



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

September 22, 2017

MEMORANDUM NO:
2017-LA-1802

Memorandum

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

Dane M. Narode
Associate General Counsel for Program Enforcement, CACC

//SIGNED//

FROM: Tanya E. Schulze
Regional Inspector General for Audit, Los Angeles Region, 9DGA

SUBJECT: SecurityNational Mortgage Company, Las Vegas, NV, Improperly Originated
FHA Loans for Properties With Restrictive Covenants

INTRODUCTION

We audited SecurityNational Mortgage Company's Federal Housing Administration (FHA) loan origination because it was among the top lenders that originated FHA-insured loans with downpayment assistance from the City of Las Vegas. A previous U.S. Department of Housing and Urban Development, Office of Inspector General (HUD OIG), audit (Evergreen Home Loans, 2016-LA-1011) found that Evergreen originated FHA-insured loans in connection with the City of Las Vegas' downpayment assistance program that contained prohibited legal restrictions on conveyance.

The objective of our audit was to determine whether SecurityNational improperly originated FHA loans for properties with restrictive covenants.

HUD Handbook 2000.06, REV-4, provides 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 the OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at <http://www.hudoig.gov>.

METHODOLOGY AND SCOPE

We performed our fieldwork at our Las Vegas, NV, and San Francisco, CA, field offices from May through August 2017. Our audit generally covered loans with closing dates from May 2012 through September 2013.

To accomplish our objective, we reviewed

- Applicable Code of Federal Regulations and HUD program requirements.
- Reports and information from HUD's Neighborhood Watch system.¹
- SecurityNational's FHA-insured loan documents, including downpayment assistance closing documents.
- SecurityNational's policies and procedures for reviewing closing documentation.

During a previous audit of another lender, we determined that closing documents associated with the City's Neighborhood Stabilization Program (NSP) downpayment assistance program contained prohibited legal restrictions on conveyance. We obtained a listing of all NSP downpayment assistance loans awarded by the City. Using HUD's Single Family Data Warehouse,² we identified which downpayment assistance loans were associated with FHA loans and originated by SecurityNational. We determined that SecurityNational originated eight FHA-insured loans that received NSP downpayment assistance. Of the eight loans, only seven were active FHA loans at the time of the audit. The outstanding mortgage balance for the seven loans was \$779,233. We obtained and reviewed the closing documents for all seven active loans. The results of our audit are limited to the seven loans reviewed and cannot be projected to all FHA-insured loans originated by SecurityNational.

We conducted the audit in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information system controls of SecurityNational. We did not follow standards in these areas because our primary objective was to determine whether closing documents related to downpayment assistance signed by borrowers contained prohibited legal restrictions on conveyance. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our review results.

¹ Neighborhood Watch is a system that aids HUD-FHA staff in monitoring lender progress and performance. The system also aids lenders and the public in self-policing the industry.

² The Single Family Data Warehouse is an extensive collection of database tables organized and dedicated to support analysis of single-family housing data.

BACKGROUND

FHA provides mortgage insurance on single-family home loans made by FHA-approved lenders. Since its creation in 1934, it has insured more than 41 million properties, making it the largest mortgage insurer in the world. FHA's mortgage insurance protects lenders against losses resulting from homeowners defaulting on their mortgage loans. This decreases the lender's risk because FHA will pay a claim to the lender should a default occur. However, loans must meet certain requirements established by FHA to qualify for this insurance.

SecurityNational Mortgage Company is a nonsupervised direct endorsement lender.³ It has 138 active branch offices throughout the United States. Its home office is located at 5300 South 360 West, Suite 150, Murray, UT. SecurityNational was approved by FHA in September 1993.

The HUD OIG audit of Evergreen Home Loans (audit report 2016-LA-1011) identified loans that received home-buyer downpayment assistance from the City of Las Vegas. The audit concluded that the agreements used to secure those loans subjected the borrower to contractual liability other than the repayment of assistance provided, which violated HUD regulations.

RESULTS OF REVIEW

SecurityNational improperly originated FHA loans for seven properties that contained prohibited restrictive covenants. This condition occurred because SecurityNational did not have adequate policies and procedures in place to identify the prohibited restrictive covenants. As a result, SecurityNational placed the FHA fund at unnecessary risk for potential losses of \$381,823.⁴ In addition, HUD paid a claim on one of the seven loans, resulting in actual losses of \$26,472.

SecurityNational Originated Loans That Contained Prohibited Legal Restrictions on Conveyance

SecurityNational improperly originated FHA loans for seven properties that contained prohibited restrictive covenants. HUD's policy of free assumability with no restrictions states that a mortgage is not eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance.⁵ However, legal restrictions are acceptable if they are part of an eligible government or nonprofit program as long as the restrictions do not subject the borrower to contractual liability other than requiring repayment of downpayment assistance received. In addition, the borrower must be allowed to recover the sum of the original purchase price, the borrower's reasonable cost of sale, and the reasonable cost of improvements made by the borrower.⁶ The borrowers of these seven loans received downpayment assistance from NSP through the City of Las Vegas. In exchange for the downpayment assistance, the borrowers agreed to a repayment clause that required repayment to the City of an amount equal to the

³ A nonsupervised direct endorsement lender is one that has as its principal activity the lending or investing of funds in real estate mortgages and is permitted by HUD to underwrite single-family mortgages without FHA's prior review and submit them directly for FHA insurance endorsement.

⁴ The estimated loss amount is based on a 49 percent loss rate from HUD's Single Family Acquired Asset Management System's case management profit and loss by acquisition as of June 2017.

⁵ 24 CFR (Code of Federal Regulations) 203.41(b)

⁶ 24 CFR 203.41(d)(1)(i)

current market value of the property, less any portion of the value attributable to expenditures of non-NSP funds for acquiring or improvements to the property. The repayment clause did not allow the borrower to recover the reasonable cost of sale as required. Under these circumstances, the borrower could repay more than the assistance received.

As a result, the seven SecurityNational loans reviewed contained legal restrictions on conveyance that violated HUD’s policy of free assumability; thus, all seven loans were ineligible for FHA insurance. The total unpaid mortgage balance of these seven loans with restrictive covenants was \$779,233, with an estimated loss to HUD of \$381,823.⁷ Of the seven active loans, HUD paid a partial claim on one loan for \$26,472.⁸ The following table identifies the active FHA-insured loans that contained prohibited restrictive covenants.

FHA loans with prohibited restrictive covenants

FHA case no.	Mortgage balance	Estimated loss to HUD (49%) ⁷
332-5774642	\$132,589	\$64,968
332-5739584	114,211	55,963
332-5804449	142,960	70,050
332-5728053	78,745	38,585
332-5537539	96,030	47,055
332-5557688	109,102	53,460
332-5743219	105,596	51,742
Totals	779,233	381,823

Conclusion

SecurityNational improperly originated FHA loans for seven properties that contained prohibited restrictive covenants. We reviewed SecurityNational’s closing policies and procedures and determined that they were not adequate to ensure that SecurityNational identified prohibited restrictive covenants. As a result, HUD paid claims totaling \$26,472, and the SecurityNational placed the FHA fund at unnecessary risk for potential losses of \$381,823.

⁷ The estimated loss amount is the mortgage balance multiplied by the 49 percent loss rate from HUD’s Single Family Acquired Asset Management System’s case management profit and loss by acquisition as of June 2017.

⁸ FHA loan number 332-5743219

RECOMMENDATIONS

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

- 1A. Work with HUD to nullify the restrictions on conveyance that violate HUD policy or indemnify HUD. This action will protect HUD against future losses of \$381,823 for the seven loans.
- 1B. Repay HUD \$26,472 for partial claims paid on one FHA loan that contained prohibited restrictive covenants.
- 1C. Develop and implement policies and procedures to identify prohibited restrictions on conveyance to ensure that it does not originate FHA loans with prohibited restrictive covenants.
- 1D. Provide training to its employees regarding HUD's requirements related to prohibited restrictions on conveyance.

We also recommend that the Associate Counsel for the Office of Program Enforcement

- 1E. Determine legal sufficiency and if legally sufficient, pursue civil and administrative remedies, civil money penalties, or both against SecurityNational, its principals, or both for incorrectly certifying to the eligibility for FHA mortgage insurance or that due diligence was exercised during the origination of FHA loans.

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A		\$381,823
1B	\$26,472	
Totals	26,472	381,823

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. In this case, ineligible costs of \$26,472 relate to partial claims paid by HUD on one FHA loan that was not eligible for FHA insurance due to prohibited restrictive covenants.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligations 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. If HUD implements our recommendation to indemnify seven loans not originated in accordance with FHA requirements, it will reduce FHA's risk of loss to the insurance fund. The questioned costs of \$381,823 represent the estimated loss to HUD based on HUD's Single Family Acquired Asset Management System's case management profit and loss by acquisition calculation as of June 2017. FHA estimates that it loses on average 49 percent of the claim amount when it sells a foreclosed-upon property.

Appendix B

Auditee Comments

SecurityNational declined the opportunity to provide written comments.