



Towne Mortgage Company, Troy, MI

HUD's Loss Mitigation Program for FHA-Insured Loans

**Office of Audit, Region 5
Chicago, IL**

**Audit Report Number: 2018-CH-1005
September 18, 2018**





To: Gisele G. Roget, Deputy Assistant Secretary for Single Family Housing, HU

From: //signed//
Kelly Anderson, Regional Inspector General for Audit, 5AGA

Subject: Towne Mortgage Company, Troy, MI, Generally Implemented Its Loss Mitigation Program in Accordance With HUD's Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Towne Mortgage Company's Loss Mitigation program for Federal Housing Administration-insured loans.

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 312-913-8499.



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Towne Mortgage Company, Troy, MI, Generally Implemented Its Loss Mitigation Program in Accordance With HUD's Requirements

Highlights

What We Audited and Why

We audited Towne Mortgage Company, a Federal Housing Administration (FHA) nonsupervised lender, as part of the activities in our fiscal year 2018 annual audit plan. We selected Towne Mortgage based on our analysis of risk factors for single-family servicing lenders in Region 5's jurisdiction.¹ Our audit objective was to determine whether Towne Mortgage properly implemented its Loss Mitigation program for FHA-insured loans in accordance with the U.S. Department of Housing and Urban Development's (HUD) requirements.

What We Found

Towne Mortgage generally implemented its Loss Mitigation program for FHA-insured loans in accordance with HUD's requirements for the 18 loans reviewed. However, it did not always accurately report borrowers' delinquent or default status to HUD. This condition occurred because Towne Mortgage lacked adequate procedures and controls regarding its default reporting for FHA-insured loans. As a result, HUD did not have complete and accurate information to properly assess the performance of the FHA-insured loans and effectively monitor Towne Mortgage's loss mitigation efforts.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Towne Mortgage to (1) implement adequate procedures and controls to ensure that borrowers' delinquent and default information is accurately reported in accordance with HUD's requirements, (2) provide verification to HUD that it has taken the appropriate action to correct its delinquent or default status code reporting for the borrowers affected as a result of its system change, and (3) ensure that the staff responsible for making entries into its servicing system is properly trained and understands HUD's reporting requirements.

¹ The region contains six States: Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.

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Background and Objective

Towne Mortgage Company, a nonsupervised lender,² received approval as a Federal Housing Administration (FHA) lender on April 12, 1983. On July 22, 1988, Towne Mortgage became an unconditional direct endorsement lender, which also originated and serviced conventional loan products.

The National Housing Act established FHA, an organizational unit within the U.S. Department of Housing and Urban Development (HUD). FHA provides mortgage insurance on loans made by FHA-approved lenders. This insurance provides private lenders with protection against losses as a result of homeowners defaulting on their mortgage loans. The basic home mortgage insurance program is authorized under Title II, section 203(b), of the National Housing Act and governed by regulations in 24 CFR (Code of Federal Regulations) Part 203.

HUD established the Loss Mitigation program in 1996 to ensure that distressed FHA-insured borrowers would have opportunities to keep their homes and reduce losses to FHA's insurance fund. Loan servicers must offer loss mitigation options to borrowers in distress based on the borrower's financial circumstances and the status of the loan. The program consists of reinstatement options to promote retention of borrowers' homes and disposition options, which assist borrowers in disposing of their homes.

The reinstatement options are special forbearance, partial claim, loan modification, and the Home Affordable Modification Program (HAMP). A special forbearance is a written repayment agreement between a loan servicer and a borrower, containing a plan to reinstate a delinquent loan. A partial claim consists of an interest-free loan to the borrower in the amount needed to reinstate the mortgage, thereby becoming a subordinate mortgage payable to HUD. The FHA-HAMP loss mitigation option, which became effective August 15, 2009, combines the loan modification and partial claim loss mitigation options.

The disposition options are preforeclosure sale and deed in lieu of foreclosure. The preforeclosure sale option allows the defaulted borrower to sell his or her home and use the sale proceeds to satisfy the mortgage debt even if the proceeds are less than the amount owed. A deed in lieu of foreclosure allows a borrower to turn over his or her home to HUD in exchange for a release from all mortgage obligations.

Our objective was to determine whether Towne Mortgage properly implemented its Loss Mitigation program for FHA-insured loans in accordance with HUD's requirements.

² A nonsupervised lender is an FHA-approved lending institution, the principal activity of which involves lending or investing funds in real estate mortgages.

Results of Audit

Finding: Towne Mortgage Generally Implemented Its Loss Mitigation Program in Accordance With HUD's Requirements

Towne Mortgage generally implemented its Loss Mitigation program in accordance with HUD's requirements for the 18 loans reviewed. However, it did not always accurately report borrowers' delinquent or default status to HUD. This condition occurred because Towne Mortgage lacked adequate procedures and controls regarding its default reporting for FHA-insured loans. As a result, HUD did not have complete and accurate information to properly assess the performance of the FHA-insured loans and effectively monitor Towne Mortgage's loss mitigation efforts.

Towne Mortgage Generally Implemented Its Loss Mitigation Program

We reviewed eight FHA-insured loans that had been in default for 90 days or more to determine Towne Mortgage's collection attempts and whether it attempted to help borrowers retain their homes. For all eight loans, Towne Mortgage generally contacted and requested financial information from the borrowers to determine whether they qualified for loss mitigation home retention options (that is, special foreclosure, loan modification, and partial claim) before four monthly mortgage payments had been due and unpaid.³

We reviewed 10 loans, for which HUD paid loss mitigation claims, to determine whether borrowers were properly evaluated for HUD's loss mitigation options. For all 10 loans, Towne Mortgage appropriately

- maintained documentation to support adequate attempts at loss mitigation,
- analyzed or evaluated borrowers' financial situation to determine eligibility for loss mitigation,
- ensured that borrowers successfully completed their trial payment plans, and
- properly calculated the loss mitigation home retention claim amounts.

³ HUD Handbook 4000.1, FHA Single Family Housing Policy Handbook, section III.A.2.i.v(A), states that the 90-day review is a lender-required evaluation, occurring before four monthly mortgage payments are due and unpaid, for appropriate loss mitigation options.

Borrowers' Loan Delinquency or Default Status Was Not Always Accurately Reported in HUD's Single Family Default Monitoring System⁴

Towne Mortgage did not always accurately report borrowers' delinquent or default status to HUD.⁵ Specifically, for the 10 loans for which HUD paid loss mitigation claims, 7 had the following reporting deficiencies:

FHA case number	Trial payment plan not reported	Completion of trial payment plan not report	Incorrect trial payment code
264-1082046	X		
264-1865698	X		
581-4482478	X		
261-9544452	X	X	
581-4598934	X	X	
261-8343754			X
413-6043899			X
Totals	5	2	2

- For five loans, Towne Mortgage did not report that the borrowers were on trial payment plans for an FHA-HAMP loan modification or partial claim in HUD's Single Family Default Monitoring System.⁶ Further, for two of the loans, it also failed to report the successful completion of the trial payment plans for an FHA-HAMP loan modification. These conditions occurred because in April 2016, Towne Mortgage began using a new servicing system that was supposed to automatically upload borrower delinquent and default information into HUD's System. Prior to the new servicing system, the default supervisor would run a report and manually check the monthly default reporting in HUD's System. However, the new system did not correctly capture and report borrowers' information to HUD. In addition, Towne Mortgage's staff were not trained

⁴ HUD's Single Family Default Monitoring System is a system used for tracking and monitoring the performance of defaulted FHA-insured loans.

⁵ HUD Handbook 4000.1, section III.A.2.h.ii(B), states that the lender must report in HUD's System the delinquency and default status codes that accurately reflect the stage of loan delinquency or lender action.

⁶ According to HUD Handbook 4000.1, sections III.A.2.k.vi(F)(7) and III.A.2.k.v(E)(8), the lender must report in HUD's System the use of an FHA-HAMP option [trial payment plan].

on which data input fields from its servicing system reported default information into HUD's System. Therefore, its staff did not verify that the information uploaded into HUD's System was accurate.

- For two loans, Towne Mortgage reported inaccurate trial payment plan codes in HUD's System. Specifically, it reported that both borrowers were on type II special forbearance trial payment plans; however, HUD's Neighborhood Watch system showed that a loan modification claim had been paid for one loan and an FHA-HAMP partial claim had been paid for other loan. The noncompliance with HUD's reporting requirements occurred because Towne Mortgage's staff selected the incorrect reporting code in its servicing system due to user error. As a result, HUD's reporting for these two loans showed a special forbearance trial payment plan when the borrowers were on a loan modification and an FHA-HAMP trial payment plan.

As a result of our audit, Towne Mortgage modified its servicing system to ensure that it would retrieve accurate borrower data to populate the correct data fields in HUD's System going forward. It also created a user guide to ensure that its staff correctly reports borrowers' delinquent and default information in HUD's System and to provide further education, guidance, and training to its staff on its servicing system.

Conclusion

Towne Mortgage lacked adequate procedures and controls regarding its default reporting for FHA-insured loans. As a result, HUD did not have complete and accurate information to properly assess the performance of the FHA-insured loans and effectively monitor Towne Mortgage's loss mitigation efforts.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Towne Mortgage to

- 1A. Implement adequate procedures and controls to ensure that borrowers' delinquent and default information is accurately reported.
- 1B. Provide verification to HUD that it has taken the appropriate action to correct its delinquent or default status code reporting for the borrowers affected as a result of its system change.
- 1C. Ensure that staff responsible for making entries into its servicing system is properly trained and understands HUD's reporting requirements.

Scope and Methodology

We performed our audit work from December 2017 through March 2018 at Towne Mortgage's office in Troy, MI, and our offices located in Chicago, IL, and Detroit, MI. The audit covered the period January 1, 2016, through December 31, 2017.

To accomplish our objective, we reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to HUD's Loss Mitigation program. Further, we reviewed Towne Mortgage's servicing policies and procedures and quality control plan. We also reviewed Towne Mortgage's electronic and hardcopy loan servicing files. We interviewed Towne Mortgage's employees and communicated with a member of HUD's National Servicing Center staff.

We also selected the following samples to test the implementation of Towne Mortgage's Loss Mitigation program.

90-day Default Review

Using HUD's data maintained in its Single Family Data Warehouse,⁷ as of January 8, 2018, we identified 2,968 loans, the borrowers of which were delinquent with their mortgage payments as of December 31, 2017. Of the 2,968 loans, the borrowers of 348 loans were 90 days or more delinquent with their mortgage payments. HUD's Single Family Post Insurance Division reviewed the claims filed for FHA insurance for three loans. This adjustment reduced our 90-day default universe to 345 loans. In our analysis of the 90-day defaults, we identified 199 loans (58 percent of 345) for which the status code had not updated from the initial default status code of delinquent (code 42) as of January 8, 2018, serving as an indicator that the servicer may not have attempted to actively engage in available loss mitigation options. This adjustment reduced our 90-day default universe to 199 loans with an unpaid principal balance of \$30.2 million. From the universe of loans identified, we randomly selected 6 loans for review, 2 loans each from the following three categories: loans for which HUD paid a loss mitigation claim, loans that went into foreclosure, and active loans that were in default 90 days or more as of December 31, 2017. We also reviewed a sample of 2 loans, which represented 100 percent of the 199 loans that went into bankruptcy. We selected a total of 8 of the 199 loans with an unpaid principal balance of \$1.1 million to review.

Loss Mitigation Incentive Claim Payments Review

⁷ HUD's Single Family Data Warehouse is a collection of database tables structured to provide HUD users easy and efficient access to single-family housing case-level data on borrowers' insured properties and associated loans, insurance, claims, defaults, and demographics.

Using HUD's data maintained in the Single Family Data Warehouse as of January 16, 2018, we identified 27 loans for which HUD paid loss mitigation incentive claims⁸ during the period January 1, 2016, to December 31, 2017. HUD's Post Insurance Division reviewed 1 of the 27 loans, and 1 loan was included in our 90-day default universe, reducing our loss mitigation universe from 27 to 25 loans. The 25 loans had total unpaid principal balance of more than \$3.4 million and more than \$661,000 in losses to HUD. We selected a nonstatistical sample of 10 loans and this sample was selected based on factors such as (1) the type of loss mitigation claim, (2) default reason code, and (3) loans with an unpaid principal balance of \$70,000 or more. We performed a detailed review of 10 loans, including (1) 5 loans with an FHA-HAMP stand-alone partial claim, (2) 3 loans with an FHA-HAMP combination partial claim and loan modification, and (3) 2 loans with a loan modification. We reviewed 10 of the 25 loans, with total unpaid principal balance of more than \$1.6 million and more than \$373,000 in losses to HUD, to determine whether Towne Mortgage properly reviewed the borrower's eligibility for loss mitigation options in accordance with HUD's requirements.

The conclusion in this audit report is limited to the 18 loans reviewed and cannot be projected to the universe. We did not review Towne Mortgage's compliance with HUD's loss mitigation requirements on its entire servicing loan portfolio.

We relied on information maintained in HUD's Neighborhood Watch⁹ and Single Family Data Warehouse systems for informational and sampling purposes only. We also relied on data maintained in Towne Mortgage's servicing system, such as electronic loan files. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes. The testing consisted of comparing data in the electronic files to information from HUD's systems. The audit results were based on our review of electronic and supporting hardcopy documentation maintained by Towne Mortgage.

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.

⁸ Fees lenders receive based on the loss mitigation option used to cure defaulted loans

⁹ Neighborhood Watch refers to a web-based software application that displays loan performance data for lenders and appraisers using FHA-insured single-family loan information. The system is designed to highlight exceptions so that potential problems are readily identifiable.

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:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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.

Significant Deficiency

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 Towne Mortgage's internal controls.

Appendix

Appendix A

Auditee Comments

Towne Mortgage declined the opportunity to provide a written response.