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INFORMATION TECHNOLOGY

Streamlining FHA's Single Family Housing Operations

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The Honorable Stephen Horn
Chairman, Subcommittee on Government
Management, Information and Technology
Committee on Government Reform and Oversight
House of Representatives

The Honorable Christopher Shays
Chairman, Subcommittee on Human Resources
and Intergovernmental Relations
Committee on Government Reform and Oversight
House of Representatives

The Secretary of Housing and Urban Development has proposed a major reinvention of the Department's programs and operations over the next few years. One such proposal is to reduce the Federal Housing Administration's (FHA) staff by more than 50 percent by the year 2000. While the Department of Housing and Urban Development (HUD) has proposed to the Congress several major policy changes to achieve the downsizing, FHA's single family housing mission will remain basically the same. Thus, significant changes will be needed to streamline its operations and achieve targeted staff reductions.

Because of your interest in FHA's streamlining plans, you asked us to determine (1) how FHA plans to use information technology to support the streamlining of single family housing operations and reduce staff, (2) whether FHA's planned initiatives are similar to those undertaken by leading mortgage organizations to increase productivity, and (3) what FHA is doing to ensure that technology initiatives will maintain or improve management controls over single family housing operations. To address these questions, we contacted FHA's Office of Single Family Housing and Denver field office, the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and two of the largest private mortgage insurance corporations. We conducted our work between December 1995 and August 1996 in accordance with generally accepted government auditing standards. Details on our objectives, scope, and methodology are provided in appendix I.

Results in Brief

FHA plans to use existing information technology capabilities to facilitate some streamlining and staff reduction initiatives, while other initiatives will require new information technology applications. FHA plans to reduce single family housing staff from its 1994 level of about 2,700 to 1,150 in the year 2000 by (1) expanding the use of existing electronic data transfer capabilities and using information systems to support the consolidation of loan processing operations from 81 offices to 5 offices, (2) implementing new loss mitigation processes that will be supported with a new information system, and (3) using information technology to support new processes associated with conducting real property maintenance and disposition operations or selling defaulted mortgage notes rather than foreclosing on properties.

FHA plans to incorporate information technology initiatives that are similar to, but not as extensive as, those used by other mortgage industry organizations to improve productivity. Further improvements may be achieved if FHA adopts other automated capabilities used by these organizations. For example, some organizations with more capable systems are currently able to process a similar volume of loans with about one-fifth of the staff planned for FHA's streamlined loan processing operations. Also, some of FHA's planned changes may help resolve management control weaknesses or maintain adequate controls for loan origination, loss mitigation, and property disposition. However, we were unable to assess the impact of the planned changes because FHA has not yet made all of the decisions, developed the detailed operating procedures, or identified the information systems requirements that will be needed to implement the planned initiatives and management controls.

FHA officials recognize that additional information technology investments are needed to achieve the efficiency and effectiveness of other mortgage organizations. However, they added that they must deal with budget and procurement limits and technical skills shortfalls to make needed improvements. In this regard, FHA is considering using the expertise of other organizations. For example, FHA is planning to test a modified Freddie Mac system to speed loan processing for lenders and reduce their costs. In making future technology acquisitions, FHA can take advantage of the recently enacted Information Technology Management Reform Act of 1996, which establishes a framework for information technology decisionmaking and implementation based on best industry practices.

Background

In December 1994, the Secretary of Housing and Urban Development announced a plan to reinvent the Department to transition it from a "lumbering bureaucracy to a streamlined partner with state and local governments." With the streamlining, the Secretary expects HUD to reduce its staffing from about 11,900 to 7,500 by the year 2000. In March 1995, the Secretary laid out the envisioned changes for HUD in a plan entitled, HUD Reinvention: From Blueprint To Action. The plan was subsequently updated in January 1996.

The HUD reinvention plan acknowledges that FHA is behind the times technologically and increasingly ill-equipped to manage its business. The plan notes that FHA needs to streamline operations and acquire state-of-the-art technology and information systems to transform itself into a results-oriented, financially accountable operation. One of the mandates of the plan is to reduce FHA staffing from about 6,000 to 2,500. As part of the downsizing, FHA's Office of Single Family Housing is planning to reduce its staff from a 1994 level of 2,700 to 1,150 by the year 2000.

The mission of FHA's Office of Single Family Housing is to expand and maintain affordable home ownership opportunities for those who are unserved or underserved by the private market. Single family housing carries out its mission by insuring private lenders against losses on single family home loans. FHA's insurance operations target borrowers such as first-time home buyers, low-income and moderate-income buyers with little cash for down payments, residents of inner cities and rural areas with inadequate access to credit, minority and immigrant borrowers, and middle-income families in high cost areas. At the end of fiscal year 1995, FHA had insurance outstanding valued at about $350 billion on mortgages for 6.5 million single family homes. FHA processed an average of about 1 million applications for mortgage insurance and disposed of properties acquired from borrower defaults on over 50,000 loans annually during fiscal years 1994 and 1995.

Single family housing operations consist primarily of four functions: loan processing, quality assurance, loss mitigation and loan servicing, and real property maintenance and disposition. The following summarizes these basic functions.

- Loan processing: FHA records data on loans originated by FHA-approved lenders, issues insurance certificates, and conducts underwriting reviews of loan documentation. FHA-approved lenders perform the underwriting[1] tasks necessary to determine whether loans meet FHA's insurance guidelines.

[1]Underwriting is the process of analyzing a borrower's willingness and ability to repay a loan, along with an analysis of the acceptability and established value of the property.

- Quality assurance: FHA reviews selected loans to ensure that approved lenders are originating loans in accordance with FHA's guidelines.
- Loss mitigation and loan servicing: FHA attempts to resolve delinquencies to minimize losses that can result if borrowers default on loans. FHA's loss mitigation efforts have generally involved (1) placing delinquent loans in the mortgage assignment program, which offered reduced or suspended payments for up to 3 years to allow borrowers to recover from temporary hardships, (2) offering alternative default resolution actions such as refinancing, or (3) using preforeclosure sales of homes. FHA services loans that are in the mortgage assignment program, which includes collecting monthly payments, paying property taxes, and maintaining accounting records.
- Property maintenance and disposition: FHA acquires properties from voluntary conveyances by borrowers or foreclosures. FHA inspects and secures the properties, performs necessary repairs, and sells the properties.

The functions performed by FHA generally parallel those performed by other organizations in the single family mortgage industry, such as Fannie Mae, Freddie Mac, and large private mortgage insurance corporations. However, the functions FHA performs differ from those of the other organizations because of differing business objectives. Fannie Mae and Freddie Mac are government-sponsored, privately owned enterprises that purchase mortgages from lenders and (1) hold them as investments in their portfolios or (2) sell securities that are backed by mortgage pools. Therefore, in addition to the functions FHA performs, Fannie Mae and Freddie Mac also establish purchase prices for mortgages, negotiate purchase contracts, and market mortgage-backed securities.

Private mortgage insurers perform the same functions as FHA and perform loan underwriting for a significant portion of the loans they insure. Similar to FHA, private mortgage insurers also accept loans underwritten by lenders to whom they have delegated the authority to initiate insurance. FHA performs some functions that are unique in the mortgage industry. For example, FHA sells houses from its real property inventory to interested nonprofit organizations, states, and local governments, and FHA works with local community development officials in their efforts to increase home ownership opportunities.

Because of its mission, FHA accepts higher levels of risk on many of the mortgages it insures. FHA covers 100 percent of losses on the mortgages it insures, whereas Fannie Mae and Freddie Mac share losses with mortgage insurers and private insurers share losses with mortgage lenders. FHA also insures higher risk mortgages because it accepts higher loan-to-value and borrower debt-to-income ratios than the private mortgage insurers. In addition, FHA has a higher proportional volume of defaults that it must manage and a higher volume of real property maintenance and disposition activities.

Historically, FHA's single family housing operations have had significant management control problems in originating insured loans, resolving delinquencies, managing assigned mortgages, and managing property maintenance and disposition activities. Information system weaknesses have been cited as a contributing factor for many of FHA's management control weaknesses. For example, independent audit reports have cited FHA systems that collect delinquency data and track default resolution actions as inadequate to support oversight responsibilities and as factors contributing to inadequate loss mitigation efforts.[2] Similarly, FHA's information systems have not adequately supported the tracking and monitoring of collection and foreclosure actions on loans in the mortgage assignment program. In addition, the lack of information system support for controlling and accounting for properties assigned to real estate brokers for property disposition was cited as a major cause of the highly publicized HUD scandals in the 1980s. According to HUD's Federal Managers' Financial Integrity Act (FMFIA) compliance reports and independent auditors' reports for fiscal years 1994 and 1995, FHA has corrected system weaknesses in the mortgage assignment and property disposition areas but is still developing systems to support delinquency monitoring and resolution.

Single Family Housing Initiatives to Reduce Staff by 57 Percent

FHA plans to use its existing information technology capabilities to facilitate some streamlining and staff reduction initiatives, while other initiatives will require new information technology applications. FHA plans to achieve the majority of the single family housing staff reductions by reducing its field staff performing loan processing from about 600 to 310, loss mitigation and loan servicing from 600 to 90, and real property

[2]Federal Housing Administration, Audit of Fiscal Year 1994 Financial Statements, May 19, 1995, and Federal Housing Administration, Audit of Fiscal Year 1995 Financial Statements, June 7, 1996, were prepared by Price Waterhouse LLP and KPMG Peat Marwick LLP, respectively, for the HUD Office of Inspector General.

maintenance and disposition from 750 to 75.[3] FHA also plans to reduce its single family housing headquarters staff from about 200 to 85. Some of these reductions will be offset by increases in field staff performing quality assurance, marketing and outreach, legal, and administrative support functions. While the staff levels for each function are not final, single family housing officials expect to reach the projected 1,150 staffing target. The planned reduction of loan processing staff is to be facilitated by expanding the use of existing electronic data transfer capabilities to enable the reduction of data entry by FHA staff and the consolidation of operations into fewer locations. New information system support will be needed for FHA's planned changes to loss mitigation and disposition operations.

Loan Processing

To reduce its loan processing staff, FHA is (1) expanding the use of its electronic data transfer capabilities so that fewer staff are needed to enter data into systems from paper documents and (2) using its information systems to support the consolidation of operations from 81 offices to 5 offices. FHA established its electronic data transfer capabilities for loan processing and made them available to lenders in 1991. In fiscal year 1995, lenders submitted about 35 percent of loan data electronically. To take further advantage of this capability, FHA plans to ask lenders to increase the use of electronic transfers to deliver loan data.

In 1994, FHA began consolidating loan processing operations into fewer offices to increase efficiency. According to officials responsible for single family loan processing operations, variations in workloads have resulted in idle time for loan processing staff at some field offices, while staff at other field offices have been overloaded and processing has been backlogged. Consolidating the work to fewer locations helps eliminate the variations in workload and increase efficiency of operations, thus reducing the number of staff needed to perform the work.

FHA is consolidating into its Denver office the loan processing workload that had been performed in 17 field offices. The Denver office is using 42 staff for the loan processing work that was performed by an estimated 96 staff[4] before the consolidation. FHA officials in charge of the pilot

[3]FHA plans to use a total of 165 staff in the field offices to perform loss mitigation and loan servicing and property maintenance and disposition functions. An FHA official responsible for these plans told us that no firm numbers have been set but estimated that about 90 staff would be used for loss mitigation and loan servicing and 75 would be used for property maintenance and disposition.

[4]The estimated number of staff performing this function before the consolidation was provided by officials responsible for the Denver pilot project. FHA does not have data on the actual staff numbers.

attributed the increased efficiency to consolidating the work at one site and increasing the use of electronic data transfer to submit loan data to FHA. According to Denver project officials and documentation, FHA persuaded lenders to increase their use of electronic data transfer from less than 40 percent of all submissions before the consolidation to about 90 percent after consolidation. They also said that loans submitted electronically can be processed in about one-third the time it takes to process loans submitted in paper form. When lenders electronically transfer the loan data, the loan processing staff only need to check that data against the paper forms submitted by the lender. If the data are not submitted electronically, the staff have to enter the loan data from the paper forms into FHA's information systems. With the initial consolidation and processing changes, the Denver office loan processing times were reduced from 5 to 8 days to an average of 2 days, according to FHA.

At the time of our review, the Denver consolidation was substantially complete. In April 1996, FHA announced that it would start consolidating loan processing operations in 32 field offices in eastern states into 2 offices—Philadelphia and Atlanta. FHA plans to complete these consolidations in 1997 and start consolidating the remaining offices in 1998.

Loss Mitigation and Loan Servicing

For loss mitigation, FHA plans to phase out its staff-intensive mortgage assignment program—which is expected to reduce loan servicing staff from about 600 to 40 staff—and implement a new default resolution program that is to be performed by 50 staff. The new processes are to be supported by a new system that will employ electronic data transfers for lender reporting of actions to resolve mortgage payment delinquencies.

FHA's mortgage assignment program was cited in independent auditors' reports on FHA financial statements and HUD's FMFIA compliance reports for fiscal years 1994 and 1995 as a material management control weakness because of extensive losses from uncollected payments. Under the mortgage assignment program, FHA (1) pays the lender for defaulted loans, (2) offers the borrowers reduced or suspended payments for up to 3 years to help them overcome temporary hardships, and (3) services the loans while they are in this program. In October 1995, we reported that while the program helps borrowers avoid immediate foreclosure, in the longer term about 52 percent of the borrowers eventually lose their homes through foreclosure.[5] We also reported that FHA's losses will total about $1.5 billion more than they would have in the absence of the program. As part of HUD's fiscal year 1996 appropriations act, the Congress included a provision directing FHA to stop accepting delinquent loans into the mortgage assignment program and providing FHA with increased flexibility to use loss mitigation alternatives. In addition to not accepting loans into the program, FHA is selling mortgages from the program portfolio to reduce the workload associated with servicing them.

FHA's current processes and system have also been labor intensive because lenders report delinquency data on paper documents that require manual handling and data entry, and the automated system is capable of producing only reports that list data for each lender and does not summarize data concerning the timeliness of actions, alternatives selected, and results of resolution actions. To improve efficiency, FHA modified its system to accommodate electronic data transfers of the delinquency data from lenders and issued instructions that require all lenders to submit delinquency reports electronically by the end of 1997. FHA also plans to develop a new system to track and analyze lenders' use of available loss mitigation alternatives to resolve mortgage delinquencies.

Property Maintenance and Disposition

FHA is considering using one or more of three alternatives to replace the current property maintenance and disposition operations and reduce staff. These alternative approaches include (1) using contractors to maintain and dispose of properties, (2) forming and using joint ventures with other organizations (which is similar to using contractors, but the partner will have an investment in the venture) to maintain and dispose of properties, and (3) selling the defaulted mortgages rather than acquiring the properties. According to FHA officials responsible for property maintenance and disposition, they will need new information technology support to track and manage the new operations regardless of the choice made.

FHA is testing the use of contractors to perform property maintenance and disposition activities for three field offices and has contracted for feasibility studies of the other two alternatives. FHA plans to complete its analyses of the studies in mid-1997 and decide which of the alternative approaches it will use.

[5] Homeownership: Mixed Results and High Costs Raise Concerns About HUD's Mortgage Assignment Program (GAO/RCED-96-2, Oct. 18, 1995).

FHA's Initiatives Are Similar to Those of Leading Organizations

FHA's planned information technology initiatives are similar to those undertaken by other mortgage industry organizations to increase productivity. Additional efficiency and effectiveness improvements may be possible if FHA incorporates other information systems capabilities used by the organizations.

Similar Initiatives Have Increased Productivity at Other Mortgage Industry Organizations

The mortgage industry organizations we visited have been using electronic data transfer extensively to eliminate or reduce the manual processes associated with the receipt and processing of data from paper documents. For example, Fannie Mae and Freddie Mac have had lenders submit loan data electronically for more than 2 years. These organizations have also consolidated their loan processing, loss mitigation, and property disposition operations to increase efficiency and improve consistency of operations and management controls. As a result of the shift to electronic data transfer and consolidation of operations, officials of these organizations stated that they achieved productivity improvements ranging up to 250 percent for the loan processing function.

Further Efficiency and Effectiveness Improvements May Be Possible

FHA may be able to achieve greater efficiency and effectiveness if it adopts the automated capabilities that are used by the other mortgage industry organizations. These capabilities include (1) the ability to electronically analyze loan data to ensure that loans meet their underwriting guidelines and (2) the use of computer models to automatically focus quality assurance activities on areas with the most vulnerability, select the most promising default prevention alternatives for delinquent loans, and analyze repair and marketing data to identify options that will minimize losses and provide the greatest returns on property repair and disposition activities. In addition, officials of the mortgage industry organizations we visited told us that they achieved further staff efficiencies through extensive use of graphical user interfaces, integration with other systems, and telecommunications to facilitate data acquisition and correspondence.[6]

According to information provided by Freddie Mac and Fannie Mae officials, these organizations are able to process similar loan volumes with about 20 percent of the staff planned for FHA loan processing operations because (1) all essential data for delegated loan underwriting are submitted electronically rather than in paper form, (2) their systems electronically perform all edit checks and comparisons against

[6]Graphical user interfaces are tools that make using computers easier and typically employ icons, pull-down menus, and computer mice.

underwriting criteria, and (3) their systems use mortgage scoring models to automatically identify loans with the greatest risk of default for underwriting and other quality assurance purposes.[7] Conversely, FHA requires lenders to submit paper files that staff use to check data submitted electronically, enter data not submitted electronically, and perform compliance checks. According to loan processing staff at the Denver pilot site, working with the paper documents consumes over 90 percent of the processing time. The remaining time is used to deal with exceptions, such as notifying lenders of missing or incorrect data. Since Freddie Mac's and Fannie Mae's systems have automated edits and compliance checks, their staffs need to work only with exception cases. Freddie Mac's and Fannie Mae's systems also use mortgage scoring models to electronically perform underwriting reviews that FHA performs manually with the paper documents in the loan files.

Freddie Mac, Fannie Mae, and private mortgage insurers use other models in their systems that have increased staff productivity. These include models that electronically analyze data to help them select the (1) most promising default prevention alternatives for delinquent loans and (2) repair and marketing options to minimize losses and provide the greatest returns. For example, officials of one organization stated that by using a model to determine whether repairs would increase sales proceeds, they realized $40 million of returns on $15 million of repair investments last year. Officials of another organization said their models have helped to reduce real property disposition losses by about $13,000 for each home.

Officials from Fannie Mae, Freddie Mac, and the private mortgage insurers also cited efficiency improvements through the use of graphical user interfaces, integration with other systems so that needed data are readily available, and telecommunications to facilitate the transfer of data from other databases and the transmission of business correspondence. In the real property maintenance and disposition function, for example, one organization reported a 50-percent increase in the productivity of workers when the new system was implemented. According to officials, the new system's graphical user interfaces enabled workers to quickly, easily, and electronically extract data from other systems, analyze investment options, and prepare and send correspondence by facsimile or electronic mail.

[7]The private mortgage insurer systems we observed also had these capabilities, but they had not achieved the same levels of staff efficiency because they did not require all lenders to submit loan data electronically.

The Deputy Assistant Secretary for Single Family Housing told us that FHA (1) recognizes the potential for using information technology to further improve the efficiency and effectiveness of operations and (2) intends to incorporate the best available technologies and move to a paperless work environment. However, the official added that FHA faces several challenges in making these information system improvements. For example, FHA officials stated they must deal with budget and procurement limits and the lack of skilled managers and technical staff that are necessary to quickly develop and implement the needed information systems.

In this regard, as part of its efforts to improve operations, FHA officials told us that they are considering using the expertise of other organizations. For example, FHA recently entered into an agreement with Freddie Mac to use a modified version of Freddie Mac's mortgage scoring system for loan origination. This system helps speed the lenders' loan origination process and reduce their costs by using mortgage scoring models to more efficiently and effectively analyze risks associated with borrower credit and loan characteristics. The system is being modified for FHA's underwriting criteria and historical experience with insured mortgages. Freddie Mac and FHA are testing the system to determine if lenders can achieve similar benefits for FHA mortgages without adversely affecting applicants who would otherwise qualify for FHA insurance. FHA has also established a process for approving lenders' use of other automated loan origination systems.

FHA Efforts to Improve Management Controls in Information Technology Initiatives

A strong system of management controls and adequate information and financial management systems are key ingredients in helping federal officials to manage operations and control risks. For many years, single family housing has had significant management control problems in its loan origination, delinquency resolution, and property disposition activities. Information system weaknesses have been cited in FMFIA compliance reports and independent audit reports as contributing factors for the last two management control weaknesses.

FHA has been taking corrective actions to address these control weaknesses as part of its ongoing efforts to improve management controls. Some of these actions include the use of information technology. Because FHA is still in the planning stages for its streamlining initiatives, sufficient information is not available at this time to assess the impact that streamlining actions will have on management controls. Appendix II describes the status of efforts to address control weaknesses.

Upcoming Challenges in Managing Information Technology at FHA

Office of Single Family Housing officials recognize that FHA needs to invest in information technology to achieve the efficiency and effectiveness of leading mortgage organizations. In making future decisions on technology acquisitions, the agency can incorporate the technology investment framework established by the new Information Technology Management Reform Act of 1996 (ITMRA), which is based on industry best practices.

Some of FHA's information technology needs are described in single family housing's 1995 Information Strategy Plan. The plan discusses FHA's current information technology environment and shortfalls and proposes investments to provide improved management controls, expanded capabilities to analyze existing data for evaluating performance and setting policy, and expanded capabilities to automate all critical functions with state-of-the-art technology.

The plan was developed using a widely accepted approach to identify needed information technology improvements, including (1) an analysis of the goals and objectives specified in the Office of Single Family Housing's Business Strategy Plan and (2) a survey of information systems users to identify weaknesses and opportunities to automate tasks and enhance efficiency or effectiveness. In formulating the streamlining plans, the Deputy Assistant Secretary for Single Family Housing and the directors of some program areas contacted officials of Freddie Mac, Fannie Mae, and selected private insurers to discuss how their operations differ with FHA's operations. These streamlining efforts include planning operational changes and information technology applications. The efforts have not included data collection and analysis to enable benchmarking comparisons of system support in terms of costs and performance or calculation of the benefits, costs, and potential return on investment for the information technology investments.

As FHA continues its planning effort and begins sorting through its investment alternatives, effective implementation of the recently enacted ITMRA could help FHA maximize the value of its investments. Although the act was not in effect at the time FHA selected and began implementing its current initiatives, the act provides an analytical framework that will be helpful as FHA continues to streamline its operations and make improvements using information technology. The act specifies that where comparable processes and organizations exist in the public or private sectors, the agency head is to quantitatively benchmark agency process performance against such processes in terms of cost, speed, productivity, and quality of outputs and outcomes. ITMRA also requires agency heads to

(1) analyze mission-related processes before making investments and (2) implement a process for maximizing the value and assessing and managing the risks of their information technology investments. The process, among other things, is to provide for the use of minimum investment selection criteria, including risk-adjusted return on investment, and specific quantitative and qualitative criteria for comparing and prioritizing alternative information systems projects. In addition to the act, the Office of Management and Budget's information technology investment guide, issued in November 1995, establishes key elements of the investment process for agencies to follow in selecting, controlling, and evaluating their information technology investments.[8]

According to HUD's Office of Information Technology, the Department plans to have its Technology Investment Board ensure that the investment provisions of ITMRA are implemented. HUD established the Board in fiscal year 1994 to evaluate, rank, and select proposed information technology investments for all HUD components, including FHA. The Board's charter has been recently revised to charge it with following ITMRA capital planning and performance-based management requirements, including determining whether the functions supported by the proposed investments should be performed by the private sector or another agency. HUD plans to incorporate ITMRA investment requirements, including quantified benefit and risk management criteria, into its strategic investment process.

Conclusions

FHA is planning to streamline its single family housing operations to increase efficiency and meet mandated staff reductions. Information technology figures prominently in the plans to support and enable the operational changes that are being contemplated. Thus far, the planned actions are consistent with, but are not as extensive as, efficiency improvement actions taken by leading mortgage industry organizations. However, the streamlining efforts are still in the early stages and, as these efforts continue, FHA will be making decisions on specific operational changes, information technology applications, and management controls that will determine the efficiency and effectiveness of operations and the achievement of staff reduction goals. In doing so, it can use the recently enacted Information Technology Management Reform Act of 1996 to establish an effective framework for making these information technology decisions.

[8] Evaluating Information Technology Investments—A Practical Guide, Version 1.0, Executive Office of the President, Office of Management and Budget, November 1995.

Agency Comments

On September 13, 1996, we discussed a draft of this report with officials from FHA's Office of Single Family Housing. In general, the officials agreed with the facts and conclusions. FHA officials suggested some clarifications to our report, and we have incorporated the suggested changes where appropriate.

We are sending copies of this report to Ranking Minority Members of your Subcommittees; interested congressional committees; the Secretary of Housing and Urban Development; the Assistant Secretary for Housing-Federal Housing Commissioner; the Director, Office of Management and Budget; and other interested parties. We will also make copies of this report available to others on request.

Please call me at (202) 512-6240 if you or your staffs have further questions. Major contributors to this report are listed in appendix III.

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Contents

Abbreviations

FHA	Federal Housing Administration
FMFIA	Federal Managers' Financial Integrity Act
HUD	Department of Housing and Urban Development
ITMRA	Information Technology Management Reform Act

Objectives, Scope, and Methodology

As requested by the Chairs of the Subcommittee on Government Management, Information and Technology and Subcommittee on Human Resources and Intergovernmental Affairs of the House Committee on Government Reform and Oversight, our objectives were to determine (1) how FHA plans to use information technology to support the streamlining of single family housing operations and reduce staff, (2) whether FHA's planned initiatives are similar to those undertaken by leading mortgage organizations to increase productivity, and (3) what FHA is doing to ensure that information technology initiatives will maintain or improve management controls over single family housing operations.

To determine how FHA plans to use information technology to streamline single family housing operations, we identified specific reinvention initiatives planned to reduce staff, obtained an explanation of how information technology will be used for each of the reinvention initiatives, and determined the basis for the estimated staff reductions from the new uses of information technology or innovative practices. We obtained and reviewed HUD's plan entitled, HUD Reinvention: From Blueprint To Action and the January 1996 update to the plan. To identify how FHA plans to use information technology in its streamlining initiatives, we (1) obtained a briefing from the Deputy Assistant Secretary for Single Family Housing, (2) interviewed officials in each functional area, and (3) obtained and analyzed documentation on planned streamlining initiatives, including single family housing's July 1995 Business Strategy Plan and September 1995 Information Strategy Plan. We also reviewed provisions in HUD's fiscal year 1996 appropriations authorization that allowed changes to FHA's mortgage assignment program and loss mitigation operations. In addition, we reviewed and analyzed proposed regulations and instructions to lenders on new operating procedures.

As part of our work to determine what information is available that the planned information technology initiatives can help achieve the projected staff reductions and efficiencies, we analyzed information from FHA's pilot test of consolidated loan processing operations, identified information technology applications and systems used by other mortgage industry organizations, and compared FHA's reinvented processes and systems to those of the other mortgage organizations. For the consolidated loan processing operations that were pilot tested in FHA's Denver field office, we interviewed FHA officials, reviewed documentation on operating procedures and workload data, and observed processes and systems in operation. We interviewed officials at Fannie Mae, Freddie Mac, and the two largest private mortgage insurers in the United States—Mortgage

Guaranty Insurance Corporation and GE Capital Mortgage Insurance—observed operations, and obtained documentation on processes and systems on their single family mortgage operations. We did not verify data provided by officials of these organizations concerning staff numbers, workload, productivity, and savings produced by information technology investments. We analyzed and performed general comparisons of FHA's planned operating procedures, information systems, and staffing levels to those of the other mortgage organizations. The comparisons were performed to identify major differences and did not include detailed analyses of work processes.

To ascertain what FHA has done to ensure that information technology initiatives will maintain or improve management controls over single family housing operations, we reviewed plans for proposed operations and systems to determine how they specifically address reported control weaknesses. To identify reported control weaknesses, we reviewed and analyzed HUD's Federal Managers' Financial Integrity Act compliance reports for fiscal years 1994 and 1995, independent auditors' reports on FHA financial statements for fiscal years 1994 and 1995, and the HUD Inspector General's reports on single family housing operations. We also interviewed FHA officials to obtain their views on how information technology initiatives will address management control weaknesses.

We visited FHA's Office of Single Family Housing in Washington, D.C.; FHA's field office in Denver, Colorado; Fannie Mae in Washington, D.C.; Freddie Mac in McLean, Virginia; Mortgage Guaranty Insurance Corporation in Milwaukee, Wisconsin; and GE Capital Mortgage Insurance in Raleigh, North Carolina, and Memphis, Tennessee. We performed our work between December 1995 and August 1996 in accordance with generally accepted government auditing standards.

We requested comments from the Secretary of Housing and Urban Development or his designee. On September 13, 1996, we discussed the facts and conclusions in our report with cognizant HUD officials. Their comments are discussed in the "Agency Comments" section of this report.

FHA Efforts to Improve Management Controls in Information Technology Initiatives

HUD has experienced long-standing deficiencies in its internal controls and information and financial management systems. Specifically, the Office of Single Family Housing has had significant management control weaknesses in loan origination, delinquency resolution, and property disposition. While planned single family housing initiatives may help resolve management control weaknesses, insufficient information is available to assess them because detailed operating procedures and system designs have not yet been developed.

Loan Origination

In 1992, we reported inadequate oversight of loan origination and underwriting activities as a material management control weakness.[1] The problems included fraudulent activities of borrowers, real estate agents, and lenders; approval of loans exceeding the statutory loan limit; inadequate assessment of applicants' repayment ability; and inflated appraisals. FHA experienced high losses in the single family mortgage program because of improper loan origination activities.

HUD's FMFIA compliance report and independent auditor's report for fiscal year 1995 discuss FHA's actions to correct the loan origination and underwriting management control weakness. According to the FMFIA report, the control weakness has been corrected but not yet validated. The corrective actions include standardizing the monitoring of lenders' loan underwriting practices, and establishing a mechanism to follow up and track sanctions imposed on lenders that do not adhere to FHA underwriting requirements. FHA is also planning to expand staff in the Quality Assurance Division to enhance loan origination oversight as part of its streamlining efforts. FHA plans also include a proposal for a data warehouse system to make data available on lenders to support the underwriting and quality assurance operations. In its fiscal year 1995 report, the independent auditor recommended that FHA continue and accelerate these initiatives to address the control weaknesses. Because FHA's initiatives to correct its loan origination weaknesses—including the design of the data warehouse system—are still being planned, sufficient information is not available to assess the impact on management controls.

Resolving Delinquencies

In HUD's FMFIA compliance reports and independent auditors' reports for fiscal years 1994 and 1995, default monitoring and loss prevention are identified as material management control weaknesses. The FMFIA reports

[1] HUD Reforms: Progress Made Since the HUD Scandals but Much Work Remains (GAO/RCED-92-46, Jan. 31, 1992).

stated that FHA did not emphasize working with borrowers to cure defaults and delinquencies and many lenders did not report on the default status of borrowers. Contributing to the management control weaknesses is an inadequate information system to collect delinquency data and track default resolution actions. The lack of management controls has resulted in high default and foreclosure rates and a large inventory of defaulted loans. Industry experience indicates that effective monitoring of delinquent mortgages and early intervention helps those borrowers experiencing financial hardships and helps reduce losses.

To correct the default monitoring and loss prevention management control weaknesses, FHA is (1) assessing penalties against lenders who are negligent in reporting defaulted mortgage loans and (2) enhancing the Single Family Default Monitoring System to track lender and servicer use of mitigation tools and provide default rates and other information for evaluating and providing feedback to lenders and servicers. Coupled with these actions, FHA established the Office of Loss Mitigation in 1995 and is implementing new loss mitigation alternatives.[2]

In assessing FHA's efforts to improve loss mitigation operations, the independent auditor's report on FHA's fiscal year 1995 financial statements stated that use of the new loss mitigation alternatives should help FHA to reduce claims and losses. However, the report stated that FHA currently does not have the appropriate tools to monitor the use of the loss mitigation programs and their costs. According to an official responsible for loss mitigation operations, FHA is developing the detailed operating procedures and the design and requirements for new systems to support these operations. Since these plans have not yet been developed, it is too early to assess whether the actions will strengthen management controls.

Property Disposition

In 1992, we reported the disposition of single family foreclosed properties as a material management control weakness that resulted in financial losses. These losses and problems were part of the highly publicized HUD scandals. Among the factors contributing to the management control weakness were (1) inadequate oversight of property management, collection of sales proceeds, and services provided by third parties and (2) inadequate information system support of the disposition process.

[2]The legislation that terminates the mortgage assignment program also authorizes FHA to expand existing alternatives to foreclosure and implement new loss mitigation alternatives, such as partial claims. For a partial claim, FHA would pay the delinquent amount and hold a second mortgage to be repaid by the borrower.

In HUD's fiscal year 1994 FMFIA compliance report, the property disposition material weakness was listed as corrected. The corrective actions included implementation of an information system to manage the property disposition process. This issue was not identified as a control weakness in the independent auditor's report for fiscal year 1994. Although the control weakness is now considered to be corrected, it is important to continue adequate management control over this area after it is streamlined.

As discussed earlier, FHA is considering which one or more of three streamlining alternatives it will use to perform real property maintenance and disposition and foreclosed mortgage disposition activities. FHA's decision will impact on the management controls and information systems support requirements. Until decisions are made and detailed plans are prepared, sufficient information is not available to assess how the changes will impact on management controls.

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