



United States General Accounting Office  
Washington, DC 20548

Accounting and Information  
Management Division

B-284041

November 19, 1999

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

The Honorable Christopher Bond  
Chairman, Subcommittee on Veterans Affairs,  
HUD and Independent Agencies  
Committee on Appropriations  
United States Senate

Subject: *Department of Housing and Urban Development: Loan Origination and Foreclosed Property Management Processes*

This letter summarizes the information provided during October 14, 1999, and October 18, 1999, briefings to your offices. You had asked us to determine (1) the extent to which the Department of Housing and Urban Development (HUD) had established adequate loan origination procedures and consistently applied them to determine whether loan applicants comply with the program's statutory, regulatory, and eligibility requirements and have any outstanding delinquent federal debt and (2) whether HUD's Management and Marketing (M&M) contractors were adequately documenting the actions taken to preserve, protect, and maintain HUD's foreclosed properties.

As agreed, we examined HUD's single-family insured loans, principally Section 203 (b) loans. Today, private sector lenders participating in HUD's Direct Endorsement lending program<sup>1</sup> process nearly all the new loans originated under this program. HUD requires these lenders to screen loan applicants for outstanding delinquent federal debt as called for by the Debt Collection Improvement Act of 1996 (DCIA). Once a loan is approved, these lenders typically service the loan, including making collection efforts in the event the loan becomes delinquent. When collection efforts fail, however, the lenders generally foreclose on the loan, file an insurance claim with

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<sup>1</sup>Under HUD's Direct Endorsement lending program, approved lenders are responsible for all aspects of the loan origination and approval process, including making eligibility determinations.

HUD, and then convey the property to HUD. HUD then assigns the foreclosed properties to its M&M contractors to manage and market.

The enclosed briefing slides highlight the results of our work and the information we provided during the briefings.

### **Results in Brief**

In our loan origination work, we found that HUD had established adequate policies and procedures for its Direct Endorsement (DE) lenders to follow when making loan eligibility determinations, including procedures to screen loan applicants for outstanding delinquent federal debt. Based upon our evaluation of a nationwide statistical sample of loans originated during the first 6 months of fiscal year 1999, we also found that the loan files prepared by the DE lenders to obtain HUD's insurance endorsement consistently contained all the documentation required by HUD to support their eligibility determinations.<sup>2</sup> In addition, we found that the DE lenders consistently used both the Credit Alert Interactive Voice Response System (CAIVRS)<sup>3</sup> as well as private sector credit reports to determine whether loan applicants had any outstanding delinquent federal debts.

For programs like HUD's Direct Endorsement program, where lenders initiate and approve transactions that are guaranteed by the federal government, effective oversight controls must be in place. HUD has a lender oversight program in place. However, in fiscal years 1997 and 1998, auditors of HUD's consolidated financial statements identified and reported weaknesses in this program and made recommendations to HUD to improve its lender oversight. One cited weakness was HUD's failure to timely follow up on the results of its post-endorsement reviews that identified risky underwriting practices. HUD officials told us that they have taken actions they believe will address the auditor's concerns. These actions will be evaluated as part of the fiscal year 1999 financial statement audit.

In our work on HUD's foreclosed properties, we found that beginning in March 1999, HUD entered into M&M contracts with private sector firms to manage and market its inventory of foreclosed properties. A key requirement of the M&M contracts is that firms take appropriate actions to preserve, maintain, and protect HUD's properties until the properties are sold. The contracts further require the M&M contractors to maintain individual property files that contain evidence of the preservation, maintenance, and protection of the properties.

We found that the M&M property files we examined lacked adequate documentary evidence that the M&M contractors were fulfilling their contractual obligation to HUD to preserve, maintain, and protect HUD's properties. For example, several files

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<sup>2</sup>We did not go to lender locations to review lender files or reperform the lenders' loan underwriting procedures.

<sup>3</sup>CAIVRS is an automated database maintained by HUD that identifies individuals who have delinquent federal debts.

did not contain the date the property was assigned to the M&M contractor making it nearly impossible for us to determine whether the contractors were performing required tasks, such as property inspections, within the time frames specified in their contracts. Also, documentation of the resolution of issues identified during property inspections was lacking. Our findings were supported by the findings of HUD's national file review contractor who reviewed more than 4,000 property files a month in July and August 1999.

To HUD's credit, we found that HUD's established oversight process, which includes examining the M&M contractor property files and other tools, identified these M&M contractor documentation issues in a timely manner. Further, the department has communicated these identified deficiencies to its M&M contractors, required some contractors to prepare written recovery plans specifying how identified problems will be addressed, and recently terminated its largest M&M contractor due in part to its failure to maintain adequate property files.

### Scope and Methodology

To fulfill our objective regarding HUD's loan origination processes, we obtained and reviewed applicable HUD policies and procedures, interviewed HUD officials responsible for HUD's insurance and underwriting operations, and reviewed the results of HUD's most recent financial statement audits. We also selected and evaluated a nationwide statistical sample of 99 loans originated during the first 6 months of fiscal year 1999 to determine if lenders followed HUD's requirements for documenting loan eligibility determinations, including evidence that loan applicants were screened for delinquent federal debts. We did not reperform the lenders' loan underwriting procedures.

To fulfill our objective regarding HUD's M&M contractors, we reviewed the requirements of the M&M contracts as well as HUD's policies for monitoring the performance of its M&M contractors. We interviewed officials in HUD's Single Family Asset Management Division and met with HUD's national file review contractor to obtain (1) an understanding of the process used to select and review the M&M property files each month and (2) the results of the contractor's July and August 1999 property file reviews. We compared the results of these reviews to the initial results we obtained in evaluating a separate statistical sample of foreclosed properties. We ultimately terminated our review of this sample because of the documentation deficiencies that we and HUD's national file review contractor found. We did not visit any of HUD's foreclosed properties nor did we assess the actions HUD or the M&M contractors have taken to address the identified deficiencies.

We are currently performing other work on HUD's single-family property disposition program that will provide additional information about HUD's oversight of its M&M contractors and the actions HUD and its M&M contractors have taken as a result of the oversight findings. We anticipate completion of this work next year.

We conducted our work from April 1999 through October 1999 in accordance with generally accepted government auditing standards. We requested comments on our

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draft briefing slides from HUD officials, who generally agreed with the information in the slides. We incorporated their comments as appropriate.

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We are sending copies of this letter to the Honorable Jim Turner and the Honorable Barbara A. Mikulski, Ranking Minority Members of your Committees; the Honorable Andrew Cuomo, Secretary of Housing and Urban Development; the Honorable Jacob J. Lew, Director of the Office of Management and Budget; and other interested parties. Copies will also be made available to others upon request.

If you have any questions about this letter or the earlier briefings, please contact me at (202) 512-9508 or Shirley Abel, Assistant Director, at (202) 512-9516. A key contributor to this assignment was Phillip McIntyre.



Linda M. Calbom  
Director, Resources, Community,  
and Economic Development, Accounting  
and Financial Management Issues

Enclosure

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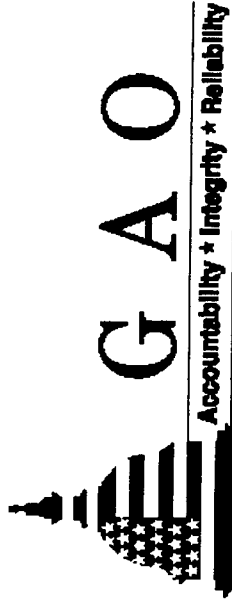
**GAO Accounting and Information  
Management Division**

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Briefings to the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform and the Subcommittee on Veterans Affairs, HUD, and Independent Agencies, Senate Appropriations Committee

The Department of Housing and Urban Development's Loan Origination and Foreclosed Property Management Processes

October 14, 1999 and  
October 18, 1999



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# GAO Contents

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- Objectives
- Background
- Overview of Applicable Debt Collection Improvement Act (DCIA) Requirements
- Scope and Methodology
- Findings
  - Loan Origination
  - Foreclosed Properties

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# GAO Objectives

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- To determine the extent to which HUD has adequate procedures to determine whether loan applicants comply with the program's statutory, regulatory, and eligibility requirements and have any outstanding delinquent federal debt.
- To assess whether HUD's Management and Marketing (M&M) contractors are adequately documenting the actions taken to preserve, protect, and maintain HUD's foreclosed properties.

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# GAO Background

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- Loan Origination
  - FHA guarantees loans made by private sector lenders.
  - Under FHA's Direct Endorsement (DE) lending program, approved lenders are responsible for all aspects of the loan origination and closing process.



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## GAO Background

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- During the first 6 months of fiscal year 1999, FHA guaranteed 561,296 single family loans totaling \$53.5 billion. Nearly all the loan approvals were processed under the DE lending program.
- FHA monitors the DE lenders through technical reviews and on-site lender monitoring.

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# GAO Background

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- Foreclosed Properties
- FHA obtains properties as a last resort through foreclosure.
- Effective March 29, 1999, FHA hired M&M contractors to manage and market foreclosed properties.

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# GAO Background

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- HUD monitors the performance of the M&M contractors by
  - utilizing private sector contractors to review a sample of M&M property files each month (national file review contract)<sup>1</sup> plus other contractors to physically inspect properties,
  - performing monthly on-site observations,
  - monitoring property status reports,

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7 <sup>1</sup>The national file review contract started in July 1999.

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# GAO Background

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- reviewing complaints about specific properties from citizens, and
- independently reviewing a small sample of property files and visiting selected properties.
- FHA staff summarize the results of its oversight activities and conduct monthly performance assessments with the M&M contractors.
- These processes are the key internal controls in HUD's oversight of the M&M contractors' performance.

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# GAO Overview of Applicable DCIA Requirements

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- The DCIA was enacted in April 1996 to facilitate collection of delinquent nontax debt owed to the federal government. DCIA provides that:
  - An entity with outstanding debt with any federal agency (other than IRS) in a delinquent status generally cannot obtain federal financial assistance in the form of a loan.

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# GAO Scope and Methodology

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- Loan Origination
  - Focused on Section 203 (b) single family loans guaranteed from October 1, 1998, through March 31, 1999.
  - Reviewed applicable FHA policies and procedures.
  - Reviewed FHA's fiscal year 1997 and 1998 financial statement audit results.

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# GAO Scope and Methodology

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- Interviewed FHA underwriting and insurance staff.
- Selected and reviewed a nationwide statistical sample of 99<sup>2</sup> loans and determined whether required loan approval documentation existed.
- Did not go to lender locations to review lender files or reperform the lenders' loan underwriting procedures.

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# GAO Scope and Methodology

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- Foreclosed Properties
  - Reviewed the requirements of the M&M contract.
  - Interviewed FHA officials responsible for the M&M contract.
  - Selected a nationwide statistical sample of 99 foreclosed properties and requested the related property files from the M&M contractors.



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# GAO Scope and Methodology

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- Determined whether the property files reviewed provided evidence that the M&M contractors were maintaining properties as contractually required.
- Did not visit the sampled properties.
- Curtailed our review of property files after analyzing eight files due to inadequate documentation of contractor actions to maintain, preserve, and protect the properties.

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# GAO Scope and Methodology

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- Met with FHA's national property file review contractor, reviewed its July and August 1999 reports to FHA, and compared findings to our initial findings.
- Obtained and incorporated agency comments as appropriate.
- Conducted review in accordance with generally accepted government auditing standards from April through October 1999.

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# GAO Findings--Loan Origination

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- FHA loan files contained documentation necessary to determine whether the applicant complied with all eligibility requirements including documentation of
  - credit history analysis,
  - mortgage credit calculations,
  - employment verification,
  - completed loan application, and
  - signed mortgage notes.

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# GAO Findings--Loan Origination

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- Sampled loans were reviewed in accordance with FHA policies, including proper screening of applicants for outstanding delinquent federal debt.
- Lenders used the Credit Alert Interactive Voice Response System (CAIVRS)<sup>3</sup> and reports from credit bureaus.
- No borrowers receiving mortgage credit had outstanding delinquent federal debt.

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## GAO Findings--Loan Origination

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- Since the DE lenders, not HUD, process and approve substantially all the loans insured by HUD, lender oversight by HUD is essential to ensuring that deficient loan underwriting practices are identified and corrected.
- Although HUD has a lender oversight process in place, its financial statement auditors continued to report weaknesses in this process for fiscal year 1998 and recommended that FHA take certain actions to strengthen its oversight process.

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# GAO Findings--Loan Origination

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- According to FHA officials, FHA has taken actions to improve its lender oversight program and expects that the auditors will review this area as part of the fiscal year 1999 financial statement audit.

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# GAO Findings--Foreclosed Properties

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- HUD's current M&M contract requires individual property files that include hard copies of all inspection reports, records of payments, correspondence, and other related material that support the maintenance, preservation, and protection of properties.
- M&M property files lacked adequate documentation to support the maintenance, preservation, and protection of properties.

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# GAO Findings--Foreclosed Properties

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- For example, we found that files lacked
  - the date the property was assigned to the M&M contractors, thereby making it nearly impossible for us to determine whether the contractors were performing required tasks within the time frames specified in their contracts;
  - a chronological history of actions taken by the contractors;
  - documentation of the resolution of issues identified during property inspections; and



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# GAO Findings--Foreclosed Properties

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- invoices and other documentation that would support the performance of routine maintenance.
- The national file review contractor's July and August 1999 summary reports corroborate our findings and indicate additional significant documentation deficiencies exist.
- The file review contractor looked at more than 4,000 properties (approximately 10 percent of HUD's foreclosed property inventory) each month and reported numerous cases where the M&M contractors could not provide the requested property files or the files

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## GAO Findings--Foreclosed Properties

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- contained no evidence of preservation and protection,
- did not contain all the required documentation related to inspections,
- lacked evidence of the resolution of identified hazardous conditions and needed emergency repairs, and
- did not contain evidence that the properties had been properly secured.

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# GAO Findings--Foreclosed Properties

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- HUD's oversight controls over the M&M contracting process functioned effectively by identifying documentation deficiencies in the contractors' property files in a timely manner.
- HUD provides a monthly performance assessment to each of the M&M contractors and has required M&M contractors to provide written recovery plans specifying how identified deficiencies will be addressed.

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# GAO Findings--Foreclosed Properties

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- We did not assess the actions the M&M contractors have taken nor any further actions taken by HUD to address the identified weaknesses. However, we are currently performing additional work related to M&M contractor performance.
- Auditors of FHA's fiscal year 1999 financial statements will review internal controls over foreclosed properties, including the M&M contracts.