United States General Accounting Office

GAO

Report to the Subcommittee on Housing and Transportation, Committee on Banking, Housing and Urban Affairs, U.S. Senate

June 1999

HOMEOWNERSHIP

Information on Single-Family Loans Sold by HUD

GAO

Accountability * Integrity * Reliability

GAO/RCED-99-145

United States General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-282006

June 15, 1999

The Honorable Wayne Allard
Chairman
The Honorable John F. Kerry
Ranking Minority Member
Subcommittee on Housing and Transportation
Committee on Banking, Housing, and Urban Affairs
United States Senate

In 1994, in an effort to make better use of its resources, the Department of Housing and Urban Development (HUD) undertook a program designed to liquidate its inventory of single-family loans. From June 1994 through September 1997, HUD sold 98,640 single-family loans in a series of six sales. Nearly all of these loans were acquired by HUD through its now defunct Mortgage Assignment Program, which, since 1976, had provided borrowers who had defaulted on their mortgages with reduced or suspended mortgage payments for a limited time.[1] The purchasers of these loans agreed to offer borrowers the same forbearance, or lower loan payments, that HUD was required to offer before the loans were sold. According to HUD, these sales allowed the Department to achieve critically needed staff reductions and resulted in over $830 million in estimated budgetary savings.

Concerned about the treatment of homeowners whose loans were sold, you asked us to describe (1) the current status of single-family loans sold and (2) the ways in which HUD has ensured that the purchasers of these loans abide by the forbearance requirements contained in the loan sales agreements. In addition, you asked us to provide information on the changes HUD has made in the staffing resources used to service the loans it holds.[2]

[1]In January 1996, the Congress passed legislation terminating the Single-Family Mortgage Assignment Program. As a result, HUD has not accepted any new applications for assignment since April 26, 1996. However, because of the large volume of last-minute filings, some applications for assignment were still being processed throughout 1997.

[2]Servicing a loan consists of, among other things, collecting mortgage payments, establishing and maintaining escrow accounts for the payment of real estate taxes, providing borrowers with annual financial reports, providing forbearance to borrowers, and initiating foreclosure procedures.

Only one of the loan servicers we contacted was willing to provide data on the current status of single-family loans sold. However, this company serviced 58,012 of the 98,640 single-family loans sold--29,348 loans it purchased directly from HUD, and 28,664 loans owned by other purchasers of HUD single-family loans.[3]

Results in Brief

As of the end of 1998, most homeowners whose loans were sold and for which we had data on the current disposition of the loan, continued to own their homes. According to the company responsible for servicing these loans, for 55 percent of the 58,012 loans that it serviced, homeowners were current under the original, or forbearance, agreement terms of the loans. An additional 14 percent of the loans had been paid off or refinanced. The remaining 31 percent of these loans were delinquent, pending foreclosure, foreclosed, in bankruptcy, or resolved in some other way.

To ensure that the servicers of single-family loans honor the borrower protections contained in the loan sales agreements--including reduced mortgage payments--HUD conducted compliance reviews of loan servicers and operated a toll-free telephone complaint and information line for borrowers whose loans had been sold. Through these methods, HUD found, among other things, that loan servicers sometimes did not appropriately consider borrowers' ability to pay higher payments and that some borrowers thought loan servicers required too high a mortgage payment. According to HUD, servicers have taken action to address the findings and concerns raised by HUD's compliance reviews and its telephone complaint line. However, in some cases, HUD's records either do not show whether servicers took corrective action or do not describe the corrective action taken.

While data on the staffing devoted specifically to servicing HUD-held loans were not available, total staffing and staffing devoted to managing both HUD-held loans and HUD-owned properties has declined dramatically, particularly in the last 2 years.[4] Specifically, staff located in field offices who were responsible for managing single-family loans and properties

[3]The purchasers of loans either serviced the loans themselves or hired other companies to do so. In either case, the company that services the loan must be a HUD-approved loan servicer.

[4]HUD acquires single-family properties when it forecloses on the loans it holds or when lenders foreclose on HUD-insured loans. During fiscal year 1998, HUD had, on average, about 40,000 single-family properties in its inventory.

declined by an estimated 56 percent--or 683 full-time equivalent staff--during fiscal years 1997 and 1998--over twice the rate of the total staffing decline during this period.[5] This decline in staffing levels occurred despite an increasing workload resulting from property disposition. Furthermore, much of the decline in staffing occurred after HUD had dramatically reduced its inventory of HUD-held loans. According to HUD officials, the reduction in the inventory of HUD-held loans allowed the Office of Housing to decrease its staffing levels.

Background

In the early 1990s, HUD was being overwhelmed by a growing number of single-family loans entering its inventory of owned assets, mainly through its single-family Mortgage Assignment Program. As a result, there was increased demand on HUD's resources to service these loans. In 1994, in an effort to make better use of its resources, HUD decided to sell its inventory of single-family loans. In June 1994, when HUD held its first loan sale, it owned over 100,000 single-family loans. Through a series of six sales, from June 1994 through September 1997, HUD sold 98,640 single-family loans. HUD's single-family loans were sold without mortgage insurance--that is, HUD did not insure the purchasers of the loans against losses that would be caused by borrowers' defaults. At the end of fiscal year 1998, HUD owned about 12,000 single-family loans.

The majority of the loans sold by HUD were acquired through its now defunct Mortgage Assignment Program. This program allowed lenders, under certain conditions, to assign defaulted Federal Housing Administration (FHA)-insured mortgages to HUD, making HUD the owner of the loan. For borrowers accepted into the program, HUD paid the mortgage debt, took assignment of the loan from the lender, and developed a new repayment plan (forbearance agreement) for the borrower. Under this agreement, mortgage payments could be reduced or suspended for up to 36 months. HUD, acting as lender, collected monthly mortgage payments from the borrowers while allowing them to keep their home.

By taking assignment of loans rather than having lenders foreclose on them, HUD can, at times, avoid foreclosure losses, help borrowers retain their homes, and provide these borrowers with an opportunity to avoid foreclosure. However, we reported in October 1995, that even with the

[5]A full-time equivalent is a measure of employment. It is determined by dividing the total number of an agency's work hours within a fiscal year by 2,087, which is the number of hours in a federal workyear.

forbearance provided by HUD to these financially strapped borrowers, over half would eventually lose their homes through foreclosure.[6] Moreover, the Mortgage Assignment Program did not reduce HUD's foreclosure losses; rather, the program's losses exceeded those that would have occurred if the loans had gone immediately to foreclosure without assignment.

All single-family loans sold by HUD came with a loan sales agreement requiring the loan purchasers and servicers to honor existing forbearance agreements. The requirements contained in the loan sales agreements varied, depending upon whether the sold loan was within or outside the initial 36-month period after assignment to HUD. If less than 36 months had passed since the loan was assigned to HUD, the forbearance agreement could reduce or suspend monthly mortgage payments, depending on the financial condition of the borrower. For a loan in which 36 months had passed since it was assigned to HUD, the sales agreement requires that the forbearance agreement stipulate a minimum monthly payment at least equal to the payment required under the terms of the original loan (including principal, interest, taxes, and insurance). After 36 months, the mortgage payments could be more than the original amount--in order to pay off past amounts due and bring the mortgage current sooner--if the borrower's financial information indicated that the borrower could afford to make higher payments. There is no regulatory limit on the size of this monthly payment. In addition, the servicer could extend the maturity date of the loan for up to 10 years if the maximum payment that the borrower could afford did not completely retire the borrower's liability within the original terms of the loan.

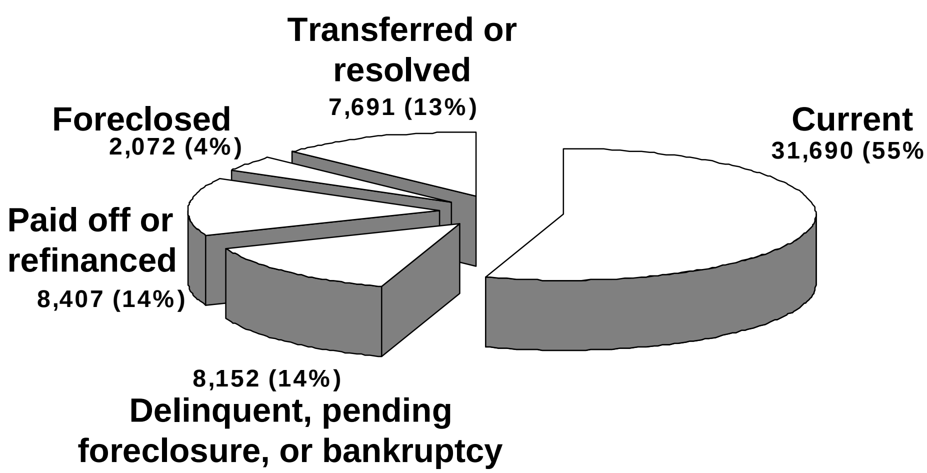
The Majority of Borrowers Whose Loans Have Been Sold Are Current With Their Loan Payment or Have Paid Off Their Loans

Data on the disposition of loans were available for 58,012 of the 98,640 single-family loans sold by HUD. These data show that, as of December 31, 1998, most of the homeowners whose loans were sold continued to own their homes. According to the company responsible for servicing these loans, it has worked with many borrowers to restructure their mortgage debt so that most were able to restore their credit; reduce their past-due interest; and, ultimately, bring the loan current. As shown in figure 1, 55 percent of this servicer's loans are current under the original loan terms or forbearance agreement terms; 14 percent have been paid off or refinanced;

[6] See Homeownership: Mixed Results and High Costs Raise Concerns About HUD's Mortgage Assignment Program (GAO/RCED-96-2, Oct. 18, 1995).

and 14 percent are delinquent, pending foreclosure, or in bankruptcy. Four percent have been foreclosed, and the remaining 13 percent have had their servicing transferred or have been resolved in some other way.

Figure 1: Status of 58,012 Sold Loans, as of December 31, 1998



Source: GAO's analysis of HUD's data.

HUD Has Controls in Place to Monitor Servicers' Compliance With Homeowner Protections

HUD's compliance reviews and a toll-free telephone service are the primary controls HUD uses to ensure that servicers comply with the borrower protections provided under each loan sales agreement. HUD has employed these two controls to uncover numerous cases in which servicers were not complying with borrower protections, and it has directed servicers to take corrective actions. According to HUD, servicers have taken actions to correct the problems with protecting borrowers that were found through compliance reviews and the toll-free telephone service. However, in some cases, HUD's records either do not show whether servicers took corrective action or do not describe the action taken.

HUD Conducted Reviews of Loan Servicers

Compliance reviews of the servicers of sold loans are undertaken by HUD's quality assurance reviewers at the direction of HUD headquarters. These directives result from complaints to the Department's toll-free telephone line and from information provided to headquarters by field office staff. The loan sales agreements serve as audit guidelines. These agreements require loan servicers to offer borrowers forbearance as required under the now defunct Mortgage Assignment Program, including the following actions: (1) within the initial 36-month period since assignment, reducing or suspending mortgage payments on the basis of the borrower's ability to pay; (2) after the initial 36 months, setting mortgage payments equal to the original mortgage payment, or more, if the borrower can afford to make higher payments; (3) allowing borrowers in default under a forbearance agreement to pay delinquent principal and interest (reinstate the forbearance agreement) and avoid foreclosure; and (4) allowing borrowers who are current under an expiring forbearance agreement to renew the agreement for an additional period of time.

We reviewed six compliance reviews of companies that serviced sold loans. These reviews involved four companies that, together, serviced about 60 percent of the single-family loans sold by HUD since 1994.[7] In letters summarizing the results of these reviews, HUD reported numerous instances in which servicers were not complying with borrower protections. Specifically, HUD found, among other things, that two servicers were not allowing borrowers to reinstate the loan once they were in default and not allowing borrowers who were current with an expiring forbearance plan to renew it for an additional period of time. In addition, HUD found that all four servicers were increasing monthly mortgage payments without any financial support showing that the borrower could afford the higher payment--for two servicers, HUD cited this finding in both the initial and subsequent reviews. Other problems identified through the compliance reviews included pressuring the borrower to refinance, harassing the borrower, and failing to employ prudent servicing practices.

Overall, in response to most findings, servicers agreed to change how they service sold loans and/or took corrective actions on individual loans. For example, after HUD informed one servicer that borrowers were not being given the opportunity to reinstate their loan, the servicer responded that its collection personnel would be made aware of the requirement and that the requirement would be made part of the servicer's collection procedures. In another review, HUD found that the servicer increased the mortgage payment without any analysis of the borrower's financial condition. In

[7]HUD conducted a total of seven compliance reviews of servicers of sold single-family loans, six of which were summarized in letters to the loan servicers. HUD did not prepare a written summary of the remaining compliance review.

response, the servicer agreed to begin documenting the financial analysis upon which mortgage increases are based.

In several instances servicers agreed to take corrective actions on individual loans in response to HUD's findings. For example, for one servicer, in six of the loans HUD reviewed, borrowers were not given the opportunity to renew expired forbearance agreements. For five of the six loans, the servicer agreed with the facts as presented by HUD and allowed the borrowers to renew their forbearance agreements. For the remaining loan, the servicer responded that the borrower had brought the loan current. Thus, there was no need to renew the expired forbearance agreement. This servicer also agreed to make changes in how it services sold loans--allowing borrowers to renew their forbearance agreements--and to communicate this requirement to its staff.

Servicers sometimes disagreed with the facts as presented by HUD and took no action or were unresponsive. For example, in one of its reviews, HUD found that for 10 borrowers, the servicer was requiring mortgage payments in excess of what the borrower could afford to pay. However, the servicer disagreed with HUD on the facts for 7 of the 10 borrowers, responding that the borrowers were already on suspended or substantially reduced mortgage payments. HUD is now gathering additional information to substantiate its earlier findings with regard to these borrowers and other issues and will present this information to HUD's Mortgagee Review Board to consider sanctions. For the remaining three borrowers, the servicer agreed with the facts as presented by HUD and responded that the problem was due to a computer system error.

HUD Provided a Telephone Complaints Service

In September 1996, when HUD held its third loan sale, it established a toll-free telephone complaint line and hired a contractor to answer the calls. To ensure that borrowers were aware of the telephone complaint line, HUD announced its existence to homeowners in its "goodbye letter."[8] HUD's contractor documents each call it receives and then transfers the information to HUD's field office in Tulsa, Oklahoma. HUD's Tulsa staff are responsible for contacting the borrower and, if necessary, the servicer, in an attempt to resolve the complaint.

[8] A "goodbye letter" informs homeowners that their loan will be included in an upcoming loan sale.

We estimate that since it began operation, HUD's complaint line has received slightly under 6,900 telephone complaints or inquiries from borrowers whose loans had been sold.[9] This telephone service allows borrowers to inquire about the status of their account or complain about their servicer. Overall, HUD headquarters officials told us that about 90 percent of the calls received over its caller complaint line dealt with routine requests for information, such as an account status, the reason their particular loan was sold, or the reasons that the new servicer used business practices that are different from HUD's. On the basis of our review of a random sample of 362 caller case files, we estimate[10] that 1,083 of about 6,900 calls received involved serious complaints that loan servicers were requiring too high a mortgage payment, demanding that the loan be brought current, and/or threatening foreclosure.[11] We categorized the remaining calls as routine borrower requests for information.

One objective of a HUD-contracted study of the loan sales program was to examine the type of inquiries and complaints that HUD had received on its toll-free complaint line. According to this study, of the calls HUD received through July 1998, about one-third concerned increases in required monthly mortgage payments; about 40 percent were inquires about the current or delinquent status of a loan and the caller's rights with the new private-sector servicer; and about 27 percent concerned specific amounts owed or the servicer's receipt of a payment.

However, according to HUD staff responsible for responding to calls, these complaints often proved to be unwarranted. That is, the staff said, borrowers often claimed some sort of grievance that did not prove to be true when the staff researched the matter. For example, the telephone service received numerous complaints on the amount required to pay off mortgages because borrowers thought that their monthly mortgage payments were always applied by servicers to pay off their original mortgage debt. Often, however, these monthly payments were only sufficient to pay interest. In other cases, borrowers did not provide updated financial information that the servicers needed to substantiate the

[9]A HUD official estimates that there were about 4,800 calls logged and that an estimated 500 calls were received before the call log was created.

[10]The margin of error for this estimate, at the 95-percent confidence level, is +/- 264 complaints.

[11]One loan servicer is currently the subject of a class action lawsuit filed on behalf of about 2,000 borrowers to whom the servicer sent notices of intention to foreclose.

continuing need for forbearance. As a result, the servicers increased the amount of payments or demanded full payment. Borrowers offered the following reasons for not providing this information: (1) the tone in the letters that the new servicer used was harsh or (2) they never read, or could not understand, the letter. Finally, some borrowers asked the servicer for a compromise sale (a forced buy-down); that is, they wanted HUD to repurchase their loan from the new owner and sell the loan to them at the compromise sale price. While this practice occurred in the past, it is not allowed in the loan sales process.

According to a HUD official and information contained in HUD's caller log, almost all calls received by HUD have been resolved. However, for the caller files we examined, we found insufficient information for us to determine the final disposition of 40 percent of these serious complaints.[12]

Loan Sales Occurred During a Period of Staffing Reductions

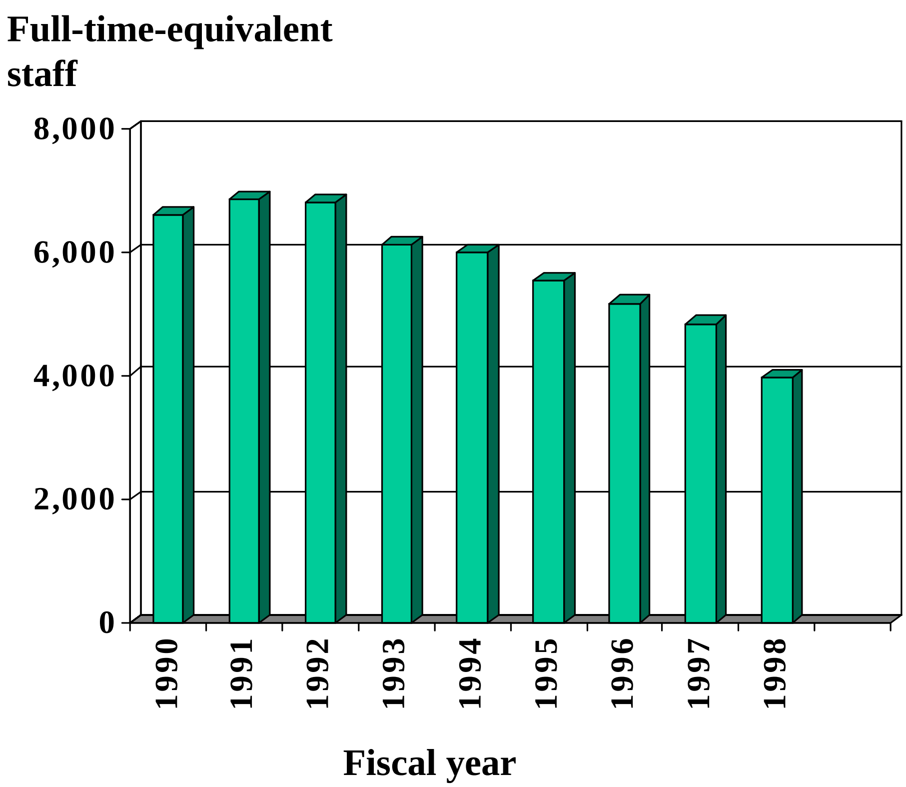
HUD has dramatically reduced its inventory of HUD-held single-family loans since the loan sale program began. At the same time, total HUD housing staffing has been reduced. Given the dramatic decline in HUD's inventory of HUD-held loans and the elimination of the Mortgage Assignment Program, it is reasonable to expect that HUD could reduce the staffing devoted to servicing HUD-held loans. While we were unable to obtain data on the staffing resources used to service HUD-held loans, the total full-time-equivalent staff for asset management--which includes the servicing of HUD-held loans--has declined from about 3,400 in fiscal year 1994 to an estimated 2,000 in fiscal 1998. Over two-thirds of this decline was for full-time equivalent staff in field offices who were managing single-family assets, and much of the decline occurred during 1997 and 1998. Finally, asset management is continuing to undergo change.

A major reason for undertaking the loan sales program was to better use limited staff resources by reducing the number of HUD-held loans, thereby freeing staff to focus on managing HUD's portfolio of insured loans. In addition, according to HUD officials, private-sector companies are much better able to service loans than are HUD staff. In fact, HUD's housing staff have many responsibilities other than servicing HUD-held loans and managing the insured portfolio. Among these responsibilities are monitoring lenders and quality assurance, managing and disposing of

[12]The margin of error for this estimate at the 95-percent confidence level is +/- 14 percent.

property, and overseeing Section 8 housing assistance activities. Since fiscal year 1991, HUD's total housing staff has declined by over 40 percent. Much of this decline has occurred since fiscal year 1994--the first year in which HUD auctioned single-family loans and a period in which FHA greatly modified its loan-processing functions. Specifically, HUD's total housing staff, as measured by full-time-equivalent staff, declined from about 6,900 for fiscal year 1991 to about 6,000 for fiscal 1994 and to an estimated 4,000 for fiscal 1998. (See fig. 2.)

Figure 2: Total Full-Time Equivalent Housing Staff, Fiscal Years 1990-98



Note: The data for fiscal year 1998 are based on a projection made as of August 31, 1998.

Source: HUD.

According to HUD, fiscal year 1998 was a year of transition, as staff and organizations were realigned to implement HUD's 2020 Management Reform. Servicing HUD-held single-family loans was performed at seven field offices in fiscal 1998. HUD plans to consolidate servicing functions in one location in fiscal 1999. According to the most recent financial statement audit of FHA, however, because of staffing changes, workload transitions, and the anticipation of selling the remaining notes, FHA was less aggressive in undertaking foreclosure actions or other servicing alternatives, such as workout plans or increased collection efforts.[13] As a result, more of the HUD-held single-family loan portfolio became delinquent during fiscal year 1998. Specifically, the portion of HUD-held single-family loans that were delinquent increased from 57 percent in fiscal year 1997 to 70 percent in fiscal 1998. In early 1999, HUD contracted for functions involving the servicing of HUD-held loans and the management and disposition of HUD-owned properties.

Agency Comments

We provided copies of a draft of this report to HUD for review and comment. HUD agreed with the report's findings and noted that it has instructed the staff responsible for resolving telephone complaints to maintain better records of how complaints are resolved and that it is continuing to pursue instances in which it finds inappropriate loan servicing. Overall, HUD affirmed the Department's intent to continue its efforts to ensure fair and equitable treatment of borrowers whose loans were sold. HUD's comments appear in appendix I.

Scope and Methodology

In preparing this report, we focused on five of HUD's six single-family loan sales.[14] The loans sold through these five sales represented about 85 percent of all the loans HUD sold from June 1994 through September 1997. Nearly all of these loans were formerly in HUD's Mortgage Assignment Program.

First, to determine the current disposition of single-family loans that have been sold, we collected information from the largest servicer of sold single-family loans on the status of its loans as of December 31, 1998. This was the only loan servicer that would agree to provide such data.

[13]See Federal Housing Administration, Audit of Fiscal Year 1998 Federal Basis Financial Statements, Department of Housing and Urban Development, Office of Inspector General (Report: 99-FO-131-0002, March 12, 1999).

[14]The first HUD sale consisted of 15,212 HUD-held 221(g) (4) loans. These are performing loans that are assigned to HUD in their twenty-first year by lenders, as previously allowed under the terms of FHA mortgage insurance.

Second, to identify what actions HUD has taken to ensure that loan servicers abide by the borrower protections contained in loan sales agreements, we interviewed HUD officials at headquarters in Washington, D.C.; Quality Assurance staff in Atlanta, Georgia; and staff at the HUD field office in Tulsa, Oklahoma, who are responsible for the toll-free borrower phone line. We also reviewed HUD's compliance reviews and the correspondence between HUD and loan servicers that were the subject of those reviews and examined HUD's telephone complaint log of calls received on its toll-free complaint line since 1996. For the estimated 6,900 of these calls received, we reviewed a random sample of 362 caller case files in order to determine the nature of callers' complaints and their current status. We did not verify whether loan servicers who agreed to make policy changes or take other corrective actions in response to HUD's findings actually made changes in the way they service loans.

Finally, to analyze changes in HUD's staffing resources, we interviewed headquarters officials responsible for overseeing the management of HUD's acquired assets and relied on staffing and workload data provided by the Department. We conducted our review from July 1998 through May 1999 in accordance with generally accepted government auditing standards.

We are providing copies of this report to Senator Connie Mack, the Chairman of the Subcommittee on Economic Policy, Senate Committee on Banking, Housing, and Urban Affairs; the Honorable Andrew M. Cuomo, the Secretary of Housing and Urban Development; and other interested parties. Copies will also be made available to others upon request.

If you or your staff have any questions about this report, please contact me at (202) 512-7631. Major contributors to this report were Bill Bley, Pat Doerning, Matt Scire, and Pat Valentine.

Judy A. England-Joseph
Director, Housing and Community
Development Issues

Comments From the Department of Housing and Urban Development

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

MAY 1 3 1999

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Ms. Judy A. England-Joseph
Director, Housing and Community
Development Issues
General Accounting Office
441 G. Street, NW
Washington, DC 20548

Dear Ms. England-Joseph:

Thank you for the opportunity to comment on the audit report, Information on Single Family Loans Sold by HUD (GAO/RCED-99-145). The Department is supportive of the review and the observations identified by the General Accounting Office (GAO).

FINDINGS BY THE GAO

We are pleased that GAO's recent audit of FHA Loan Sales Program generally was very favorable. We agree with GAO's general conclusions that the note sales have been a success. Still we share GAO's concern that HUD records do not show whether servicers of former HUD loans took corrective action or do not describe corrective action taken as the result of findings and concerns raised by HUD during compliance reviews and the telephone complaint line which receives requests for assistance from borrowers. GAO also identified that HUD staff, responsible for resolving borrower complaints or questions regarding loans which HUD sold, did not maintain adequate records in individual caller files to determine the final disposition of 40 percent of the serious complaints sampled.

THE DEPARTMENT'S RESPONSE

The Department has been involved in a dispute with a purchaser/servicer (bank) of former HUD loans with respect to its servicing practices including the method the bank uses to establish forbearance agreement payment amounts. Conference calls have been held with key officials of the bank and HUD has sent letters outlining the bank's misinterpretation of the Loan Sale Agreement requirements. An onsite compliance review confirmed that the bank is continuing to service loans in an unacceptable manner. Action is presently being taken to gather additional data regarding the status of the loans in the bank's portfolio. The results of the recent onsite compliance review and any other data obtained will be presented to HUD's Mortgagee Review Board for consideration of sanctions against the bank.

The Department agrees with GAO's finding that in some cases information was not recorded in individual caller files which would present a complete description of how the complaints were resolved. The Tulsa Office, currently responsible for resolving such complaints, has been instructed that staff must record sufficient information in caller files so that it could be determined from the file: the nature of the complaint, the names of individuals contacted regarding the complaint, the action being taken, who will take the action and within what period of time and any follow-up which is required.

CONCLUSION

The findings of the GAO are of great concern to us. It is our intent to continue in our efforts to ensure fair and equitable treatment of borrowers and that the loans sold in HUD's Asset Sales are serviced in the manner prescribed by the Loan Sale Agreements.

Sincerely,

William C. Apgar

William C. Apgar
Assistant Secretary for Housing-
Federal Housing Commissioner

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