

**U. S. Department of Housing and Urban Development**

**Office of Inspector General for Investigation**

**Inspections and Evaluations Division**



**Evaluation of Debt Servicing and Collections  
Financial Operations Center,  
Albany, NY**

March 2010  
IED-09-007

## Executive Summary

The Office of Inspector General, Inspections and Evaluations Division, conducts independent, objective examinations of U.S. Department of Housing and Urban Development (HUD) activities, programs, operations, and organizational issues.

As a follow-up to our evaluation of Mortgagee Review Board enforcement actions (Report No. IED-09-003, May 2009), we reviewed the efforts of HUD's Financial Operations Center (FOC) in managing Federal Housing Administration (FHA) debts due HUD as a result of single-family indemnification agreements and civil money penalties (CMP). We wanted to know whether FOC debt servicing and collections complied with applicable Federal laws and regulations. We also wanted to determine the status and assess the collectability of the September 30, 2008, indemnification debt balance of more than \$45.9 million.

We conducted the evaluation primarily at the FOC offices located in Albany, NY. The evaluation included discussions with FOC management and staff, analysis of servicing and collection data, and limited review of indemnification and CMP debt servicing case files. The FOC assumed servicing and collection responsibilities for the indemnification debt in April 2004 and the CMP debt in February 2007. We also contacted the U.S. Department of the Treasury's (Treasury) Financial Management Service to determine its role in the debt collection process.

FOC staff complied with the Federal statutory and regulatory guidelines covering the collection of indemnification and CMP debt. The FOC serviced debt in a timely manner, and debt management decisions were reasonable and prudent, resulting in recoveries of

- \$119.7 million in indemnification debt from fiscal years (FY) 2005 through 2008, representing a 68 percent debt collection rate, and
- \$4.7 million in CMP debt from FY 2007 through 2008, representing a 42 percent debt collection rate.

Further, FOC collection rates compared favorably with rates of the U.S. Department of Veterans Affairs and private collection agencies.

Regarding the indemnification debt balance of \$45.9 million, our analysis disclosed that much of it is seriously delinquent and old and the likelihood of collection is doubtful. FOC records showed that about \$42 million (or 92 percent) of the debt balance represented indemnified loans that were more than 180 days delinquent and the majority of this debt was transferred to Treasury for continued collection. Moreover, about \$27.9 of the \$45.9 million is old debt incurred in FY 2004 or earlier. According to FOC and Treasury officials, the probability of recovering such longstanding debt is unlikely. Consequently, it is likely that most of the indemnification debt balance will not be recovered to offset FHA insurance fund losses. As of September 30, 2009, the debt balance stood at almost \$40.9 million.

Apart from our evaluation objectives, we observed one other matter concerning the tracking of indemnification debt cases by the originating HUD office. We plan to conduct a separate

evaluation to determine whether the debt history of lenders is considered when deliberating on future administrative actions.

We provided a draft copy of our observations to the Assistant Secretary for Housing-Federal Housing Commissioner on February 19, 2010. Comments in the form of an email from the Director of the FOC disclosed that as a result of our evaluation, the FOC has taken proactive steps to further improve its operations.

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## Introduction

The Financial Operations Center (FOC) services and collects debts resulting from U.S. Department of Housing and Urban Development (HUD) sanctions imposed on Federal Housing Administration (FHA) single-family lenders for violations of regulations and guidelines. Primarily, these debts reflect lender agreements to indemnify HUD for losses on mortgage insurance claims and civil money penalties (CMP) resulting from Homeownership Center (HOC) reviews and/or Mortgagee Review Board (MRB) rulings.

### Legal Authority

The Debt Collection Improvement Act of 1996 (DCIA) (P.L. 104-134) provides the FOC with the legal authority to collect debt owed HUD. It stipulates that Federal agencies must ensure quick action to enforce recovery of debts and use all appropriate collection tools to maximize collections. In support of agency collection activities, DCIA provides a framework to ensure more effective debt servicing and centralized management of seriously delinquent obligations within the U.S. Department of the Treasury (Treasury). DCIA requires Federal agencies to transfer debts that are more than 180 days delinquent (after meeting specific conditions) to Treasury for further collection efforts. Treasury and U.S. Department of Justice guidelines for the FOC's collection activities are codified in the 31 CFR (Code of Federal Regulations) 900 series and augmented in Office of Management and Budget (OMB) Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables."

### Collection History

The FOC began collecting FHA single-family indemnification debts in April 2004 and CMP debts in February 2007, becoming HUD's primary single-family debt collector. The following table shows the FOC's debt collection efforts for fiscal years (FY) 2005 through 2008 for the indemnification debt and FY 2007 through 2008 for the CMP debt.

Type of debt	Amount of debt serviced	Amount of debt collected
Indemnification	\$176.4 million	\$ 119.7 million
Civil money penalty	\$11.1 million	\$4.7 million
Total	<b>\$187.5 million</b>	<b>\$124.4 million</b>

Of the cumulative \$187.5 million debt serviced by the FOC, it wrote off and closed out about \$8.7 million (or 5 percent) of the debt as uncollectible. The uncollectible debts were primarily the result of the debtor lender's going out of business.

### Debt Transferred to Treasury

Treasury requires the FOC to suspend its collection activities once the debt is transferred to it. The FOC transferred almost \$45 million of the \$187.5 million in indemnification and CMP debt to Treasury from FY 2005 through 2008, representing 24 percent of all FHA single-family debt serviced during the period. Transferred debt can stay with Treasury for up to 10 years. However, FOC management retains approval authority over Treasury decisions that affect the

debt, such as accepting a compromised payment in lieu of full payment or closing out the debt as uncollectible.

## **Scope and Methodology**

We reviewed the FOC's debt servicing and collection policies and interviewed FOC management and loan servicing specialists to understand the debt servicing and collection processes. We also reviewed FOC records of communication with the MRB and HUD's four HOCs, the Office of Program Enforcement (OPE) within the Office of General Counsel, and the Chief Financial Officer concerning collection activities.

We gathered and analyzed servicing and collection data for FY 2005 through 2008, the first complete fiscal years that the FOC serviced indemnification debts, and we updated the status of the indemnification debt as of September 30, 2009. We also analyzed CMP collection data for the period FY 2007 through 2008.

To test for compliance with Federal statute and regulations, we examined a nonstatistical sample of indemnification and CMP debt servicing case files. The sample included a cross section of open and closed cases, representing examples of fully collected and uncollected debt. We also selected and examined an additional number of closed indemnification cases to determine why the FOC stopped servicing and wrote off the debt as uncollectible. Lastly, we gathered information on the collection activities from Treasury's Financial Management Service (FMS), and the U.S. Department of Veterans Affairs (VA) and conducted Internet searches for data on collection activities in the private sector.

We focused on the FOC activities during FY 2008, which ended with an indemnification debt balance of more than \$45.9 million. We analyzed the composition of this debt and updated the status as of September 30, 2009.

Because we relied mostly on data from the FOC's computer-based information system, the Debt Collection and Asset Management System (DCAMS), we assessed the reliability of the data in accordance with HUD Office of Inspector General (OIG) policies. We concluded that the data could be relied on to satisfy our evaluation objectives.

We initiated the evaluation in July 2009, performed our data gathering at the FOC in Albany, NY, and completed the data analysis and related fieldwork in October 2009.

We conducted the evaluation in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

## Observations

### **Observation 1: FOC Debt Servicing and Collections Complied With DCIA and Federal Guidelines**

The debt servicing and collection activities of the FOC complied with the intent and requirements of DCIA and Federal guidelines as set forth in 31 CFR Part 900 and OMB Circular A-129. The FOC serviced debt in a timely manner, and debt management decisions were reasonable and prudent, resulting in recoveries of

- \$119.7 million in indemnification debt from FY 2005 through 2008, representing a 68 percent debt collection rate.
- \$4.7 million in CMP debt from FY 2007 through 2008, representing a 42 percent debt collection rate.

Further, FOC collection rates compared favorably with the rates of VA and private collection agencies.

#### Servicing and Collection Efforts Were Timely

FOC servicing and collection efforts were conducted in a timely manner and with the appropriate use of available collection tools. DCAMS records the indemnification debt receivables, notifies debtors with 30-day demand letters<sup>1</sup> of their obligation to pay the debt owed HUD in a timely manner, and tracks and controls recoveries. As documented in the case files, staff employed appropriate collection methods, such as negotiated repayment plans, notices of delinquent debt to credit bureaus, debt compromise decisions, and warnings to the debtors of extra charges (e.g., a surcharge of a minimum of 28 percent) added to the debt principal if the debt is transferred to Treasury for continued collection efforts.

#### Debt Management Decisions Were Reasonable and Prudent

FOC debt management decisions were reasonable and prudent. The FOC transferred debts that were more than 180 days delinquent to Treasury in accordance with the statutorily mandated requirement. Indemnification receivables were not written off and closed out as uncollectible until FOC management was assured that the debt could not be recovered.

We examined 60 cases that were closed as uncollectible (about 43 percent of cases closed as uncollectible during the period March 2008 through August 2009) and found, without exception, documentation to show that debtor companies were defunct and out of business. According to FOC management, FOC staff defers to OPE on decisions concerning CMP servicing and collection measures. OPE is directly involved because the conditions for CMP debt collection are typically stipulated in settlement agreements that the MRB reached with the debtor lender.

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<sup>1</sup> In addition to the 30-day demand letter generated by DCAMS, FOC staff prepares a 30-day demand letter that contains greater detail on the debt owed by the lender. Both of these letters are sent to the respective lender.

## Collection Rates Compared Favorably With VA and Private Collection Agencies

FOC collection rates compared favorably with the collection rates of VA and private collection agencies. From FY 2005 through 2008, the FOC collection rate for indemnification debt was 68 percent, while the collection rate for CMP debt was 42 percent from FY 2007 through 2008. VA's Veterans Housing-Guaranteed and Insured Loans program, which is similar to HUD's single-family insured loan programs, had an aggregate collection rate of 37 percent for FY 2005 through 2008 for its defaulted loans.

Additionally, according to a 2004 nationwide industry survey, the collection rate for private collection agencies averaged almost 18 percent.<sup>2</sup> In a more recent survey of debt recoveries, for FY 2006, private collection agencies collected almost \$740 million in delinquent debt owed to Federal agencies, for a collection rate of 4.2 percent.

### **Observation 2: Indemnification Debt Was Longstanding and Mostly Uncollectible**

Analysis of FOC indemnification debt records disclosed that most of the \$45.9 million in indemnification debt as of September 30, 2008, is seriously delinquent and old and the likelihood of collection is doubtful. According to officials from the FOC and Treasury's FMS, typically as debt ages, the probability of collection drops. Consequently, it is likely that most of the indemnification debt balance will not be recovered to offset FHA insurance fund losses. As of September 30, 2009, the debt balance stood at almost \$40.9 million.

### Composition of the Debt Fiscal Year Ending 2008

FOC indemnification debt records disclosed that the \$45.9 million consisted of the following:

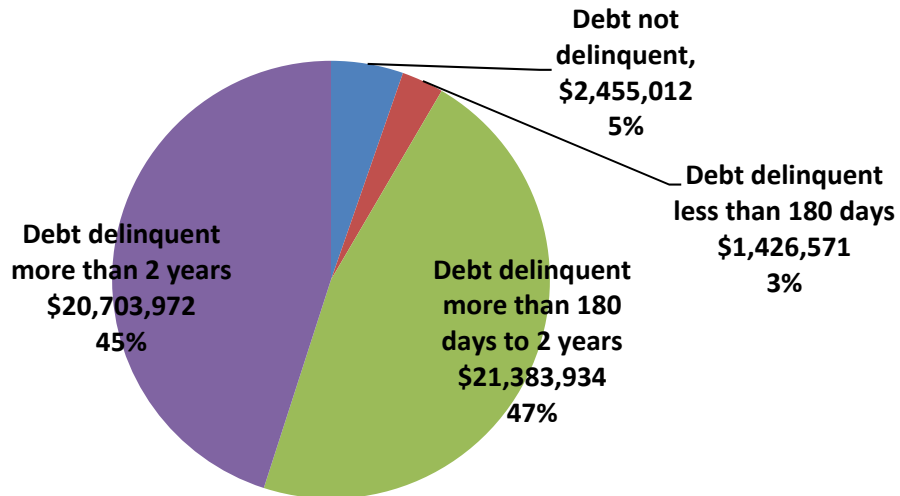
- About \$42.1 million (or 92 percent) was delinquent greater than 180 days, and \$30.2 million of this delinquent debt was transferred to Treasury for collection.
- Approximately \$27.9 million (or 61 percent) of the debt balance was outstanding debt at the time the FOC assumed its expanded debt collection responsibilities in 2004.
- Some \$20.7 million (or 45 percent) is more than 2 years old.

According to FOC management, much of the indemnification debt went back further than 2004. However, staff could not provide the historical details of pre-2004 debt, because when the FOC began servicing indemnification debt, new start dates for the collection activities were established in DCAMS to coincide with the mailing of FOC demand letters to the lenders. The following chart illustrates the aging of the \$45.9 million in indemnification debt due HUD as of September 30, 2008.

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<sup>2</sup> It should be noted that debt collections by private collection agencies were obligations mostly owed by individuals in contrast to the corporate obligations of mortgage lenders that participate in FHA's single-family mortgage insurance programs.





Our analysis of FOC debt collection data found that the prospect of collecting debt is diminished once it is more than 180 days delinquent and transferred to Treasury. FOC officials acknowledged that the prospect for collecting debt declines once it is transferred to Treasury. Further, analysis of the collection data for the period FY 2005 through 2008 disclosed that the collection rate for indemnification debt dropped by almost half after the FOC transferred the debt to Treasury.

Status of the Debt Fiscal Year Ending 2009

One year later, as of September 30, 2009, the FOC reported that the indemnification debt of more than \$45.9 million had declined to almost \$40.9 million. This reduction of about \$5 million was primarily due to the FOC’s writing off about \$6.7 million in uncollected debt because the debtor companies went bankrupt and an additional \$2.2 million in debt that was collected. The net reduction of \$5 million is calculated after considering accrued penalties, interest charges, and administrative costs, which were added to the September 30, 2009, ending balance.

**Other Matter**

During our evaluation we noted the following other matter, which requires further development by OIG.

Tracking of Indemnification Debt

The FOC does not track indemnification debts by its originating source (i.e., HOC reviews or MRB rulings). However, it does have the capability to identify the originating source if requested. According to FOC senior management, it is not critical to the FOC’s mission to systemically collect and record data that distinguish the originating sources of the debts. FOC staff told us that neither the HOCs nor the MRB have asked for this information. Federal statutory and regulatory debt collection requirements do not include the recording or reporting of this type of data.

When FHA lenders enter into indemnification agreements with the HOCs or the MRB, this information is recorded and coded by the HOCs in HUD's Computerized Home Underwriting Management System. The codes identify the office which originated the agreement. Using the FHA loan number, the FOC can track the source of a specific indemnification loan debt and provide a status report on the debt. The process involves cross-checking the FHA loan number against debt case data maintained in DCAMS.

At our request, the FOC provided a report that summarizes cumulative indemnification debt information by its originating source. For FY 2008, the HOCs were the primary source (92 percent) of the indemnification debts. In our opinion, the data offer a valuable analytical tool for FHA quality assurance and rule enforcement. We plan to conduct a separate evaluation to determine whether the debt history of lenders is considered by the originating HUD office when deliberating on future administrative actions.

### **Recommendations**

We make no recommendations. The debt servicing and collection activities of the FOC complied with the intent and requirements of DCIA and Federal guidelines. Our "other matter" observation will be the subject of a separate evaluation.

### **Comments and OIG Response**

We provided a draft copy of our observations to the Assistant Secretary for Housing-Federal Housing Commissioner on February 19, 2010, for comment. Comments in the form of an email from the Director of the FOC disclosed that as a result of our evaluation, the FOC has taken steps to further improve its operations.

The FOC is working with its contractor "...to amend and add to the routine reports produce[d] by DCAMS." Also, the FOC is "...proactively and routinely checking the indemnification portfolio to see if there are any delinquent debts owed by lenders that are still open and doing business with HUD – in order to refer them to the MRB at an earlier point in the collection cycle."