Highlights of GAO-06-515, a report to congressional addressees

May 2006

RESIDENTIAL CARE FACILITIES MORTGAGE INSURANCE PROGRAM

Opportunities to Improve Program and Risk Management

Why GAO Did This Study

Through its Section 232 program, the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) insures approximately $12.5 billion in mortgages for residential care facilities. In response to a requirement in the 2005 Consolidated Appropriations Conference Report and a congressional request, GAO examined (1) HUD's management of the program, including loan underwriting and monitoring; (2) the extent to which HUD's oversight of insured facilities is coordinated with the states' oversight of quality of care; (3) the financial risks the program poses to HUD's General Insurance/Special Risk Insurance (GI/SRI) Fund; and (4) how HUD estimates the annual credit subsidy cost for the program.

What GAO Recommends

GAO recommends, among other things, that the HUD Secretary establish a process for sharing practices among field offices, assure appropriate levels of staff with appropriate expertise, and incorporate reviews of federal or state inspection reports into loan monitoring. GAO also recommends that HUD explore factoring additional information into its credit subsidy model. In written comments, HUD agreed with all of GAO's recommendations except exploring the value of adding certain factors to its credit subsidy model.

www.gao.gov/cgi-bin/getrpt?GAO-06-515.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David G. Wood at (202) 512-6878 or WoodD@gao.gov.

What GAO Found

While HUD's decentralized program management allows its 51 field offices flexibility in their specific practices, GAO found differences in the extent to which staff in the five field offices it visited were aware of current program requirements. For example, four offices were unaware of required addendums to the programs' standard regulatory agreement. Further, while individual offices had developed useful practices for loan underwriting and monitoring, they lacked a mechanism for systematically sharing such practices with other offices. Also, field office officials were concerned about adequate current or future levels of staff expertise—a critical factor in managing program risk in that health care facility loans are complicated and require specialized knowledge and expertise.

FHA requires a review of the most recent annual state-administered inspection report for state-licensed facilities applying for program insurance, and recommends, but does not require, continued monitoring of such reports for facilities once it has insured them. Four of the five HUD field offices GAO visited do not routinely collect annual inspection reports for their insured facilities. While the reports are but one of several monitoring tools, they provide potential indicators of future financial risk. HUD has proposed revising its standard regulatory agreements to require insured facility owners or operators to submit annual inspection reports and to report notices of violations. However, the proposed revisions have been awaiting approval since August 2004, and the implementation date is uncertain.

The Section 232 program accounts for only about 16 percent of the GI/SRI Fund's total unpaid principal balance, but program and industry trends pose potential risks to the Section 232 program and to the GI/SRI Fund. For example, in recent years the program has insured increasing numbers of assisted living facility loans and refinancing loans, for which there are limited data available to assess long-term performance. Other potential risk factors include increasing prepayments (full repayment before loan maturity) and loan concentration in several large markets and among relatively few lenders. Projected shifts in demand for residential care facilities could affect currently insured facilities and the overall market for the types of facilities that HUD insures under the program.

To estimate the program subsidy cost, HUD uses a model to project cash flows for each loan cohort (the loans originated in a given fiscal year) over its entire life. HUD's model does not explicitly or fully consider certain factors, such as loan prepayment penalties, interest rate changes, or differences in loans to different types of facilities, and uses some proxy data that is not comparable to Section 232 loans. The model's exclusion of potentially relevant factors and it use of this proxy data could affect the reliability of HUD's credit subsidy estimates.