Office of Housing
Washington, DC

Distressed Asset Stabilization Program

Office of Audit, Region 7
Kansas City, MO

Audit Report Number: 2018-KC-0003
September 6, 2018

To:	Susan Betts, Acting Deputy Assistant Secretary for Finance and Budget Office of Housing, HW
	//**signed**//
From:	Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
Subject:	HUD's DASP Note Sales Generally Resulted in Lower Loss Rates Than Conveyance Claims

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) results of our latest review of the single-family note sales 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 913-551-5870.

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HUD's DASP Note Sales Generally Resulted in Lower Loss Rates Than Conveyance Claims

Highlights

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) single-family note sales program. This is the third in a series of audits on the note sales program. The first audit, 2017-KC-0006, reported that HUD did not conduct rulemaking or develop formal procedures for its single-family note sales program. The second audit, 2017-KC-0010, reported that HUD generally ensured that purchasers followed the requirements outlined in the conveyance, assumption, and assignment contracts (purchase agreements). However, the requirements in the purchase agreements needed improvement. We conducted a third audit of the Distressed Asset Stabilization Program (DASP) because we wanted to determine if it was a cost effective addition to HUD's various asset disposition programs.

Our audit objective for this audit was to determine the loss rates for notes sold in HUD's DASP and compare them to the loss rates for notes processed through the traditional conveyance claim process.

What We Found

HUD's DASP note sales generally had a lower loss rate than that of its comparable conveyance process. The DASP loss rate was more than 3 percentage points lower than the loss rate of similar conveyance notes identified during our analysis. This calculation took into account the loss rate for actual DASP sales during the same period as the similar real-estate-owned conveyance claims. Ultimately the DASP program generally saved the insurance fund more money than its comparable conveyance process.

What We Recommend

This report contains no recommendations

Table of Contents

Background and Objective

The U.S. Department of Housing and Urban Development's (HUD) Office of Housing conducts single-family mortgage note sales under section 204(g) of the National Housing Act. The sales structure consists of whole loan, competitive auctions, offering for purchase defaulted single-family mortgages provided by Federal Housing Administration (FHA)-approved loan servicers. The notes are sold with minimal postsale restrictions or reporting requirements.

Since HUD began selling pooled notes in its Distressed Asset Stabilization Program (DASP), it has sold 108,616 notes totaling $18 billion. HUD asserts that DASP saves the insurance fund money compared to similar HUD real-estate-owned sales.

A HUD real-estate-owned home is a one-to-four-unit residential property acquired by HUD as a result of a foreclosure action on an FHA-insured mortgage. HUD becomes the property owner and offers the property for sale to recover the loss on the foreclosure claim. The HUD Home Store is the listing site for HUD real-estate-owned single-family properties where the public, brokers, State and local governments, and nonprofit organizations can search the inventory of HUD properties for sale.

The FHA Office of Housing conducts mortgage loan sales under the Single Family Loan Sale Initiative, and most distressed notes are sold through DASP. The initiative aims to meet the mission and financial objectives of maximizing recoveries to the insurance fund. The sales structure consists of whole loan, competitive auctions, offering for purchase defaulted single-family mortgages provided by FHA-approved loan servicers. The loans sold contain specified representations and warranties and may be sold with postsale restrictions or reporting requirements. FHA sells loans in large national pools, as well as loan pools in designated geographic areas that are aimed at stabilizing neighborhoods affected by foreclosures.

In June 2015, HUD implemented a series of changes to the note sales program. These changes included preventing foreclosure for a year after the note was sold rather than 6 months. Under the policy, borrowers had a year to work with the purchaser to resolve the default. At that time, FHA also required servicers to evaluate borrowers for the Home Affordable Modification Program (HAMP) or a substantially similar modification, and FHA implemented nonprofit-only sales. HAMP allows the use of a partial claim up to 30 percent of the unpaid principal balance as of the date of default, combined with a loan modification, for the purposes of reinstating the mortgage as current.

Due to the changes, our audit concentrated on the three most recent DASP note sales: 2015-1, 2016-1, and 2016-2. These pools contained 18,008 distressed notes, with an unpaid principal balance of $2.9 billion.

The key difference between REO sales and the DASP program is that REO sells individual foreclosed upon properties whereas DASP pools multiple defaulted loans then sells them through an auction process.

Our audit objective was to determine the loss rates for notes sold in DASP and compare them to the loss rates for notes processed through the traditional foreclosure and conveyance claim process.

Results of Audit

Results: HUD's DASP Note Sales Generally Resulted in Lower Loss Rates Than Those of Conveyance Claims

HUD's DASP note sales generally had a lower loss rate than that of its comparable conveyance process. The DASP loss rate was more than 3 percentage points better than the loss rate of similar conveyance notes identified during our analysis. This calculation took into account the loss rate for actual DASP sales during the same period as the similar real-estate-owned conveyance claims. Ultimately the DASP program generally saved the insurance fund more money than its comparable conveyance process.

DASP Note Sales Generally Saved the Mutual Mortgage Insurance Fund More Money

HUD's DASP note sales generally saved the Mutual Mortgage Insurance fund more money than its comparable conveyance process. The DASP loss rate was more than 3 percentage points better than the loss rate for loans, which met the criteria to be included in the DASP note sales but were instead allowed to proceed through the foreclosure process, resulting in a conveyance claim.

> The DASP loss rate was 3 percent better than the similar loss rate for notes that went to conveyance.

We identified all conveyance claims that met predefined criteria for DASP and were located in a similar geographic area from January 2014 to December 2015 and calculated the loss rate for those loans. Then we calculated the loss rate for actual DASP sales during the same period as the conveyance analysis.

The conveyance loss rate for the more than 81,000 notes in our analysis, which met the DASP criteria but went to conveyance, was 61percent from January 1, 2014, to December 31, 2015. The nationwide DASP loss rate for loans during that same period was 58 percent. The DASP loss rate was more than 3 percentage points better than that of similar conveyance notes identified during our analysis.

According to HUD FHA's Annual Report to Congress, dated November 15, 2016, FHA estimated that since 2013, DASP recoveries had netted $2.4 billion, about $16,000 per unit, over what would have been collected through the standard real-estate-owned execution.

Our complete methodology and analysis are located in appendix B of this report.

Recommendations

There are no recommendations.

Scope and Methodology

Our audit work covered the DASP records from 2010 to 2016. We performed our work from October to November 2017 at HUD headquarters in Washington, DC.

To accomplish our objective, we

- conducted interviews with HUD officials on the note sales process;
- interviewed various purchasers to determine the viability of individual note sales;
- determined the total number of loans sold through DASP;
- developed a sampling selection to determine audit objectives;
- reviewed conveyance, assignment, and assumption contract sale requirements;
- reviewed conveyance loss and note sales loss rates; and
- compiled data to determine the number of sample loans bought for properties that were either vacant or in an active foreclosure.

We developed a sample of loans to determine our audit universe and review sample. The full sampling plan is located in appendix B of this audit report. The following are highlights from the sample plan:

- The sample contained loans that could have been selected for DASP from January 1, 2014, to December 31, 2015.
- The sample resulted in 81,311 distressed notes.
- We found 57,776 DASP notes during the same period.
- This sample was not designed to be projected to the larger universe of all DASP loans.

To achieve our objective, we relied on data obtained from HUD's Office of Asset Sales individual note sales bidder data and HUD's Single Family Housing Enterprise Data Warehouse. The warehouse maintains the loan data for individuals who have obtained a mortgage insured under HUD/FHA's single family mortgage insurance programs and individuals who assumed an insured mortgage. We used data from the Office of Asset Sales to develop an individual sales breakout and data from the Data Warehouse to develop comparable conveyances. We used both for contextual information in the report. We also used these data to establish the total number of notes and the note sales' unpaid principal balance. We performed sufficient work to determine that the data in the Data Warehouse were reliable for the purposes 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.

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 HUD's pricing of note sales resulted in a savings to FHA's Mutual Mortgage Insurance fund.

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 HUD's internal control.

Appendixes

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

Office of Housing

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

AUG 15 2018

MEMORANDUM FOR: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

FROM: Susan Betts, Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to Discussion Draft Report - HUD's DASP Note Sales Generally had a Lower Loss Rate than that of its Comparable Conveyance Process

Comment 1

Thank you for the opportunity to respond to the Discussion Draft Report - HUD's DASP Note Sales Generally had a Lower Loss Rate than that of its Comparable Conveyance Process. The Office of Finance and Budget has reviewed this draft report and agrees with the Office of Inspector General that HUD's DASP note sales generally had a lower loss rate than that of its comparable conveyance process and the DASP program generally saved the insurance fund more money than its comparable conveyance process.

OIG Evaluation of Auditee Comments

Comment 1 The Office of Finance and Budget agreed with the conclusions in the report.

Appendix B

Loss Rate Analysis

We identified and analyzed conveyance claims that would have qualified for DASP if the current servicer had released them into the program. Our analysis calculated the loss rate for conveyances that could have been selected for DASP and then compared that with the loss rate for the actual DASP.

1) Our objective for this data analysis was to identify all conveyance claims that met the criteria for DASP and calculate the loss rate for those loans. Our objective was also to calculate the loss rate for actual DASP sales during the same period as the conveyance analysis.
2) We calculated the loss rate for conveyance claims that could have been selected for DASP (but were not).
    a. We selected January 1, 2014, to December 31, 2015, as the analysis period.
    b. We identified applicable program criteria that we would use to identify conveyance claims that would have qualified for DASP from the Single Family Loan Sales Program Participating Servicer Desk Guide. Specifically, we used pages 8-10:

Table 1 – Eligible Mortgage Loan Criteria	
Standard	**Sale and Claim Eligibility Criteria**
1. FHA Insurance program	The Mortgage Loan must be actively insured by FHA under either Section 203(b) or Section 234 of the National Housing Act, 12 U.S.C.§§ 1709 (b) and 1715y.
2. Approved Participating Servicer	An approved Participating Servicer is a servicer of HUD loans that has agreed to participate in the current phase of the SFLS Program and has signed a PSA with HUD. Loans must either (a) be owned and serviced by the Participating Servicer or (b) be serviced (but not owned) by the Participating Servicer but with respect to which Participating Servicer is authorized by the holder to purchase the loan from, or submit SFLS Claims on behalf of, the holder. The current sale may limit the number of participating servicers. Participation will be made on a first come first serve basis.
3. Collateral type	The related Mortgaged Property must be a single-family, 1-4 unit dwelling located in jurisdictions other than Hawaii, Guam, American Samoa and the Northern Marianas Islands.
4. Unpaid principal balance	The Mortgage Loan must have an unpaid principal balance of not less than $20,000.

Table 1 – Eligible Mortgage Loan Criteria	
Standard	**Sale and Claim Eligibility Criteria**
5. Loan is in default	For any Mortgage Loan where the Participating Servicer has the determined that the Mortgaged Property is vacant or abandoned, it is at least three (3) full payments past due under the terms of the Mortgage Note. If the Mortgage Note was permanently modified in connection with a Loss Mitigation Option, the Mortgage Loan as modified must meet the delinquency requirements of the preceding sentence
6. Loss mitigation	With respect to the current default, the Participating Servicer (or a prior servicer) has evaluated all FHA Loss Mitigation Home Retention Options (Special Forbearance, FHA-HAMP and Loan Modification) and Non-Retention Options (Pre-Foreclosure Sale, and Deed-in-Lieu of Foreclosure) in accordance with regulations at 24 C.F.R. §§ 203.501 and 203.605 and all applicable FHA Handbooks and Mortgagee Letters, and has determined the Borrower to be ineligible for any Loss Mitigation or such appropriate Loss Mitigation Options have been attempted and failed.
7. Participating Servicer Certifications	Participating Servicers will be required to self-certify that they have complied with the sale and claim eligibility criteria. The Self-Certification form is at the end of Appendix 2.
8. Loan to Value	The Eligible Mortgage Loan has a Loan to Value (LTV) Ratio greater than or equal to the LTV provided in Chart 1 below. LTV Ratio means the ratio determined by dividing the Unpaid Principal Balance as of the SFLS Claim Submission Report Date or Claim Date, as applicable, by the BPO Value.
9. Maximum Missed Payments	The Eligible Mortgage Loan is not past due, as of the SFLS Claim Submission Report Date, by more than the Maximum Missed Payments for the jurisdiction in which the Mortgaged Property is located. See Table1 A below.
10. Eligible Default Status (SFDMS) Codes and Minimum Missed Payments by Occupancy Status	The Mortgage Loan must be six (6) full payments due and unpaid under the terms of the Mortgage Note and coded AO, AP, or AQ in SFDMS, or eight (8) full payments due and unpaid under the terms of the Mortgage Note and coded 68 in SFDMS, or at least three (3) full payments past due under the terms of the Mortgage Note and coded AO, AP, AQ, or 68 and the Participating Servicer has determined that the Mortgaged Property is vacant or abandoned in accordance with 24 C.F.R. & 203.377 and Handbook 4330.1 Rev-5, and as evidenced by a BPO inspection. If the Mortgage Note was permanently modified in connection with a Loss Mitigation Option, the Mortgage Loan as modified must meet the delinquency requirements of the preceding sentence see Eligible Default Status Codes and Minimum Missed

Table 1 – Eligible Mortgage Loan Criteria	
Standard	**Sale and Claim Eligibility Criteria**
11. Additional Criteria	As of the date of SFLS Claim Submission Report and as of the Claim Date: ➢ The Mortgaged Property is not a condemned property, or has not been seized by the United States Department of Justice and is not otherwise the subject of a seizure order. ➢ The Mortgage Loan is not subject to an Indemnification Agreement or other settlement agreement setting for specific obligations with respect to the Mortgage Loan unless such obligations have been fully satisfied. ➢ The Mortgaged Property has not sustained any Surchargeable Damage. ➢ No foreclosure sale has been scheduled for a date prior to September 18, 2015; and as of the Claim Date there has been no foreclosure or pre-foreclosure sale, and no deed-in-lieu of foreclosure has been accepted. ➢ If the Mortgage Loan is a Bankruptcy Loan with a confirmed repayment plan under Chapter 13 of the United States Bankruptcy Code, the mortgagor is not current under the terms of that plan (note that Mortgage Loans under Bankruptcy Chapters 7, 11, and 12 are eligible); ➢ The Mortgage Loan is not subject to pending litigation related either to the origination of the Mortgage Loan or the underlying Mortgaged Property securing the Mortgage Loan. For purposes of this section, the term "pending litigation" does not include any active litigation in which the only counts, claims, or causes of action are (i) asserted by the mortgagee or secured lender and (ii) necessary for the foreclosure of the mortgage; and ➢ The Mortgage Loan has not been previously offered for sale as part of an FHA Single Family Loan Sale, unless the reason for non-delivery as part of the previous sale was the result of additional loss mitigation actions offered by Participating Servicer, Surchargeable Damage (that has been subsequently repaired), a bankruptcy action, or litigation (that has been subsequently resolved), a lien (that has been subsequently satisfied), no hazard and/or flood insurance (that has been subsequently reinstated), an inaccurate unpaid principal balance (that has subsequently been corrected), or an incomplete collateral file (that has been subsequently completed to contain all

c. We also used pages 12-13 for the State-specific criteria for the maximum number of missed payments before the loan no longer qualified for DASP. We also used the chart on page 13, table 1B.
d. We then accessed HUD's Single Family Data Warehouse via Sybase ODBC software to identify all conveyance claims that met the above criteria between January 1, 2014, and December 31, 2015.

e. We used the following structured query language (SQL) script to download these loans from the Data Warehouse.
f. This process resulted in 81,311 records that we downloaded from the Data Warehouse to an Excel file.
g. We calculated the following figures:

Total loss(gain) from conveyance sale	5317639203
tota UPB	8675934222
loss rate is loss(gain)/UPB	
loss rate	0.61291834
average days in default	1065.305615

1. We calculated "Total loss(gain) from conveyance sale" as the sum of all records in column Q. This amount is the total of claim A, claim B, and any selling or holding costs of the conveyed property minus the proceeds of the sale.
2. We calculated "total UPB" (unpaid principal balance) as the total of column R. This is the amount of the unpaid principal balance at the time of the claim process date.
3. We calculated loss rate by using the formula for calculation of the loss rate. Page 149 of the guide states:

For tractability, we simplify this two-step cash flow into one lump-sum amount. We also separately estimate losses from pre-foreclosure sales, wherein the property is sold prior to the completion of a foreclosure and the property is not conveyed to HUD (see Appendix E). The claim loss payment estimated in our model at time *t* is

$$Claim\ Loss_t = UPB_t * \ Loss\ Rate_t$$

We divided the total loss by the UPB to obtain a conveyance loss rate of 61 percent.

4. We also calculated the average days in default by using the (AVERAGE) Excel function on column N. This column shows the number of days between the most recent date of default and the date on which the claim was processed. This process resulted in an average of 1,065 days when the mortgage was in default before the claim was paid.

3) We set out with an objective to calculate the loss rate for DASP loans from January 1, 2014, to December 31, 2015.
   a. We used the SQL query to download all DASP loans (nationwide) from January 1, 2014, to December 31, 2015.

b. This process provided 57,776 results, and we loaded these data into ACL which is an audit analytics program capable of handling large amounts of raw data for analysis.

Overview Log Variables

SFDW_Table_2014_2015 | Records: 57,776

c. Loading the data into ACL resulted in 60,607 records.
d. We used the MERGE command in ACL to join the two tables:

```
OPEN SFDW_Table_2014_2015
OPEN Erics_Table_2014_2015
    INDEX ON FHA_Case_No TO "Erics_Table_2014_2015_on_FHA_Case_No"
OPEN SFDW_Table_2014_2015
    DEFINE RELATION case_nbr WITH Erics_Table_2014_2015 INDEX Erics_Table_2014_2015_on_FHA_Case_No
```

e. The point of this step was to combine the DASP sales auction price to that of loans identified as DASP loans in the Data Warehouse (the Data Warehouse does not have a field for the auction price).
f. After merging the tables, we exported to an Excel file having 57,776 records.
g. We then calculated the following figures within the Excel file:

total sales price	5578131186
tota claim	10953484099
Total UPB	9300317755
loss rate	0.577975189
average days in default	984.457447
total loss mit	110088178.3

1. We calculated total sales price as the total sum of column T.
2. We calculated the total claim as the total sum of column R.
3. We calculated the total UPB as the total sum of column S.
4. We calculated the loss rate as follows: the (total claim – the total sales price)/the total UPB. This amounted to approximately 58 percent.

5. We calculated the average days of default as the total of column J. This amount is the difference in days between the most recent default date and the date on which the claim was processed. This amount represents how long the mortgage went unpaid before it was sold at auction.

4) In summary, we found the nationwide conveyance loss rate for loans that met the criteria of DASP to be 61 percent from January 1, 2014, to December 31, 2015. We found the nationwide DASP loss rate for loans to be 58 percent from January 1, 2014, to December 31, 2015.