



OFFICE of
INSPECTOR GENERAL
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UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

HUD Did Not Always Address Risks Reported in Borrowers' Audited Financial Statements for Section 232 Residential Care Facility Portfolios

Audit Report Number: 2026-BO-0001

April 2, 2026

Highlights

HUD Did Not Always Address Risks Reported in Borrowers' Audited Financial Statements for Section 232 Residential Care Facility Portfolios | 2026-BO-0001

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development (HUD), Office of Residential Care Facilities' (ORCF), oversight of Section 232 residential care facilities' mortgage insurance program. We performed this audit because HUD-insured residential care facility loan defaults were rising. As of June 2024, 167 of the 3,670 HUD-insured Section 232 borrowers, or nearly 5 percent, defaulted on their mortgages. These 167 loans had an unpaid principal balance of more than \$1.1 billion. Our audit objective was to assess the extent to which HUD identifies and mitigates risks in Section 232 residential care facility portfolios.

What We Found

We reviewed 4 portfolios composed of 70 properties with 84 loans with a collective unpaid balance of more than \$410.6 million. A portfolio is two or more borrower entities that are under common ownership and/or common control. HUD rated all 84 loans as troubled as of June 2024. Our review revealed that HUD ORCF can better recognize and address risks in its portfolios. Specifically, HUD ORCF is not promptly mitigating financial risks reported in borrowers' audited financial statements. The audited financial statements disclosed that (1) borrowers withdrew funds from the properties when the properties did not have available surplus cash, (2) properties had cash deficiencies, and (3) properties did not generate sufficient cash flow to pay the current debts. HUD ORCF did not (1) receive the audited financial statements from all borrowers as required, (2) ensure that all borrowers fully developed their action plans to address risks that threaten the viability of a property, and (3) notify the Departmental Enforcement Center before the borrowers defaulted on their HUD-insured loans.

These conditions occurred because HUD ORCF staff lacked the time to conduct the detailed analysis needed. HUD ORCF stated that, due to the size and complexity, staff did not have the manpower to conduct the analysis required to identify whether borrowers improperly removed funds from the properties (unauthorized distributions). In addition, the staff decreased from 61 employees in October 2024 to 38 employees in May 2025. The average number of properties that staff managed changed from 60 - 80 to 165 - 200 properties each, which might increase the risk to the program. HUD-ORCF workload management practices led to no team having insight into an entire portfolio. Although regulations require borrowers and operators to report risks to HUD at any time, regulations do not require borrowers and operators to develop and implement action plans to address these risks until defaults. As of July 2025, lenders could make insurance claims for 58 of 84 loans totaling more than \$329.5 million.

What We Recommend

We recommend that HUD's ORCF Director of Asset Management (1) work with the borrowers and lenders to develop a plan to address the issues for each of the 58 troubled loans and implement corrective action for the 58 loans, thereby protecting HUD's investment of more than \$329.5 million; (2) quantify the amount of unauthorized distributions in the portfolio with 35 loans reported by the independent public accountant on the borrowers' audited financial statements and require the borrowers to repay the amount of unauthorized distributions or pursue enforcement of the borrowers' regulatory agreements by a written referral to HUD's Departmental Enforcement Center (DEC); and (3) develop and implement policies and procedures to ensure that borrowers and lenders develop and implement action plans that properly list all specific risks at a property, identify the root causes of each risk, specify the actions to address each root cause, and establish a timetable to complete each action.

We also recommend that HUD's ORCF Director of Asset Management (4) develop and implement policies and procedures to ensure that borrowers and lenders execute action plans that properly list all specific risks at a property, the root causes of each risk, the actions to address each root cause, and a timetable to complete each action; and (5) develop and implement policies and procedures to ensure that HUD account executives document each action plan, properly list all specific risks at a property, identify the root causes of these risks, specify the actions to address the root causes, establish timetables for completion, and document monthly progress towards completion of the actions in the Integrated Real Estate Management System (iREMS).

Table of Contents

- Background and Objective 1**
- Results of Audit 3**
 - HUD Did Not Always Address Risks Reported in Borrowers’ Audited Financial Statements for
Section 232 Residential Care Facility Portfolios..... 3
- Scope and Methodology 10**
- Appendixes 12**
 - Appendix A – Schedule of Funds to Be Put to Better Use 12
 - Appendix B – Management Response 13

Background and Objective

In 1959, Congress passed Section 232 of the National Housing Act, which authorized the U.S. Government to insure mortgages for nursing homes. The U.S. Department of Housing and Urban Development (HUD) has insured these types of mortgage loans since its creation in 1965. HUD's Office of Residential Care Facilities (ORCF) administers the Section 232 mortgage insurance program that enables the financing and refinancing of residential care facilities nationwide. Borrowers may use Section 232 mortgage insurance to insure loans to construct, purchase, refinance, or rehabilitate a residential care facility. Residential care facilities include nursing homes, assisted living facilities, intermediate care facilities, board and care homes, or facilities that are a combination of these types.

Within HUD ORCF is the Asset Management and Lender Relations Division which services insured mortgages, monitors risk, and works to minimize claims. The Asset Management Division includes a Loan Management Branch and a Risk Mitigation Branch. The Loan Management Branch conducts routine loan servicing on routine loans. The Risk Mitigation Branch concentrates on troubled loans that are HUD-held, or in serious financial and/or operational condition. Each Account Executive, employed by either branch, works with the borrower and the lender to ensure each loan is financially and operationally strong, that each property provides a safe, quality place of residence, and that the loan remains viable for the term of the mortgage. The Loan Management Branch monitors Section 232 loans by reviewing state inspection surveys, analyzing borrower Financial Assessment Subsystem submissions, and monitoring the Centers for Medicare and Medicaid Service (CMS) ratings.

HUD defines a portfolio as two or more borrower entities that are under common ownership and/or common control. As of April 12, 2024, HUD insured 376 portfolios with 2,119 loans. The loans had a collective unpaid principal balance of more than \$18.1 billion. These portfolios ranged in size from 1 loan to 133 loans. Borrowers may enter an operating lease in which the borrower provides the operator with the use of the property for a particular period. To be eligible for HUD insurance, borrowers shall be a single asset entity where the property is the only asset of the borrower. Each property in the portfolio has a separate borrower. Each borrower is a separate company with separate partners in a partnership or separate officers in a corporation. The common link is one or more individuals is/are part of the companies.

In some cases, the borrower, who owns the property, leases the property to a separate company, an operator, who runs the residential care operation. Borrowers and operators may be related parties. HUD requires master leases where there are common ownership interests for three or more properties and/or common ownership interests for \$15 million or more in aggregate loans to properties under the same ownership. National and regional healthcare borrowers may use master leases. The master lease creates a tiered structure with a master tenant leasing multiple projects from the borrowers. Through the master lease agreement, the master tenant agrees, among other things, to pay rent to the borrowers at an amount necessary to satisfy the borrower's financial obligations under the FHA-insured loan. The HUD master lease structure ties together the operating leases from each healthcare facility into one master lease for the portfolio. The HUD master lease requires each operator to allow available funds from its property to be used for any other property in that master lease that is unable to generate adequate cash flow to make its required lease payments. HUD views master leases as an important tool to lessen the financial risk posed by a portfolio and provide assurance that all portfolio project resources are available to financially support troubled properties in the portfolio.

HUD requires a regulatory agreement between HUD and the borrower, and there may be a regulatory agreement between HUD and the operator.¹ The Regulatory agreements govern the operation of the residential care facilities. HUD must enforce borrower regulatory agreements and ensure that stakeholders abide by the program requirements. Examples of risks requiring action plans include 1) delinquent or defaulted mortgage payments, 2) a debt service coverage ratio below 1.0, 3) Special Focus Facility (SFF) designation,² 4) quality of care issues, and 5) operator- or lender-identified risks (e.g. bankruptcies). HUD requires borrowers, operators, and lenders to promptly report risks and threats to HUD. HUD asks each property to develop action plans to address these risks.

Our audit objective was to assess the extent to which HUD's Office of Residential Care Facilities identifies and mitigates risks in Section 232 residential care facility portfolios.

¹ Not every HUD-insured mortgage has an operator.

² CMS has a Special Focus Facility Initiative that places a facility with a history of serious quality issues into a special program that is meant to stimulate the property to improve its quality of care to residents.

Results of Audit

HUD Did Not Always Address Risks Reported in Borrowers' Audited Financial Statements for Section 232 Residential Care Facility Portfolios

HUD ORCF can better recognize and address risks in its portfolios. Specifically, HUD ORCF is not promptly mitigating financial risks reported in audited financial statements. The audited financial statements disclosed that (1) borrowers withdrew funds from the properties when the properties did not have surplus cash, (2) properties had negative cash flow, and (3) properties did not generate sufficient cash flow to pay the current debts. HUD ORCF did not (1) receive the audited financial statements from all borrowers as required, (2) ensure that all borrowers fully developed their action plans, and (3) notify the DEC of these risks before the borrowers defaulted on their HUD-insured loans. These conditions occurred because HUD ORCF staff lacked the capacity to conduct the detailed analysis needed. HUD ORCF stated that, due to the size and complexity, staff did not have the manpower to conduct the analysis required to identify whether borrowers improperly removed funds from the properties (unauthorized distributions). In addition, the number of staff decreased and the average number of properties in each staff member's workload increased. HUD-ORCF workload management practices led to no team having insight into an entire portfolio. Although regulations require reporting risks at any time, regulations do not require action plans to address the risks until default. As of July 2025, lenders could make insurance claims for 58 of 84 loans totaling more than \$329.5 million.

HUD Did Not Always Identify and Mitigate Risk in Section 232 Residential Care Facilities

HUD ORCF is not promptly mitigating financial risks reported in audited financial statements. Borrowers of HUD-insured properties must submit annual audited financial statements to HUD and their lenders no later than 90 days after the end of their fiscal year unless the HUD Secretary grants an extension. These financial statements provide HUD ORCF with information about the properties' financial operations for that fiscal year. HUD ORCF uses this information to help identify and mitigate risks to prevent defaults.

For 4 portfolios with 70 properties and 84 loans,³ a review of the borrowers' audited financial statements showed that

- Borrowers withdrew funds from the properties when the properties did not have available surplus cash,
- Properties had cash deficiencies and did not generate sufficient cash flow to pay the current debts, and
- Borrowers did not submit audited financial statements.

HUD ORCF did not promptly address borrowers who withdrew funds from properties when the properties did not have surplus cash available. Surplus cash is the cash remaining after the property pays its operating obligations and loan payments and makes required deposits to the reserves for replacement

³ The audit covered 4 portfolios with 84 loans. One portfolio had 21 properties with 35 loans, another portfolio had 21 properties with 21 loans, a third portfolio had 26 properties with 26 loans, and a fourth portfolio had 2 properties with 2 loans.

and funds held in trust (for example, security deposits). Borrowers taking funds out of the property when the property does not have enough funds to pay its HUD-insured loan and operating expenses increases the likelihood that the borrower may default on the loan and the lender may claim the benefits of the HUD insurance.

An unauthorized distribution is any distribution when the property does not have surplus cash. HUD’s regulatory agreements with the borrowers may limit distributions to surplus cash. There were 204 instances of unauthorized distributions across the 84 loans in the four portfolios. Borrowers made 174 unauthorized loans from project funds, 29 unauthorized distributions of project funds, and 1 unauthorized reserve withdrawal. According to 24 CFR 232.254, borrowers may make and take distributions of mortgaged property provided that the mortgaged property generated surplus cash. If the surplus cash is negative, the borrower must repay any distributions within 30 calendar days unless HUD approves a longer time period.

In January 2024, HUD ORCF analyzed the available 2020, 2021 and 2022 audited financial statements for 2 related portfolios with a combined total of 28 loans. This analysis led HUD ORCF to believe that the borrowers may have committed various regulatory violations via unauthorized distributions at multiple properties. HUD ORCF initially identified unauthorized distributions of more than \$1.7 million in fiscal year 2020, \$111,007 in fiscal year 2021, and \$959,638 in fiscal year 2022 for a combined total of more than \$2.8 million. HUD ORCF then performed additional analysis and determined more than \$1.7 million were not for unauthorized distributions. HUD ORCF stated that the borrower did not challenge the remaining unauthorized distributions and returned approximately \$1.2 million. In addition, the financial statements identified unauthorized reserve withdrawals in one property.

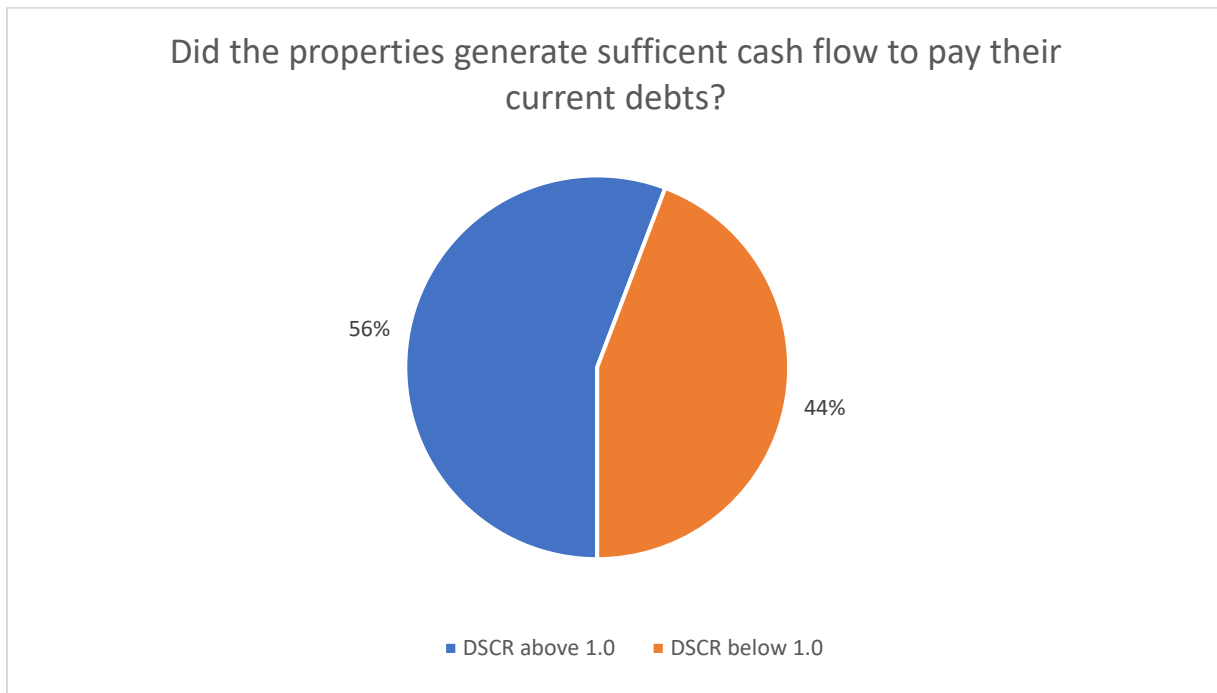
The audited financial statements disclosed cash deficiencies for 65 of 70 properties (93 percent). For example, in a portfolio of 21 properties, the independent public accountant reported that each property was in a cash deficiency during each fiscal year from 2018 through 2024. These 21 properties collectively have 35 HUD-insured loans. HUD insured operating loss loans for 14 properties to mitigate COVID-19 related temporary revenue reductions. The borrowers defaulted on all 35 loans (see table below).⁴

Month and Year of Defaults	Number of Loans Defaulted
February 2020	1 loan
April 2020	7 loans
September 2022	3 loans
August 2023	1 loan
September 2023	10 loans
October 2023	12 loans
December 2023	1 loan
Total number of loans in default	35 loans

⁴ The borrowers paid off two loans for one property after default.

The borrowers' audited financial statements disclosed that some properties did not generate sufficient cash flow to pay the current debts through the debt service coverage ratio. For example, the debt service coverage ratio for 180 of 407 statements⁵ (44 percent) was below HUD's target of 1.

This ratio measures the property's available cash flow to pay its current debt obligations. It shows whether a property generates enough income to pay its current debts. Properties with ratios below one are more likely to default on the HUD-insured mortgage (see graphic below).



Under 24 CFR 5.801(a)(4)(x), borrowers of HUD-insured properties must submit annual audited financial statements to HUD and their lender no later than 90 days after the end of their fiscal year unless the HUD Secretary grants an extension. In 2 related portfolios with 28 loans and 28 properties, the borrower of one property did not submit financial statements for fiscal years 2020 through 2024.⁶ These financial statements provide HUD ORCF systemic information about the properties' financial operations for that fiscal year. HUD ORCF uses this information to help minimize claims. Borrowers for 21 of the 28 loans defaulted in October 2023, and borrowers for 7 of 28 loans defaulted in November 2023.

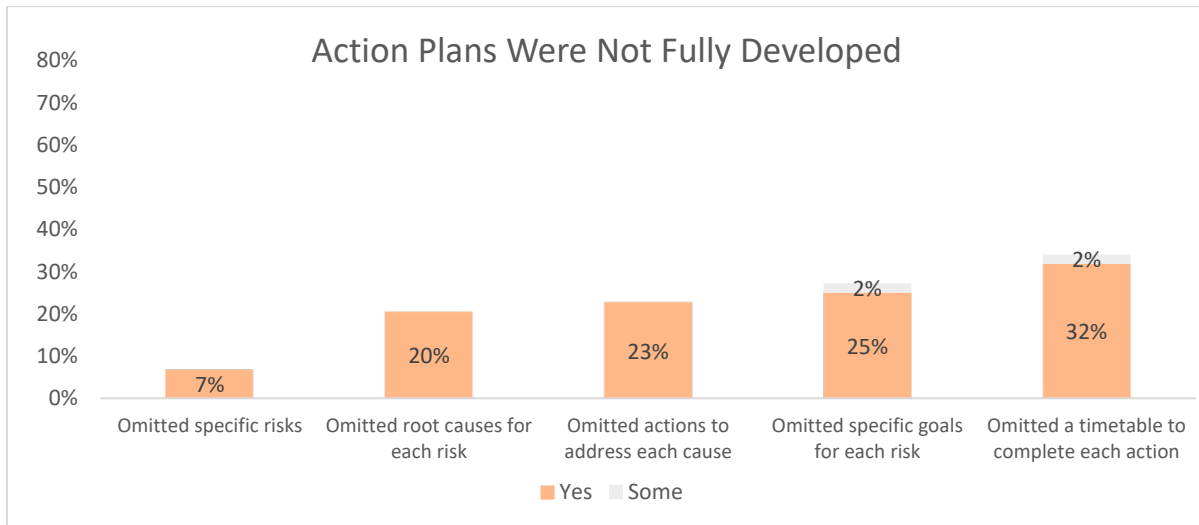
In addition, borrowers usually developed action plans; but HUD ORCF did not ensure that all action plans were fully developed. According to 24 CFR 207.258(a)(2)(iv), as implemented in HUD Form-93334-ORCF, the borrowers and lenders must cooperate with HUD to take reasonable steps to avoid an insurance claim. HUD calls these steps an action plan. For 46 of 70 properties, borrowers developed 88 action plans to address one or more risks that the properties experienced between 2018 and 2024. Borrowers developed 58 of 88 action plans before default and 30 of 88 after default. These action plans did not always include complete information on the specific risks, the root causes of each risk, the actions to

⁵ One audited financial statement did not list its debt service coverage ratio.

⁶ This property closed on its HUD-insured loan in July 2020.

address each root cause, the specific measurable goals for each risk, and the timetable to complete the planned actions.

For example, in a portfolio with 21 properties and 21 loans, the action plans for these properties were submitted to HUD between March 1, 2020, and February 26, 2024. Borrowers submitted 33 action plans before default and 11 action plans after default. These plans omitted elements, as follows:



In addition, this portfolio showed low CMS ratings for the properties. Low CMS ratings mean that upon inspection the facilities were deficient in their operations. Sixteen of 21 properties received low CMS ratings. Eight properties included their low CMS ratings in their action plans, and eight properties did not. If borrowers and their operators do not improve the CMS ratings, the properties may lose the ability to receive revenue from CMS and the risk borrowers defaulting on their HUD-insured mortgage increases.

Furthermore, the properties faced new challenges, such as COVID-19 and receivership, which complicated its planned actions and the timetables to complete these actions. To identify and mitigate risks, HUD ORCF staff indicated that they have begun developing new tools specific to portfolios. HUD ORCF began conducting annual update calls with large portfolios where key HUD ORCF employees meet with borrowers and operators to discuss status of the operations of the facilities within the portfolios. HUD ORCF developed a questionnaire to provide a script for Account Executives to use during the calls, which includes asking borrowers and lenders questions about financial performance, CMS concerns, mortgage payments, accounts payable, census, staffing, and marketing. It hired an independent contractor to conduct forensic accounting analyses. HUD ORCF automated a risk surveillance process specific to portfolios that aggregates 53 risk characteristics for all properties in a portfolio.

HUD DEC provides HUD program offices, such as HUD ORCF, with the analytical resources to support a strong program compliance and enforcement effort. The DEC focuses on assuring financial accountability in HUD programs by bringing program participants into compliance with HUD's statutory and regulatory requirements and seeks civil money penalties or other enforcement when needed. In April 2025, the DEC's officials stated that HUD ORCF identifies and submits compliance issues to them too late. Also, the DEC officials stated it would be beneficial for HUD ORCF to engage DEC earlier to implement changes to fix issues before the borrowers defaulted.

In June 2025, HUD ORCF and HUD DEC established a working group. This group consists of two HUD DEC analysts and three HUD ORCF employees who meet each month to establish goals, discuss noncompliance issues, and revise protocols for the mutual benefit of HUD ORCF and HUD DEC. Contacting DEC before borrowers default on their HUD-insured loans can help HUD to minimize claims against the HUD insurance fund. Documenting discussions between DEC and ORCF and any decisions about enforcement can also help mitigate risk. This should include flagging principals of borrowers in HUD's computer systems, so that only entities and individuals without open flags can receive future HUD-insured loans. Entities and individuals that want to obtain HUD insurance for healthcare projects must obtain HUD approval to participate. HUD uses the Active Partners Performance System (APPS) to allow business partners to submit information electronically to HUD, and for HUD staff to review and approve the business partners' participation in the HUD-insured loan programs.

These conditions occurred because HUD ORCF staff lacked the time to conduct the detailed analysis needed. HUD ORCF stated that, due to the size and complexity, routine Account Executives did not have the manpower to conduct the analysis required to identify unauthorized distributions and loans. In addition, the staff decreased from 61 employees in October 2024 to 38 employees in May 2025. The average number of properties that a routine Account Executive managed changed from 60 - 80 to 165 - 200 properties each. Further, HUD-ORCF workload management practices led to no team having complete insight into an entire portfolio. HUD-ORCF assigns properties to its teams based on which lender funded the loan. Each of the four portfolios utilized multiple lenders. With different Account Executives and different Workload Managers overseeing different lenders, no team had the full risk profile of a portfolio. Furthermore, HUD ORCF regulations require reporting risks at any time, but do not require action plans to address these identified risks until a default has been called.

As a result, HUD, lenders, and borrowers are working with 21 loans in bankruptcy. HUD paid claims for three loans and borrowers paid off two loans. As of July 2025, lenders could make insurance claims for the remaining 58 defaulted loans with unpaid principal balances totaling more than \$329.5 million.

Conclusion

HUD, lenders, and borrowers are working with 21 loans in bankruptcy. HUD paid claims for three more loans and borrowers paid off two other loans. As of July 2025, lenders could make insurance claims for the remaining 58 defaulted loans with unpaid principal balances totaling more than \$329.5 million. These conditions occurred because HUD ORCF staff lacked the time to conduct the detailed analysis needed, staff numbers decreased, workload management practices led to no team having insight into an entire portfolio, and HUD does not require action plans until after default has been called.

Recommendations

We recommend HUD's Director of Asset Management

- 1A. Work with borrowers and lenders to develop a plan to address the issues for each of the 58 defaulted loans within a reasonable time frame and implement corrective actions for the 58 loans; thereby protecting HUD's investment of \$329,541,272.
- 1B. Quantify the amount of unauthorized distributions in the portfolio of 21 properties with 35 loans reported by the independent public accountant on the borrowers' audited financial statements covering fiscal years 2018 to 2024 and require the borrowers to repay the amount

of unauthorized distributions or pursue enforcement of the borrowers' regulatory agreements by a written referral to HUD's DEC.

1C. Flag all principals of the borrowers with unreimbursed and unauthorized distributions in the Active Partners Performance System (APPS) to ensure that HUD appropriately evaluates the risks associated with doing business with these principals.

1D. Refer any borrowers to the DEC for a civil money penalty or any other appropriate enforcement actions within 60 days of borrowers' financial statement receipts for all unauthorized distributions not repaid within 30 days. If HUD ORCF chooses to allow a longer repayment period, document in iREMS the amount of the loan, the longer repayment period, and the reasons for the longer period.

1E. Document DEC decisions and any penalties awarded in iREMS for each affected property for any ORCF referrals to the DEC about unauthorized loans.

1F. Flag any borrowers in APPS for each unpaid penalty to ensure that HUD appropriately evaluates the risks associated with doing business with these principals.

1G. Determine and document in iREMS the reasons that the borrowers did not make the mortgage payments and the specific steps HUD is taking to address the borrowers' failure to make mortgage payments for all failures to make mortgage payments listed in borrowers' audited financial statements.

1H. Train HUD Account Executives on how to evaluate borrower action plans to ensure that action plans identify specific risks, identify the root causes of each risk, develop actions to address each root cause, identify specific measurable goals for each risk, and establish a timetable to complete the planned actions. Also, train HUD Account Executives on how to work with borrowers and lenders to ensure that borrowers properly develop, implement, and adhere to their action plans.

1I. Develop and implement policies and procedures to ensure that borrowers and lenders execute action plans that properly list all specific risks at a property, identify the root causes of each risk, specify the actions to address each root cause, and establish a timetable to complete each action.

1J. Develop and implement policies and procedures to ensure that HUD Account Executives document each action plan, properly list all specific risks at a property, identify the root causes of these risks, specify the actions to address the root causes, establish the timetables for completion, and document monthly progress towards completion of the actions in iREMS.

1K. Develop and implement policies and procedures for a course of action when borrowers and/or lenders do not timely develop action plans. These policies and procedures should include civil money penalties, flagging the borrower in APPS, and inclusion in the Excluded Parties List System.

1L. Update the protocols to ensure that all HUD ORCF teams working with any subset of the portfolio have insight into the entire portfolio for any portfolio split amongst lenders.

Management Response

HUD ORCF agreed with most of the report's recommendations and provided proposed technical edits to the finding and recommendations. First, HUD ORCF requested that we clarify the time period in which the loan default rate increased, because it stated that it is no longer true. Second, HUD ORCF indicated that the loan default rate increased in the industry as a whole because of the COVID-19 pandemic; however, HUD loan default rates were minimal, in part because of ORCF servicing actions. Third, HUD ORCF requested that we acknowledge that 1) despite the loss of staff and increase in production volumes, it has continued to provide excellent customer service and has decreased both the loan default and delinquency rates; and 2) while increased staff time and training may increase the ability for HUD ORCF to analyze the cause of the quality of loan servicing and asset management, it does not necessarily follow that the default/delinquency rate will decrease based on staff actions. Finally, HUD ORCF wanted to clarify Single Audit submission requirements for non-profit borrowers. HUD ORCF provided comments on the recommendations and requested recommendations 1C, 1H, and 1L be closed. Management's response is included in Appendix B.

OIG Evaluation of Management Response

We appreciate HUD ORCF's general agreement with the finding and recommendations. We considered HUD ORCF's proposed technical edits and adjustments. We made changes where appropriate and the changes did not impact the audit report results. For the changes, we revised the audit report to identify when increased residential care defaults occurred. We did not add additional information about COVID-19 because the audit report already discusses the impact of COVID-19. In regard to HUD ORCF's comments on its continued excellent customer service despite a loss of staff and an increased number of HUD-insured loans, we believe that the reduction in staffing affects the time that HUD ORCF has to conduct the detailed analysis needed to understand the challenges facing nursing homes. In addition, the Single Audit Act requirements are only relevant for non-profit borrowers and the 84 loans that we reviewed were for-profit borrowers.

We acknowledge HUD ORCF's efforts to better analyze portfolio data. For example, in April 2025, HUD ORCF began developing a Power App to assist its staff with analyzing data on a portfolio level. This Power App also allows analysis of a specific property within a portfolio.

We had discussions with HUD ORCF staff on their disagreements with the recommendations and made changes where appropriate to address HUD's concerns. We will not close any recommendations during the issuance of this audit report. All recommendations will be closed during audit resolution because HUD ORCF has not provided all the documents needed for closure. Specifically, for recommendation 1C, HUD ORCF only provided evidence for two of the three portfolios. For recommendation 1H, HUD ORCF needs to provide evidence of the training materials and a listing of the attendees. For recommendation 1L, HUD ORCF needs to provide evidence that HUD ORCF staff can access the Power App created in the Risk Surveillance Dashboard.

We appreciate HUD ORCF's commitment to address the audit report's recommendations and look forward to collaborating during the audit resolution process to ensure that the corrective actions fully address the recommendations.


Scope and Methodology

We performed our audit off-site from our office in Boston, MA, from December 2024 to August 2025. The audit covered the period January 1, 2018, through December 31, 2024.

To accomplish our objective, we

- Reviewed applicable laws, regulations, HUD Handbook 4232.1 REV-1, HUD's enforcement tip sheet and other HUD policies and procedures.
- Interviewed HUD personnel from the Office of Residential Care Facilities and the Departmental Enforcement Center.
- Reviewed and analyzed information from HUD's Integrated Real Estate Management System. This system includes information regarding borrower annual audited financial statements, property risk rating, date of default, delinquency period, risks, and action plans.
- Reviewed and analyzed information from HUD's Multifamily Delinquency and Default Reporting System. This system identifies when a loan went into delinquency, when a loan went into default, and delinquencies. Delinquencies can include the loan principal, loan interest, past due taxes, and past due insurance.
- Obtained and analyzed data from HUD's Financial Assessment Subsystem for Multifamily Housing. ORCF participants are required to submit annual electronic financial statement data to HUD. HUD requires this data to determine the financial health of properties, protect HUD from financial loss, and assess borrower compliance with various business agreements such as regulatory agreements.
- Obtained and analyzed data from HUD's Online Property Integrated Information Suite (OPIIS). OPIIS is a data mart that collects and aggregates data from other HUD systems. HUD generally updates this data mart monthly to quantify the number of HUD-insured loans and identify servicer, Federal Housing Administration number, property ID, amortized unpaid principal balance, and troubled status.
- Selected a focused sample of four residential care facility portfolios. We decided to use a focused sample because we knew enough about the residential care facility portfolios to identify a relatively small number of portfolios of interest that were higher in risk. We identified portfolios that had all troubled loans according to HUD's Online Property Integrated Information Suite. Because this is not a statistical sample, the results of our work cannot be projected. Our sample of 4 portfolios had 84 HUD-insured loans that had a combined unpaid principal balance of \$410,633,180 in April 2024. HUD insured properties in 376 portfolios with 2,119 loans that had a combined unpaid principal balance of \$18,108,978,665. As of July 2025, lenders could make insurance claims for the 58 defaulted loans totaling \$329,541,272. The remaining 26 loans include 21 loans in bankruptcy, 3 loans where HUD paid insurance claims, and 2 loans that borrowers paid off.

We used the computer-processed data from HUD's Integrated Real Estate Management System, Multifamily Delinquency and Default Reporting System, and the Financial Assessment Subsystem for the Federal Housing Administration to achieve our audit objective. These systems rely on data provided to



HUD by lenders, borrowers, and operators participating in the origination or operation of residential care facilities with HUD-insured mortgages. We did not access computer systems and source documents available at the lenders, owners, operators, and management agents. However, we determined that it was reasonable to use this information because this is the information that HUD used to identify and mitigate risk in Section 232 residential care facility portfolios. Also, we used evidence other than this data to support our conclusions, including information from other Federal agencies, bankruptcy court filings, and interviews with HUD staff.

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

Appendixes

Appendix A – Schedule of Funds to Be Put to Better Use

Table 1. Schedule of Questioned Costs and Funds to Be Put to Better Use

Recommendation Number	Funds to be put to better use 1/
1A	\$329,541,272

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. By implementing this recommendation, HUD will avoid paying more than \$329.5 million to lenders for defaulted loans.

Appendix B – Management Response



OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

March 10, 2026

MEMORANDUM FOR: Ronald Lloyd, Regional Inspector General for Audit, 1AGA

FROM: Roger Lewis, Director, Office of Residential Care Facilities

ROGER LEWIS
Digitally signed by ROGER LEWIS
 DN: CN = ROGER LEWIS C = US O = U.S. Government OU =
 Department of Housing and Urban Development, Office of
 Administration
 Date: 2026.03.10 11:32:31 -0400

SUBJECT: Response to Draft Audit Report, “HUD Did Not Always Address Risks Reported in Borrowers’ Audited Financial Statements for Section 232 Residential Care Facility Portfolios,” Audit Report Number: 2026-BO-00XX

This memorandum responds to your draft audit report titled, “HUD Did Not Always Address Risks Reported in Borrowers’ Audited Financial Statements for Section 232 Residential Care Facility Portfolios.” ORCF pursues continuous improvement and welcomes any information and constructive recommendations that can foster improvement. However, ORCF is providing clarification and correction to some of the conclusions in the draft report as well as our responses to the draft recommendations.

We respectfully request adjustments to the audit as detailed below:

- 1) In the Section of the draft audit titled, “What We Audited and Why,” you stated that “HUD insured residential care facility loan defaults are rising.” We recommend that this statement be altered to either use the past tense or to indicate the period of time in which this condition was true. This statement is no longer true, as the loan default rate in the ORCF portfolio is currently dramatically declining. Please see chart below. Moreover, the loan default rates are not the same as claim rates. ORCF has a Risk Mitigation Team that provides robust servicing of defaulted loans to minimize the claim rates.

Defaults As Of:	Late Payments	Default UPB	UPB As Of:	Loans	Portfolio UPB	Default Rate	HUD Held Loans	UPB of HUD Held Loans
02/25/2025	30	\$206,136,880	2/26/2025	3,905	\$39,340,976,205	0.66%	34	\$192,336,954.74
11/18/2025	64	\$931,657,208	11/17/2025	3,937	\$38,016,127,664	1.40%	47	\$215,080,252.97
08/25/2025	103	\$660,260,913	8/25/2025	3,890	\$37,289,332,448	1.77%	39	\$258,638,919.09
05/27/2025	74	\$563,898,692	5/27/2025	3,843	\$36,000,614,186	1.57%	36	\$154,693,250.00
02/25/2025	97	\$752,191,045	2/25/2025	3,816	\$35,449,006,114	2.12%	31	\$212,681,988.02

- 2) The scope of the audit (January 1, 2018 through December 31, 2024) covered the exact period of time marked by the COVID-19 pandemic, which notably impacted the nursing home industry, yet this causal condition was only briefly mentioned in the audit. While the default rate did increase as a result of the COVID-19 pandemic, this was true for the industry as a whole. Given the remarkable conditions affecting our country, ORCF default

rates were minimal. ORCF servicing actions mitigated what could have been larger defaults.

- 3) You noted that the staff reduction sustained between October 2024 to May 2025 that changed the average number of properties managed by staff “might increase the risk to the program.” We appreciate that you recognized the significant staff reduction that ORCF has sustained. Despite this loss of staff and increase in Production volumes, ORCF has continued to provide excellent customer service and has decreased both the loan default and delinquency rates. The audit report should at least acknowledge this.
- 4) To that end, throughout the draft audit, you state that certain conditions occurred because of lack of HUD ORCF staff training and/or time. While increased staff and training are certainly desirable factors which can positively impact the quality of loan servicing and asset management, they are not causative in and of themselves for the conditions cited (e.g., project negative cash flow, default rates etc.). Further, while increased staff time and training may increase the ability for ORCF to *analyze* the cause of these conditions, it does not necessarily follow that the default/delinquency rate, etc. will decrease based on staff actions, particularly when the conditions causing the project conditions (e.g., COVID) are outside of ORCF’s control. The audit report should at least acknowledge this.
- 5) In numerous places in the draft audit, you state that Audited Financial Statements are due “no later than 90 days after the end of their fiscal year unless the HUD Secretary grants an extension.” We wanted to clarify that this statement is true for for-Profit Borrowers. However, the requirements for the submission of Audited Financial Statements for non profit Borrowers are covered by the Single Audit Act, which supersedes HUD regulations.

Responses to Draft Recommendations:

Draft Recommendation 1A. Work with borrowers and lenders to develop a plan to address the issues for each of the 58 defaulted loans within a reasonable time frame and implement corrective actions for the 58 loans; thereby protecting HUD’s investment of \$329,541,272.

ORCF Response to Draft Recommendation 1A:

ORCF has already been working with the borrowers and lenders to develop plans of action and implement corrective actions to address the issues for the 58 loans reviewed. To that point, a large number of the loans audited have either been brought current or terminated since the audit was conducted, and therefore, the number of loans for which a plan of action would be applicable is far fewer. For those loans that remain in the inventory and are not current, and within the constraints of the applicable Regulatory Agreements, we agree to work with the borrower, through the lender, on developing plans to address outstanding defaults.

Draft Recommendation 1B. Quantify the amount of unauthorized distributions in the portfolio of 21 properties with 35 loans reported by the independent public accountant on the borrowers’ audited financial statements covering fiscal years 2018 to 2024 and require the borrowers to repay the

amount of unauthorized distributions or pursue enforcement of the borrowers' regulatory agreements by a written referral to HUD's DEC.

ORCF Response to Draft Recommendation 1B:

We concur with this Recommendation, with the caveat that the OIG accepts the results of the forensic audit being obtained by an independent third party auditor of the 21 properties referenced to determine if unauthorized distributions do exist.

Draft Recommendation 1C. Flag all principals of the borrowers with unreimbursed and unauthorized distributions in the Active Partners Performance System (APPS) to ensure that only entities and individuals without open flags can receive future HUD-insured loans.

ORCF Response to Draft Recommendation 1C:

ORCF agrees with this Recommendation and requests that it be closed concurrently. OIG was provided with evidence (screen shots) of the flags placed in APPS on 2/9/2026.

Draft Recommendation 1D. Refer any borrowers to the DEC for a civil money penalty or any other appropriate enforcement actions within 30 days of borrowers' financial statement receipts for all unauthorized distributions not repaid within 30 days. If HUD ORCF chooses to allow a longer repayment period, document in iREMS the amount of the loan, the longer repayment period, and the reasons for the longer period.

ORCF Response to Draft Recommendation 1D:

We request that the recommendation be reworded as follows: "Refer any borrowers to the DEC or OPE for a civil money penalty or any other appropriate enforcement actions as appropriate (e.g., borrowers' financial statement receipts for all unauthorized distributions not repaid within 30 days) unless the project(s) are in a positive Surplus Cash position. If HUD ORCF chooses to allow a longer repayment period, document in iREMS the amount of the loan, the longer repayment period, and the reasons for the longer period."

As worded, the recommendation did not take into account the terms of the Borrower Regulatory Agreement which allow for the repayment of distribution taken in excess of Surplus Cash within 30 days of the Surplus Cash calculation. As originally written, the recommendation would require referral to the DEC before the 30 days are over, potentially wasting staff time in preparing a referral package. In addition to the "cure" period, if the project is subsequently in a positive Surplus Cash position, it is our experience that the DEC declines to pursue penalties.

Further, while ORCF does recognize that the DEC is organizationally tasked with issuing Civil Money Penalties and certain other enforcement actions, we do note that they have frequently declined to accept referrals, including for the enforcement of Master Tenant Regulatory Agreements. As a result, ORCF has been engaging with the Office of Program Enforcement for more agile enforcement actions.

Additionally, distributions are often erroneously flagged as unauthorized in FASS for eligible

transactions (such as payments made to other projects due to a bona fide Master Lease). As a result, referral to the DEC without additional analysis can be either premature or fruitless. As noted, ORCF and the DEC established a working group in June 2025 to address and document these decisions. The DEC has increasingly asked ORCF to take on many of their previously designated roles in enforcement activities.

Draft Recommendation IE. Document DEC decisions and any penalties awarded in iREMS for each affected property for any ORCF referrals to the DEC about unauthorized loans.

ORCF Response to Draft Recommendation IE:

ORCF agrees with the need for proper documentation in iREMS of DEC decisions and penalties. However, the DEC is responsible for updating iREMS as to their decisions and penalties. The recommendation to require ORCF to additionally document the system is inappropriate. We request that you either direct this recommendation to the DEC or remove the recommendation.

Draft Recommendation IF. Flag any borrowers in APPS for each unpaid penalty to ensure that only entities and individuals without open flags can receive future HUD-insured loans.

ORCF Response to Draft Recommendation IF:

Regarding the ability of any party subject to an open APPS flag to do additional FHA business, ORCF follows the parameters of Housing Notice 2016-15. Additionally, there is no authorization in this Notice to flag participants for unpaid Civil Money Penalties. Additionally, activities related to the CMP fall under the jurisdiction of the DEC. Therefore, we request that this recommendation be removed.

Draft Recommendation IG. Determine and document in iREMS the reasons that the borrowers did not make the mortgage payments and the specific steps HUD is taking to address the borrowers' failure to make mortgage payments for all failures to make mortgage payments listed in borrowers audited financial statements.

ORCF Response to Draft Recommendation IG:

ORCF does regularly update iREMS to document causes and corrective actions for delinquencies and defaults. However, the assumption that reasons for missed mortgage payments can always be identified and quantified is erroneous. Therefore, we request that you revise the recommendation to add a parenthetical, "when discernable."

Draft Recommendation IH. Train HUD Account Executives on how to evaluate borrower action plans to ensure that action plans identify specific risks, identify the root causes of each risk, develop actions to address each root cause, identify specific measurable goals for each risk, and establish a timetable to complete the planned actions. Also, train HUD Account Executives on how to work with borrowers and lenders to ensure that borrowers properly develop, implement, and adhere to their action plans.

ORCF Response to Draft Recommendation IH:

ORCF agrees with this Recommendation as we have already provided staff training

(including 3/4/2026, 2/7/2024, 8/2/23, 8/23/23 and 8/16/23). As such, we request that this recommendation be closed concurrently.

Draft Recommendation II. Develop and implement policies and procedures to ensure that borrowers and lenders execute action plans that properly list all specific risks at a property, identify the root causes of each risk, specify the actions to address each root cause, and establish a timetable to complete each action.

ORCF Response to Draft Recommendation II:

ORCF objects to this recommendation because its scope is overly broad and entirely inconsistent with ORCF's current Asset Management and Risk Mitigation practices. ORCF has created a sophisticated Risk Surveillance Dashboard (RSD) with associated protocols that staff follow in managing their portfolios. While a detailed borrower action plan may sometimes be used, ORCF relies on many other tools in managing a very large portfolio, with a very limited number of staff. ORCF requests that this recommendation be completely rewritten to state, "Develop and implement policies to ensure that ORCF (1) holds lenders accountable to follow up with borrowers to address defaults, delinquencies and unauthorized distributions and (2) communicates with borrower, where appropriate, with, e.g., Notices of Violation, and then pursues remedies within the applicable Regulatory Agreement to attain compliance, e.g., APPS flags." It is important that the IG not try to prescribe ORCF procedures beyond that level, although in the Management Decisions and Evidence to Close, ORCF would certainly provide more detail as to its Risk Surveillance dashboard and the protocols through which Account Executives act on that data. Additionally, ORCF requests that the preface to the recommendation be reworded to refer to the Director of the Asset Management Division in coordination with the Director of the Policy, Risk Analysis and Lender Relations Division.

Draft Recommendation IJ. Develop and implement policies and procedures to ensure that HUD Account Executives document each action plan, properly list all specific risks at a property, identify the root causes of these risks, specify the actions to address the root causes, establish the timetables for completion, and monthly progress towards completion of the actions in iREMS.

ORCF Response to Draft Recommendation IJ:

See response to II above. ORCF requests that this Recommendation be replaced with the language proposed by ORCF for II.

Draft Recommendation IK. Develop and implement policies and procedures for a course of action when borrowers and/or lenders do not timely develop action plans. These policies and procedures should include civil money penalties, flagging the borrower in APPS, and inclusion in the Excluded Parties List System.

ORCF Response to Draft Recommendation IK:

See response to II above. ORCF requests that this Recommendation, be replaced with the language proposed by ORCF for II. We note that ORCF does not have the authority to either impose Civil Money Penalties or include participants in the Excluded Parties List System.

Draft Recommendation 1L. Update the protocols to ensure that all HUD ORCF teams working with any subset of the portfolio have insight into the entire portfolio for any portfolio split amongst lenders.

ORCF Response to Draft Recommendation 1L:
ORCF agrees with this Recommendation, as we have already updated the RSD to encompass the review of portfolios, cross-lenders. Therefore, we request concurrent closure.