared showing the amount of each monthly payment to be applied to service charges, principal, and interest over the life of the loan. The schedule considers the amount borrowed, the life of the loan, the frequency of repayment, and the interest rate charged. In developing the schedule, it is assumed that each payment will be received on the due date. Once a mortgagor becomes delinquent, the monthly accrued interest in the schedule is no longer valid because the unpaid principal remains outstanding for a longer period of time and additional interest accrues. HUD, however, always uses the original amortization schedule to apply payments and assumes that all payments are received on the due date. As a result, no additional interest is charged to delinquent mortgagors.

This procedure is inconsistent with both the terms of the mortgage and the U. S. Rule which governs payments received on debts owed to the Government. The U. S. Rule states that each payment must first be applied to the payment of accrued interest and then to principal. Our review of a sample of assigned mortgages indicated that the average delinquency increased from about 12 to 14 months during calendar 1977, indicating that many of the mortgage payments received by HUD are at least 1 year late. HUD, however, considered that all payments were received when due and applied the payments to service charges, principal, and interest in accordance with the original amortization schedule. Therefore, too much of the delinquent payments were applied to principal and not enough was applied to service charges or interest. As a result, from the time HUD assumed management of the mortgages to December 31, 1977, up to \$2.7 million owed the Government was not collected.

Incorrect approach to  
compute escrow amounts

Part of the monthly mortgage payments received is held in escrow accounts so that funds will be available to pay property taxes as they come due. However, HUD's method of computing the monthly escrow amounts was incorrect resulting in insufficient amounts available to pay the taxes. To preclude tax sales by taxing authorities, HUD advanced funds to pay the taxes and handled the advances as an interest-free loan. As of May 1978, over \$2.6 million in advances was outstanding and had not been recovered.

Mortgagors are required to submit one-twelfth of the annual escrow requirement for property taxes as part of their monthly mortgage payment. After each tax disbursement, HUD recalculates the monthly escrow needed from the mortgagor to pay subsequent taxes and adjusts the monthly mortgage payment accordingly. To calculate the monthly escrow requirement, HUD estimates the tax for the current year and subtracts any existing escrow balance to arrive at the funds needed for the next 12 months. When a deficit balance exists in the escrow account, HUD bills the mortgagor separately for the deficit.

Since few mortgagors pay the delinquent escrow payment, in many instances escrow collections were insufficient to pay the next tax bill that came due. As of May 31, 1978, over 57 percent of all mortgagors had deficit escrow balances. Deficits in excess of \$5,000 were noted in 64 mortgagors' accounts, and interest-free cash advances increased from about \$1.5 to about \$2.7 million in 8 months. These figures could have been much worse, since we estimate that during 1977 HUD failed to pay the taxes on about 21 percent of the mortgages. (See p. 8.)

The mortgage instrument states that payments received from mortgagors will be applied to property taxes before they are used to collect interest or reduce principal. HUD, however, did not follow this term of the mortgage; it applied payments from delinquent mortgagors toward reducing unpaid principal balances before escrow advances were fully collected. We believe that an interest charge should be assessed on the homeowners and that advances should be collected before payments are used to reduce principal.

POSTING DELAYS MADE MORTGAGORS'  
ACCOUNTS INACCURATE

At the time of our review, collections and disbursements totaling almost \$500,000 had not been posted to mortgagors' records. As a result, many records did not reflect the true status of the account.

HUD headquarters must establish each Secretary-held mortgage in the computer master file before collections and disbursements will be accepted and processed by the computer. Any transaction rejected by the computer becomes a "computer exception." Because of administrative processing delays incurred by HUD field offices and various headquarters divisions, establishing a Secretary-held mortgage in the master file often took several months, which often resulted in computer exceptions. Other problems, such as keypunch errors, also resulted in exceptions.

As of August 1978, there were approximately 2,300 unresolved computer exceptions valued at over \$545,000; 82 percent of these exceptions represented mortgage collections which had not been credited to individual mortgagors' accounts, and another 10 percent represented tax disbursements which had not been charged to individual mortgagors' accounts. The remaining 8 percent represented such things as uncollectible checks and adjustments between accounts, which had not been posted to individual mortgagors' accounts.

Even though HUD officials stated that every effort is made to process current cash exceptions within a few days after they are reported, the dollar value of exceptions has remained high. In December 1977, cash exceptions were valued at about \$603,000. By August 1978, this amount was reduced to only about \$545,000 of which over \$498,000 represented unposted collections and disbursements. Over 23 percent of the August 1978, exceptions were at least 1 year old, with the oldest exception dated September 1972. These and other exceptions must be resolved and properly recorded to have accurate mortgage accounting records.

PROCEDURES CAUSED LATE  
PAYMENT OF TAXES

Before June 1978, HUD's tax payment procedures resulted in many mortgagors being charged late penalties because tax bills were obtained late and processing of tax payments was delayed. The late charges, incurred between August 1977 and June 1978, amounted to more than \$118,000 because over 50 percent of the property tax bills were paid late.

Our statistical sample of 138 mortgages revealed that HUD had the following success record in paying tax bills during 1977:

- 24 percent were paid by the due date or had no tax owed,
- 55 percent were paid late, and
- 21 percent had not been paid by the end of the year.

We noted that 33 percent of the penalties incurred were passed on to the mortgagors.

Before June 1978, all tax penalties incurred were charged to an individual mortgagor's account. An adjusting entry was required to remove the penalty, and often these entries were not made, leaving the penalties charged to the mortgagors' escrow accounts. New procedures, effective in June 1978, ended the practice of initially charging the penalties to the escrow accounts. Therefore, the adjusting entries will no longer be necessary, and penalties should not be erroneously assessed against the mortgagors.

Additionally, new procedures were issued in April 1978 requiring, among other things, that each HUD field office establish a system to ensure that all tax bills due after November 30, 1978, were

- requested for all mortgages under that field office's jurisdiction;
- obtained, validated, and posted to local records; and
- forwarded to headquarters for processing and payment at least 30 days before the bills were due.

HUD officials doubted that all local tax authorities could make the bills available to HUD field offices in sufficient time to allow for the amount of administrative lead-time which HUD headquarters desired. Therefore, to expedite

the payment of tax bills, HUD is considering the decentralization of the payment of the tax bills to the field offices. If properly implemented, these new procedures should result in the prompt payment of all tax bills and should substantially reduce the late penalties currently being paid.

SYSTEM LACKED ESSENTIAL  
INVENTORY CONTROL FEATURES

Prior to our review, HUD's accounting system lacked the necessary controls to ensure that an accurate inventory of Secretary-held mortgages was being maintained. As a result, HUD's master file of mortgages was incomplete, inaccurate, and included numerous mortgages which had been paid off or foreclosed, so HUD's management had no basis for judging whether all amounts due were being collected.

A trial balance was printed monthly showing all case numbers in the mortgage notes master file. On the last day of each month, a delinquency report was prepared listing all mortgagors who, under the terms of the original mortgage, would be at least 90 days delinquent if payment was not received on the next day. We compared the September 30, 1977, mortgage notes trial balance with inventories of Secretary-held mortgages maintained by HUD field offices in San Francisco, St. Louis, and Philadelphia. Inventory differences existed between HUD headquarters and each of the three field offices. Specifically, the headquarters' trial balance for San Francisco contained 81 mortgages while the field office inventory contained 82 mortgages. However, differences existed on more than one mortgage. Only 73 HUD mortgages were identified by the same case number while the true inventory was actually 83 mortgages because:

- San Francisco did not have on its inventory one mortgage which had been recommended for foreclosure.
- The headquarters' trial balance contained one mortgage which had been paid in full 4 months earlier in May 1977.
- The headquarters' trial balance failed to record one mortgage assignment that was accepted 9 months earlier in December 1976. Since the mortgage was assigned, the mortgagor had made seven payments totaling \$750 which were reported as computer exceptions at HUD headquarters.
- San Francisco had two recent assignments which had not yet been picked up on the headquarters' trial balance.



--San Francisco was reporting eight mortgages under different HUD case numbers than were shown on the headquarters' trial balance for the same mortgages.

Similar situations were noted during our test at HUD's St. Louis and Philadelphia field offices. For example, HUD's St. Louis field office inventory contained 353 mortgages, while the headquarters' trial balance for St. Louis contained only 345 mortgages.

HUD officials said that, before our review, no mortgage inventory reconciliations between HUD headquarters and the field offices were made. No requirement for such a reconciliation existed until April 1978, when HUD issued new procedures. One of these procedures calls for a semi-annual inventory reconciliation on March 31 and September 30 of each year. HUD started its initial reconciliation efforts on April 30, 1978, and completed the reconciliation on November 2, 1978. We believe that, if promptly and accurately completed, the semi-annual inventory reconciliations should provide adequate controls over future mortgage inventories.

PROJECTED LOSS TO GOVERNMENT  
AND MORTGAGORS

HUD's method of accounting for Secretary-held mortgages resulted in gross over- and undercharges to HUD mortgagors. We estimate that from the date HUD assumed management of the mortgages to December 31, 1977, the erroneous charges could total as much as \$3 million.

We based our estimate on a statistical sample of 56 purchase money mortgages and 82 assigned mortgages on hand during 1977. All collections, disbursements, and adjustments made to these mortgages during calendar 1977 were analyzed; prior year and subsequent year transactions which affected calendar 1977 were also analyzed. On January 1, 1977, the average purchase money mortgage was 4 months delinquent, while the average assigned mortgage was about 12 months delinquent. We accrued interest monthly and charged interest on deficit escrow balances for each sampled mortgage through December 31, 1977. Using HUD's methodology, the principal balance for the sampled mortgages was adjusted to reflect the amount needed to pay the mortgage in full, including the interest due. Our computation of the ending unpaid principal balance was then compared with HUD's to determine over- or undercharges. The results of that comparison are on the following page.

	<u>Undercharges to mortgagors</u>		<u>Overcharges to mortgagors</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Purchase money mortgages	25	\$5,454	31	\$2,681
Assigned mortgages	64	\$29,357	18	\$5,173

Using the results of the comparison, we projected the total amount of over- and undercharges as of December 31, 1977. Our projection was made using scientific projection techniques that assured the projection was accurate within plus or minus 10 percent. We estimate that HUD is undercharging 65 percent of the mortgagors while overcharging 35 percent. As of December 31, 1977, the total undercharge was estimated to be between about \$1 million and \$2.7 million while the total overcharge was estimated to be between about \$161,000 and \$658,000. Over the actual lifespan of the mortgages, cumulative undercharges and overcharges would be considerably greater.

Generally, undercharges resulted because HUD did not accrue interest based on the actual payment frequency or did not charge interest on cash advances. Overcharges resulted from (1) not promptly posting payment to mortgagors' accounts, (2) charging tax penalties to mortgagors, and (3) not reducing interest charges for prepayments.

### CONCLUSIONS

Weaknesses in HUD's accounting system have resulted in most mortgagors being over- or undercharged. In addition, many mortgagors have received interest-free advances to pay property taxes. Mortgagors had little incentive to pay off a delinquent mortgage since a mortgagor's effective interest rate decreased as the period of delinquency increased. This situation costs the Government and is unfair to the majority of insured mortgagors who have not defaulted on their mortgages.

During our review, the Department made a number of improvements in the accounting system, such as requiring semi-annual mortgage inventories and not charging tax penalties to mortgagors' accounts. Additional improvements are needed, however, to provide servicing personnel in HUD's field offices with adequate accounting information and to collect all funds due the Government.

## RECOMMENDATIONS

We recommend that the Secretary of HUD direct the Assistant Secretary for Administration to incorporate procedures in the accounting system that will:

- Accrue interest on delinquent principal balances and assess penalties for late payments.
- Calculate realistic escrow requirements, charge interest on escrow advances, and collect escrow advances from payments before reducing the mortgage balance.
- Promptly and accurately post all collections and disbursements to the individual mortgagors' accounts.
- Provide adequate accounting data for field offices to properly monitor mortgages and thereby eliminate the need for duplicate collection records.
- Promptly reconcile differences disclosed by the semi-annual inventories of Secretary-held mortgages.

## AGENCY COMMENTS

The Department agreed with our recommendations and stated that corrective actions will be taken. (See app. I.)

## CHAPTER 3

### MORTGAGE SERVICING NEEDS IMPROVEMENT

Besides accounting problems, the Department's mortgage servicing efforts have been hampered by outdated servicing procedures and ineffective collection practices, such as untimely foreclosure actions. GAO believes that these conditions contributed to the high volume of delinquent mortgage payments which had increased to over \$17 million by January 31, 1979.

Since the Department's headquarters had not either developed current servicing and foreclosure procedures or properly monitored the servicing efforts of the field offices, many field offices had not undertaken effective collection actions or made timely foreclosure recommendations.

#### OUTDATED SERVICING PROCEDURES

HUD's mortgage servicing handbook was issued in 1969 and has not been updated to provide adequate servicing guidance for mortgages accepted under the 1976 assignment program. These assigned mortgages currently represent the majority of the single-family mortgages in HUD's inventory.

Many procedures in the 1969 handbook are not being followed in servicing assigned or purchase money mortgages. For example, the 1969 handbook states that recommendations from the field offices to foreclose will be sent directly to the accounting office where a final statement of account will be prepared and forwarded to HUD's Office of General Counsel. According to the handbook, these cases have normally been serviced effectively enough to preclude further consideration of forbearance.

The Office of General Counsel did not foreclose, however, based on the recommendations of the field offices. Instead, in November 1977, the foreclosure unit of the Office of General Counsel set up an informal servicing and collection activity. Under its procedures, all mortgagors recommended for foreclosure were sent a final demand letter requesting that they contact the General Counsel's foreclosure unit. When no response was received, the case was sent out to the Department of Justice, an independent attorney, or a commercial mortgagee under contract to HUD to perform the actual foreclosures. If the mortgagor contacted the foreclosure unit, an attempt was made to enter into an informal forbearance agreement. When an agreement was reached, the mortgagor was instructed to make subsequent payments directly to the foreclosure unit rather

than to HUD's accounting office. The foreclosure unit was therefore performing a servicing function that should have been performed by HUD field offices and a bookkeeping function that should have been performed by HUD's accounting office.

Our review of a sample of 49 mortgages carried under informal repayment agreements in the foreclosure unit revealed that even though internal controls over cash receipts were poor and the collection records were often inaccurate, the foreclosure unit reduced the overall delinquency rate of all 49 mortgages. At the time these 49 mortgages were recommended for foreclosure, they had been delinquent for an average of about 23 months. As of June 1978, the average delinquency had decreased to about 21 months because

--32 cases improved their delinquency position,

--11 cases worsened their delinquency position, and

--6 cases remained unchanged.

The success of HUD's Office of General Counsel in reducing the overall delinquency rate on these mortgages indicates that, with more aggressive field office servicing, the collections on delinquent mortgages could be increased. This function should, however, be performed by HUD's field offices and not duplicated by its Office of General Counsel. The practice also discouraged field offices from recommending foreclosure since many cases that are recommended are not foreclosed but ultimately returned to the field offices.

HUD officials said that a new servicing handbook was being prepared. We believe that this handbook should provide servicing and foreclosure guidelines to be followed by field offices. It should also provide a basis for monitoring the servicing efforts of the field offices so that cases recommended for foreclosure can be promptly foreclosed.

#### INEFFECTIVE COLLECTION PRACTICES AND UNTIMELY FORECLOSURE ACTIONS

HUD field offices were not adequately servicing delinquent mortgages or recommending foreclosure when repayment appeared doubtful. As a result, the dollar value of delinquent payments was over \$17 million as of January 31, 1979.

HUD only accepts assignments of delinquent mortgages if there is a reasonable prospect that the mortgagor will be able to resume full mortgage payments after a temporary

period of reduced or suspended payments. After accepting the mortgages, HUD's field offices negotiate special payment agreements, known as forbearance agreements, with the mortgagors. These forbearance agreements can provide temporary financial relief for up to 36 months by suspending or lowering the payment amount called for in the mortgage. The agreements are also used to cure delinquencies by increasing the payment amount called for in the mortgage instrument. When delinquent mortgagors do not meet the terms of the forbearance agreements, foreclosure should be recommended or the agreement should be modified.

As of May 31, 1978, HUD's Office of Finance and Accounting reported that field offices had special payment--forbearance agreements--in effect for only 2,869 of the 6,260 delinquent mortgages. Yet only 387 were in the process of foreclosure. The 6,260 delinquent mortgages, which represented about 75 percent of the 8,358 mortgages on hand, were, under the terms of the mortgage, delinquent by 2 months or more. An analysis of the May 1978 delinquency report disclosed 678 mortgages on which no payments had been received in calendar 1978. These mortgages were delinquent as long as 6 years, but according to accounting records, many had no forbearance agreements in effect, and none had been recommended for foreclosure.

At HUD's Philadelphia field office, delinquent mortgages were not being adequately serviced or recommended for foreclosure. For 12 months or more, no payment had been received on 22 of the delinquent mortgages. In addition, the field office had 32 mortgages which were 60 or more months delinquent but had not been recommended for foreclosure.

One mortgage was assigned to HUD in June 1972. Although the mortgagor had never made a mortgage payment to HUD, as of April 1978, HUD's Philadelphia office did not have a forbearance agreement with the mortgagor and had not recommended foreclosure action. An official in HUD's Philadelphia field office stated that this case would be recommended for foreclosure when he found time.

In another instance, the Philadelphia office accepted a mortgage assignment in August 1972 that was delinquent for 9 months. Two partial payments of \$112 each were received from the mortgagor during 1973, but no subsequent payments were ever collected. As of April 1978, the mortgagor was delinquent for 76 months, and HUD had paid \$4,370 in property taxes; however, HUD's Philadelphia office had not recommended foreclosure action. In the 5 years and 8 months (through April 1978) that this mortgage had been assigned to HUD, the average monthly cost to the mortgagor was \$3.29.

## CONCLUSIONS

HUD's servicing of Secretary held home mortgages has not been effective and has contributed to millions of dollars not being collected that is owed the Government. Rather than helping delinquent mortgagors eliminate or reduce their delinquencies, HUD has allowed many mortgagors to fall further behind in their payments. Considering the amounts of their current delinquencies, some mortgagors may never be able to repay their mortgages.

Improvements are needed in servicing procedures, and field office servicing efforts should be more closely monitored. Mortgagors who are not making payments on their mortgages should be recommended for foreclosure, and HUD headquarters should initiate foreclosure action rather than duplicating the servicing efforts of the field offices.

## RECOMMENDATIONS

We recommend that the Secretary of HUD improve the Department's mortgage servicing efforts by requiring the Assistant Secretary for Housing to:

- Issue new guidelines and procedures for the servicing of Secretary-held mortgages. The new guidelines should emphasize the need to take effective action to collect mortgage payments when due or, when appropriate, to promptly recommend foreclosure.
- Develop a monitoring system that will ensure that HUD field offices comply with the servicing guidelines to assure prompt payments.
- Assume the servicing and collection activity currently performed by the Office of General Counsel so that the General Counsel can promptly initiate foreclosure on cases recommended by the field offices.

Finally, we recommend that the Secretary have the Inspector General review changes to improve the accounting and mortgage servicing systems to ensure that they are adequate, promptly completed, and closely followed.

AGENCY COMMENTS

The Department agreed with our recommendations to improve mortgage servicing and stated that corrective actions will be taken. (See app. I.)

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This review was performed at HUD headquarters and three HUD field offices selected because of potential accounting rather than servicing problems. GAO is currently undertaking a comprehensive review of mortgage servicing at several agencies, including HUD. The results of that review will be furnished in a separate report.





DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY  
FOR ADMINISTRATION

MAY 24 1979

IN REPLY REFER TO:  
AFM

Mr. D. L. Scantlebury  
Director  
Division of Financial and General  
Management Studies  
United States General Accounting Office  
Washington, D. C. 20548

Dear Mr. Scantlebury:

The draft report on weaknesses in servicing and accounting for home mortgages held by the Department, transmitted with your letter of May 3, 1979, has been reviewed by responsible officials and our comments follow. The report findings were discussed with your staff at earlier meetings and our position on most of the findings are contained in the report.

The report accurately points out that at the time the accounting and ADP system for servicing mortgages was designed most of the mortgages being serviced were current purchase money mortgages taken by the Department upon the sale of a Secretary-owned property. A change in Department policy to accept the assignment of insured mortgages in default resulted in the processing problems cited in the report. Since most mortgages previously serviced were current, it was the policy of HUD not to assess penalties for late payments, charge interest on escrow advances, and accrue interest on delinquent principal balances. The change in our portfolio to mostly delinquent assigned mortgages makes it realistic to change our policies on the above and collect these additional amounts from mortgagors.

Implementation of the following recommendations will require major system modifications:

1. Accrue interest on delinquent principal balances and assess penalties for late payments;
2. Calculate realistic escrow requirements, charge interest on escrow advances, and collect escrow advances from payments before reducing the mortgage balance; and

3. Provide adequate accounting data for field offices to properly monitor mortgages and thereby eliminate the need for duplicate collection records.

The present mortgage note system cannot be effectively modified to incorporate features which would respond to these revised policies and the GAO recommendations. The new HUD Mortgage Insurance Accounting System (MIAS), presently under development, includes features which will respond to the recommendations. The mortgage note accounting features of the Single Family Subsystem of MIAS are not scheduled to be implemented until October through December 1981. Because this is two years in the future, the Department has initiated action to develop an interim system for mortgage note accounting that will respond to the GAO recommendations.

The MIAS functional requirement's specification will be scoped down so that it can be implemented in a shorter elapsed period of time than two years and responds to the maximum extent possible to the GAO recommendations. A minimum of three alternatives to satisfy the scoped-down functional requirement's specifications will be evaluated: (1) building software to operate on existing HUD computers and computer services; (2) leasing or buying proprietary software to operate in existing HUD computers and computer services; and (3) acquiring a data service.

If any of the alternatives can be implemented in a substantially shorter elapsed period of time than two years, the alternative representing the best combination of technical features and schedule to implement will be selected and implemented by HUD.

We have taken action to address the remaining recommendations in Chapter Two of the report. The processing delays incurred in establishing mortgage accounts in the computer system have been reduced with a corresponding reduction in the number of exception transactions. We are modifying the present system to accept input transactions on the basis of the case number only without referring to the section of the Act number. We estimate that these changes will reduce the number of exception transactions by 75%. Special attention has been given to correction and reentry of monthly exception transactions and the number of unresolved exceptions have been reduced to 1,258, valued at \$335,879, compared to 2,300, valued at \$545,000, at the time of the audit. The foregoing will greatly improve the promptness and accuracy of posting collection and disbursement transactions to the mortgage accounts.

Procedures have been implemented that require prompt reconciliation of differences disclosed in the inventories of Secretary-held mortgages. We expect to have all differences disclosed in the March 31, 1979 reconciliation with field offices completed no later than June 30, 1979.

The staff of the Assistant Secretary for Housing-Federal Housing Commissioner has been engaged in an effort to improve outdated servicing and ineffective collection practices.

The issuance of Notice 78-43 on April 26, 1978 established marked changes in mortgage servicing procedures by delegating to field offices the lead responsibility for collections contacts with mortgagors, maintaining servicing records, receiving and depositing mortgage payments, initiating foreclosure agreements, and establishing a new reporting system between field offices and the Office of Finance and Accounting to reconcile and maintain current accountings. That new system has been operative since September 1, 1978. Improved counseling operations have accompanied Notice 78-43 and a series of training sessions were held to indoctrinate field offices in the new procedures.

The existing Mortgage Servicing Handbook, dated 1969, has undergone extensive revisionary work during the past year and it is intended that a revised version be put into clearance within the next 45 days. The Notice 78-43 has covered a substantial portion of mortgage servicing procedures and detailed operational procedures for the field in these servicing operations.

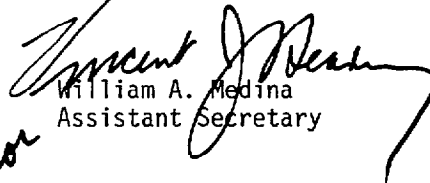
It is intended that new procedures be implemented which will require the Central Office Single Family Loan Servicing Division to review foreclosure recommendations from the field, to assure that added servicing will not produce favorable results, prior to the cases being sent to the General Counsel's Office for foreclosure.

To further improve mortgage servicing operations, the Single Family Loan Servicing Division has initiated action in an effort to have the mortgage portfolio incorporated in our existing Single Family Default Reporting System and we are hopeful that this may be accomplished at an early date. When completed, regular and complete monthly reports would be produced and made available to each field and all Central Office personnel affected, reflecting the status of each Secretary-held mortgage in inventory, together with the actions being undertaken to service the mortgage.

As to the Secretary-held mortgages presently in the hands of the General Counsel's Office, which were originally referred for foreclosure and thereafter serviced by that office, steps have been initiated to terminate that circumstance. Arrangements have been made between General Counsel and Housing to transfer in orderly fashion those cases now being serviced by Counsel to the respective field offices involved. The General Counsel Staff and Housing Staff are in the process of arranging the details of such transfers and will alert field offices to the impending transfers at an appropriate time.

The Inspector General will review the changes made to the Mortgage Note Accounting and ADP Systems in accordance with your recommendations.

Sincerely,

  
for  
William A. Medina  
Assistant Secretary

(906390)

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