



Bank2, Oklahoma City, OK

Section 184 Loan Guarantees for Indian Housing Program

**Office of Audit, Region 9
Los Angeles, CA**

**Audit Report Number: 2019-LA-1007
July 11, 2019**



To: Heidi Frechette, Deputy Assistant Secretary, Office of Native American Programs, PN

//SIGNED//

From: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

Subject: Bank2, Oklahoma City, OK, Originated Loans Reviewed in Accordance With Section 184 Loan Guarantees for Indian Housing Program Processing Guidelines

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Bank2's Section 184 Loan Guarantees for Indian Housing program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.



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Highlights

What We Audited and Why

We audited Bank2's origination of Section 184 Loan Guarantees for Indian Housing program loans. We selected Bank2's Section 184 program because (1) an internal audit report and corrective action verification determined that the U.S. Department of Housing and Urban Development (HUD) lacked proper oversight of the program and lenders did not underwrite loans in accordance with HUD requirements,¹ (2) Bank2 is one of the largest Section 184 lenders, and (3) reviews of Section 184 lenders were aligned with the goals of our annual audit plan. Our audit objective was to determine whether Bank2 originated Section 184 Loan Guarantees for Indian Housing loans in accordance with HUD's processing guidelines.

What We Found

Bank2 originated all 14 loans reviewed in accordance with Section 184 Loan Guarantees for Indian Housing program processing guidelines. Specifically, it ensured that borrowers met income, debt, and credit requirements; property values were supported; and the borrowers and properties were eligible for the program. Because the 14 loans reviewed met the processing guidelines, there was not an increased risk to HUD's Loan Guarantee Fund.

What We Recommend

This report contains no recommendations.

¹ Audit Report 2015-LA-0002, issued July 6, 2015, and Corrective Action Verification Memorandum 2018-LA-0801, issued August 27, 2018

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Background and Objective

Under the provisions of Section 184 of the Housing and Community Development Act of 1992 and as amended by the Native American Housing Assistance and Self-Determination Act of 1996, the U.S. Department of Housing and Urban Development (HUD) was authorized to guarantee loans made by private lenders to Native Americans, Indian housing authorities or tribally designated housing entities, and tribes. The Section 184 Loan Guarantees for Indian Housing program is a home mortgage product specifically designed for American Indian and Alaska Native families, Alaska villages, tribes, or tribally designated housing entities. A borrower may use a Section 184 loan, both on and off native lands, for new construction, rehabilitation, purchase of an existing home, or refinance of single-family housing.

The Section 184 Loan Guarantee Fund receives annual appropriations to cover the cost of the program. Guarantee fees and any other amounts, claims, notes, mortgages, contracts, and property acquired by the HUD Secretary under the Section 184 program reduce the amount of appropriations needed to support the program and, together with appropriations, are used to fulfill obligations of the Secretary with respect to the loans guaranteed under this section.

The HUD Office of Loan Guarantee guarantees the mortgage loans made to eligible borrowers. The loan guarantee assures the lender that its investment will be repaid in the event of a foreclosure. As of November 2018, there were more than 42,000 loans insured for more than \$7 billion under the Section 184 program, with more than 19,000 of those loans located in Oklahoma.

Bank2 opened in 2002 and offers federally insured Section 184 loans for purchase, refinance, new construction, and renovation. Bank2 is a wholly owned subsidiary of the Chickasaw Banc Holding Company and is 100 percent owned by the Chickasaw Nation. Its headquarters is located in Oklahoma City, OK. From January 1, 2016, through December 31, 2018, Bank2 originated 1,917 loans totaling \$297 million.

Our audit objective was to determine whether Bank2 originated Section 184 Loan Guarantees for Indian Housing loans in accordance with HUD's processing guidelines.

Results of Audit

Finding: Bank2 Originated Loans Reviewed in Accordance With Section 184 Loan Guarantees for Indian Housing Program Processing Guidelines

Bank2 originated the 14 loans reviewed in accordance with HUD's Section 184 Loan Guarantees for Indian Housing program processing guidelines. Specifically, it ensured that borrowers met income, debt, and credit requirements; property values were supported; and the borrowers and properties were eligible for the Section 184 Loan Guarantees for Indian Housing program. Also, Bank2 developed internal controls to ensure that its loan files were complete. Because the loans reviewed met the processing guidelines, there was not an increased risk to HUD's Loan Guarantee Fund.

Bank2 Ensured That Borrower's Met Income, Debt, and Credit Requirements

The Section 184 processing guidelines provide instructions for implementing the Section 184 Loan Guarantees for Indian Housing program. Specifically, chapter 5 (Office of Public and Indian Housing (PIH) Notice PIH 2014-22) of the guidelines provides detailed underwriting guidelines and procedures. Chapter 5 states that underwriters should focus their review on two major factors: (1) the prospect of repayment and (2) the property value.

Bank2 performed a detailed review of the borrower's ability to repay for each of the 14 loans reviewed. It evaluated the income, debt, and creditworthiness of each borrower. Its analysis included a review of documents, such as pay stubs, bank statements, tax returns, financial statements, and credit reports. This process also involved obtaining verification of employment and rent and ensuring that the loan file documentation, including each borrower's income and credit history, supported Bank2's decision to approve the loan.

Bank2 Ensured That Property Values Adequately Secured the Loans

Bank2 is required to perform a thorough analysis of all property appraisals with a focus on risk factors pertaining to value and condition. Bank2 obtained appraisal reports for each of the 14 properties. It evaluated the appraisal reports to ensure that the property values and conditions were supported and the loan-to-value ratios were within Section 184 guidelines.

Bank2 Ensured That Borrowers and Properties Were Eligible for the Section 184 Program

Section 184 borrowers must be members of an Indian tribe or Alaska Natives who will occupy the property as a principal residence or a tribally designated housing entity, such as an Indian housing authority. In addition, the property must be located either on land that is trust or restricted land or within an Indian area, which may include homes on fee simple land² outside the

² Trust land is land or an interest in land held in trust by the United States Government for an individual Indian or tribe. Fee title or fee simple title generally denotes an estate in land that is absolute and unrestricted. The owner is entitled to dispose of the entire property or various interests in the property without hindrance.

tribes' Indian operating area. Bank2 ensured that borrowers and properties for all 14 loans complied with these processing guidelines.

Bank2 Developed Written Internal Controls

Bank2 developed written internal controls to assist its underwriters and loan officers with the origination of Section 184 loans. It had checklists and detailed procedures to ensure that its staff was able to navigate its loan origination system and its loan files were complete. In addition, Bank2 had a detailed quality control plan and procedures for its Section 184 loan program.

Recommendations

This report contains no recommendations.

Scope and Methodology

We performed our audit work between February and April 2019. We conducted our onsite fieldwork at Bank2's office in Oklahoma City, OK, and our work covered Bank2's Section 184 loan originations from January 2016 through December 2018.

To accomplish our objective, we

- Reviewed HUD's regulations and loan processing guidelines.
- Reviewed Bank2's written policies and procedures related to Section 184 loans.
- Determined the total number of loans Bank2 originated during the audit period.
- Selected a statistical sample of loans to review.
- Analyzed individual loan files to determine whether Bank2 complied with loan processing guidelines.

Bank2 provided a list of the Section 184 loans it originated. During our audit period, Bank2 originated 1,917 loans totaling more than \$297.1 million. We identified some loans that were paid off and others that Bank2 originated for different lenders. To develop our universe, we filtered out these types of loans. After removing these loans, the universe contained 1,356 loans with an unpaid balance of more than \$187.3 million.

We selected a stratified statistical sample of 74 loans to review to determine whether Bank2 originated Section 184 loans in accordance with HUD's processing guidelines. We designed the strata to group sampling units by the size of their valuation. Therefore, we rank ordered the sampling units by the loan balance amounts.

We selected 14 of the 74 loans in our sample to review during the survey phase of the assignment. We did not identify any discrepancies with these loans. As a result, we did not review the remaining 60 loans. Since we did not review all 74 loans in the statistical sample, the results cannot be projected to the universe. Of the 14 loans reviewed, 10 of them were loans to individual homeowners, and 4 were loans made to an Indian housing authority. For the 10 loans made to individuals, we reviewed the loan files using HUD's processing guidelines. However, the processing guidelines do not provide detailed guidance on loans with Indian housing authorities.³ Without specific guidelines for these loans, we used the general processing guidelines in chapter 5 (Notice PIH 2014-22) related to the prospect of repayment and property value and assessed the risk of these loans to HUD. We used the loan-to-value ratio, the rental cash flow of the property, and the housing authority's financial statements to assess the risk of these loans.

We did not rely on computer-generated data as audit evidence or to support our audit conclusions. We based our conclusions on the supporting documentation obtained and reviewed

³ Audit reports 2015-LA-0002, recommendation 1I, and 2018-LA-0801 identified the lack of policies and procedures for loans when the borrower was a housing authority. The recommendation remained open as of the date of this audit report.

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

Internal Controls

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

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls to ensure that Bank2 properly originated Section 184 Loan Guarantees for Indian Housing program loans.

We assessed the relevant controls identified above.

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

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of Bank2's internal controls.

Appendixes

Appendix A

Auditee Comments and OIG's Evaluation

Auditee Comments

Ref to OIG
Evaluation

Comment 1



OIG Evaluation of Auditee Comments

Comment 1 We appreciate and value Bank2's cooperation throughout the audit process and the courtesies extended to our staff.