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COMPTROLLER GENERAL OF THE UNITED STATES
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Chairman, Senate Committee on Government Operations
Chairman, House Committee on Government Operations
Chairman, Senate Committee on Appropriations
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This report assesses the appropriateness of the monthly fee of $3.50 a mortgage that the Department of Housing and Urban Development pays to mortgagees for handling mortgages insured under section 235 of the National Housing Act, as amended (12 U.S.C. 1715z). In November 1972 and May 1974, we told the Secretary of Housing and Urban Development that we questioned the appropriateness of the amount of the fee and recommended that the Department take certain actions to establish a fee which would more accurately reflect actual additional expenses incurred by mortgagees. Both the Department and our studies have shown that the amount of the fee was excessive; however, the Department has done little to adjust the fee since its inception in 1968.

The Secretary of Housing and Urban Development submitted his written statement on actions taken on the recommendations in our May 1974 report to the Chairmen of the Senate and House Committees on Government Operations on October 18, 1974, and to the Senate and House Committees on Appropriations on January 17, 1975. The Secretary said, because of certain factors, he believed he would be ill-advised to reduce the fee at that time. We have analyzed the factors the Secretary cited and disagree with his position that they provided a basis for not reducing the fee. Also, to update our prior studies and provide a current assessment of the fee's appropriateness, we recently made a limited survey in the Washington, D.C., area, the results of which indicate that the $3.50 fee continues to be excessive.

BACKGROUND

Section 235 of the National Housing Act, as amended, which was added by section 101(a) of the Housing and Urban Development Act of 1968, authorizes the Department to help low- and moderate-income families become homeowners by providing mortgage insurance and subsidizing portions of the monthly payments due under the mortgages.

RED-76-29

The act authorizes the Department to reimburse mortgagees, as it determines appropriate, for expenses incurred in handling section 235 mortgages. The Department reimburses mortgagees for those additional expenses which are not incurred in handling other Department-insured mortgages. The fee is to reimburse the mortgagees for necessary bookkeeping and paperwork involved in computing and billing the Department for assistance payments, maintaining the prescribed records supporting billings, posting the Department's assistance payments in the accounts, and certifying and recertifying the mortgagors' incomes.

To provide a basis for setting a fee under the section 235 program, the Department held discussions with members of various banking associations. The Department then asked these associations to review a list the Department prepared that showed the extra work done by a mortgagee in handling interest assistance payments and to give their best estimate of the cost involved. In August 1968, the Department's Assistant Secretary-Comptroller recommended that the handling fee be set at $42 per mortgage per annum ($3.50 per mortgage per month), which was based on the average of the cost estimates submitted by the 18 banking institutions which responded to the Department's inquiry. He recommended further that the fee remain at this level until there was enough activity under the subsidized programs to enable the Department to obtain more accurate cost figures. This fee, however, has continued to be used since October 1968, and the Department estimates that the handling fees paid over the life of the program will amount to about $183 million.

PRIOR REPORTS AND THE DEPARTMENT'S COMMENTS

In the fall of 1972 we surveyed the monthly fees paid to mortgagees for servicing subsidized mortgages insured under section 235. Although we limited our survey, the $3.50 handling fee appeared to be excessive. Our November 2, 1972, letter to the Secretary recommended that the Department make a detailed study to determine the additional expenses mortgagees incurred and to revise the handling fee accordingly.

The former Secretary in responding to our letter on December 19, 1972, said that the Department's frequent changes in requirements, such as the shift from biennial to annual recertifications of participants' incomes, and its new requirement that mortgagees verify the reported incomes had affected the cost of servicing the mortgages and had delayed adjusting the section 235 handling fee. He also said that the Department had begun a detailed study to determine the additional servicing costs the mortgagees incurred.

In June 1973 the Department's detailed study of the section 235 handling fee was completed, and in November 1973 the study group gave its report to the Assistant Secretary for Housing Management. The study group reviewed 51 servicing mortgagees from all geographical areas of the country, covering over 23 percent of the mortgages insured under the program. The study group's report recommended that the handling fee be

--reduced from $3.50 to not less than $2.27 per mortgage per month and

--adjusted at the beginning of each fiscal year to reflect any cost-of-living change during the previous fiscal year.

As of May 6, 1974, the Department had not acted on the recommendations. Accordingly, in a letter dated May 31, 1974, we recommended that the Secretary make the changes recommended by the study group without further delay since each month's delay costs the Federal Government about $400,000.

As a result of our May 31, 1974, recommendations, the Secretary informed the Chairmen of the Senate and House Committees on Government Operations on October 18, 1974, and the Senate and House Committees on Appropriations on January 17, 1975, that, although the Department's study was based on the best available knowledge at the time, he believed the following factors made it ill-advised to carry out the study group's recommendations.

1. Although actual servicing costs were measured during the study they were not correlated to either the amount or the quality of work done.

2. Changes in Department regulations, which had not taken full effect at the time of the study, were expected to increase greatly the responsibilities, and therefore the costs, of most section 235 mortgagees. For example:

   --Effective in July 1972, mortgagees were required to recertify homeowners' incomes on an annual basis rather than on the biennial basis originally stipulated.

--Many section 235 homes are located in areas where hazard insurance was available at the time the loans originated but has since been canceled. In June 1974 the Department strengthened mortgagees' responsibilities for handling these cases by requiring them to continually try to secure replacement insurance. Mortgagees must now report annually on the attempts they have made to locate coverage for each uninsured mortgagor, and the Department, in turn, must pass on the adequacy of their efforts.

--Effective June 1974 mortgagees were no longer allowed to automatically assign to the Department section 235 mortgages on properties abandoned by the mortgagors. Mortgage companies must now foreclose and must convey the properties to the Department. This, again, imposes more administrative costs on the mortgagees.

--As a result of inflation, fluctuating unemployment, and the energy crisis, many mortgagors have been forced (or allowed) to recertify their incomes at more frequent intervals than was contemplated at the time of our study. These mortgagees must also bear these administrative costs.

OUR EVALUATION OF THE DEPARTMENT'S COMMENTS

We have analyzed the Secretary's October 18, 1974, response and believe his contentions do not support mortgagee costs higher than those developed by the Department's study. The additional requirements cited were in effect at the time of the study or are not unique to section 235 loan servicing.

Department regulations prescribe the level of servicing required of mortgagees which service section 235 loans. Although the Department study group did not attempt to correlate the amount or the quality of work done with the costs of servicing, it found that mortgagees were providing at least the level of service required. Therefore the mortgagees' costs, as measured by the Department study group, and the Department's payment of the $3.50 handling fee were for defined services.

The former Secretary also contended the requirement for annual rather than biennial recertification, effective July 1972, was not reflected in the final cost data. According to the director of the Department's study group, however, its study of mortgagee costs was delayed 6 months to consider the effect of the recertification change. The data, gathered between December 1972 and June 1973, reflects the costs of annual recertification.

The Department requires mortgagees to report annually on their attempts to attain hazard insurance for Department-insured mortgages. These increased responsibilities and their related costs, according to the former Secretary, were not included in the Department's study. The hazard insurance reporting requirements, however, apply to all Department-insured mortgages and are not unique to servicing section 235 loans. The cost of these efforts therefore is not an additional expense and is not reimbursable.

The former Secretary noted a change in foreclosure procedures effective in June 1974. The new procedure requires mortgagees to foreclose on property before transfer to the Department, rather than the former method of transferring property without foreclosure. These costs were not included in the Department's survey of mortgagee expenses. However, in a letter to all mortgagees, dated May 6, 1974, the Department agreed to reimburse mortgagees for all foreclosure, acquisition, and conveyance costs separate from the monthly handling fee.

The former Secretary also contended that economic conditions had affected the costs of servicing section 235 loans. This contention, we believe, was adequately covered in our limited survey which is discussed more fully below.

The former Secretary concluded it would be ill-advised at that time to alter the existing handling fee for section 235 mortgages until the Department decided what a reasonable cost for section 235 loan servicing should be. The former Secretary said that he had instructed the Assistant Secretaries for Housing Management and Housing Production and Mortgage Credit to develop a more accurate and reliable data collection system to enable the Department to establish and maintain a proper fee schedule.

In July 1975, over 9 months later, representatives of these offices told us that such data had not been collected and that there were no plans to collect data on additional servicing costs unique to servicing section 235 mortgages. In addition, officials of the Department's Single Family Housing Division responsible for administering the section 235 loan program told us that they were unaware of the former Secretary's assurance to the Congress that this data would be collected. After our discussions with these officials, the Department prepared a draft notice to its field offices which required that cost data be collected from mortgagees during the Department's annual review of mortgagees' operations. The draft notice was being circulated to various Department offices for comment as of September 5, 1975.

RESULTS OF RECENT SURVEY

Since the Department had not acted on the study group's recommendations and recognizing that costs could be affected by changing economic conditions, we tried to determine the present costs of handling section 235 loans.

In an attempt to determine the reasonableness of the Department's study, we made a limited survey at three mortgagees in the Washington, D.C., area and found that the additional monthly costs of servicing a section 235 loan ranged from $1.72 to $2.62. This corresponded closely with the results of the Department's earlier study. We allowed the mortgagee, in each case, to allocate the costs it considered appropriate. We did not, for example, question the largest mortgagee's assertion that a $250,000 computer program development cost should be allocated to servicing section 235 loans. Officials of all three mortgagees expressed basic agreement that these calculated costs fairly represent their costs of providing the additional services required for section 235 loans.

Our cost computations indicated that considerable savings might be possible if a fee were established which more accurately reflected actual additional monthly costs. The monthly potential savings from the three mortgagees we surveyed are as follows.

Mortgagee	Number of loans	Monthly cost per loan	Total monthly cost	Department's monthly payment (note a)	Department's potential monthly saving
A	3,957	$2.62	$10,351	$13,850	$3,499
B	348	1.72	598	1,218	619
C	177	2.42	429	619	191
			$11,378	$15,687	$4,309

[a]$3.50 for each loan.

Two of the mortgagees told us that they believed they were making money on the $3.50 servicing fee, although they were not sure of their costs. One official commented that a number of mortgage companies, with rather refined systems for servicing section 235 loans, were purchasing these loans because of the $3.50 fee. After we developed cost figures for two mortgagees, their officials said that it would be worthwhile for them to acquire additional loans. Since most of their costs were fixed at this point, they believed they could service a greater number of loans at little additional expense.

CONCLUSION

The Department reimburses the mortgagees for any additional expenses incurred in handling section 235 mortgages. Although the $3.50 fee was an interim fee, subject to development of actual cost, the fee has not been adjusted since it was established in 1968. The study the Department made in 1974 was its effort to determine the actual additional costs of servicing section 235 loans. This study showed that the additional costs of servicing section 235 mortgages was considerably less than the $3.50 fee being paid to mortgagees; however, the Department took no action to reduce the fee. Further, until we discussed this matter with Department officials, there was no ongoing effort to develop more accurate and reliable data to serve as a basis for reimbursing the mortgagees. Our current limited survey of three mortgagees in the Washington, D.C., area indicated that the $3.50 fee continued to be excessive.

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As the Department has taken little positive action on the basis of our two previous reports, we plan no further report to the Department. The Committee, however, should discuss the appropriateness of handling fees for section 235 loans during future Department hearings.

We are sending a copy of this report to the Secretary of Housing and Urban Development.

Elmer B. Staats
Comptroller General
of the United States