



## **HUD's Office of Single Family Housing's Oversight of Lenders' Underwriting of FHA- Insured Loans Was Generally Adequate**



Issue Date: August, 17, 2012

Audit Report Number: 2012-CH-0001

TO: Charles S. Coulter, Deputy Assistant Secretary for Single Family Housing, HU

*Kelly Anderson*

FROM: Kelly Anderson, Regional Inspector General for Audit, 5AGA

SUBJECT HUD's Oversight of Lenders' Underwriting of FHA-Insured Loans Was Generally Adequate

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the HUD's Oversight of Lenders' Underwriting of FHA-Insured Loans.

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 8L, requires that OIG post its publicly available reports on the OIG Web site. 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 312-353-7832.



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# Highlights

Audit Report 2012-CH-0001

## What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) oversight of Federal Housing Administration (FHA)-insured loans. We initiated the audit as part of the activities in our 2011 annual audit plan and strategic plan. Our audit objective was to determine whether HUD had adequate oversight of lenders' compliance with FHA's underwriting requirements.

## What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require the Office of Single Family Housing to (1) determine whether FHA loan number 095-1259735 was covered under the settlement with Flagstar Bank FSB, (2) ask the lender to provide adequate supporting documentation for FHA case number 541-8917153 to show that the two remaining borrowers were eligible, using credit-qualifying streamline refinancing, or reimburse HUD for \$89,052 for the actual loss incurred on the disposal of the associated property; and (3) improve its existing policies and procedures to address the issues identified in this report.

## What We Found

HUD generally had adequate oversight of lenders' compliance in underwriting FHA-insured loans. Its Processing and Underwriting and Quality Assurance Divisions appropriately identified lenders' underwriting deficiencies and initiated appropriate corrective actions, with the exception of two out of the 18 loans reviewed by its Quality Assurance Division. For these loans, HUD's Quality Assurance Division did not (1) require the lender to correct an error that it identified during a review for one loan or (2) identify a material underwriting deficiency for the other. The weaknesses occurred because HUD did not adequately oversee the quality assurance loan file review process. As a result, HUD incurred losses totaling \$280,107 on the disposal of the associated properties.

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## **BACKGROUND AND OBJECTIVES**

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The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA insures mortgages on single-family and multifamily homes including manufactured homes and hospitals. It is the largest insurer of mortgages in the world, having insured more than 34 million properties since its inception in 1934. FHA mortgage insurance provides lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet certain requirements established by FHA to qualify for insurance.

The U.S. Department of Housing and Urban Development's (HUD) Office of Housing provides vital public services through its nationally administered programs. It oversees FHA as well as regulating housing industry business. The mission of the Office of Housing is to (1) contribute to building and preserving healthy neighborhoods and communities; (2) maintain and expand home ownership, rental housing, and healthcare opportunities; (3) stabilize credit markets in times of economic disruption; (4) operate with a high degree of public and fiscal accountability; and (5) recognize and value its customers, staff, constituents, and partners. The Office of Single Family Housing provides guidance for and oversight of the lenders and loan correspondents that participate in its mortgage insurance programs. The two main oversight authorities are HUD's Office of Lender Activities and Program Compliance's Quality Assurance Division and the Homeownership Centers' Processing and Underwriting Division.

The Office of Lender Activities and Program Compliance's Quality Assurance Division is responsible for monitoring FHA-approved lenders. In performing its monitoring duties, the Quality Assurance Division assesses lenders' performance, internal controls, and compliance with HUD's origination and servicing requirements through onsite reviews and offsite evaluations and analyses. The internal quality control function is intended to ensure that reviews are conducted and deficiencies are identified consistently and an accurate tracking database of reviews is maintained.

HUD's Homeownership Centers located in Philadelphia, PA, Denver, CO, Santa Ana, CA, and Atlanta, GA, originate FHA single-family mortgage insurance and oversee the selling of HUD homes in their respective jurisdictions. Within the Homeownership Centers is the Processing and Underwriting Division. The Processing and Underwriting Division performs postendorsement technical reviews to ensure that lenders understand and comply with HUD's requirements. To execute this function, the Division reviews selected mortgages after endorsement. The process includes a review of the appraisal report, mortgage credit analysis, underwriting decisions, and closing documents from the mortgage case endorsement file.

Our audit objective was to determine whether HUD had adequate oversight of the underwriting of FHA-insured loans. Specifically, we wanted to determine whether HUD (1) appropriately identified lenders' underwriting deficiencies and (2) initiated appropriate corrective actions when warranted.

## RESULTS OF AUDIT

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### Finding: HUD Generally Performed Adequate Reviews of FHA-Insured Loans

HUD generally had adequate oversight of lenders' compliance in underwriting FHA-insured loans. Specifically, it appropriately identified underwriting deficiencies and initiated corrective actions, with the exception of two out of the 18 loans reviewed by its Quality Assurance Division. For these loans, HUD's Quality Assurance Division did not (1) require the lender to correct an error that it identified during a review for one loan or (2) identify a material underwriting error for the other. The weaknesses occurred because HUD did not adequately oversee the quality assurance loan file review process. As a result, HUD incurred losses totaling \$280,107 on the disposal of the associated properties.

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#### **HUD's Postendorsement Technical Reviews Were Generally Adequate**

HUD's Processing and Underwriting Division generally performed postendorsement technical reviews and resolved identified underwriting deficiencies in accordance with its internal policies and procedures. We reviewed 16 of 18 loans selected to evaluate the results of the postendorsement technical reviews and corrective actions if applicable.<sup>1</sup> For the 16 loans reviewed, we reexamined applicable loan documents such as the borrowers' cash assets used to meet the minimum required investment, employment and income records, liabilities, and credit characteristics and did not identify any significant discrepancies from the underwriting deficiencies identified during the postendorsement technical review. Further, we determined that the Division initiated corrective actions in accordance with its internal postendorsement technical review policies and procedures to resolve the identified underwriting deficiencies. For the cases that could not be mitigated, the loans were referred to the Quality Assurance Division for further review.

#### **HUD's Quality Assurance Reviews Were Generally Adequate**

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<sup>1</sup> Although we selected 18 loans, we were only able to review 16 because HUD's Processing and Underwriting Division had referred the remaining 2 to HUD's Quality Assurance Division for further review.

HUD's Quality Assurance Division generally performed quality assurance reviews and resolved identified underwriting deficiencies in accordance with its internal policies and procedures for 16 of the 18 loans reviewed. For the remaining two loans, the reviewers did not (1) identify an underwriting deficiency or (2) require a lender to correct an underwriting deficiency that was identified during the quality assurance review. Specifically, for FHA case number 541-8917153, the original mortgage before refinancing contained three borrowers (one primary borrower and two coborrowers). When reviewing the loan, the reviewer did not identify that one of the coborrowers had been deleted from the original mortgage. Therefore, a credit-qualifying streamline refinance should have been used to determine whether the remaining two borrowers were eligible for refinancing.

According to HUD, the borrowers' loan file did not contain evidence that the second coborrower was on the original mortgage or that this coborrower was credit-qualifying on the original loan before refinancing. Therefore, the lender would not have known about the second coborrower. However, when we reviewed the commitment for title insurance policy that was in the borrowers' loan file, the second coborrower was identified as a borrower on the original mortgage with Countrywide Bank FSB. According to HUD's requirements, a refinance transaction involves repaying an existing real estate debt from the proceeds of a new mortgage that has the same borrower(s) and the same property.<sup>2</sup> Additionally, it states that credit-qualifying streamline refinances contain all the normal features of a streamline refinance but provide a level of assurance of continued performance on the mortgage. The lender must provide evidence that the remaining two borrowers (primary borrower and a coborrower) have an acceptable credit history and the ability to make payments.<sup>3</sup> As of February 29, 2012, HUD had incurred a loss of \$89,052 on the disposal of the associated property.

For case 095-1259735, the review identified that the coborrower had been deleted from original mortgage, which would trigger the due-on-sale clause<sup>4</sup>; thus, the lender should have performed a credit-qualifying streamline refinance to determine whether the remaining borrower was eligible for refinancing. However, the reviewer did not report this deficiency to the lender for corrective action. According to HUD, the reviewer should have notified the lender that this loan file did not comply with HUD's requirements. The lender should have performed a credit-qualifying streamline refinance transaction, thus requiring the borrower to provide evidence of cash to close. As of February 29, 2012, the note

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<sup>2</sup> HUD Handbook 4155.1, REV-5, paragraph 1.10. See appendix C

<sup>3</sup> HUD Handbook 4155.1, REV-5, paragraph 1.12(C). See appendix C

<sup>4</sup> A due-on-sale clause is a clause in a loan or promissory note that puts a condition that the full balance may be called due upon sale or transfer of ownership of the property used to secure the note. The lender has the right, but not the obligation, to call the note due in such a circumstance.

was assigned to HUD for insurance benefits. HUD incurred a loss of \$191,055 on the disposal of the associated property.

### **HUD's Quality Assurance Division Needs To Improve Its Oversight of Reviewers in The Loan Files Review Process**

HUD's Quality Assurance Division needs to improve its oversight of its reviewers in the loan file review process. According to HUD, for case number 095-1259735, through the process of cutting and pasting, the finding was inadvertently omitted by the reviewer when attempting to transfer the results of the review onto the communications (final findings letter) to the lender. For case number 541-8917153, HUD contended that the lender would not have known about the second coborrower. Therefore, the reviewer performed the review in accordance with its requirements. However, the borrowers' loan file contained documentation showing that there were three borrowers on the original mortgage. Therefore, HUD could benefit from improvements to its procedures, which would reduce errors and enhance the quality of the loan file reviews.

### **Conclusion**

HUD's Processing and Underwriting and Quality Assurance Divisions generally had adequate oversight of lenders' compliance in underwriting FHA-insured loans. Specifically, both Divisions appropriately identified lenders' underwriting deficiencies and initiated appropriate corrective actions, with the exception of two loans reviewed by HUD's Quality Assurance Division. The weaknesses occurred because HUD did not adequately oversee the quality assurance loan file review process. HUD incurred losses totaling \$280,107 on the disposal of the associated properties.

### **Recommendations**

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

- 1A. Determine whether the FHA loan number 095-1259735 is covered under the settlement that Flagstar Bank FSB entered with HUD. If it is determined that this loan is not covered by the settlement, HUD should reopen the case and ask the lender to provide support documentation or reimburse HUD for the actual loss totaling \$191,055 incurred on the disposal of the associated property.

- 1B. Ask the lender to provide adequate supporting documentation to show that the two remaining borrowers were eligible, using credit-qualify streamline refinancing, or reimburse HUD \$89,052 for the actual loss incurred on the disposal of the associated property for FHA loan number 541-8917153.
- 1C. Improve its existing policies and procedures to ensure it has adequate oversight of its reviewers in the loan file review process which would enhance the quality of loan files reviewed.

## SCOPE AND METHODOLOGY

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Our audit work was performed at the Chicago regional office, and the Detroit field office between September 29, 2011 and March 31, 2012. The audit covered the period August 1, 2009, to August 31, 2011, but was modified as necessary. We relied partly on computer-processed data for our reviews of the FHA case binders. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes. The testing entailed matching electronic data maintained in HUD's Single Family Housing Enterprise Data Warehouse<sup>5</sup> system to hardcopy case binder documentation for the loans. To accomplish our audit objectives, we researched and reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to the program. We also interviewed and communicated with HUD's staff and management as appropriate.

### Postendorsement Technical Reviews

Using HUD's data maintained in its Single Family Data Warehouse system, we identified that 19,346 loans were reviewed by HUD's Processing and Underwriting Division during the period October 4, 2010, to August 31, 2011. Of the 19,346 loans, 6,733 were initially rated as unacceptable. We used statistical sampling to generate a random sample of 54 from 6,733 loans to review. Based on this sample, we randomly selected 18 loans for a preliminary review. However, we were only able to review 16 of the loans because the remaining 2 loans had been referred to HUD's Quality Assurance Division for further review. Therefore, we were unable to review these two loan files. Our review of the 16 loan files disclosed that HUD's Processing and Underwriting Division generally initiated corrective actions in accordance with its internal postendorsement technical review policies and procedures to resolve the identified underwriting deficiencies; therefore, we did not review the remaining 36 loans in our sample.

In performing our review of the 16 loans selected for postendorsement technical review, we

- Performed our own analysis of the documentation maintained in the FHA case binders and postendorsement technical review files to support that the borrowers met eligibility requirements and the accuracy of the calculations.
- Obtained additional documentation from the originating or sponsoring lenders as applicable.
- Compared our results with the reviewer's notations on the respective review sheets and determined whether the items identified were complete if applicable.

We also reviewed the postendorsement technical review desk guide developed by HUD headquarters' and Homeownership Centers' postendorsement technical review working group. Effective October 4, 2010, the postendorsement technical review process was revised to promote

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<sup>5</sup> HUD's Single Family Housing Enterprise Data Warehouse system is a large and extensive collection of database tables organized and dedicated to support the analysis, verification, and publication of single-family housing data.

better risk analysis, promote consistency throughout the Homeownership Centers, provide for data integrity, and promote efficiency with data management and report generation through automation.

### Quality Assurance Division Review

Using HUD's data maintained in its Approval Recertification and Review Tracking System<sup>6</sup> provided by Quality Assurance Division and data maintained in the Single Family Housing Enterprise Data Warehouse system, we identified 10,864 FHA-insured loans endorsed between August 1, 2009, and August 31, 2011, that were reviewed by the Quality Assurance Division. Of the 10,864 loans, HUD paid claims on 467. Of the 467 loans, Quality Assurance Division identified 47 as having underwriting deficiencies. For our preliminary review, we randomly selected 18 of the 47 loans to review. Our review of the 18 loans disclosed that HUD's Quality Assurance Division generally performed quality assurance reviews and resolved identified underwriting deficiencies in accordance with its internal policies and procedures; therefore, we did not review the remaining 29 loans.

In performing our review of the quality assurance review process, we

- Performed our own analysis of the documentation maintained in the FHA case binders and quality assurance review files to support that the borrowers met eligibility requirements and the accuracy of the calculations.
- Obtained additional documentation from the originating or sponsoring lenders as applicable.
- Reviewed the quality assurance review sheets and other documentation maintained in the files used in the quality assurance review process and the criteria applicable to the program.
- Compared our results with the reviewers' notations on the respective review sheets and determined whether the items identified were complete if applicable.

We also reviewed the quality assurance desk guide developed by the headquarters Quality Assurance Division. The desk guide describes the Division's process for targeting high-risk lenders and preparing for various reviews and related documentation requirements. The desk guide was last updated in 2009 and is undergoing another update.

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 finding and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

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<sup>6</sup> The Approval Recertification and Review Tracking System is a HUD system that is used to track incoming application and recertification packages from lenders and to monitor reviews of approved lenders.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A significant weakness 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.

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

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Recommendation number	Unsupported 1/
1A	\$191,055
1B	<u>\$89,052</u>
Totals	<u>\$280,107</u>

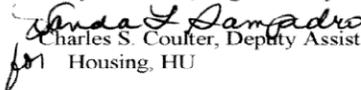
- 1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

## Appendix B

# 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
JUL 31 2012	
MEMORANDUM FOR:	Kelly Anderson, Regional Inspector General for Audit, SAGA
FROM:	 Charles S. Coulter, Deputy Assistant Secretary for Single Family for Housing, HU
SUBJECT:	Discussion Draft Report HUD's Oversight of Lenders' Underwriting of FHA Insured Loans Was Generally Adequate
<p>This is in response to your memorandum of June 29, 2012, transmitting the subject draft audit report. We are providing formal comments to the draft for your consideration.</p>	
<p>The Office of the Inspector General (OIG) audited the U. S. Department of Housing and Urban Development's (HUD or the Department) oversight of the Federal Housing Administration's (FHA) –insured loans. OIG initiated the audit as part of its 2011 annual audit plan and strategic plan activities to help HUD resolve its major management challenges and contribute to improving the integrity of FHA's single-family insurance program. OIG's audit objectives were to determine whether HUD had adequate oversight of lenders' compliance with FHA underwriting requirements, specifically whether in the 36 loans OIG selected for review, HUD: 1) appropriately identified lender's underwriting deficiencies; and 2) initiated appropriate corrective actions when warranted.</p>	
<p><u>Post Endorsement Technical Review Process</u></p>	
<p>OIG determined that Housing's Processing and Underwriting Division (P&amp;U) generally performed post endorsement technical reviews and resolved underwriting deficiencies in accordance with its internal policies and procedures. OIG reviewed 16 of the 18 loans selected for review.<sup>1</sup> OIG did not identify any significant discrepancies from the underwriting deficiencies indentified during the post endorsement technical review loan review process, and determined that P&amp;U initiated corrective actions in accordance with its internal post endorsement technical review policies and procedures to resolve the identified underwriting deficiencies.</p>	
<p>Housing values the OIG's perspective regarding our post endorsement technical review processes. During FY 2010 Housing initiated a thorough review of its post endorsement loan review processes. While loan reviews can be performed at any point in the loan lifecycle, the primary goal of Housing's review was to improve the post endorsement technical review business processes. At the start of FY 2011, Housing implemented improvements in the process as a result of this analysis which included: changing case selection from volume-based criteria to an adverse selection based on loan risk (rules based algorithm and early payment defaults); establishing</p>	
<p><sup>1</sup> OIG selected 18 loans, but only 16 were available for review. The remaining 2 loans were escalated by P&amp;U to the Quality Assurance Division for additional action.</p>	

consistent findings codes and unacceptable basis of ratings; standardizing loan level review methods for P&U underwriters; developing a consistent approach to the recording of findings in the Underwriting Review System (URS) and implementing a URS Data Entry Guide; and developing a “draft” Post Endorsement Technical Review Process Guide and providing to P&U managers for additional guidance.

During FY 2012 and FY 2013 Housing continues to transform its loan review processes and plans to implement a “state of the art” Loan Review System (LRS) to administer the post endorsement technical review process. Once the LRS is fully deployed, it will: 1) facilitate retirement of legacy URS module (CHUMS component); 2) implement a statistical based loan selection algorithm deployed with improved loan targeting; 3) automate workflow and skills-based assignment to streamline review processes, minimize manual hand-offs, and avoid errors and delays; 4) implement SmartScripts to drive consistent reviews and application of material findings standards; 5) execute event-driven communications to lenders; 6) standardized reports to drive consistent management of loan review operations; 7) enhance lender performance reports to provide insight into overall loan performance and trends for each lender; and 8) standardize data cohorts to allow trending of loan review results over time and drill- down into detailed areas of interest.

Quality Assurance Reviews

OIG determined that Housing’s Quality Assurance Division (QAD) generally performed lender monitoring reviews and resolved identified underwriting deficiencies in accordance with its internal policies and procedures for 16 of the 18 loans reviewed. For the remaining two loans 095-1259735 and 541-8917153 (both streamline refinances) HUD’s QAD either 1) failed to escalate the underwriting deficiency to the lender for resolution; or 2) failed to identify the material underwriting deficiency.

**Comment 1**

Housing agrees with the draft audit Recommendation 1A that in FHA Case No. 095-1259735, the QAD reviewer failed to notify the lender of the identified material underwriting deficiency. The deficiency involved an FHA-to-FHA streamline refinance in which a co-borrower was removed from the note which triggered the “due on sale clause”. Thus, the lender should have performed a credit qualifying streamline refinance to determine the remaining borrower’s eligibility. Housing notified the lender of the material deficiencies in this case in a letter dated March 14, 2012. The lender responded on March 22, 2012 and provided supporting documentation to demonstrate the remaining borrower’s eligibility for a credit qualifying streamline refinance without an appraisal. Housing closed this issue in a letter to the lender dated April 3, 2012. In addition, Housing verified with HUD’s Office of General Counsel that this case was included in HUD’s settlement agreement of February 24, 2012, with Flagstar Bank FSB. Housing requests the OIG close draft audit Recommendation 1A associated with this finding based on the attached documentation.

**Comment 2**

Housing agrees with the draft audit Recommendation 1B that in FHA Case No. 541-8917153, the QAD reviewer failed to identify an inconsistency in file documentation (title commitment) which should have alerted the lender to the possibility that more than the two borrowers’ who made application for an FHA to FHA streamline refinance were on the original

an appraisal to determine the remaining borrowers eligibility. Housing notified the lender by letter dated July 20, 2012 (attached), of the material deficiency and requested the lender either provides adequate supporting documentation to demonstrate that the two remaining borrowers were eligible for FHA credit qualify for streamline refinancing without an appraisal; or execute an indemnification agreement and subsequently reimburse HUD for the associated loss on the disposal of the property.

OIG states in draft audit Recommendation 1C that QAD improve its existing policies and procedures to ensure it has adequate oversight of its reviewers in the loan file review process which would enhance the quality of the loan files reviewed.

**Comment 3**

The two files cited by the OIG which depart from QAD standard review processes and procedures were reviewed by the Philadelphia HOC staff and involved similar underwriting issues in FHA's streamline refinance product. Based on the OIG audit report, Housing believes the oversight issue is limited to its Philadelphia HOC QAD. As part of the Philadelphia HOC QAD's ongoing training of its lender monitoring reviewers, it conducted a two-day on-site training for all lender monitoring reviewers at the Philadelphia HOC on June 19-20, 2012. The agenda included a roundtable discussion on common findings, review tips and requirement references; and also two sessions involving enhanced monitoring during origination reviews, including case studies.

Housing agrees to issue a memorandum to all its QAD staff emphasizing the lender monitoring review requirements for FHA to FHA refinances as outlined in its Quality Assurance Division Guide (version August 2009), Chapter 5 Title II Origination, which requires the review of credit report(s), payoff statement, title commitment, warranty deed, appraisal report(s), and HUD-1 Settlement Statement to confirm eligibility requirements have been met, and that the maximum mortgage calculation is correct.

Conclusion

Housing continues to take the additional steps to ensure appropriate policies and procedures, system controls, and reporting tools are in place to provide Housing management with a consistent view of its loan review processes. Housing shares the OIG's ongoing interest in ensuring the robustness of HUD's monitoring and oversight mechanisms for FHA programs. The Department is confident that its continued efforts to strengthen and effectively implement the risk management tools and loan review efforts at its disposal have yielded significant improvements that permit HUD to satisfactorily protect its insurance funds.

Attachments

### **OIG Evaluation of Auditee Comments**

- Comment 1** HUD agreed with the discussion draft audit report's Recommendation 1A. As recommended, it determined that FHA case number 095-1259735 was included in its settlement agreement, dated February 24, 2012, with Flagstar Bank FSB. Further, HUD contacted the lender to obtain additional documentation indicating that the lender approved the loan as a credit qualifying streamline refinance. Since HUD implemented our recommendation, we consider this implementation as an agreed upon management decision. Thus, this recommendation will be closed in conjunction with the final issuance of this audit report.
- Comment 2** HUD agreed with the discussion draft audit report's Recommendation 1B. As recommended, it asked the lender to provide adequate supporting documentation to demonstrate that the two remaining borrowers were eligible for FHA credit qualifying streamline refinancing without an appraisal. HUD requested that the lender either provides supporting documentation or sign an indemnification agreement to reimburse it for the associated loss on the disposal of the property. Since HUD implemented our recommendation, we consider this implementation as an agreed upon management decision.
- Comment 3** HUD agreed with the discussion draft audit report's Recommendation 1C. HUD provided training to its staff in the Philadelphia HOC, and will issue a memorandum to its entire QAD staff emphasizing the lender monitoring requirements. We commend HUD for continuing to improve its policies and procedures, system controls, and reporting tools, to strengthen its risk management.

## Appendix C

### FEDERAL REQUIREMENTS

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HUD's Quality Assurance Division Desk Guide, effective August 2009, states that the purpose of the Quality Assurance Division is to protect HUD-FHA from unacceptable risk by assessing lender performance, internal controls, and compliance with HUD-FHA origination and servicing requirements, as well as requiring corrective measures or initiating enforcement actions as appropriate. The Quality Assurance Division monitors lender performance and takes appropriate actions to manage risk, mitigate losses, and curtail unacceptable practices.

Chapter 5, of the desk guide states that (HUD's reviewers should) review credit report(s), payoff statement, title commitment, warranty deed, appraisal report(s), and HUD-1 settlement statement to confirm eligibility requirements have been met, and that the maximum mortgage calculation is correct.

HUD Handbook 4155.1, REV-5, paragraph 1.10, states that a refinance transaction involves repaying an existing real estate debt from the proceeds of a new mortgage that has the same borrower(s) and the same property.

Paragraph 1.12(C) of the Handbook states that credit-qualifying streamline refinances contain all the normal features of a streamline refinance but provide a level of assurance of continued performance on the mortgage. The lender must provide evidence that the remaining borrowers have an acceptable credit history and the ability to make payments. Credit-qualifying streamline refinance may be used when (b) deletion of a borrower or borrowers will trigger the due-on-sale clause or (c) following an assumption of a mortgage that does not contain restrictions (such as due-on-clause) limiting assumptions only to creditworthy borrowers and the assumption occurred less than 6 months previously or (d) following an assumption of a mortgage in which the transferability restriction (such as due-on-clause) was not triggered, such as in a property transfer resulting from a divorce decree or by devise or descent and the assumption occurred less than 6 months previously.