Issue Date	February 9, 2012
Audit Report Number	2012-PH-0004

TO: Deborah C. Holston, Acting Deputy Assistant Secretary for Single Family Housing, HU

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FROM: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

SUBJECT: HUD Controls Did Not Always Ensure That Home Equity Conversion Mortgage Loan Borrowers Complied With Program Residency Requirements

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) oversight of its Home Equity Conversion Mortgage (HECM) program based on our annual audit plan and our strategic goal to improve the integrity of HUD's single-family programs. This is the first of two reports that we plan to issue on HUD's oversight of the program. Our objective was to determine whether HUD's controls effectively ensured that HECM loan borrowers complied with program residency requirements.

What We Found

HUD controls did not always ensure that HECM loan borrowers complied with program residency requirements. Our review disclosed that 33 borrowers had more than 1 HECM loan and that they falsely certified to principal residency for properties that they were not living in. As a result, 33 loans insured under the HECM program were ineligible for insurance and should be declared in default and due and payable to reduce the potential risk of loss of an estimated $3.9 million to HUD's Federal Housing Administration (FHA) insurance fund.

What We Recommend

We recommend that HUD direct the servicing lenders to identify which property is the HECM loan borrower's principal residence for each of the 33 cases, declare the loan for the other property in default, and declare it due and payable, thereby putting an estimated $3.9 million to better use. We also recommend that HUD perform quality assurance tests at least annually to ensure that edits in its FHA Connection system are effective in preventing the approval and generation of FHA case numbers for borrowers with existing loans.

For each recommendation in the body of the report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-4. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a discussion draft audit report to HUD on December 12, 2011, and discussed it with HUD at an exit conference on January 3, 2012. HUD provided written comments on the draft audit report on January 24, 2012. HUD agreed with the audit report. The complete text of HUD's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVE

The U.S. Department of Housing and Urban Development (HUD) provides reverse mortgage insurance through the Home Equity Conversion Mortgage (HECM) program.

The purpose of a HECM loan is to enable elderly homeowners to convert the equity in their homes to monthly streams of income or credit lines. To be eligible for a HECM loan, the borrower must be 62 years of age or older, own the property outright or have a small mortgage balance, occupy the property as a principal residence, not be delinquent on any Federal debt, and participate in a consumer information session given by a HUD-approved HECM counselor. The maximum amount (principal limit) the borrower or borrowers can receive is based on the age of the youngest borrower, interest rate, mortgage insurance premium (MIP), and value of their home or HUD's loan limits, whichever is less. The loan is secured by the home's equity. Eligible properties include single-family homes or one- to four-unit homes with one unit occupied by the borrower, HUD-approved condominiums, and manufactured homes that meet Federal Housing Administration (FHA) requirements.

The borrower is not required to repay the loan as long as the borrower continues to occupy the home as a principal residence, maintains the property, and pays the property taxes and the mortgage insurance premiums. The loan agreement defines "principal residence" as the dwelling where the borrower maintains his or her permanent place of abode and typically spends the majority of the calendar year. A person may have only one principal residence at any one time. The borrower must certify to principal residency initially at closing and annually thereafter.

Servicing lenders are responsible for ensuring that borrowers meet the program requirements, including the annual certification of principal residency. The mortgage note contains a clause stipulating that the lender may require immediate payment in full of all outstanding principal and accrued interest, upon approval of an authorized representative of the HUD Secretary, if the property ceases to be the principal residence of the borrower for reasons other than death and the property is not the principal residence of at least one other borrower.

Our audit objective was to determine whether HUD's controls effectively ensured that HECM loan borrowers complied with program residency requirements.

RESULTS OF AUDIT

Finding: HUD Controls Did Not Always Ensure That HECM Loan Borrowers Complied With Program Residency Requirements

HECM loan borrowers did not always comply with program residency requirements. Twenty-seven loan borrowers were principal borrowers on 2 HECM loans, clearly indicating a violation of the program residency requirements. Also, six borrowers, who were both a principal borrower on one HECM loan and a coborrower on another, were not residing in the property associated with the loan of which they were the principal borrower. Therefore, 33 loans insured under the HECM program were ineligible. The violations occurred because HUD did not have adequate controls to prevent the borrowers from obtaining multiple loans. In June 2009, HUD implemented improvements that should help prevent borrowers from obtaining multiple loans. However, since it did not have the proper controls in place before 2009, approximately $3.9 million in FHA funds is potentially at risk for the 33 ineligible loans.

33 HECM Loan Borrowers Violated Program Residency Requirements

According to HECM program regulations at 24 CFR (Code of Federal Regulations) 206.39, the property associated with the loan must be the principal residence of each borrower at closing. Also, regulations at 24 CFR 206.211 require servicing lenders to at least annually determine whether the property associated with a HECM loan is the principal residence of at least one borrower and require borrowers to certify that the property associated with the HECM loan is their principal residence. Further, regulations at 24 CFR 206.27 state that the mortgage balance will be due and payable in full if the property ceases to be the principal residence of a borrower for reasons other than death and the property is not the principal residence of at least one other borrower.

We analyzed HUD data on HECM loans and identified 27 borrowers with potentially 2 loans each. Based on documents provided by servicing lenders, we confirmed that the borrowers had 2 loans in all 27 cases. In 22 of the 27 cases, the borrowers provided annual certifications[1] that both properties were their principal residence, clearly indicating a violation of the program residency requirements. In the remaining five cases, the lenders did not provide adequate documentation to show that the borrowers complied with the annual certification

[1] We requested the borrowers' annual certifications for the last 3 years from the applicable servicing lenders.

requirements or that they complied with the principal residency requirement (see appendix C).

In addition, six borrowers, who were both a principal borrower on one HECM loan and a coborrower on another, were not residing in the property associated with the loan of which they were the principal borrower, thus violating the principal residency requirement.

HUD Lacked Adequate Controls but Has Made Improvements

HUD's FHA Connection system[2] allowed lenders to generate and obtain approval of FHA case numbers for borrowers with existing HECM loans because the system did not have the necessary edits or controls in place to identify those borrowers. As a result, 33 borrowers violated the program residency requirements as discussed above.

Of the 33 cases identified, 31 loans were closed before June 2009. HUD officials said that beginning in June 2009, edits were implemented in the FHA Connection system that should help prevent borrowers from improperly obtaining multiple loans. According to the officials, the FHA Connection system was programmed to send a warning alert message if a lender enters a potential borrower's name and Social Security number into the system and the data entered match an existing case number. The lender cannot obtain a case number until the alert message is resolved with HUD. We did not test the new edits; however, 2 of the 33 loans closed after HUD implemented the edits. Therefore, HUD should implement a process to conduct periodic quality assurance reviews to ensure that the edits and controls are working properly. Such quality assurance reviews will allow HUD to determine the effectiveness of the edits implemented and should help prevent borrowers from improperly obtaining multiple HECM loans.

About $3.9 Million in FHA Funds Is Potentially at Risk

Because the FHA Connection system lacked adequate controls to prevent borrowers from improperly obtaining more than 1 HECM loan, 33 existing borrowers were able to obtain at least 1 additional HECM loan. These borrowers falsely certified to principal residency and violated the program residency requirements; therefore, 33 HECM loans were ineligible, and an estimated $3.9 million in FHA funds is potentially at risk for the loans. In accordance with program regulations, the ineligible loans should be identified and immediately declared in default and declared due and payable.

[2] The FHA Connection system provides FHA-approved lenders and business partners with direct, secure, online access to HUD computer systems.

Conclusion

HUD's implementation of edits in its FHA Connection system should help prevent borrowers from improperly obtaining multiple HECM loans by ensuring that FHA case numbers are not generated and approved for existing borrowers; however, HUD needs to perform periodic quality assurance reviews to ensure that the system edits are effective. Also, for each of the 33 cases, HUD needs to direct the applicable servicing lenders to identify the property that is the principal residence of the borrower, declare the loan for the other property in default, and declare it due and payable. Doing so will reduce the potential risk of loss of an estimated $3.9 million to HUD's FHA insurance fund.

Recommendations

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing

1A. Direct the applicable servicing lenders for each of the 33 cases to identify which property is the HECM loan borrower's principal residence, declare the loan for the other property in default, and declare it due and payable, thereby putting $3,960,192 to better use.

1B. Perform quality assurance tests at least annually to ensure that edits in its FHA Connection system are effective in preventing the approval and generation of FHA case numbers for borrowers with existing loans.

SCOPE AND METHODOLOGY

We conducted the audit from March to October 2011 at our office in Richmond, VA. The audit covered the period January 2001 through December 2010 but was expanded as necessary to accomplish our objective. We relied in part on computer-processed data in HUD's Single Family Data Warehouse.[3] Although we did not perform a detailed assessment of the reliability of data, we performed a minimal level of testing and found the data to be adequate for our purposes. The testing entailed matching information obtained from the Single Family Data Warehouse to hardcopy documents provided by servicing lenders.

To accomplish our objective, we reviewed

- Relevant background information on HECM loans and applicable regulations,
- HECM program requirements,
- Loan information on the HECM borrowers provided by the servicing lenders,
- Lexis Nexis[4] information on the HECM borrowers, and
- Information in HUD's Single Family Data Warehouse.

We interviewed HUD's single-family program staff, including loan servicing personnel, and servicing lender officials.

We obtained all available HECM loan level data from HUD's Single Family Data Warehouse system as of February 2011. As of that date, the system contained information on 515,000 HECM loans. We used Audit Command Language (ACL) software to filter the universe of 515,000 loans by borrower's Social Security number and identified 27 borrowers with 2 HECM loans. We then obtained the loan information from the applicable servicing lenders and verified that the borrowers had two loans. We also used ACL to filter the universe of HECM loans to determine whether there were borrowers who were both a principal borrower and a coborrower on HECM loans. We identified 12 borrowers who were the principal borrower on one HECM loan and a coborrower on another. Using the LexisNexis public database, we determined the borrowers' current residences and verified the information by obtaining the related loan documentation from the applicable servicing lenders. Based on the information obtained from the servicing lenders, six borrowers, who were the principal borrower on one loan and a coborrower on another, were not living in the property associated with the loan of which they were the principal borrower. For these 6 borrowers and the 27 discussed above, the information we obtained from the servicing lenders and reviewed included annual recertification documents for the last 3 years, HUD-1forms, certification of counseling letters, and Deeds of Trust.

[3] HUD's Single Family Data Warehouse system contains information on FHA-insured mortgages.
[4] The LexisNexis database is an online resource that provides information on legal and public records.

In all, there were 33 cases in which the borrower had 2 HECM loans. In each case, one loan was ineligible and should not have been insured. Determining and declaring the ineligible loans in default and making them due and payable will reduce the risk of loss to HUD's FHA insurance fund because HUD will be relieved of potential future claim liabilities related to the undisbursed loan amounts. We estimated this savings to HUD (funds to be put to better use) to be about $3.9 million.

We calculated the $3.9 million in estimated funds to be put to better use by first determining the difference between the principal limit[5] and the loan balance[6] for each loan. These differences represented the estimated undisbursed principal for each loan. We then totaled the lower undisbursed principal amount for each of the 33 cases to determine the estimated funds to be put to better use. We used the lower amounts to obtain a conservative estimate of the savings to HUD since the servicing lenders are yet to determine which loans were ineligible. A breakdown of the loans questioned for each of the 33 cases is provided in appendix C of this report.

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.

[5] Principal limit represents the maximum approved loan amount as reflected on Deeds of Trust related to the loans.
[6] Loan balances were obtained from the Single Family Data Warehouse as of November 2011, and include advances, repayments, payoffs, fees, interest, and mortgage insurance premiums.

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:

- Program operations – Policies and procedures that management has implemented to reasonably ensure that the HECM program meets its objectives.

- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports for the HECM program.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that program participants comply with HECM program 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

Based on our review, we believe that the following item is a significant deficiency:

- HUD did not have adequate controls in place to prevent HECM loan borrowers from improperly obtaining multiple loans.

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$3,960,192

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, implementation of our recommendation to identify the ineligible loans, declare them in default, and declare them due and payable will reduce the risk of loss to the FHA insurance fund because HUD will be relieved of potential future claim liabilities related to undisbursed loan amounts.

Appendix B

AUDITEE COMMENTS

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

JAN 2 0 2012

MEMORANDUM FOR: John P. Buck, Regional Inspector General for Audit, Philadelphia Region, 3AGA

FROM: Charles S. Coulter, Deputy Assistant Secretary for Single Family Housing, HU

SUBJECT: HUD Comments on Discussion Draft Audit Report
HUD Controls Did Not Always Ensure That Home Equity Conversion Mortgage Loan Borrowers Complied with Program Residency Requirements
OIG Audit Report 2012-PH-000x

The Office of Inspector General (OIG) performed the subject audit of the U. S. Department of Housing and Urban Development's (HUD) Home Equity Conversion Mortgage (HECM) Program to determine whether HUD's controls effectively ensured the HECM borrowers complied with program residency requirements. During the course of the audit, OIG concluded 33 HECM borrowers had more than one HECM loan and that those borrowers falsely certified to principal residency for properties that they were not occupying. OIG concluded that HUD controls did not always ensure HECM borrowers complied with program residency requirements. The Office of Single Family Housing's (Single Family) response to the audit is as follows:

OIG's Determination:

The report states that 28 HECM borrowers annually certified to principal residency on two properties and in five cases, the servicing lender did not provide adequate documentation to show that the borrowers complied with the annual certification requirements. To correct this deficiency, OIG recommended that Single Family direct the applicable servicing lenders for each of the 33 cases to identify which property is the HECM loan borrower's principal residence, declare the loan for the other property in default, and declare it due and payable.

Single Family's Response:

Single Family acknowledges OIG's finding. However, it is important to note that while the regulations cited require the property to be the mortgagor's principal residence at the time of closing and that the mortgagee obtain occupancy certification from each mortgagor annually; these regulations also only provide for the loan being due and payable if the property is not the principal residence of at least one mortgagor. Upon obtaining further documentation, Single Family will seek guidance from OGC as to the appropriateness of declaring these loans in default.

www.hud.gov espanol.hud.gov

OIG's Determination:

In June 2009, HUD implemented edits to the FHA Connection system to prevent borrowers from improperly obtaining multiple loans; however, two of the 33 HECM loans closed *after* HUD implemented these edits and allowed the borrower to obtain more than one HECM. To correct the deficiency, OIG recommended that HUD perform quality assurance tests at least annually to ensure that edits in its FHA Connection system are effective in preventing the approval and generation of FHA case numbers for borrowers with existing loans.

Single Family Response:

Single Family agrees with OIG's finding. However, the FHA Connection edits were not implemented to prevent borrowers from obtaining more than one HECM. Instead these edits were implemented to: 1) make HUD and the lender aware of instances where a borrower's name and social security number matched an existing case number; and 2) prompt further action to ensure each borrower meets the principal residency requirements. It is important to note that the local Homeownership Center has authorization to override the warning and insure the loan once the lender provides documentation to support the property being insured is the principal residence of each mortgagor.

Description of Planned Actions:

To further address this audit, Single Family will follow the guidance provided by OGC and take the following actions:

- Order and review the servicing lender's annual certification documents and other other documentation required by OGC for the 33 HECM borrowers to determine the appropriate course of action for each loan.
- Review existing FHA Connection edits and Single Family procedures to ensure compliance with Section 206.39 principal residency requirements prior to the issuance of the mortgage insurance certificate.

Appendix C

BREAKDOWN OF ESTIMATED FUNDS TO BE PUT TO BETTER USE

#	FHA case number	Borrower's certification status	Principal limit (a)	Loan balance (b)	Undisbursed principal (a-b)
1	249-5157251	1	$544,185	$261,954	$282,231
2	241-8390501	1	472,500	200,161	272,339
3	251-3170411	1	469,343	208,650	260,693
4	044-4328357	1	544,185	322,702	221,483
5	048-4539620	2	472,500	256,941	215,559
6	095-0212669	2	442,500	261,469	181,031
7	521-6462158	1	252,000	88,629	163,371
8	093-6201487	1	352,500	198,648	153,852
9	023-2925857	1	285,000	134,784	150,216
10	052-4608822	1	208,500	62,376	146,124
11	093-6245702	1	240,000	112,721	127,279
12	263-3935656	1	250,500	124,672	125,828
13	541-7649808	1	234,000	110,953	123,047
14	561-8440954	1	226,500	118,716	107,784
15	493-8610158	3	193,500	86,673	106,827
16	431-4184335	1	237,000	133,494	103,506
17	371-3804182	1	225,000	125,103	99,897
18	331-1159284	1	255,000	156,000	99,000
19	581-2721861	1	219,000	121,836	97,164
20	105-3502089	1	174,000	76,936	97,064
21	105-3284381	1	169,500	74,973	94,527
22	431-4361161	1	217,500	123,628	93,872
23	061-2856346	4	237,000	157,652	79,348
24	541-5610783	5	144,000	75,158	68,842
25	095-0646658	5	132,000	65,644	66,356
26	493-8715380	5	123,000	56,720	66,280
27	581-2840181	1	141,000	78,891	62,109
28	441-7959208	1	123,000	61,338	61,662
29	441-8505726	1	124,500	69,093	55,407
30	381-8023026	1	127,500	72,222	55,278
31	022-1807263	2	127,500	80,328	47,172
32	182-0897748	1	75,000	35,145	39,855
33	501-7347714	1	134,000	98,811	35,189
Total					**$3,960,192**

Borrower's Certification Status Key[7]

1= Borrower annually certified to principal residency for both loans.
2= Servicing lender did not provide any annual borrower certifications for this loan; however, the borrower annually certified to principal residency for the other loan.
3= Servicing lender provided the borrower's most recent annual certification for this loan; however, the certification was inadequate because it did not include the property address. The borrower did not certify to principal residency on the other loan; however, as a condition of obtaining the loans, the borrower certified to principal residency at loan closing.
4= Borrower did not annually certify to principal residency for either loan. However, as a condition of obtaining the loans, the borrower certified to principal residency at loan closing.
5= Borrower was a principal on one loan and a coborrower on another, and annually certified to principal residency on both loans.

[7] See footnote 1.