United States General Accounting Office

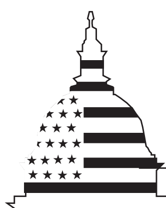
GAO

Report to Congressional Requesters

April 2000

SINGLE-FAMILY HOUSING

Stronger Oversight of FHA Lenders Could Reduce HUD's Insurance Risk



GAO/RCED-00-112

Contents

Letter

Letter 3

Appendixes

Appendix I: Comments From the Department of Housing and Urban Development 36

Appendix II: Objectives, Scope, and Methodology 42

Appendix III: GAO Contacts and Staff Acknowledgments 44

Tables

Table 1: Results of the First Three Rounds of HUD's Credit Watch Program 25

Table 2: Summary of the Mortgagee Review Board's Fiscal Year 1999 Actions on 24 Cases as of November 1999 29

Figures

Figure 1: Number of Single-Family Mortgage Loans Insured by FHA, Fiscal Years 1997-99 6

Figure 2: Steps in the Approval Process for FHA-Insured Mortgage Loans 7

Figure 3: Locations and Geographical Jurisdictions of HUD's Four Homeownership Centers 9

Figure 4: Frequency of Poor Ratings for Mortgage Credit Analysis Given to 36 Approved Lenders in Their Last 15 Preclosing Reviews 13

Figure 5: Number of Lender Reviews Performed, Fiscal Years 1996-99 15

Figure 6: Percentage of Loans Receiving Technical Reviews by Homeownership Center, Fiscal Year 1999 18

Figure 7: Percentage of Lenders, by Type, Whose Loan Origination Authority Was Terminated Because of Excessive Defaults and Insurance Claims on Loans Made For the 24-Month Period Ending March 31, 1999 26

Abbreviations

CHUMS	Computerized Homes Underwriting Management System
FHA	Federal Housing Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development

United States General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-283389

April 28, 2000

The Honorable Rick A. Lazio
Chairman, Subcommittee on Housing
and Community Opportunity
Committee on Banking
and Financial Services
House of Representatives

The Honorable Susan M. Collins
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Every year, the Department of Housing and Urban Development (HUD), through its Federal Housing Administration (FHA), insures billions of dollars in home mortgage loans made by private lenders. During fiscal year 1999 alone, FHA insured 1.3 million mortgages valued at about $124 billion. While FHA insures lenders against nearly all losses resulting from foreclosed loans, it relies on the lenders to underwrite the loans and determine their eligibility for FHA mortgage insurance. Recent cases of mortgage fraud across the country have raised concerns about HUD's oversight of these lenders. For example, in December 1999, HUD's Office of the Inspector General and the Department of Justice announced criminal charges against 39 California mortgage lenders, real estate professionals, and other persons accused of obtaining more than $110 million in fraudulent FHA-insured loans.

As you requested, this report provides information on HUD's oversight of lenders participating in FHA's mortgage insurance programs for single-family homes. While almost 10,000 lending institutions are approved to participate in FHA's single-family mortgage insurance programs, only about 2,900 of these institutions also have direct endorsement authority, meaning that they can underwrite loans and determine their eligibility for FHA mortgage insurance without HUD's prior review. Specifically, this report addresses the following questions: (1) How well does HUD ensure that lenders granted direct endorsement authority by FHA are qualified to receive such authority? (2) To what extent does HUD focus on high-risk lenders in monitoring the lenders participating in FHA's mortgage

insurance programs? (3) To what extent is HUD holding lenders accountable for poor performance? To address these questions, we reviewed the activities of HUD's headquarters and its four homeownership centers in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California, which administer HUD's single-family housing activities in all 50 states, the District of Columbia, and Puerto Rico. Our review focused on the adequacy of HUD's policies and procedures for overseeing lenders. We performed limited tests and analyses to determine whether these policies and procedures were properly utilized to limit HUD's insurance risk.

Results in Brief

HUD's process for granting FHA-approved lenders direct endorsement authority—the ability to underwrite loans and determine their eligibility for FHA mortgage insurance without HUD's prior review—provides limited assurance that lenders receiving this authority are qualified. According to HUD's guidance, FHA-approved lenders seeking direct endorsement authority must demonstrate "acceptable performance" in underwriting at least 15 mortgage loans, which undergo evaluations, known as *preclosing reviews*, by HUD's homeownership centers. However, the guidance does not define what would constitute overall acceptable performance on the 15 loans. In the absence of such a clear definition, HUD's homeownership centers' recent performance in approving lenders for direct endorsement authority was uneven. In the 6 months prior to our 1999 visits, the centers granted direct endorsement authority to a total of 36 lenders. While many of these lenders had demonstrated proficiency in underwriting mortgages, many others made multiple and serious underwriting errors. Overall, 12 of the 36 lenders had received 4 or more "poor" ratings from the centers for their last 15 preclosing reviews.

Contrary to HUD's guidance, the homeownership centers' monitoring of lenders does not adequately focus on the lenders and loans that pose the greatest insurance risks to the Department. On-site evaluations of lenders' operations—known as *lender reviews*—are one of HUD's primary tools for assessing the quality of lenders' mortgage-lending practices. HUD's guidance states that 85 percent of the lender reviews should be targeted at high-risk lenders. However, the homeownership centers have often not reviewed the lenders that they consider to be the highest risk. For example, although the Philadelphia center conducted reviews of 228 lenders during fiscal year 1999, it reviewed only 39 of the 131 high-risk lenders (about 30 percent) that it designated as high priority for review that year. HUD officials told us that the lack of experienced staff and limited travel funds

impeded their ability to visit and review the riskiest lenders. Desk audits to evaluate the underwriting quality of individual loans insured by FHA—known as *technical reviews*—are another important tool for overseeing lenders. Although the homeownership centers met the Department's goal to perform technical reviews of no less than 10 percent of all loans insured in fiscal year 1999, they generally did not target these reviews at high-risk lenders and loans as recommended by HUD's guidance.

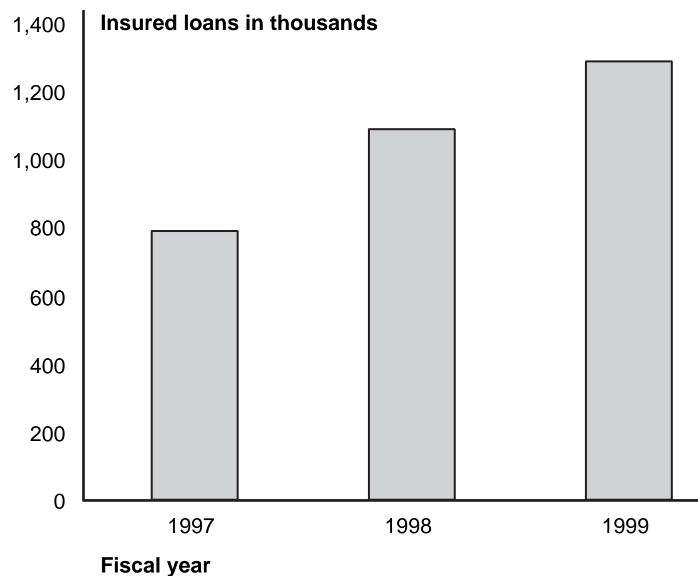
HUD has not taken sufficient steps to hold lenders accountable for poor performance and program violations. Although HUD's guidance allows the homeownership centers to suspend the direct endorsement authority of lenders that fail to comply with FHA's underwriting requirements, the centers have made limited use of this ability. In fiscal year 1999 the Philadelphia center suspended the direct endorsement authority of eight lenders; however, the other three centers did not take this action against any lenders. Furthermore, HUD's technical review ratings for fiscal year 1999 showed frequent noncompliance by lenders with FHA's requirements, indicating that many other lenders may be candidates for this action. For example, we identified 206 lenders that received "poor" ratings for their mortgage credit decisions in more than 30 percent of the loans that HUD reviewed in fiscal year 1999. Furthermore, on the basis of our analysis, if HUD had reviewed all of the lenders' fiscal year 1999 loans, the percentage of poor ratings could have been expected to exceed 30 percent. Of these lenders, 131 made 10 or more FHA-insured loans in fiscal year 1999. As of October 1, 1999, HUD's homeownership centers had not suspended the direct endorsement authority of any of the 131 lenders we identified. In May 1999, HUD's headquarters implemented its Credit Watch program to terminate the loan origination authority of lenders with excessive defaults and insurance claims on FHA-insured mortgages. However, because the program's regulations pertain only to the lenders that originated the troubled loans, HUD does not always hold accountable lenders that underwrote and approved the loans. According to HUD, the program's regulations did not permit the Department to take enforcement actions against these lenders.

This report makes recommendations designed to improve HUD's processes for (1) approving lenders to underwrite FHA-insured mortgages, (2) targeting lenders and loans for quality control reviews, and (3) taking enforcement actions against poorly performing lenders.

Background

Established by the National Housing Act, FHA insures lenders against losses on mortgages for single-family homes. Lenders usually require mortgage insurance when a homebuyer has a down payment of less than 20 percent of the value of the home. FHA mortgage insurance allows a homebuyer to make a modest down payment and obtain a mortgage for the balance of the purchase price. FHA plays a particularly large role in certain market segments, including low-income borrowers and first-time homebuyers. During fiscal years 1997 through 1999, the number of single-family mortgage loans that FHA insured grew from approximately 800,000 to nearly 1.3 million—a 63-percent increase. (See fig. 1.) For the 3 years combined, FHA insured over 3 million mortgages with a total value of $292 billion.

Figure 1: Number of Single-Family Mortgage Loans Insured by FHA, Fiscal Years 1997-99

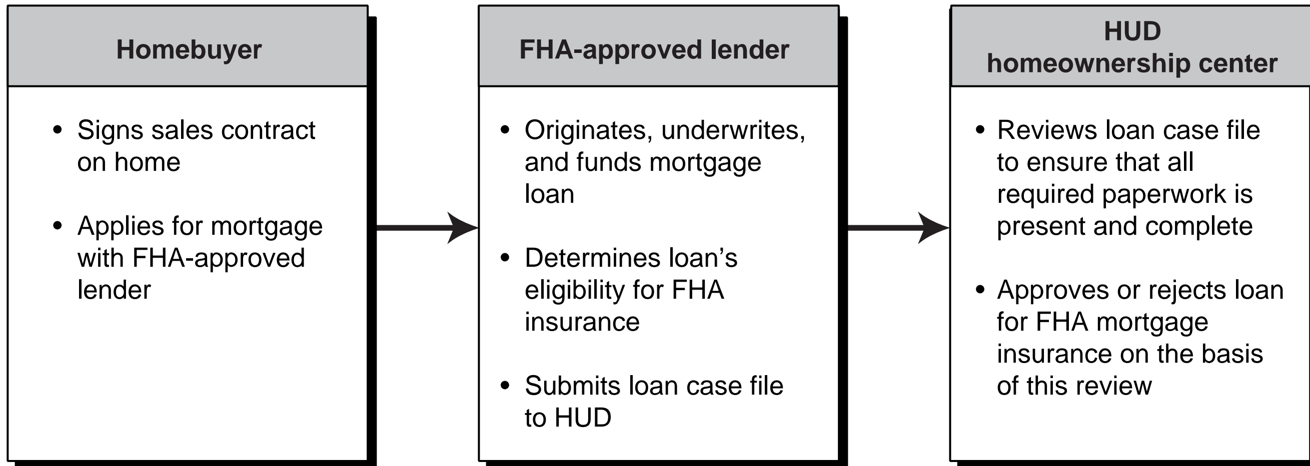


Source: HUD.

A homebuyer seeking a FHA-insured mortgage must submit a mortgage application to a FHA-approved lender. Once the lender approves the loan, it sends the loan documents to HUD for approval of FHA mortgage insurance. (See fig. 2.) If the borrower defaults and the lender subsequently forecloses on the loan, the lender can file an insurance claim with HUD for

the unpaid balance of the loan. FHA insures most of its mortgages for single-family housing under its Mutual Mortgage Insurance Fund (Fund). To cover lenders' losses, FHA collects insurance premiums that borrowers pay to lenders and deposits the premiums in the Fund. The Fund has historically been self-sufficient. An actuarial study by Deloitte & Touche LLP indicated that, as of September 30, 1999, the Fund exceeded the legislative target for capital reserves.

Figure 2: Steps in the Approval Process for FHA-Insured Mortgage Loans



Lenders must obtain approval from HUD to participate in FHA's mortgage programs. In addition to an application form and fee, lenders are required to submit supporting documentation, including the resumes of senior corporate officers; certified financial statements; and photographs and floor plans of the lender's main office. HUD uses this information to determine whether the applicants meet FHA's requirements for lending experience; financial worth; and adequacy of facilities, among other things. HUD also determines whether any of the lenders' principal officers are ineligible to participate in FHA's programs because of outstanding federal debts; because of recent bankruptcies or derogatory credit; or because they have been suspended, debarred, or otherwise excluded from the Department's programs and activities. Lenders must be annually recertified by HUD to maintain their FHA-approved status.

As of December 1999, about 9,950 lending institutions were approved to participate in FHA's mortgage insurance programs for single-family homes.

Most FHA-approved lenders are authorized to originate FHA-insured loans, meaning that they can accept mortgage applications, obtain employment verifications and credit histories on applicants, order appraisals, and perform other tasks that precede the loan underwriting process. Approximately 2,900 of the FHA-approved lending institutions also have direct endorsement authority, meaning that they can underwrite loans and determine their eligibility for FHA mortgage insurance without HUD's prior review.[1] Underwriting refers to a risk analysis that uses information collected during the origination process to decide whether to approve a loan. Virtually all FHA-insured mortgages for single-family homes are underwritten by lenders with direct endorsement authority. In 1996, as part of an effort to streamline its lender approval process, HUD stopped individually approving underwriters working for FHA lenders that were granted direct endorsement authority. Prior to 1996, underwriters seeking FHA's approval had to submit applications to HUD, and HUD reviewed and verified their experience and qualifications. HUD now relies on lenders to certify that their underwriters meet FHA's standards.

Some FHA-approved lenders with direct endorsement authority, known as *sponsoring lenders*, enter agreements to underwrite and fund loans originated by FHA lenders without direct endorsement authority, known as *loan correspondents*. About 40 percent of FHA's approved lenders are loan correspondents, meaning that they originate FHA-insured mortgages and sell or transfer the loan paperwork to sponsoring lenders for underwriting and approval. According to HUD's regulations, sponsoring lenders are responsible for the loan origination activities of their loan correspondents.

HUD's 2020 Management Reform Plan, which was announced in 1997, consolidated the single-family mortgage housing activities of HUD's 81 field offices into four homeownership centers, each of which is responsible for a multistate area. (See fig. 3.) Under the 2020 plan, HUD's single-family housing staff was cut by more than 50 percent. The homeownership centers are located in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California, and report directly to HUD's Deputy Assistant Secretary for Single-Family Housing.

[1]To be eligible to receive direct endorsement authority and to underwrite FHA-insured loans, a lender, in addition to meeting other HUD requirements, must be one of the following: (1) a member of the Federal Reserve System or an institution whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration; (2) a financial institution whose principal activity is lending or the investing of funds in real estate mortgages; or (3) a federal, state, or municipal government agency.

Figure 3: Locations and Geographical Jurisdictions of HUD's Four Homeownership Centers

The centers are responsible for processing and approving mortgage insurance as well as several critical aspects of HUD's lender approval, monitoring, and enforcement activities. These responsibilities include (1) granting direct endorsement authority to qualified FHA-approved lenders; (2) on-site evaluations of lenders' operations, known as *lender reviews*, and monitoring lenders' performance through reviews of individual loans, known as *technical reviews*, and (3) taking and initiating enforcement actions against lenders that have not complied with FHA's requirements.

HUD's headquarters also has important approval, monitoring, and enforcement functions. For example, HUD's headquarters approves and annually recertifies lenders wishing to participate in FHA's mortgage programs. HUD's Credit Watch program, an initiative to identify and impose sanctions against lenders with unacceptably high rates of defaults and insurance claims on FHA-insured mortgages, is managed by HUD's Office of Lender Activities and Program Compliance. HUD's Mortgagee Review Board, an enforcement body chaired by HUD's Assistant Secretary for Housing-Federal Housing Commissioner,[2] can impose administrative sanctions against lenders, including withdrawing the lenders' authority to make FHA-insured loans.

Direct Endorsement Approval Process Provides Limited Assurance That Lenders Are Qualified

HUD's process for granting FHA-approved lenders direct endorsement authority—the ability to underwrite loans and determine their eligibility for FHA mortgage insurance without HUD's prior review—provides only limited assurance that lenders receiving this authority are qualified. HUD's guidance does not adequately define the level of proficiency that lenders must achieve in order to receive direct endorsement authority. As a result, HUD's homeownership centers have applied the guidance differently and granted direct endorsement authority to lenders that demonstrated various levels of proficiency. Many lenders were approved by the centers despite making multiple underwriting errors. Lenders such as these may pose a high insurance risk to the Department once they begin underwriting and approving FHA-insured loans without HUD's prior review.

[2]The other members of the Board are HUD's General Counsel, Chief Financial Officer, Assistant Secretary for Administration, Assistant Secretary for Fair Housing and Equal Opportunity, and the President of the Government National Mortgage Association.

Standards for Granting Direct Endorsement Authority Are Not Adequately Defined

HUD's homeownership centers are responsible for granting direct endorsement authority—the ability to underwrite loans and determine their eligibility for FHA mortgage insurance without HUD's prior review—to lenders participating in FHA's programs. According to HUD's guidance, FHA-approved lenders seeking direct endorsement authority must go through a probationary period during which they are required to demonstrate acceptable performance in underwriting at least 15 mortgage loans. At HUD's discretion, the probationary period may extend beyond 15 loans. The mortgages are submitted to and evaluated by HUD's homeownership centers against FHA's underwriting requirements before the lenders close the loans. Known as *preclosing reviews*, these evaluations rate various aspects of the lender's work, including the analysis of the mortgage credit decision and the property appraisal, as "good," "fair," or "poor."[3] A "good" rating indicates no underwriting deficiencies, a "fair" rating indicates the presence of deficiencies that did not significantly affect HUD's insurance risk, and a "poor" rating indicates that underwriting errors significantly increased HUD's insurance risk. HUD's guidance provides specific criteria for the centers to use in determining these ratings.

While HUD's guidance requires that lenders seeking direct endorsement authority demonstrate acceptable performance on their preclosing reviews, the guidance for what constitutes overall acceptable performance is unclear. For example, the guidance does not state whether acceptable performance requires that lenders receive all "good" scores or whether combinations of "good" and "fair" scores are permitted. The guidance makes no mention of whether a lender can receive any "poor" scores and still qualify for direct endorsement authority. As a result of HUD's vague performance standards, the four homeownership centers have interpreted what constitutes overall acceptable performance on the preclosing reviews differently. Philadelphia center officials said they generally approved only those lenders that had submitted at least 15 cases and had received only "good" or "fair" ratings in their last five preclosing reviews. The Denver and Atlanta centers interpreted the guidance as meaning that lenders had to submit a total of 15 loans for which they received only "good" or "fair" ratings in their preclosing reviews. Santa Ana center officials said they did not have strict requirements regarding the number of loans that had to receive "good" or "fair" ratings. While some officials at the centers believed

[3]A preclosing review rates the quality of the loan-closing documents, the property appraisal, the construction exhibits (for new or rehabilitated homes), and the mortgage credit evaluation of the borrower.

that the existing approval guidance gave them the flexibility they needed to make approval decisions, others believed that more specific guidance was necessary to ensure that the decisions were more consistent.

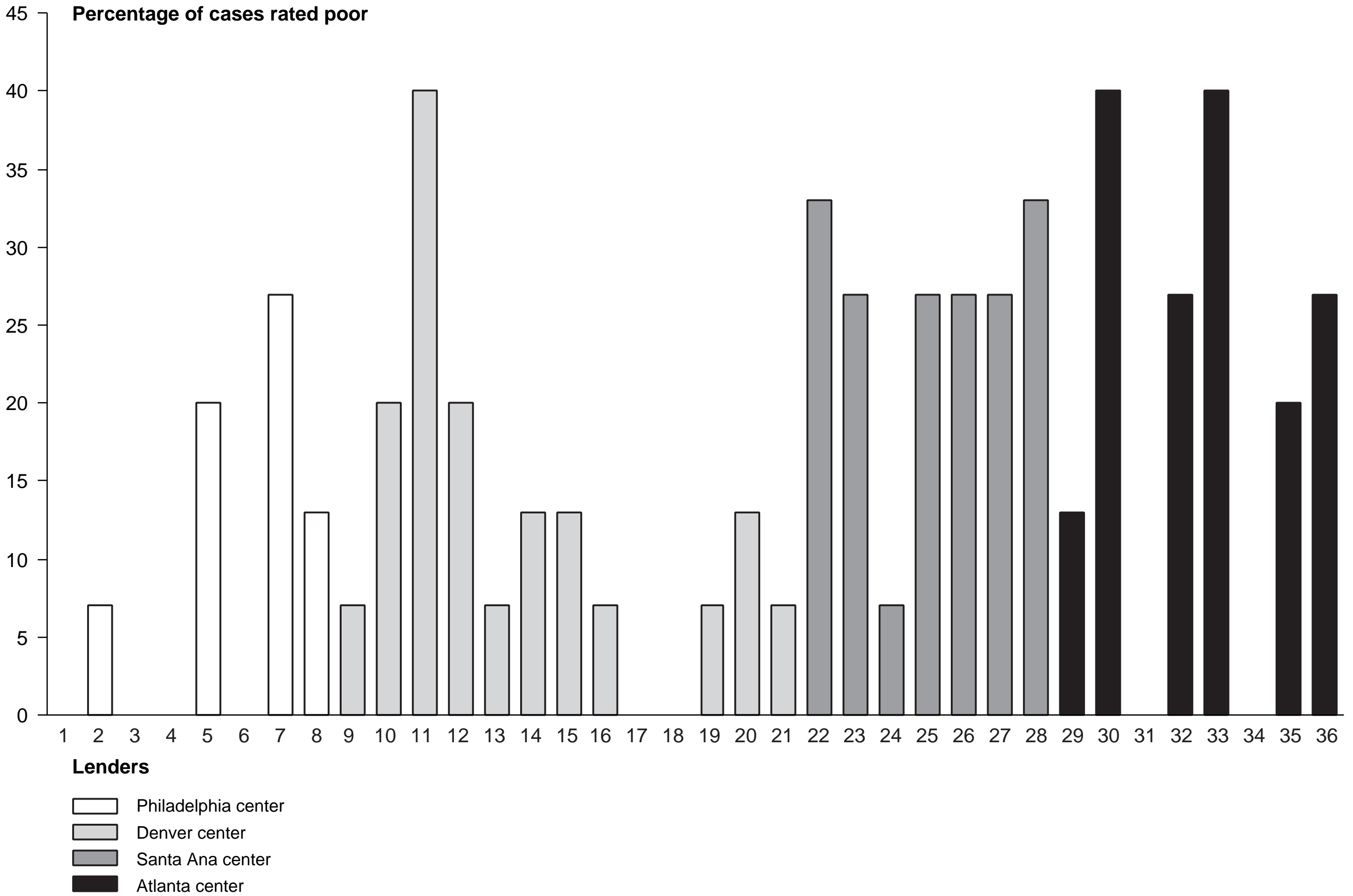
Recently Approved Lenders Varied in Their Performance in Preclosing Reviews

HUD's four homeownership centers granted direct endorsement authority to a total of 36 lenders during the 6 months prior to our 1999 visits to the centers.[4] Approximately 230 other lenders were in the process of seeking but had not yet received direct endorsement authority at the time of our visits. The 36 lenders submitted an average of 18 loans to the centers for preclosing reviews.

We analyzed the 36 lenders' ratings in preclosing reviews to illustrate the different types of performance that the centers considered as acceptable. Specifically, we reviewed the ratings that each lender received for mortgage credit analysis—the evaluation of the borrower's credit worthiness—on the last 15 preclosing reviews before the lender received direct endorsement authority. Our analysis showed significant variations in what HUD's homeownership centers considered as acceptable performance, reflecting the vagueness and inconsistent application of HUD's approval standards. Overall, of the 36 lenders, 8 received no "poor" ratings during their last 15 preclosing reviews, while 3 received 6 "poor" ratings during their last 15 preclosing reviews. (See fig. 4.) The lenders' errors included their failure to (1) verify the borrower's employment and income, (2) ensure that the borrower had sufficient income to support the monthly mortgage payments, (3) explain delinquent accounts and collections on the borrower's credit reports, and (4) properly calculate the borrower's debts or liabilities. Twelve of the 36 lenders received "poor" ratings in 4 or more of their last 15 preclosing reviews. In other words, these 12 lenders made serious errors in underwriting over a quarter of the mortgages they submitted to HUD to demonstrate their abilities to comply with HUD's requirements. While the centers felt that the lenders they approved had shown the ability to underwrite FHA-insured loans properly, we believe that lenders such as these 12 may pose a high insurance risk to the Department once they begin underwriting and approving loans without HUD's prior review.

[4]We visited the Philadelphia center in August 1999 and the Atlanta, Denver, and Santa Ana centers in October 1999.

Figure 4: Frequency of Poor Ratings for Mortgage Credit Analysis Given to 36 Approved Lenders in Their Last 15 Preclosing Reviews



Note: Our analysis included all 36 lenders to whom the four homeownership centers had granted direct endorsement authority in the 6 months prior to our visits to the centers. We visited the Philadelphia center in August 1999 and the Denver, Santa Ana, and Atlanta centers in October 1999.

Source: GAO's analysis of data from HUD's homeownership centers.

Monitoring Process Does Not Adequately Focus on Riskiest Lenders and Loans

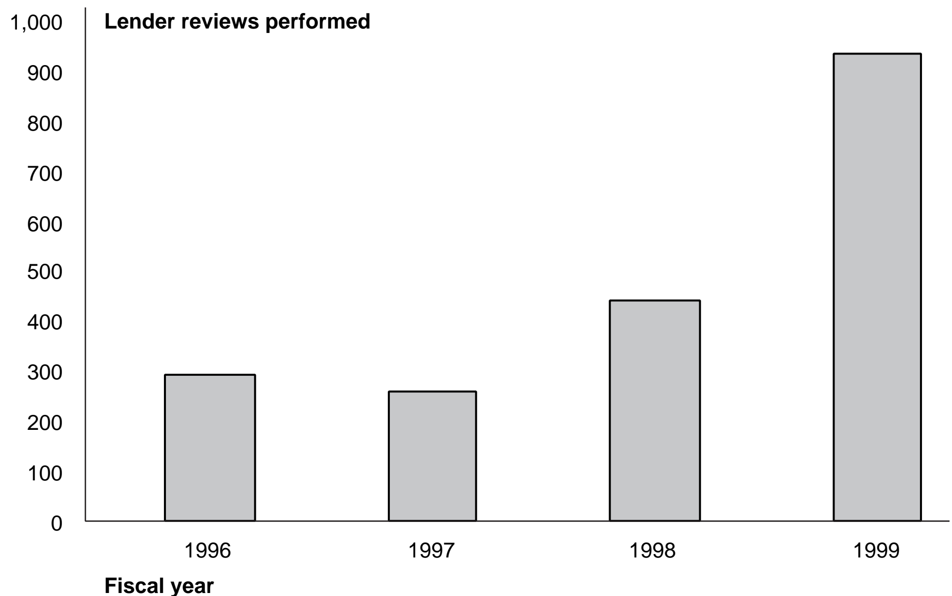
HUD's guidance stresses the importance of using risk analysis to allocate a larger share of monitoring resources to program activities that pose the highest risks to the Department. However, HUD's homeownership centers have not adequately focused their monitoring efforts on lenders and loans that pose the greatest insurance risks. The centers use two monitoring tools to ensure lenders' compliance with FHA's mortgage requirements: (1) on-site evaluations of lenders' operations, known as *lender reviews*, and (2) desk audits of the underwriting quality of individual loans already insured by FHA, known as *technical reviews*. In recent years, HUD substantially increased the number of lender reviews that it performs. However, contrary to HUD's guidance, the centers have not always reviewed the lenders they consider to be high risk. With respect to technical reviews, in fiscal year 1999, the centers met HUD's goals regarding the percentage of loans undergoing these reviews but, contrary to HUD's guidance, selected most of the loans at random instead of using a risk-based selection process. In addition, while contractors perform most of the homeownership centers' technical reviews, three of the four centers did not track the quality of the contractors' work against performance standards in the contracts.

Lender Reviews Increased but Were Often Not of Riskiest Lenders

In recent years, HUD has placed greater emphasis on performing on-site evaluations of lenders' operations. These lender reviews typically involve an in-depth analysis of a sample of loans and assessments of lenders' internal control systems for making loans. If a lender review finds serious deficiencies with specific loans or the lender's internal controls, HUD may take actions that reduce the Department's insurance risk, such as requiring the lender to compensate HUD for financial losses that HUD incurred or may incur on certain loans. Staff assigned to each homeownership center's quality assurance division are responsible for scheduling and performing these reviews. During fiscal years 1996 through 1999, HUD increased the number of staff performing lender reviews from 23 to approximately 140. Over this period, the number of lender reviews that HUD conducted also increased. In fiscal year 1999, HUD's homeownership centers conducted 932 lender reviews, exceeding the Department's goal of 900 reviews.[5] (See fig. 5.)

[5]HUD's fiscal year 1999 goals required each of the four homeownership centers to conduct 225 lender reviews. All four centers exceeded this goal.

Figure 5: Number of Lender Reviews Performed, Fiscal Years 1996-99



Source: GAO's analysis of data from HUD.

HUD's guidance states that lenders should be rated and prioritized for review and that 85 percent of the reviews should be targeted at high-risk lenders, while 15 percent should be selected randomly. Focusing on high-risk lenders increases the likelihood that HUD will uncover improper lending practices, which the Department can then take steps to curtail. However, we found that the homeownership centers did not always review the lenders that they considered to pose the highest risks. The Philadelphia center was the only one that had developed and could provide us with a list of high-risk lenders that it considered to be a high priority for review in fiscal year 1999.[6] The list consisted of 131 lenders in the center's geographical jurisdiction. However, despite conducting reviews of 228 lenders during fiscal year 1999, the center reviewed just 39 of the 131 lenders on its priority list. Had the Philadelphia center complied with

[6]The Denver center's quality assurance division produces prioritized targeting lists for each of the HUD field office locations within the center's geographic jurisdiction. However, the division did not save copies of the lists it used for targeting lenders in fiscal years 1998 or 1999. Therefore, we were unable to determine the extent to which the highest-priority lenders had been reviewed.

HUD's guidance and targeted 85 percent of its reviews at high-risk lenders, the center would have been able to review all of the lenders on its priority list. We were unable to determine the extent to which the other three centers reviewed the lenders they considered to be the highest risk because they could not provide us with similar priority lists of high-risk lenders for their fiscal year 1999 reviews. However, officials at these centers told us that they often targeted for review those lenders that did not pose a high insurance risk to HUD. For instance, the director of the Santa Ana center's quality assurance division estimated that half of the reviews that the center performed in fiscal year 1999 were of lenders that had few or no early defaults. Because early defaults are an indicator of poor lending practices that may result in insurance losses, HUD considers them to be an important factor in assessing lenders' risk.

Homeownership center officials cited inexperienced staff and limited or uncertain travel funds as reasons why high-risk lenders were not always reviewed. According to center officials, most of the centers' 140 staff who conduct lender reviews assumed their current positions in fiscal years 1998 and 1999, largely from the pool of HUD field staff who remained unassigned after HUD's 1998 reorganization. The officials said that many of these individuals had no background in lender monitoring or mortgage credit issues. To address this problem, the officials said that they provided both classroom and on-the-job training to the new staff. However, center officials also told us that they generally did not allow staff with less than a year of experience to review high-risk lenders because their inexperience might lead them to overlook serious deficiencies. Furthermore, the centers' quality assurance directors told us that they typically had little or no travel funding during the first 2 to 3 months of the fiscal year. They said that during these periods, center staff are forced to identify and review lenders within commuting distances of the staffs' homes or offices—without primary regard to the lenders' risk—in order to avoid incurring travel expenses.

Furthermore, although HUD's guidance states that lenders should be rated and prioritized for review, the Department has not developed a systematic process for doing so. HUD's guidance lists several risk factors that should be considered in targeting lenders for reviews, including default rates, the late payment of mortgage insurance premiums to HUD, and the volume of business. But the guidance indicates neither how these factors should be weighted nor how lenders should be prioritized. As a result, the centers have not targeted lenders for reviews in a consistent manner. We found that neither the Santa Ana nor the Atlanta centers had standardized ways to

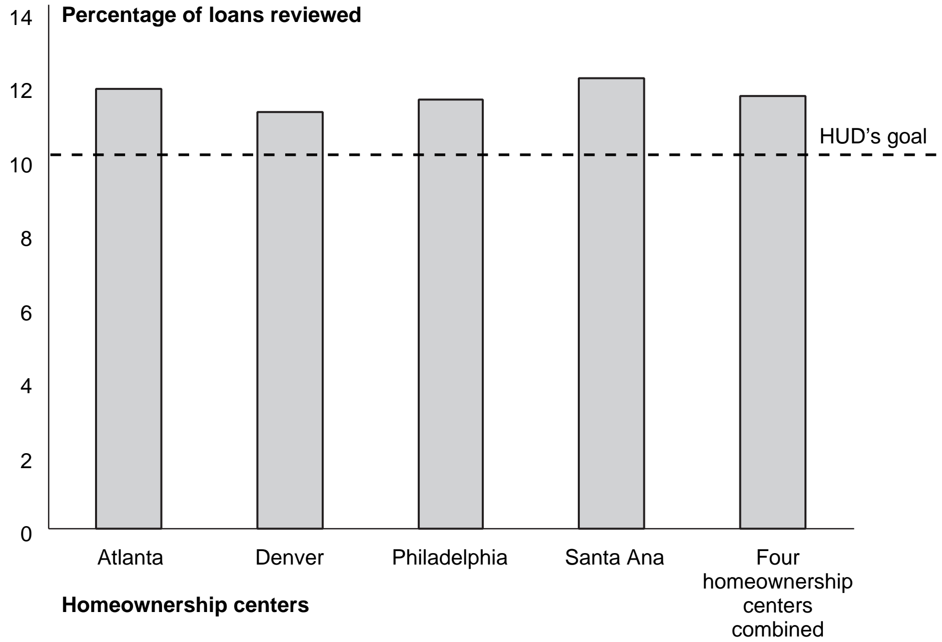
assess lenders' risk and prioritize them for review. In contrast, the Philadelphia and Denver centers had implemented more systematic but different approaches. For example, the Philadelphia center established, as a high priority for review, those lenders that, during the previous 5 years, had made over 500 FHA-insured mortgages and had high percentages of loans that defaulted within 24 months relative to the national and corresponding state averages. By comparison, the Denver center focused on lenders that, during the previous 3 years, had the largest number of loans that defaulted within 13 months.

Selection of Loans for Technical Reviews Was Not Based on Risk

Technical reviews—desk audits that evaluate the underwriting quality of individual loans already insured by FHA—are another tool that HUD uses to monitor the performance of lenders. Technical reviews that reveal serious deficiencies may result, among other things, in HUD's requiring the lenders to compensate the Department for financial losses or HUD's suspending the lenders' direct endorsement authority. While the homeownership centers met the numerical goals for conducting technical reviews during fiscal year 1999, the reviews, contrary to HUD's guidance, did not focus on loans that (1) exhibit high-risk characteristics or (2) were made by lenders with known performance problems or newly approved lenders. As a result, underwriting practices that significantly increase HUD's insurance risk may be going undetected.

All four of HUD's homeownership centers met the Department's goal to perform technical reviews on no less than 10 percent of the FHA-insured mortgage loans made during fiscal year 1999. The four centers combined performed 151,575 technical reviews in fiscal year 1999, representing 11.7 percent of the loans that FHA insured that year. (See fig. 6.)

Figure 6: Percentage of Loans Receiving Technical Reviews by Homeownership Center, Fiscal Year 1999



Source: GAO's analysis of data from HUD.

The homeownership centers, however, have not effectively implemented HUD's guidance, which recommends that high-risk loans should be selected for technical reviews. The guidance cites as high-risk loans those mortgage transactions involving multiunit dwellings; foreclosed HUD-owned properties; and borrowers with unusually high expenses relative to their income, among other factors. According to HUD officials, loans that exhibit these high-risk characteristics are, all other things being equal, more likely to be subject to default and/or contain underwriting errors than loans that do not. Instead, the centers rely primarily on a random process for selecting loans for technical reviews. According to center officials, HUD's Computerized Homes Underwriting Management System (CHUMS)—a computer system that assists and supports HUD staff in processing mortgage insurance for single-family homes—is programmed to randomly select a certain percentage of each lender's loans. However, CHUMS currently cannot automatically identify and select for review those loans that exhibit high-risk characteristics. Center officials told us that they sometimes manually selected high-risk loans for review but that the large

volume of loans they processed for FHA insurance, coupled with staffing constraints, made it impractical to do this on a routine basis. According to HUD officials, the Department is developing a "mortgage scorecard" system, which, they believe, will enable HUD to readily identify high-risk loans for technical reviews by assigning risk scores to all FHA-insured mortgage loans on the basis of various characteristics of the loans. The officials said that they hope to fully implement this system by the end of fiscal year 2001.

CHUMS permits homeownership center staff to adjust the percentage of each lender's loans that are selected for technical reviews. HUD's guidance suggests that 5 to 10 percent of a lender's loans should be selected for technical reviews but that this percentage should be increased up to 100 percent if problems are noted with the lender's performance (e.g., high default rates, poor technical review ratings, or homebuyers' complaints). However, the centers have infrequently used their ability to adjust the percentage of lenders' loans selected for technical reviews to more closely monitor lenders whose performance problems may increase HUD's insurance risk. HUD's guidance states also that the centers should perform technical reviews of 100 percent of the FHA-insured loans that are made by lenders that are newly granted direct endorsement authority for 6 months or through their first 50 loans. However, we found that the centers did not consistently follow this guidance and lacked information systems to readily identify and track the technical review ratings of new direct endorsement lenders. For example, officials at the Philadelphia center told us they were not aware of the guidance and selected only 10 percent of these lenders' loans for technical reviews.

In contrast to HUD, both Fannie Mae and Freddie Mac—government-sponsored enterprises that purchase home mortgages and issue mortgage-backed securities—perform quality control reviews on samples of loans selected on the basis of risk as well as samples of loans selected at random. Officials with both organizations told us they had databases and statistical models to generate these samples automatically. The officials said they used risk-based samples to focus their monitoring resources at high-risk loans and lenders that made such loans.[7] They said they used random

[7]Some of the risk factors used by Fannie Mae and Freddie Mac to identify high-risk loans may be applicable to FHA's loan portfolio, while other factors may not. Fannie Mae and Freddie Mac consider the specific factors they use to assess risk as confidential business information.

samples to determine the prevalence of underwriting deficiencies throughout their entire loan portfolios.

Homeownership Centers' Oversight of Technical Review Contractors Was Limited

The large majority of HUD's technical reviews are performed by firms under contract with the homeownership centers.[8] Each contract contains specific performance standards expressed as the maximum acceptable percentage of reviews that could contain significant errors or omissions. However, we found that three of the four centers were not tracking the contractors' work against these standards. As a result, these centers lack the information necessary to evaluate the quality of the contractors' work or to determine whether actions should be taken against the contractors for poor performance.

Each technical review contract states that each month, HUD staff will review the accuracy and completeness of the contractor's work and provide the contractors with performance feedback. The contracts for the Atlanta, Philadelphia, and Santa Ana centers state that HUD may reject the reviews if more than 10 percent of them contain significant errors or omissions (e.g., incorrect ratings given or significant issues not identified) and that an error rate of over 10 percent may be considered failure to perform. The corresponding percentages in the Denver center's contracts are 20 percent.

We found that the Atlanta, Denver, and Philadelphia homeownership centers did not track the percentage of the contractors' work that contained significant errors and omissions. Without this information, these centers were not in a position to provide the contractors with adequate performance feedback or, if necessary, to enforce the contracts' performance clauses. The Santa Ana homeownership center's evaluations of one of its two technical review contractors revealed an error rate of over 20 percent for the 5-month period from April through August 1999—double the center's acceptable rate. However, the center did not hold the contractor responsible for the high error rates, as provided for by the contract. In October 1999, the center began to intensively monitor both of

[8]Virtually all of the Atlanta, Santa Ana, and Denver centers' technical reviews are performed by contractors. In contrast, Philadelphia center officials said that their own staff performed about one-third of the center's reviews in fiscal year 1999. At the time of our review, the Santa Ana and Denver centers each had two firms under contract, while the Atlanta and Philadelphia centers each used a single contractor. The total annual value of the centers' technical review contracts is about $2 million.

its contractors in order to provide the contractors with detailed feedback and to more aggressively enforce the contracts' performance clauses. At the time of our review, all four centers indicated that they were planning to adopt a database system developed by the Denver center to, among other things, capture and track the results of their evaluations of the technical review contractors' work.

Efforts to Hold Lenders Accountable for Poor Performance Have Not Been Sufficient

To hold lenders accountable for program violations or poor performance, HUD may (1) suspend their direct endorsement authority, (2) terminate their loan origination authority through its Credit Watch program, or (3) take enforcement action through its Mortgagee Review Board. However, the homeownership centers have made only limited use of their ability to suspend the direct endorsement authority. And while HUD's Credit Watch program is designed to hold lenders accountable for excessive loan defaults and insurance claims on FHA-insured mortgages, the program focuses on lenders who originated the troubled loans and has not held accountable other FHA lenders who underwrote and approved the loans. Furthermore, the Department's authority to implement the program is also facing a legal challenge, leaving the future of the program in doubt. Lastly, HUD's Mortgagee Review Board often takes over a year to impose sanctions against lenders for program violations.

Homeownership Centers Made Limited Use of Their Ability to Suspend Lenders' Direct Endorsement Authority

HUD's homeownership centers have made limited use of their ability to suspend the direct endorsement authority of lenders that fail to comply with FHA's program requirements. The centers suspended a total of eight lenders in fiscal year 1999, but our analysis of HUD's technical review ratings for fiscal year 1999 showed frequent noncompliance by lenders with FHA's requirements, indicating that many additional lenders may be candidates for this action. By not suspending poorly performing lenders, HUD leaves itself vulnerable to lending practices that increase the Department's insurance risk.

HUD's guidance allows the homeownership centers to suspend the direct endorsement authority of lenders that fail to comply with FHA's program requirements but provides only general guidelines for determining which lender's direct endorsement authority should be suspended. For example, the guidance states that the centers should consider suspending lenders that exhibit "patterns" of noncompliance, but it does not define what would constitute a pattern. Lenders whose direct endorsement authority is suspended must submit their mortgage case files to the centers, which

evaluate the lenders' underwriting decisions before deciding whether to insure the loans. The lenders must follow this procedure until HUD's evaluations of the case files indicate that the lenders have demonstrated satisfactory performance in underwriting loans. Lenders that cannot demonstrate satisfactory performance may have their direct endorsement authority withdrawn by the centers.

Among the four homeownership centers, we found that the Philadelphia center was the only one that had suspended the direct endorsement authority of any lenders during fiscal year 1999. Specifically, the Philadelphia center took this action against eight lenders in fiscal year 1999, citing underwriting violations identified by technical reviews or lender reviews. While the Santa Ana center did not suspend any lender's direct endorsement authority, in October 1999, the center warned 27 lenders that it might do so if they did not submit plans to eliminate and prevent the recurrence of underwriting deficiencies revealed in technical reviews. The Denver and Atlanta centers did not suspend any lender's direct endorsement authority. Officials at these centers told us they had concerns about the additional workload associated with suspending lenders and lacked the information systems necessary to evaluate lenders' performance. The centers have taken steps to address these problems, as follows:

- In September 1999, the Atlanta center hired a contractor to evaluate the underwriting decisions of lenders whose direct endorsement authority may be suspended by the center in the future. Officials at the Atlanta center said they lacked sufficient underwriting staff to do this function themselves.
- Denver center officials said they were developing a database system to, among other things, help all four centers better track and analyze the results of technical reviews and identify poorly performing lenders for enforcement actions. Although technical review ratings are entered into CHUMS, this system is a limited monitoring tool because it does not capture the reason for each rating—information that center officials believe is necessary to justify enforcement actions against lenders.

We also found that the centers had not developed consistent criteria for suspending lenders' direct endorsement authority. For example, the Philadelphia center suspended several lenders because, according to center officials, the lenders received "fair" or "poor" ratings for underwriting in over half of their technical reviews in fiscal years 1998 and 1999 and had above-average default rates on their FHA-insured mortgage

loans. In contrast, the Santa Ana center proposed suspending lenders solely because the lenders' underwriters received six or more "poor" ratings in technical reviews conducted during July through September 1999, regardless of the number of reviews the lenders received during the period. Neither the Atlanta nor the Denver center had developed criteria for suspending lenders' direct endorsement authority.

Although HUD's homeownership centers suspended the direct endorsement authority of relatively few lenders in fiscal year 1999, our analysis of HUD's technical review ratings for fiscal year 1999 showed frequent noncompliance by lenders with FHA's requirements, indicating that many lenders may be candidates for this action. Specifically, our analysis showed that in fiscal year 1999, about 5,000 lenders received technical review ratings for mortgage credit analysis for the FHA-insured mortgages they originated and underwrote.[9] Nearly 20 percent of the loans subject to technical reviews received "poor" ratings for mortgage credit analysis, meaning that the lenders made mistakes in evaluating the borrowers' credit worthiness that significantly increased HUD's insurance risk. We identified 206 lenders nationwide that, during fiscal year 1999, received "poor" ratings for mortgage credit analysis on more than 30 percent of their reviewed loans and whose percentage of "poor" ratings, on the basis of statistical analysis, could have been expected to exceed 30 percent, had HUD reviewed all of their fiscal year 1999 loans.[10] Of these lenders, 131 made 10 or more FHA-insured loans in fiscal year 1999. HUD's guidance does not define the extent of noncompliance with FHA's underwriting requirements that would warrant the suspension of a lender's direct endorsement authority. However, in our opinion, the extent of noncompliance demonstrated by these 131 lenders indicates that they may be candidates for this action. As of October 1, 1999, HUD's homeownership centers had not suspended any of these lenders' direct endorsement authority.

[9]Lenders could have been counted more than once if they underwrote FHA-insured mortgages in more than one HUD field office jurisdiction. The lenders made a total of 111,699 mortgage loans that received technical reviews from HUD.

[10]Our statistical analyses identified, at the 95-percent level of confidence, those lenders that we would have expected to receive "poor" ratings on at least 30 percent of their loans, had all of their fiscal year 1999 loans been subject to technical reviews.

Lenders Underwriting Loans Originated by Others Escape Responsibility for Excessive Default and Claim Rates Under HUD's Credit Watch Program

HUD's Credit Watch program is an enforcement tool that the Department has used to terminate the loan origination authority of lenders with excessive default and claim rates on FHA-insured loans. However, because the program's regulations pertain only to the lenders that originated the troubled loans, HUD does not always hold accountable those lenders that underwrote and approved the loans. For example, 18 of the 33 lenders whose loan origination authority was terminated by HUD during the first round of Credit Watch used other FHA lenders to underwrite all or virtually all of the troubled loans that the 18 lenders originated. However, HUD did not hold the lenders that underwrote these loans accountable. In addition, a legal challenge to HUD's authority to implement the program leaves the program's future in doubt.

In May 1999, HUD announced that it would begin to use its Credit Watch program to sanction lenders with excessively high loan default and claim rates. HUD planned to terminate the loan origination authority of any lender whose default and claim rates on mortgages insured by FHA during the preceding 24 months exceeded both the national average and 300 percent of the average rate for the HUD field office serving the lender's geographic location. Similarly, HUD planned to place on "Credit Watch" status the lenders whose default and claim rates exceeded both the national average and 200 percent of the corresponding HUD field office average. While on Credit Watch status, the lender can continue to originate FHA-insured loans, but its performance receives greater scrutiny from HUD.

As of the end of January 2000, HUD had analyzed lenders' default and claim rates for the three 24-month periods ending on March 31, 1999, June 30, 1999, and September 30, 1999. HUD limited its analyses to lenders that had a minimum of 25 defaults or claims during these periods. This program has resulted in the Department's actual or proposed termination of 50 lenders' loan origination authority and the placement of 104 additional lenders on Credit Watch status. (See table 1.)

Table 1: Results of the First Three Rounds of HUD's Credit Watch Program

Credit Watch round	Number of lenders whose FHA loan origination authority was terminated by HUD	Number of lenders that HUD placed on Credit Watch status
1	33	56
2	5	25
3	12[a]	23
Total	**50**	**104**

[a]Proposed as of February 1, 2000.

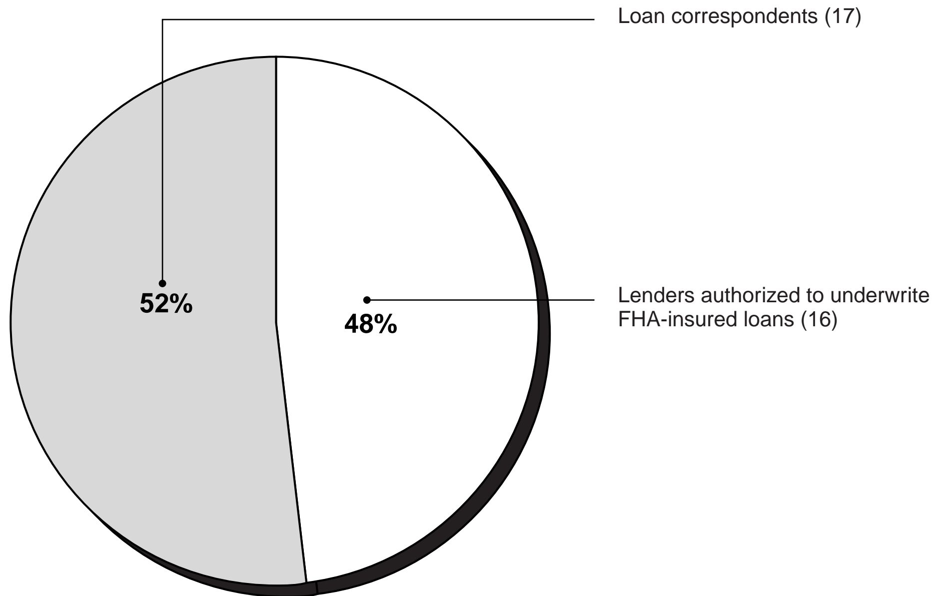
Source: HUD's Office of Lender Activities and Program Compliance.

The regulations governing HUD's Credit Watch program allow the Department to hold accountable for excessive defaults or insurance claims the lenders that originated the troubled loans. However, the regulations do not address HUD's authority to also hold accountable those lenders that have underwritten the loans. When originating mortgage loans, lenders perform such functions as accepting mortgage applications and obtaining employment verifications and credit reports on the borrowers. When underwriting mortgage loans, lenders use this information to determine whether borrowers are able to make their mortgage payments and whether the loans should be approved. HUD officials told us they recognized that the underwriting lenders contributed to excessive defaults and insurance claims but that the Credit Watch program's regulations did not permit them to take enforcement actions against these lenders. The officials said they were considering regulatory changes to address this problem.

The results of the first round of the Credit Watch program illustrate the program's limitations as an enforcement tool. As shown in figure 7, of the 33 lenders that HUD terminated during the first round of the program, 17 were loan correspondents. Under HUD's regulations, loan correspondents sell or transfer loans that they originate to other FHA lenders, known as sponsoring lenders, for underwriting and approval. Sponsoring lenders underwrote the nearly 6,200 loans that the 17 loan correspondents originated and FHA insured during the 24-month period of analysis, but HUD did not impose sanctions against the sponsoring lenders through the Credit Watch program. The remaining 16 lenders had the authority to underwrite FHA-insured loans. However, 1 of these 16 lenders relied largely on other lenders to underwrite the loans it originated. Specifically, HUD's data showed that other lenders underwrote 364 of the 365 loans that the

lender had originated and FHA insured during the 24-month period. The data showed further that three lenders had underwritten 274 of these 364 loans and that the lenders' default and claim rates for these loans were 6 to 13 times the national average and 3 to 6 times the corresponding HUD field offices' averages. Nevertheless, the three lenders were not subject to enforcement actions under the Credit Watch program.

Figure 7: Percentage of Lenders, by Type, Whose Loan Origination Authority Was Terminated Because of Excessive Defaults and Insurance Claims on Loans Made For the 24-Month Period Ending March 31, 1999



Source: GAO's analysis of data from HUD.

In September 1999, one lender whose authority to originate FHA-insured mortgage loans was terminated by HUD filed a lawsuit seeking to overturn HUD's actions. Among other issues, the lender contended that HUD had exceeded its statutory authority when it issued its Credit Watch regulations and that the manner in which HUD terminated the lender's authority had deprived the lender of due process. In October 1999, a federal district court ruled that HUD's Credit Watch regulations were invalid and set aside HUD's termination of the lender. The court stated that HUD's statutory authority requires that after determining that a lender has excessive defaults and claims, HUD must provide the lender the opportunity to provide the Department with a plan and timetable for correcting the defaults. The court stated that HUD had sidestepped its statutory mandate by enacting regulations that allowed the Department to terminate a lender's authority to originate loans whenever HUD deemed it appropriate because of the lender's default and claim rates. The court also concluded that even if HUD had the authority to issue such regulations, the regulations denied the lender its right to due process.[11] In December 1999, the same court ruled that its October 1999 decision did not affect the other lenders whose FHA's loan origination authority was terminated by HUD.

HUD has appealed this decision. An Assistant General Counsel in HUD's Litigation Division told us that, in HUD's view, the National Housing Act provides the Department with broad authority to issue regulations and fashion programs for dealing with lenders with excessive default and claim rates. According to this official, HUD also disagrees with the court's contention that HUD's regulations denied the lender due process. He said that the lenders whose authority HUD proposed to terminate were given 30 days written notice of HUD's intention and were provided the opportunity to explain the reasons for the high default and claim rates. HUD officials told us that if the Department loses its appeal of the court decision, it will seek legislation that authorizes HUD to continue the Credit Watch program.

Mortgagee Review Board's Process for Sanctioning Lenders Is Time-Consuming

HUD's Mortgagee Review Board (Board) can impose administrative actions against FHA lenders that commit program violations. However, the Board frequently takes over a year to impose sanctions against lenders and faces challenges to improving its timeliness. As a result, some of these lenders continue making FHA-insured loans for a year or more before they are held accountable for the violations.

[11] *Capitol Mortgage Bankers, Inc. v. Cuomo*, 77 F. Supp. 2d 690 (D. Md. 1999).

In fiscal year 1999, 68 cases were referred to the Board for action. The majority of the cases referred to the Board are the result of lending violations revealed in lender reviews performed by HUD's homeownership centers and involve lenders that make mortgages for single-family homes. Once the Board reviews and accepts a referral, it sends the lender a notice of violation that provides the lender 30 days to respond in writing to the Board. After reviewing the lender's response, the Board decides what actions to take. The Board may impose a number of sanctions against FHA-approved lenders, ranging from a letter of reprimand to withdrawal of a lender's FHA approval.

The majority of the Board's actions result in settlement agreements, which require lenders to indemnify improperly originated loans, pay fines, and/or take actions to prevent future lending violations. For example, we reviewed the Board's records for 24 of the 30 cases involving single-family housing lenders that the Board acted on from October 1998 through April 1999.[12] As of November 1999, we found that in 18 of the 24 cases, the Board had either reached settlement agreements with the lenders (5 cases) or was still attempting to reach settlement agreements (13 cases). In the remaining six cases, the Board had withdrawn the lenders' FHA approval. (See table 2.)

Our analysis of the 24 cases further showed that the Board's efforts to review the cases and impose sanctions against lenders or to enter into settlement agreements with them is frequently a time-consuming process. As table 2 shows, for the 11 cases that the Board completed action on as of November 1999, it took an average of 8.5 months from the notice of violations to withdraw lenders' FHA approval and an average of 11.2 months to reach settlement agreements. For one of the withdrawals and for two of the settlement agreements, the Board took over a year to complete these actions. For the 13 cases that the Board had not completed action on, an average of 14.3 months had elapsed since the Board sent the lenders notices of violation. The length of time required by the Board to complete its actions in these 13 cases has allowed some of these lenders to continue making FHA-insured loans for over a year without being held accountable for their violations. For example, in April 1998, the Board sent a notice of violation to one of these lenders because the lender committed several

[12]The records for the remaining six cases were being used by HUD staff and were not available for our review (three cases) or our preliminary review indicated that the cases did not involve single-family mortgage loans (three cases). As of November 1999, the official minutes of the Board's meetings during fiscal year 1999 were available only for the period covering October 1998 through April 1999.

violations, including using false information to originate loans. However, the Board had not resolved the case as of November 1999—19 months later—and during the 19-month period, the lender made over 300 FHA-insured mortgage loans.

Table 2: Summary of the Mortgagee Review Board's Fiscal Year 1999 Actions on 24 Cases as of November 1999

Type of Board action	Number of cases	Average number of months elapsed since the notices of violation
Board action completed		
Lender's FHA approval was withdrawn	6	8.5
Lender entered into a settlement agreement	5	11.2
Board action ongoing		
Board and lender attempting to reach a settlement agreement	13	14.3
Total	24	

Source: GAO's analysis of data from HUD.

HUD does not have guidelines for the time it should take for the Board to take enforcement actions against lenders. However, the Board recognizes that its review process and its efforts to impose sanctions against or enter into settlement agreements with lenders that commit program violations can be time-consuming. The Board has taken some steps to speed up the process. For example, the Board's secretary told us that in December 1998, the Board adopted a policy of meeting every 2 months to consider case referrals. This official told us that prior to adopting this policy, the Board did not have an established meeting schedule and met only whenever a sufficient number of cases had accumulated for review. Also, the Board recently hired another person to help the Board's secretary review case referrals and prepare the cases for the Board's action. In addition, to speed up the settlement agreement process, the Board plans in future violation letters to ask the lenders whether they would be willing to settle their cases and, if so, under what terms and conditions. If a lender's settlement offer was acceptable to the Board, a settlement agreement could be prepared and signed immediately. If a lender's offer was not acceptable, the Board could then make its own proposal for settling the case.

Conclusions

FHA insures tens of billions of dollars in mortgages for single-family homes each year. While FHA's Mutual Mortgage Insurance Fund is currently financially healthy, poor lending practices could adversely affect the Fund's financial position. Because lenders underwrite virtually all FHA-insured mortgages without HUD's prior review, it is important for HUD to hold lenders accountable for the quality of these loans. However, HUD has not taken adequate steps to maximize the effectiveness of its oversight resources and minimize its insurance risk. Weaknesses in HUD's approval, monitoring, and enforcement efforts point to the need for improvements in HUD's oversight of FHA mortgage lenders.

HUD could significantly improve its process for approving lenders seeking the authority to underwrite FHA-insured loans. Because the Department lacks clear and specific standards for granting lenders direct endorsement authority, its homeownership centers have implemented the existing standards differently and approved lenders that demonstrated varying levels of proficiency, including lenders that made multiple and serious underwriting mistakes. Consequently, HUD has only limited assurance that the lenders it is approving are qualified to underwrite loans and, therefore, may be exposing the Department to unreasonable insurance risks. Addressing this deficiency is especially important, given that since 1996, HUD has no longer individually reviewed the qualifications of lenders' underwriting staff.

Contrary to HUD's guidance, the homeownership centers' monitoring of lenders does not adequately focus on the lenders and loans that pose the greatest insurance risks to the Department. Focusing on high-risk cases would increase HUD's opportunities to uncover and curtail improper lending practices. However, HUD's homeownership centers often have not conducted lender reviews of the lenders considered to pose the highest risk, and HUD lacks a systematic process for identifying and prioritizing such lenders for review. Furthermore, HUD's centers have not consistently targeted for technical reviews either high-risk loans or loans made by problem lenders and newly approved lenders. In addition, HUD's oversight of contractors that perform technical reviews does not provide adequate assurance that the contractors are doing a good job. Because of these deficiencies, HUD's lender reviews and technical reviews are not as effective as they could be in mitigating financial losses to the Department.

HUD has not taken sufficient steps to hold lenders accountable for poor performance and program violations. Numerous lenders are not complying

with FHA's underwriting requirements, yet HUD's homeownership centers have suspended the direct endorsement authority of relatively few lenders. Furthermore, HUD's Credit Watch program is a strong enforcement tool but a court decision has left the future of the program in doubt. In addition, we believe that the program would be more effective if it held accountable all the lenders involved in making problem loans rather than just those that originated the loans. When poorly performing lenders are not held responsible, they may continue to make loans that increase potential losses to FHA's insurance fund.

Recommendations

To reduce the financial risks assumed by FHA and to improve HUD's oversight of FHA mortgage lenders, we recommend that the Secretary of HUD direct the Assistant Secretary for Housing-Federal Housing Commissioner to do the following:

- Improve the process for granting lenders direct endorsement authority by developing specific standards for overall acceptable performance in preclosing reviews and ensuring that the homeownership centers comply with these standards.
- More effectively monitor lenders' performance by
  - developing procedures to identify and prioritize high-risk lenders for lender reviews and ensuring that the homeownership centers consistently apply these procedures;
  - developing procedures and enhancing FHA's management information systems to identify and select, for technical reviews, loans and lenders within each homeownership center's jurisdiction that pose a high insurance risk to the Department;
  - complying with guidance to perform technical reviews of all the FHA-insured loans that are made by lenders that are newly granted direct endorsement authority; and
  - tracking the performance of contractors conducting technical reviews against performance standards in the contracts and taking appropriate actions against contractors whose performance is not acceptable.
- Strengthen its enforcement efforts by clarifying and implementing guidelines for identifying lenders whose direct endorsement authority should be suspended.

In addition, we recommend that once the legal basis of the Credit Watch program is resolved, the Secretary of HUD direct the Assistant Secretary for Housing-Federal Housing Commissioner, to revise the Credit Watch

program's regulations to cover lenders that underwrite FHA-insured loans with excessive default and claim rates as well as those lenders that originate such loans.

Agency Comments

We provided HUD with a draft of this report for review and comment. HUD stated that while it did not always agree with the report's characterization of the Department's practices and procedures for overseeing FHA lenders, it generally agreed with the report's recommendations.

In commenting on the draft report's discussion of technical reviews of loans, HUD took issue with our statement that its selection of loans for review was not based on risk. HUD stated that it performs technical reviews of all Section 203(k) rehabilitation loans, mortgages made to nonprofit agencies, and other categories of mortgages that historically have had higher default rates. Our report recognizes that the homeownership centers have, on a limited basis, targeted some high-risk loans for technical reviews. At the same time, the centers' lack of information systems capable of identifying high-risk loans makes it impractical for the centers to select and review high-risk loans on a routine basis. Furthermore, the categories of loans cited by HUD—Section 203(k) loans and mortgages made to nonprofit agencies—account for a very small portion of FHA's loan portfolio.

HUD also disagreed with our finding that it was not monitoring the performance of technical review contractors. Our draft report did not present such a finding. Rather, we observed that three of the four homeownership centers did not track the percentage of the contractors' work that contained significant errors and omissions and, therefore, were not in a position to provide the contractors with adequate performance feedback or, if necessary, to enforce the contracts' performance clauses.

HUD commented that our draft report's discussion of lender reviews did not adequately recognize that its targeting guidance requires homeownership center staff to consider several factors, in addition to lenders' default and claim rates, in selecting lenders for review. Our report recognizes that HUD's guidance requires that various risk factors, such as lenders' loan volume and the late payment of mortgage insurance premiums to HUD, be considered in targeting lenders for review. However, our concern is that the guidance neither indicates how these factors should weighted nor how lenders should be prioritized. As a result, the

homeownership centers have not targeted lenders for reviews in a consistent manner.

While agreeing with our recommendation to clarify and implement guidelines for identifying lenders whose direct endorsement authority should be suspended, HUD disagreed with the draft report's finding that the Department had made limited use of its ability to suspend the direct endorsement authority of lenders. HUD stated that while the homeownership centers had not actually suspended the authority of many lenders, they had threatened suspension in several dozen cases every year in an attempt to improve lenders' performance. As our report notes, one center suspended 8 lenders in fiscal year 1999 and another center threatened to suspend 27 lenders in October 1999. At the other two centers, we found only one instance in which the center threatened to suspend the authority of a lender. Taken together, the actions of the four centers do not appear to support HUD's assertion that the centers have routinely used the threat of suspension to improve lenders' performance.

Finally, while HUD agreed with our recommendation to revise its Credit Watch program to hold loan underwriters accountable for excessive default and claim rates, HUD did not believe that it would be appropriate to stop taking enforcement action against loan originators. We did not intend for HUD to stop taking enforcement action against loan originators but rather that the Credit Watch program hold both the lenders that originated the troubled loans and the lenders that underwrote the loans accountable for excessive default and claim rates because both share responsibility for the quality of the loans.

The full text of HUD's letter is presented in appendix I.

We conducted our work at HUD's headquarters and its Atlanta, Denver, Philadelphia, and Santa Ana homeownership centers. Our review focused on the adequacy of HUD's policies and procedures for overseeing lenders. We reviewed regulations, handbook guidance, and other documents related to HUD's approval, monitoring, and enforcement activities for FHA lenders. We interviewed officials from HUD's Office of Insured Single-Family Housing, Enforcement Center, Mortgagee Review Board, and the four centers. We also interviewed representatives from Fannie Mae, Freddie Mac, and a firm contracted by HUD to perform technical reviews. In addition, we performed limited tests and analyses to determine whether HUD's policies and procedures were properly utilized to limit the

Department's insurance risk. We analyzed information on the performance of all 36 lenders granted direct endorsement authority by the four homeownership centers in the 6 months prior to our 1999 visits. We also reviewed documentation from the centers pertaining to targeting of lenders for on-site monitoring and technical reviews, the oversight of technical review contractors, and enforcement actions against lenders. We analyzed data from HUD's Computerized Homes Underwriting Management System to determine how frequently lenders received "poor" ratings for mortgage credit analysis in technical reviews. We determined the number and types of lenders sanctioned by HUD under its Credit Watch program as of the end of January 2000. Finally, we reviewed the Mortgagee Review Board's files for information on its enforcement activities. We performed this review from June 1999 through April 2000 in accordance with generally accepted government auditing standards. Appendix II provides additional details on our scope and methodology.

As arranged with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Honorable Barney Frank, Ranking Minority Member, Subcommittee on Housing and Community Opportunity, House Committee on Banking and Financial Services; the Honorable James A. Leach, Chairman, and the Honorable John J. LaFalce, Ranking Minority Member, House Committee on Banking and Financial Services; the Honorable Carl Levin, Ranking Minority Member, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs; the Honorable Phil Gram, Chairman, and the Honorable Paul S. Sarbanes, Ranking Minority Member, Senate Committee on Banking, Housing, and Urban Affairs; and the Honorable Fred Thompson, Chairman, and the Honorable Joseph Lieberman, Ranking Minority Member, Senate Committee on Governmental Affairs. We will also send copies of this report to the Honorable Andrew M. Cuomo, Secretary of HUD; the Honorable William C. Apgar, HUD Assistant Secretary for Housing-Federal Housing Commissioner; and the Honorable Jacob J. Lew, Director, Office of Management and Budget. We will make copies available to others upon request.

Please call me on (202) 512-7631 if you or your staff have any questions about this report. Major contributors to this report are listed in appendix III.

Stanley J. Czerwinski
Associate Director, Housing and Community
Development Issues

Comments From the Department of Housing and Urban Development

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

APR 14 2000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Mr. Stanley J. Czerwinski
Associate Director, Housing and Community Development Issues
United States General Accounting Office
Washington, D.C. 29548

Dear Mr. Czerwinski:

Thank you for the opportunity to comment on your report entitled Single Family Housing: Stronger Oversight of FHA Lenders Could Reduce HUD's Insurance Risk (GAO/RCED-00-112). HUD is proud of the tremendous progress we have made in putting much greater organizational emphasis and resources on lender monitoring and enforcement activities. Since 1997, HUD has increased the number of lender monitors from approximately 23 to more than 140, and the number of annual lender monitoring reviews from approximately 220 to more than 900. Over the last two years, FHA also has developed two new powerful technological systems to assess lender default and claim rates – FHA's Neighborhood Watch/Early Warning System, a web-based application that tracts lender default and claim rates by census track, and the Mortgagee Portfolio Analysis Subsystem (MPAS), which tracks default and claim rates by lender for 81 regions. Using analysis generated through these systems, FHA also has implemented Credit Watch, a powerful new enforcement tool that in just nine months of operation has terminated or proposed termination of 68 lenders and put another 140 on probationary status.

Moreover, all recent independent, non-partisan analysis of the financial condition of the FHA indicate that these new programs and resource investments are paying off. FHA's 1999 Actuarial Review performed by Deloitte & Touche indicated that:

- The **economic value of the fund** – a measure of the value of projected premium payments for current insurance in force less estimated claim payments and expenses – stands at an **all-time record high of $16.637 billion, an increase of $5.277 billion from the economic value as reported for FY98.** The Actuarial studies show that this improvement is due to fundamental changes in FHA, not simply recent economic prosperity, and will withstand future economic downturns. This is a remarkable turnaround from just ten years ago, when the FHA MMI Fund had an economic value of **negative $2.7 billion in 1990**.

- Furthermore, the Review indicates that FHA's MMI Fund **capital ratio** -- defined as the economic value of the fund divided by the total insurance in force -- is 3.66 in FY 1999, a dramatic increase over the FY 1998 capital ratio of 2.71 percent, and well in excess of the Congressional mandate to exceed a benchmark ratio of 2.00 by the year 2000.

Still, in spite of this progress, FHA appreciates many of GAO's recommendations for ways to enhance and more fully document existing monitoring procedures. While in many cases HUD does not agree with GAO's characterization of current practices and procedures, we do agree with many of the recommendations included in the report.

GAO Response—Oversight of Lenders

FHA's comments on specific statements and recommendations in the report follow:

GAO Statement: Standards for Granting Endorsement Authority Are Not Adequately Defined and Recently Approved Lenders Varied in Their Performance in Preclosing Reviews

FHA's existing guidance for the process of approving new lenders for Direct Endorsement (DE) authority clearly identifies the number of loans to be re-underwritten and graded by HOC staff, and it sets clear underwriting standards to be applied in grading lender performance. This guidance currently is widely followed by HOC staff. However, determining the appropriate overall rating of an individual lender's performance and making the final approval decision necessarily requires some judgment on the part of HOC management. For example, even within loans rated as "poor" the nature of the deficiency can range from egregious disregard for underwriting standards to a failure to follow FHA documentation requirements due to a lack of familiarity with HUD guidelines. Moreover, HOC staff pay close attention to whether a new lender shows progress over time in their underwriting performance in response to FHA feedback and guidance. Therefore, it is not appropriate to rely solely on a numeric evaluation, in the complete absence of judgment, in making the final DE approval decision.

Still, HUD generally agrees with GAO's conclusion that the process for determining DE eligibility would benefit from more detailed HUD Headquarters (HQ) guidance on what constitutes overall acceptable performance. Within the next 60 days HUD will develop additional procedures that will establish a minimum number of good and fair ratings necessary for a lender to receive DE approval, and clearly identify requirements for additional acceptable test cases to be submitted should the first 15 not reach a satisfactory score. The procedures will also put greater weight on the more recent submissions since the lender is expected to learn from its mistakes. Although HOC staff currently consistently follow the same process for grading individual loan underwriting, this additional guidance will ensure greater consistency in the basis for making final approval decisions. In addition, HUD will also retain the right to withhold DE approval from any lender if in the opinion of management that lender has not earned the right to participate as a full DE lender.

Finally, it is important to note that FHA has very clear field guidance requiring HOC staff to review loans originated by newly approved lenders at the 100 percent level for the first 50 cases or 180 days, whichever comes first. This requirement allows FHA staff to closely monitor the lender's performance immediately following DE approval. This 100 percent review requirement was recently reiterated to management in the four HOCs.

GAO Statement: Selection of Loans for Technical Reviews Was Not Based on Risk

It is not accurate to state that FHA's selection of mortgages for technical reviews is not a function of the perceived risk of those loans. As a business practice, FHA reviews all Section 203(k) rehabilitation loans, mortgages made to nonprofit agencies, and other categories of mortgages that have historically had higher default rates. Further, while GAO may criticize FHA for its method of targeting by loan type, FHA believes that targeting technical reviews by **lender** performance makes more sense and produces greater results.

GAO Response---Oversight of Lenders

Moreover, FHA has now implemented the new ACCESS Technical Review Reporting System which tracks results of all technical reviews by lender. ACCESS is designed to capture specific errors in five review categories including mortgage credit analysis and property value assessment, and it also has the ability to track risk characteristics such as secondary financing, "gifted" downpayment sources, and other loan application variables thought to be associated with insurance risk. This data base is extremely flexible in its reporting capability and can produce ad-hoc reports by lender, underwriter, type of error, contract reviewer and loan rating. Such ad-hoc reports can serve as a valuable tool to select specific cases and/or lenders for a higher percentage of post-endorsement reviews. In selecting loans for technical review, FHA HOC staff currently examine the individual **lender's** performance by using two measures to determine if additional review action is warranted. First, FHA's Processing and Underwriting Division (P&U) primarily focuses on lenders' underwriting performance by examining the new ACCESS Technical Review Reports to determine which lenders are receiving an unusually high number of poor or fair ratings. If a lender appears on the list as having a considerable volume of less-than-good ratings, the next action is to consult Neighborhood Watch (NW) to determine if the deficient underwriting performance is also resulting in loan defaults.

If a lender is performing unsatisfactorily based on its ratings profile, the HOC analyzes the degree of risk created and resets the percentage of loans to be reviewed above the routine 10% level. The HOC then monitors the results of the additional underwriting reviews via ACCESS to determine if further action should be taken, possibly including an increased percentage of reviews, termination of DE authority, etc.

Second, Neighborhood Watch is used as an *initial* source of information to determine if an increased percentage of technical reviews of a lender should be required. Underwriting reviews per se do not always give definitive information on a lender's underwriting performance, but a rising default rate is cause for further scrutiny.

Moreover, when the default rate is significantly higher than the area average FHA targets the poorest performing lenders are targeted for 100% technical reviews. It is at this point that the HOCs send letters to these poorly performing lenders advising them of the high number of poor and fair ratings and the need for improved performance. The correspondence advising the lender of poor underwriting performance, also cites the NW default data to give them an idea of how they compare with other lenders in the same geographic area.

With the ACCESS database we are now monitoring the results of the reviews to learn if performance improves. If a lender continues to submit poorly-rated cases, then various sanctions, including termination of the lender's DE status, are proposed and communicated to the lender.

It should also be pointed out that FHA has developed a mortgage scorecard that accurately and immediately assesses the risk on a mortgage. Once deployed, FHA will have information on each loan as it enters the endorsement stream. From this information, we can determine which loans contain risk indicators and, thus, are candidates for post-endorsement technical reviews.

GAO Response---Oversight of Lenders

GAO Statement: Lender Reviews Increased but Were Often Not of Riskiest Lenders

As GAO noted in the report, FHA has put tremendous organizational emphasis on enhanced lender monitoring over the last three years. Since 1997, the Department has increased the number of lender monitors from 23 to more than 140, and the number of annual reviews from approximately 220 to more than 900. As part of this greater emphasis on monitoring GAO also notes that FHA has clear guidance requiring targeting of high risk lenders for on-site monitoring reviews. The guidance clearly identifies risk assessment factors to be used in selecting lenders for review. All FHA Quality Assurance Division (QAD) staff have been thoroughly trained in the guidance and risk factors to be used.

Furthermore, over the last two years FHA has developed two new technological systems to assess lender default and claim rates – FHA's Neighborhood Watch/Early Warning System, a web based application that tracts lender default and claims by census tract, and the Mortgagee Portfolio Analysis Subsystem (MPAS), which tracks default and claim rates by lender for 81 geographic regions around the country and provides all analysis used to administer HUD's new Credit Watch Program. All QAD staff also have been trained in the use of the Neighborhood Watch/Early Warning System, and they have access to data produced by MPAS.

What GAO fails to completely recognize however, is that FHA's targeting guidance also requires QAD staff to consider several other factors, in addition to the lender's default and claim rate, in selecting lenders for review. Specifically, FHA's guidance requires that the following risk factors be included in targeting reviews: early default and claim rate, late payment on upfront mortgage insurance premiums, level of use of high risk loan programs, length of time since the last review, complaints from the public, state consumer regulatory agencies or other partners, and frequency of underwriting irregularities noted in technical reviews. All of these factors inform FHA's targeting decisions – not exclusively the lender default and claim rate, as GAO seems to imply.

Moreover, the evidence indicates that factors other than lender default and claim rate are very effective targeting tools. For instance, taken together, on-site monitoring reviews of lenders selected for reasons other than exclusively a high default and claim rate in FY1999 produced the following results:

	Signed Indem. Agreements	MRB Refer	OIG Refer	Sus/ Debar Refer	LDP Refer
HOC					
Santa Ana	91	18	3	3	17
Denver	331	18	6	1	5
Philadelphia	358	18	37	12	9
Atlanta	310	16	57	16	29

Taken together, these reviews resulted in 1,090 loan indemnifications representing savings to FHA of nearly $35 million, almost three times as many loan indemnifications as FHA produced in all the reviews conducted in FY 1998 (454 indemnifications, with savings of just $13.2 million in FY1998).

GAO Response---Oversight of Lenders

Still, FHA recognizes that it would benefit from more clearly **documenting** loan monitoring targeting decisions. That is why we have developed more detailed targeting procedures that require all QAD Directors and Branch Chiefs to uniformly use the Neighborhood Watch system to identify lenders with high early default and claim rates, evaluate other risk factors included in the guidance, and clearly document all targeting decisions and assignments. This more detailed approach already has been implemented by all four HOCs, and will be tested through the third quarter of this fiscal year, and finalized at the start of the fourth quarter.

Further, the Office of Lender Activities and Program Compliance in HUD HQ will monitor the implementation of the targeting methodology with the receipt of a standard report from each HOC, which will be received at least quarterly. This report will identify the lenders targeted for the quarter along with a more detailed explanation of the rationale for targeting decisions.

GAO Statement: Homeownership Centers' Oversight of Technical Review Contractors was Limited

HUD disagrees with GAO's assertion that the HOC staff are not monitoring technical review contractors' performance. Each HOC re-analyzes all loans rated "poor", and reviews a sample of the loans with "good" or "fair" ratings. However, HUD does concur with GAO's suggestion that the process can be improved through automation. In the past, these contractor reviews were done through handwritten review documents. With implementation of the ACCESS Technical Review database over the last few months, HUD now captures contractor performance on missed and overturned findings. With this data, HOC staff can better determine if the contractor is performing its post-endorsement technical reviews up to HUD's standards.

GAO Statement: Homeownership Centers Made Limited Use of Their Ability to Suspend Lenders' Direct Endorsement Authority

FHA disagrees with GAO's assertion that the HOCs made limited use of their ability to suspend lenders' DE authority. Although it is true that the HOCs have not actually suspended many lenders' DE authority, FHA has **threatened suspension** in several dozen cases every year. In our experience the threat of suspension often has proven to dramatically improve lenders' performance. It is very common for the HOC to send a letter threatening suspension of DE status to lenders with high default and claim rates. In such cases the management of the lender typically requests and is granted an interview with HOC personnel. The lender's principal staff and underwriters then meet with the HOC underwriters and quality control staff to discuss specific examples of poor underwriting and highlight suggestions for improving performance. In the vast majority of cases, this one-on-one interaction coupled with the clear threat of suspension of DE status, results in dramatic improvements in the quality of the loan submissions to FHA. This approach – threatening loss of DE status, but then providing very specific lender feedback and suggestions for improvement – has proven to be a constructive and successful means of improving lenders' performance.

Still, FHA agrees with GAO's recommendation to further clarify the conditions under which lenders should ultimately be placed on pre-closing review, to ensure greater consistency in application of this enforcement tool across all four HOCs.

GAO Response---Oversight of Lenders

GAO Statement: Lenders Underwriting Loans Originated by Others Escape Responsibility for Excessive Default and Claims Rates Under HUD's Credit Watch Program (p. 22)

FHA agrees with GAO's statement that the newly developed Credit Watch System is a very powerful enforcement tool. By relying on automated analysis of lenders' early default and claim rate and simply terminating lenders with excessively high rates relative to other lenders in the same region, Credit Watch packs a powerful punch while using relatively few resources. Since launching this new program in May, 1999, HUD has terminated, or proposed termination, of 68 lender branches and placed another 140 lenders on probation. In just nine months of operation this new initiative already has taken more actions against lender branches than the Mortgage Review Board (MRB) took over the last two years. A complete summary of Credit Watch results to date appear below:

	Round 1(5/ 99)	Round 2(9/ 99)	Round 3(1/00)	Round 4 (4/ 00)
Terminations	32 Branches (26 lenders)	5 Branches (5 lenders)	11 Branches** (10 lenders)	16 Branches** (15 lenders)
Credit Watch	56 Branches (51 lenders)	25 Branches (24 lenders)	33 Branches (31 lenders)	26 Branches (14 lenders)

**Rounds 3 and 4 are proposed actions since, final Decisions have not been made.

In regard to GAO's criticism of the program, FHA believes it is appropriate to hold loan originators responsible for loan performance. In many respects, it is the loan originator who in taking the loan application and collecting and analyzing all necessary documentation poses the greatest risk to FHA. Therefore, FHA does not believe it would be appropriate to forego enforcement actions against the loan originator. However, FHA does agree that holding the underwriter responsible, **in addition to** the loan originator would enhance the Credit Watch System.

Sincerely,

William C. Apgar
Assistant Secretary for Housing-
Federal Housing Commissioner

GAO Response---Oversight of Lenders

Objectives, Scope, and Methodology

Our objectives were to answer the following questions: (1) How well does the Department of Housing and Urban Development (HUD) ensure that lenders granted direct endorsement authority by the Federal Housing Administration (FHA) are qualified to receive such authority? (2) To what extent does HUD focus on high-risk lenders in monitoring the lenders participating in FHA's mortgage insurance programs? (3) To what extent is HUD holding these lenders accountable for poor performance? Our review focused on the adequacy of HUD's policies and procedures for overseeing lenders. We performed limited tests and analyses to determine whether these policies and procedures were properly utilized to limit HUD's insurance risk.

To determine how HUD ensures that lenders granted directed endorsement authority are qualified to receive such authority, we reviewed HUD's regulations, procedures, and other guidance relating to its process for approving lenders and granting lenders direct endorsement authority. Lenders with direct endorsement authority can underwrite and close FHA-insured mortgage loans without prior FHA review or approval. We interviewed officials from HUD's Office of Lender Activities and Program Compliance and its four homeownership centers. We developed information on the number of lenders granted direct endorsement authority by each of the four homeownership centers during the 6 months prior to our visit to each of the centers. We visited the Philadelphia center in August 1999 and the Denver, Santa Ana, and Atlanta centers in October 1999. For each of the 36 lenders approved during this time period, we reviewed documentation maintained by the centers to determine (1) the ratings that the lender received on the mortgages it submitted to the center to demonstrate its ability to comply with FHA's requirements and (2) whether the centers followed FHA's procedures in granting lenders direct endorsement program authority.

To determine the extent to which HUD is focusing its monitoring efforts on high-risk lenders, we reviewed HUD's guidance and procedures for conducting technical reviews (i.e., review of individual loans performed after approval of mortgage insurance to assess the quality of lenders' underwriting practices) and lender reviews (i.e., on-site reviews of lenders' operations by HUD staff). We determined the extent to which each of the four homeownership centers met HUD's fiscal year 1999 goals to (1) conduct technical reviews of at least 10 percent of the single-family mortgage loans insured by FHA during the fiscal year and (2) perform 225 lender reviews. We reviewed HUD's use and oversight of contractors that perform technical reviews and interviewed representatives from one

contractor that was performing reviews for three of the four homeownership centers. We interviewed officials at each of the centers on a variety of issues dealing with technical reviews and lender reviews. The issues discussed included the (1) centers' criteria for targeting loans and lenders for review, (2) procedures for monitoring the work of technical review contractors, and (3) number and experience of the centers' staff who were performing lender reviews. We also interviewed representatives from Fannie Mae and Freddie Mac regarding their efforts to monitor the performance of lenders whose loans they purchase.

To determine the extent to which HUD is holding lenders accountable for poor performance, we reviewed HUD's regulations and policy guidance to determine the enforcement options available to HUD. We interviewed officials from HUD's Office of Lender Activities and Program Compliance, Enforcement Center, and Mortgagee Review Board. At each of the four homeownership centers, we discussed with cognizant officials each center's efforts to take enforcement actions against poorly performing lenders. Using data from HUD's Computerized Homes Underwriting Management System on the technical reviews conducted during fiscal year 1999, we determined the percentage of reviews that gave a "poor" rating for mortgage credit analysis. Using these same data, we performed statistical analyses to identify, at the 95-percent level of confidence, those lenders we would have expected to have received "poor" ratings on more than 30 percent of their loans, had all of their fiscal year 1999 loans been subject to technical reviews. We determined the number and types of lenders sanctioned by HUD under its Credit Watch program as of the end of January 2000. We reviewed the Board's files for 24 of the 30 cases involving single-family mortgage lenders that the Board acted on during October 1998 through April 1999 and determined the nature and status of the Board's actions as of November 1999.

Our reliability assessments of the specific data elements required for this review indicated that the data were reliable enough for our analyses. To assess reliability, we reviewed existing information about data quality and controls supporting the data systems and discussed the data we analyzed with agency officials to ensure that we interpreted them properly.

We performed this review from June 1999 through April 2000 in accordance with generally accepted government auditing standards.

GAO Contacts and Staff Acknowledgments

GAO Contacts

Stanley J. Czerwinski (202) 512-7631

Paul J. Schmidt (312) 220-7681

Acknowledgements

In addition to those named above, Karen Bracey, Karin Lennon, John McGrail, Stan Ritchick, Steve Westley, and Shana Whitehead made key contributions to this report.

Ordering Information

The first copy of each GAO report is free. Additional copies of reports are $2 each. A check or money order should be made out to the Superintendent of Documents. VISA and MasterCard credit cards are accepted, also.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:
U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

***Orders by visiting*:**
Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders by phone:
(202) 512-6000
fax: (202) 512-6061
TDD (202) 512-2537

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

Orders by Internet:
For information on how to access GAO reports on the Internet, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web home page at:

http://www.gao.gov

To Report Fraud, Waste, or Abuse in Federal Programs

Contact one:

- **Web site: http://www.gao.gov/fraudnet/fraudnet.htm**
- **e-mail: fraudnet@gao.gov**
- **1-800-424-5454 (automated answering system)**

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Official Business
Penalty for Private Use $300

Address Correction Requested

Bulk Rate
Postage & Fees Paid
GAO
Permit No. GI00