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Audit Report Number 2011-FW-1008

TO: Ivery Himes, Acting Director, Office of Single Family Asset Management, HUF

FROM: *//signed//*
Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: Midland Mortgage Company, Oklahoma City, OK, Generally Complied With
FHA-HAMP Rules and Regulations

HIGHLIGHTS

What We Audited and Why

We performed a limited review of Midland Mortgage Company (Midland) as a result of our internal audit of the Federal Housing Administration's (FHA) Home Affordable Modification Program (HAMP). During the internal audit, we visited Midland and reviewed a limited number of loans to determine whether the National Servicing Center implemented and operated FHA-HAMP in accordance with rules and regulations. Our objective for this limited review was to determine whether Midland followed U. S. Department of Housing and Urban Development (HUD) rules and regulations when processing defaulted loans for the FHA-HAMP loss mitigation option.

What We Found

Overall, Midland complied with FHA-HAMP rules and regulations. Our limited review of 15 loans¹ showed that Midland did not always check for borrower eligibility or assign the appropriate maturity date for FHA-HAMP partial claims.

¹ We reviewed 10 loans that had FHA-HAMP paid claims and 5 loans for default status code issues. We did not have any findings concerning the five loans selected for default status code issues.

Midland has since developed processes to ensure that it complies with FHA-HAMP rules and regulations for the two areas of noncompliance.

What We Recommend

Midland implemented several recommendations during the review to correct issues of noncompliance detailed in this report. However, we recommend that the Acting Director of the Office of Single Family Asset Management require Midland to correct the maturity dates on the legal documents for the three FHA-HAMP loans identified during our review.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft report to Midland on March 14, 2011, and requested comments by March 29, 2011. We held an exit conference with Midland on March 23, 2011. Midland provided its comments on March 30, 2011. Midland agreed with our one recommendation. However Midland stated payment of the partial claim is not required until payoff of the mortgage or notification of the borrower no longer living in the property. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVE

On August 31, 1950, Oklahoma City businessmen organized Midland Mortgage Company (Midland) in Oklahoma City, OK. Midland services approximately 400,000 mortgage loans. Midland's parent company is MidFirst Bank.

This limited review of Midland resulted from a spinoff of an internal audit of the Federal Housing Administration's (FHA) Home Affordable Modification Program (HAMP) loss mitigation option.² Midland is an FHA-approved servicer. Therefore, it can offer the FHA-HAMP loss mitigation option for FHA-insured loans either facing imminent default or already in default.

HUD introduced the FHA-HAMP loss mitigation option on July 30, 2009, and it became effective August 15, 2009.³ FHA-HAMP combines the already established loan modification and partial claim loss mitigation options. The FHA-HAMP loan modification must reduce the unmodified monthly principal and interest payment, and the servicer must reamortize the loan for 30 years. The FHA-HAMP partial claim can be up to 30 percent of the unmodified unpaid principal balance. The FHA-HAMP partial claim is due at the (1) maturity of the FHA-HAMP mortgage, (2) sale of the property, or (3) payoff or refinancing of the FHA-HAMP mortgage.

As of June 7, 2010, Midland had the most completed FHA-HAMP claims with 337, or more than 46 percent of the 731 FHA-HAMP completed claims. We chose Midland to review during our internal audit due to the number of completed FHA-HAMP claims.

Our objective was to determine whether Midland followed U. S. Department of Housing and Urban Development (HUD) rules and regulations when processing defaulted loans for the FHA-HAMP loss mitigation option.

² See audit report 2011-FW-0001, dated April 8, 2011, "The National Servicing Center Implemented the FHA-HAMP Loss Mitigation Option in Accordance with Rules and Regulations" for the results of the review.

³ Mortgagee Letter 2009-23

RESULTS OF AUDIT

Finding: Midland Generally Complied With FHA-HAMP Rules and Regulations

Overall, Midland followed FHA-HAMP rules and regulations. However, it did not always comply with checking for borrower eligibility and assigning the appropriate maturity date for the FHA-HAMP partial claim. Since this was a recently developed program, a limited review within the first year of the program showed that some processes needed improvement. While Midland had implemented new polices to correct future occurrences, it needs to correct the maturity dates of three instances noted. If Midland does not correct the maturity dates, then it will obligate the borrowers to pay off the partial claim before the modified mortgage is due and potentially result in defaulted loans.

Midland Did Not Ensure Borrower Eligibility

In the 10 loans reviewed for FHA-HAMP paid claims, Midland did not check to ensure borrower eligibility. To participate in FHA-HAMP, regulations required servicers to check HUD's Limited Denial of Participation list and General Services Administration's (GSA) Excluded Parties List System (EPLS) to ensure borrower eligibility before approving a borrower for the loss mitigation option.⁴ Review of EPLS showed that all borrowers were eligible.⁵ Nonetheless, Midland must check borrower eligibility to ensure that it does not approve an ineligible borrower for FHA-HAMP. Midland had implemented this change and no further action was necessary.

Maturity Dates Were Not Always in Agreement With Requirements

Of the 10 loans reviewed for FHA-HAMP paid claims, three had FHA-HAMP partial claim documentation with a maturity date not in accordance with requirements. FHA-HAMP regulations required servicers to assign the FHA-HAMP partial claim the same maturity date as that of the FHA-HAMP loan modification.⁶ Contrary to requirements, Midland inadvertently used the unmodified loan maturity date and filed legal documents with the incorrect

⁴ Mortgagee Letter 2009-23 and its attachment

⁵ We did not review the Limited Denial of Participation list.

⁶ Mortgagee Letter 2009-23 and its attachment

maturity date.⁷ If uncorrected, the borrower will be required to payoff the FHA-HAMP claim before paying off the loan. Upon notification, Midland revised its policy to ensure that the FHA-HAMP partial claim maturity date was the same as that of the loan modification maturity date. However, it needs to correct the three instances reviewed in which it used the incorrect maturity date.

Conclusion

Overall, Midland complied with FHA-HAMP rules and regulations. Midland's new policies to check borrower eligibility and assign the appropriate maturity date for the FHA-HAMP partial claim will help it service the FHA-HAMP loss mitigation option in accordance with rules and regulations. HUD should require Midland to correct the maturity date on the three FHA-HAMP loans identified during the review. If not, the borrowers will be obligated to pay off the partial claim before the mortgage and potentially result in defaulted loans.

Recommendations

We recommend that the Acting Director of the Office of Single Family Asset Management require Midland to

- 1A. Correct the maturity dates on the legal documents for the three FHA-HAMP loans identified during our review.

⁷ For example, a borrower's unmodified loan maturity date was October 2037 with the modified loan maturity date of December 2039. Midland filed the partial claim with the maturity date of October 2037 instead of December 2039; which was not in accordance with Mortgage Letter 2009-23 and its attachment.

SCOPE AND METHODOLOGY

To accomplish our objective, we

- Reviewed relevant criteria,
- Reviewed Midland loan files,
- Reviewed GSA's EPLS system to ensure borrowers' eligibility,
- Interviewed National Servicing Center and Midland staff, and
- Analyzed the Single Family Data Warehouse's loss mitigation table and default history table as discussed in detail below. We performed this analysis under the internal audit; however, we used it to select a sample of loans to review from Midland.

Loss Mitigation Table

The Single Family Data Warehouse's loss mitigation table contained more than 1.1 million records⁸ as of June 7, 2010. Using ACL software, we filtered these records to show paid claims for loan modifications and partial claims with or without an FHA-HAMP indicator. We ran a duplicates test to determine whether HUD paid any claims twice on the same loan that had a loan modification or partial claim with an FHA-HAMP indicator. One loan had a duplicate claim for a loan modification with an FHA-HAMP indicator. Further, we joined tables of these filtered records to determine the number of

- Completed FHA-HAMP claims (731),
- Paid claims for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim (14),
- Paid claims for an FHA-HAMP partial claim without a corresponding FHA-HAMP loan modification (131),
- Paid claims for an FHA-HAMP partial claim that had a previous partial claim without a HAMP indicator (41), and
- Instances in which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date (7).

As of June 7, 2010, Midland had the most completed FHA-HAMP claims with 337.

We chose a total of 10 files as follows:

- Two loans from the completed FHA-HAMP table—one with the oldest endorsement date and one with the highest FHA-HAMP partial claim amount;
- Two loans from the paid claim for an FHA-HAMP partial claim without a corresponding HAMP loan modification—one with the highest FHA-HAMP partial claim amount and one with the oldest process date with the highest FHA-HAMP partial claim amount;

⁸ The loss mitigation table included special forbearance, loan modification, and partial claim.

- Two loans from the paid claim for an FHA-HAMP loan modification without a corresponding FHA-HAMP partial claim—the first two listed;
- Two loans from the paid claim for an FHA-HAMP partial claim that had a previous partial claim without a HAMP indicator—one with the highest FHA-HAMP partial claim amount and one with the highest regular partial claim amount; and
- Two loans for which the FHA-HAMP loan modification claim process date was before the FHA-HAMP partial claim process date; Midland only had two of these loans.

Default History Table

As of June 10, 2010, the Single Family Data Warehouse’s default history table for default status codes 39 and 41⁹ contained more than 18,800 records. We filtered the records to isolate the default status codes into individual tables: default status code 39 contained 16,662 records and default status code 41 contained 2,139 records. We then joined the default status code tables to determine how many loans had a default status code 39 that matched and did not match default status code 41. After eliminating any duplicate case numbers,¹⁰ our analysis showed that 746 loans had both default status codes of 39 and 41. Additionally, 8,848 loans had a default status code of 39 but not 41.

We chose a total of five loans to review that had a default status code of 39 but not 41. We assigned a random number to each loan and sorted in ascending order. Before selecting the loan to review, we reviewed Neighborhood Watch to ensure that the loan did not already have a completed FHA-HAMP claim.¹¹ If the loan had a completed FHA-HAMP claim, we discarded that loan and chose the next loan until we had five loans total.

We relied on the above data to select a sample of loans to review for our objective. We reviewed the underlying documentation to form our conclusions. We do not express an opinion on the overall reliability of the data.

We initially performed this work under an internal audit. We performed audit work at Midland’s office and our office in Oklahoma City from June 2010 through January 2011.

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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

⁹ Default status code 39 indicates the servicer approved a borrower to participate in the FHA-HAMP trial plan. Default status code 41 indicates the borrower completed the trial plan and the servicer is beginning the process to file the partial claim and loan modification claims.

¹⁰ Servicers would report a default status code 39 for the 3- or 4-month period during which the participant was in the trial plan.

¹¹ HUD considered the FHA-HAMP loss mitigation option failed when the servicer reported a default status code 39 but not 41. We did not select any borrowers that had completed FHA-HAMP claims because this indicated they did not fail FHA-HAMP.

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 – Local policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that it obtains, maintains, and fairly discloses valid and reliable data in reports.

We assessed the relevant controls identified above.

A deficiency in internal controls 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. We did not design our evaluation of internal controls 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 the Midland's internal control.

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

Comment 2



March 28, 2011

U.S. Department of Housing & Urban Development
Office of Inspector General, Region VI
Attention: Gerald R. Kirkland
819 Taylor Street, Suite 13A09
Fort Worth, Texas 76102

Dear Mr. Kirkland:

Midland Mortgage Co. appreciates the opportunity to work with your Audit team during their review of FHA's Home Affordable Modification Program (FHA-HAMP). We feel that the FHA-HAMP program is an excellent addition to the suite of available workout options available on FHA insured loans.

The audit report contains one recommendation requiring further corrective action on the part of Midland Mortgage Co. Specifically, it is recommended that Midland obtain corrected partial claim documents for three loans where the maturity dates on the partial claim documents were incorrectly listed as the pre-HAMP modification maturity date. Our documentation team will begin work immediately to obtain these corrected documents and record in the appropriate jurisdiction where the properties are located. Once obtained and recorded, we will send the documents to HUD's contractor, C&L Services. We would like to point out that we do not feel as though this inconsistency in maturity dates would result in a borrower being required to pay off the partial claim prior to the original mortgage. According to program guidance for the Partial Claim program (a component of FHA-HAMP) payment of the partial claim is only triggered by the payoff of the first mortgage or notification that the borrower no longer owns the property. We are of the opinion that the maturity date listed on the partial claim note and security instrument is not the trigger to determine when the borrower must pay the partial claim advance in full. Furthermore, an inconsistency will exist between the maturity of a partial claim and the mortgage maturity on any loan subsequently modified following a partial claim.

Midland commends FHA on the addition of the FHA-HAMP program to the suite of home retention options available on FHA insured loans. We look forward to continuing to work with FHA on ways to improve the available loss mitigation programs in an attempt to maximize home ownership.

Sincerely,

Kevin Osuna
Senior Vice President – Default Management

OIG Evaluation of Auditee Comments

- Comment 1 We appreciate Midland's cooperation during this review. We commend Midland for taking appropriate action regarding the incorrect maturity dates.
- Comment 2 Our objective focused on the FHA-HAMP rules and regulations. Those rules and regulations required the maturity date of the FHA-HAMP partial claim to be the same as the maturity date of the FHA-HAMP loan modification.