Office of Single Family Housing, Washington, DC

Preforeclosure Claim Costs

Office of Audit, Region 9
Los Angeles, CA

Audit Report Number: 2018-LA-0007
September 27, 2018

To: Gisele G. Roget
Deputy Assistant Secretary for Single Family Housing, HU

//SIGNED//

From: Tanya E. Schulze
Regional Inspector General for Audit, 9DGA

Subject: HUD Paid an Estimated $413 Million for Unnecessary Preforeclosure Claim Interest and Other Costs Due to Lender Servicing Delays

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's Federal Housing Administration preforeclosure claim costs.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.

Audit Report Number: 2018-LA-0007
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HUD Paid an Estimated $413 Million for Unnecessary Preforeclosure Claim Interest and Other Costs Due to Lender Servicing Delays

Highlights

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration's (FHA) preforeclosure sale claim process based on an internal Office of Inspector General audit suggestion noting that existing regulations may allow excessive preforeclosure claim interest costs. Our audit objective was to determine the amount of unnecessary preforeclosure claim interest and other costs that resulted from lender noncompliance with HUD's loan-servicing timeframe requirements.

What We Found

HUD paid an estimated $413 million in unnecessary interest and other costs for 27,634 preforeclosure claims because lenders failed to complete servicing actions for defaulted loans within established timeframes. Although the unnecessary amounts were caused by lenders' inaction, HUD reimbursed lenders for these added costs through FHA insurance claims. This condition occurred because HUD's requirements and procedures do not limit unnecessary preforeclosure claim interest and other costs that result from lenders' servicing delays. As a result, the FHA insurance fund incurred unnecessary and unreasonable costs and fewer funds were available to pay other claims or apply toward reducing FHA borrower mortgage insurance premiums.

What We Recommend

We recommend that HUD's Office of Single Family Housing implement a change to regulations at 24 Code of Federal Regulations Part 203, to require curtailment of preforeclosure interest and other costs that are caused by lender servicing delays, resulting in $413 million in funds to be put to better use. This should include updating or seeking statutory authority to update HUD's regulations as necessary and coordinating with HUD's Office of Finance and Budget, well before any changes go through departmental clearance, to ensure that planned curtailment requirements can be consistently enforced through the claims process.

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Background and Objective

The U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) provides mortgage insurance on home loans made by its approved lenders. This insurance is paid for by borrowers and provides lenders with protection against losses if the homeowner defaults on the loan. Lenders may submit an insurance claim to HUD for losses incurred if a property is foreclosed upon, but the lender must first attempt to work with the homeowner and consider options available as part of HUD's loss mitigation program, which can assist the borrower in bringing the loan current or allow the borrower to dispose of the home without foreclosure. HUD's single-family preforeclosure sales program is one option under HUD's loss mitigation program.

A preforeclosure sale allows an FHA borrower in default to sell his or her home at fair market value and use the sales proceeds to satisfy the mortgage debt, even if the proceeds are less than the amount owed. After the property is sold, lenders submit an FHA insurance claim and are compensated for the difference between the sales proceeds and the amount owed on the mortgage. Through the insurance claim, lenders are paid interest at a specified debenture interest rate[1] on the outstanding loan principal and claim expenses. Lenders are also reimbursed for other costs, such as hazard insurance premiums, property taxes, legal fees, and property inspections. Effective use of the preforeclosure sales can reduce HUD's losses on certain insurance claims. However, because the interest and property-related expenses continue to accumulate as a defaulted loan is being serviced, delays in the servicing process can result in additional FHA insurance claim costs. HUD's Office of Single Family Housing administers the FHA mortgage insurance program for single-family homes and the Office of Finance and Budget is responsible for processing FHA claim payments.

HUD regulations require lenders to comply with specific deadlines when servicing defaulted loans.[2] For example, lenders generally must institute foreclosure, initiate a preforeclosure sale, or implement one of several other available loss mitigation actions within 6 months of the loan default date. Also, once initiated, preforeclosure sales must be completed within 4 to 6 months. The required loan-servicing deadlines can be extended automatically when certain criteria apply or when HUD approves a lender's extension request. Automatic extensions may apply, for example, if a borrower filed for bankruptcy or was on active duty military service.

From August 1, 2012, through July 31, 2017, FHA paid 100,077 preforeclosure sale claims totaling more than $8 billion.

Our audit objective was to determine the amount of unnecessary preforeclosure claim interest and other costs that resulted from lender noncompliance with HUD's loan-servicing timeframe requirements.

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1 The debenture interest rate is published by HUD and used for calculating the interest allowance paid to lenders for FHA insurance claims.

2 See appendix D.

Results of Audit

Finding: HUD Paid an Estimated $413 Million for Unnecessary Preforeclosure Claim Costs Due to Lender Servicing Delays

HUD paid an estimated $413 million in unnecessary interest and other costs for 27,634 preforeclosure claims because lenders failed to complete servicing actions for defaulted FHA loans within established timeframes. Although these unnecessary costs were due to lenders' inaction, HUD absorbed the added costs and reimbursed the involved lenders through FHA insurance claims. This condition occurred because HUD's requirements and procedures do not limit unnecessary preforeclosure claim interest and other costs attributable to lender servicing delays. As a result, the FHA insurance fund incurred unnecessary and unreasonable costs, and fewer funds were available to pay other claims or apply toward reducing FHA borrower mortgage insurance premiums.

HUD Reimbursed Lenders for Unnecessary and Unreasonable Interest and Other Costs

HUD paid unnecessary and unreasonable preforeclosure claim interest and other costs that resulted when lenders failed to comply with HUD's servicing deadlines. We analyzed available HUD system data for 100,077 preforeclosure claims paid during the period August 1, 2012, through July 31, 2017, and identified 30,061 claims that had indications of missed servicing deadlines.[3] We selected and reviewed a statistical sample of 72 claims from this targeted group. Lenders missed one or more of HUD's required servicing deadlines in 70 of the 72 (97 percent) sample preforeclosure claims reviewed[4]. Specifically, FHA-approved lenders failed to comply with HUD's servicing timeframes and caused delays as they missed the deadlines to (1) initiate foreclosure or loss mitigation, (2) complete preforeclosure sales, and (3) complete foreclosure. The following table shows the number of sample loans identified with each type of missed servicing deadline.

FHA-approved lenders failed to comply with HUD's servicing deadlines, causing unnecessary and unreasonable costs.

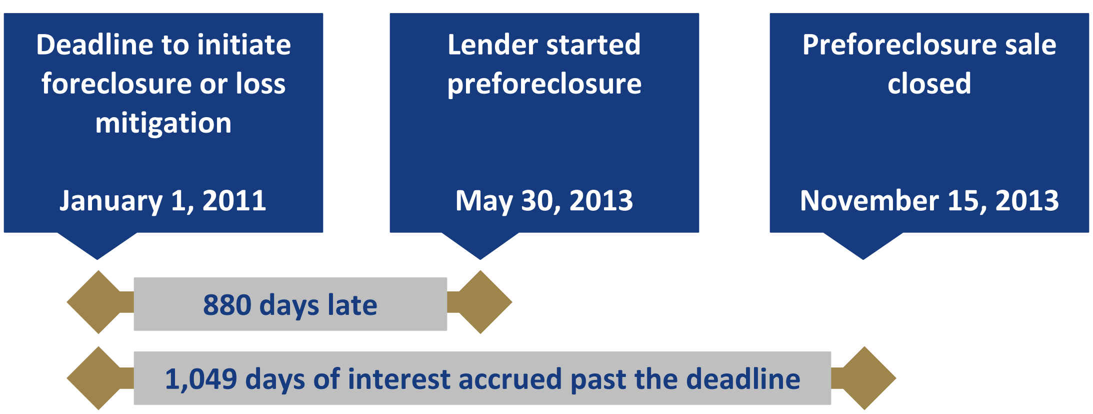
Missed HUD servicing deadline	Number of sample loans	Percentage of sample loans
Initiate foreclosure or loss mitigation	51	71%
Complete preforeclosure	24	33%
Complete foreclosure	51	71%

3 See the Scope and Methodology section for details regarding the audit sample testing.
4 See appendix C.

Lenders Missed the Deadline To Initiate Foreclosure or Loss Mitigation

HUD incurred unnecessary and unreasonable preforeclosure claim costs because lenders missed the deadline to initiate foreclosure or implement a loss mitigation action. Regulations at 24 CFR (Code of Federal Regulations) 203.355 generally require that lenders institute foreclosure, initiate a preforeclosure sale, or implement one of several other available loss mitigation actions within 6 months of loan default.[5] Of the 72 sample claims reviewed 51 (71 percent) missed this deadline, and interest continued to accumulate for an average of approximately 25 months during the loan-servicing process after the missed deadline.[6] The servicing process was delayed by an average of approximately 13.5 months until the required action was completed, resulting in unnecessary other costs, such as property taxes and hazard insurance. In 10 of these 51 cases, the servicing process was delayed by more than 2 years before the required foreclosure or loss mitigation action was taken.

For example, sample loan 413-3799157 went into default on July 1, 2010, and the deadline to commence foreclosure or take a required loss mitigation action was 6 months later on January 1, 2011. However, the lender did not initiate the preforeclosure process until May 30, 2013, 880 days after the deadline, and did not document that an extension applied. The preforeclosure sale was finalized on November 15, 2013. Based on the unpaid loan balance of $155,161 and the applicable debenture interest rate of 5.25 percent for this claim, $23,411 in interest accrued from the missed preforeclosure initiation deadline until the preforeclosure sale closing date, 1,049 days later. Because the servicing process was effectively extended by 880 days, the FHA insurance claim to HUD also increased by an estimated $11,440 for other unnecessary expenses, including property maintenance, inspection costs, property taxes, and hazard insurance premiums. The following chart demonstrates the delayed action for this claim.



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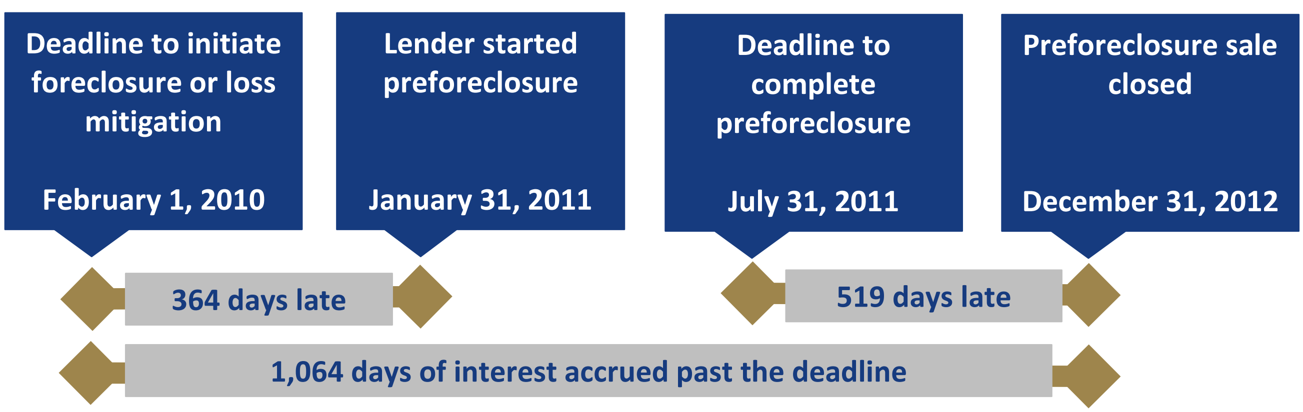
5 See appendix D.

6 HUD's criteria and procedures for conveyance type claims require that lenders curtail interest from the first missed servicing action forward. Although HUD does not apply these criteria to preforeclosure claims, we considered this standard for audit sample testing purposes to estimate the amount of unnecessary interest costs when the lenders failed to meet the required deadline to initiate foreclosure or implement an appropriate loss mitigation option. Unnecessary other claim expenses were estimated based on the delay that occurred from the missed deadline until the applicable action was completed.

Lenders Missed the Deadline To Complete Preforeclosure Sales

HUD incurred unnecessary and unreasonable preforeclosure claim costs because lenders failed to complete initiated preforeclosure sales within required timeframes. Regulations at 24 CFR 203.355(g)[7] require that lenders complete a preforeclosure sale within 4 to 6 months.[8] Of the 72 sample claims, 24 (33 percent) missed this deadline and continued to accumulate interest and other costs for an average of approximately 7.4 months during the period of delay.

For example, the lender for sample loan 043-7438248 approved the borrower to participate in the preforeclosure process on January 31, 2011. In accordance with applicable HUD requirements,[7] the preforeclosure sale should have been finalized within 6 months, by July 31, 2011. However, the lender did not complete the preforeclosure sale until December 31, 2012, 519 days after the deadline. In this case, the lender received approval from HUD to proceed with the transaction based on an extended program participation date, but the extension request was not submitted until more than a year after the servicing deadline. Therefore, the unnecessary delay had already occurred. In this case, the lender also missed the deadline to initiate the preforeclosure sale by 364 days, resulting in a total delay of 883 days. Based on the unpaid loan balance of $274,608 and the applicable debenture interest rate of 3.59 percent, HUD incurred an estimated $28,738 in unnecessary interest for the 1,064-day period from the missed preforeclosure initiation deadline until the preforeclosure sale closing. Because the servicing process was effectively extended by 883 days, HUD also incurred $10,011 in unnecessary other claim expenses, including property taxes, hazard insurance premiums, and a second property appraisal.[9] The following chart demonstrates the delayed action for this claim.



Lenders Missed the Deadline To Complete Foreclosure

HUD incurred unnecessary and unreasonable preforeclosure claim costs because lenders failed to initiate preforeclosure sales until after the deadline for completing foreclosure had expired.

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7 See appendix D.

8 HUD requirements allow a marketing period of up to 4 months from the borrower's approval to participate in the preforeclosure program. The deadline is automatically extended to 6 months if the borrower has secured an acceptable property sale contract or if the involved lender qualified for an extension based on a servicing performance rating assigned by HUD.

9 See the Scope and Methodology section for details regarding the calculation of estimated unnecessary amounts.

Regulations at 24 CFR 203.356(B) require that when foreclosure is necessary, lenders complete the process to obtain title to and possession of the property within established State-specific "reasonable diligence" timeframes.[10] For 51 of the 72 (71 percent) sample claims, lenders failed to meet this deadline and delayed the servicing process by an average of approximately 2 years. Because the servicing process should have already been completed through foreclosure, the continued loan-servicing period from the related conveyance deadline until the preforeclosure sale closing was unnecessary.

For example the lender for sample loan 095-0402266 initiated foreclosure on April 21, 2008, and the foreclosure process should have been completed within the applicable reasonable diligence period of 7 months, by November 21, 2008. However, the lender missed this deadline and eventually initiated a preforeclosure sale on February 27, 2014. Because the preforeclosure process was started years after the foreclosure should have been completed, the 2,019-day period from the required foreclosure completion date of November 21, 2008, to the preforeclosure sale closing date of June 2, 2014, was unnecessary. Based on the unpaid loan balance of $176,218 and the applicable debenture interest rate of 4.1 percent for this loan, HUD incurred an estimated $39,965 in unnecessary interest as a result of the lender's delayed servicing actions. The delay also resulted in $20,009 in unnecessary property-related claim expenses, which occurred from the related conveyance deadline until the property sale closing. The following chart demonstrates the delayed action for this claim.

Estimated Unnessary Claim Interest and Other Costs Totaled at Least $413 Million

We projected[11] the sample review results to the audit universe of 30,061 claims and determined that HUD paid at least $413 million in unnecessary interest and other expenses for 27,634 preforeclosure claims because lenders failed to comply with HUD's servicing deadlines.[12] This amount included $267.8 million for interest costs and $145.6 million for other claim costs, such as property taxes and hazard insurance. These amounts were not necessary or reasonable because they resulted from lenders' noncompliance with HUD requirements and could have been avoided if the lenders had met the requirements or if HUD had implemented procedures to

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[10] See appendix D.

[11] The audit testing was not designed to identify all potential unnecessary claim costs; therefore, the actual number of preforeclosure claims paid with unnecessary interest and other costs could be greater than indicated by our audit sampling results. See the Scope and Methodology section for more details.

[12] See appendix D.

curtail claim amounts based on missed servicing deadlines.[13] As a result, these funds were not available to pay other claims or apply toward reducing the costs to FHA borrowers whose mortgage insurance premiums ultimately funded the unnecessary claim amounts paid to lenders.

HUD Did Not Have Adequate Requirements and Procedures To Prevent Unnecessary Preforeclosure Claim Costs

HUD does not have requirements and procedures to limit unnecessary preforeclosure claim interest and other costs that result from lender servicing delays.[14] When a preforeclosure claim is submitted, HUD's claim review and payment process does not include steps to determine whether lenders met required servicing deadlines or curtail interest or other costs based on servicing delays.[15] Without such curtailment, HUD effectively absorbs the additional costs and lenders are not held financially responsible for their delays. Knowing that they will not be held financially responsible and can simply pass any added costs on to HUD, lenders have little incentive to complete the servicing process in a timely manner.

HUD's requirements are not adequate and do not limit unnecessary preforeclosure claim costs that result from lender servicing delays.

HUD officials stated that they were aware that delayed preforeclosure claims had resulted in additional claim costs; however, related claim curtailment procedures were not implemented because the existing Federal regulations did not explicitly require this. Although HUD regulations pertaining to conveyance (that is, foreclosure) type claims specifically provide for interest curtailment when servicing deadlines are missed, there is no corresponding regulatory requirement applicable to preforeclosure claims.[16] HUD regulations also do not require curtailment of other preforeclosure claim costs that result from lender servicing delays, such as property maintenance, taxes, and hazard insurance. HUD initiated a proposed rule in July 2015, which would have provided for additional interest and other cost curtailment due to preforeclosure claim servicing delays; however, this rule was canceled after lenders raised objections to the proposed policy. Without such changes, HUD continues to incur the added interest and other preforeclosure claim costs caused by lenders' servicing delays.

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13 See the Scope and Methodology section for details regarding the calculation of estimated unnecessary amounts.

14 HUD Mortgagee Letter 2008-43, issued on December 24, 2008, indicated an intention by HUD to curtail preforeclosure claim interest based on servicing delays by stating, "Mortgagees are subject to interest curtailment if they do not initiate the PFS [preforeclosure sale] transaction or report the initiation of the PFS transaction to HUD via SFDMS [Single Family Default Monitoring System] timely." However, HUD officials stated that claim curtailment procedures were not implemented because Federal regulations did not explicitly require this.

15 HUD does not curtail interest for delays that occur during the loan-servicing period before the preforeclosure sale closing. HUD procedures provide only for preforeclosure interest curtailment when lenders miss the applicable claim submission deadline.

16 HUD regulations regarding preforeclosure claim interest curtailment at 24 CFR 203.402(k)(3)(i)(B) cite only the deadline to submit a claim (24 CFR 203.365) as a basis for curtailment and do not reference the loan-servicing deadlines to initiate foreclosure or loss mitigation actions (24 CFR 203.355(a)), the deadline to complete foreclosure within established reasonable diligence timeframes (24 CFR 203.356(b)), or the deadline to complete preforeclosure (24 CFR 203.355(g)). See appendix D.

Conclusion

HUD paid an estimated $413 million in unnecessary interest and other costs because lenders failed to meet required loan-servicing deadlines. This condition occurred because HUD's program requirements and controls do not require curtailment of additional claim costs that result from lender servicing delays. As a result, the FHA insurance fund incurred unnecessary and unreasonable expenses, and the associated funds were not available to pay other claims or apply toward reducing FHA borrower mortgage insurance premiums.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

1A. Implement a change to regulations at 24 CFR Part 203 to require curtailment of preforeclosure interest and other costs that are caused by lender servicing delays, resulting in $413,513,975 in funds to be put to better use.[17] This should include updating or seeking statutory authority to update HUD's regulations as necessary[18] and coordinating with HUD's Office of Finance and Budget, well before any changes go through departmental clearance, to ensure that planned curtailment requirements can be consistently enforced through the claims process.

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[17] See appendix A and the Scope and Methodology section for details on funds to be put to better use and the $413 million, respectively.

[18] Because the lack of preforeclosure claim curtailment was the result of HUD's requirements and procedures, we did not make a specific recommendation for HUD to seek repayment of unnecessary or unreasonable costs from lenders.

Scope and Methodology

We performed our audit fieldwork from December 2017 to August 2018 remotely at the Office of Inspector General (OIG), Office of Audit, in Phoenix, AZ. Our audit period covered FHA preforeclosure claims paid from August 2012 through July 2017.

To accomplish our objective, we

- reviewed applicable statutes, regulations, and HUD policies;
- interviewed HUD officials;
- reviewed available data related to preforeclosure claims; and
- reviewed a statistical sample of preforeclosure claims, including loan-servicing and claim documentation obtained from servicing lenders.

We analyzed available claim, default, and timeframe extension data from HUD's Single Family Housing Enterprise Data Warehouse[19] and Extension and Variance Automated Requests System[20] for 100,077 preforeclosure claims paid during the period August 1, 2012, through July 31, 2017, and identified 30,061 claims that had indications of missed FHA loan-servicing deadlines. We evaluated whether claims appeared late based on reported loan default dates, preforeclosure program initiation dates, and preforeclosure sale closing dates. We selected claims based on data reported within the most recent default episode and considered indications that an extension applied based on lender-reported default codes and HUD extension data.

We initially selected a statistical sample of 85 FHA preforeclosure sale claims from this targeted group. We reduced the sample size to 72 after additional simulation testing found that a reduced sample size would yield accurate results and follow a one-sided 95 percent confidence interval.

For projection, we used the survey means procedure in SAS®[21] to estimate the dollar amounts. We reduced the average amount by the margin of error associated with this sample design. For complex sample designs, such as the stratified technique used for this review, the survey means procedure in SAS uses the Taylor expansion method to estimate sampling errors (standard errors). We computed the percentage and number of loans impacted based on the sampling results, and we extended this result to the population using the survey freq procedure provided by SAS®. We estimated the upper and lower confidence intervals using a Gaussian sampling distribution, which is appropriate for error rates in this range.

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19 The Single Family Housing Enterprise Data Warehouse is a large collection of database tables dedicated to support analysis, verification, and publication of FHA single-family data.

20 The Extension and Variance Automated Requests System provides automated request, review, approval, and rejection of extensions and variances related to FHA loan programs.

21 SAS provides data management software and services.

Dollar Projection Results, Unnecessary Interest
In 70 of 72 loan records reviewed, HUD paid unnecessary interest. This amounts to a weighted average of $9,498 per loan. Deducting the statistical margin of error to accommodate the uncertainties inherent in statistical sampling, we can say – with a one-sided confidence interval of 95 percent – that this amounts to at least $8,911 in unnecessary interest payments per loan. In the context of the total universe of 30,061 loan records, this amounts to a loss to HUD in interest payments of at least $267.8 million.

Dollar Projection Results, Unnecessary Expense Costs
In 70 of 72 loan records reviewed, HUD paid unnecessary expenses. This amounts to a weighted average of $5,762 per loan. Deducting the statistical margin of error to accommodate the uncertainties inherent in statistical sampling, we can say – with a one-sided confidence interval of 95 percent – that this amounts to at least $4,845 in unnecessary expense payments per loan. In the context of the total universe of 30,061 loan records, this amounts to a loss to HUD in expense payments of at least $145.6 million.

Percent-Count Projection Results
In 70 of 72 loan records reviewed, HUD paid unnecessary costs. This amounts to a weighted average of 96.45 percent of the loans. Deducting the statistical margin of error to accommodate the uncertainties inherent in statistical sampling, we can still say – with a one-sided confidence interval of 95 percent – that this amounts to at least 91.93 percent of the loans in the universe having this same characteristic. Extending this percentage to the total universe count of 30,061 loan records, we can say that HUD paid unnecessary costs on at least 27,634 loans.

We obtained loan-servicing and claim documentation from the associated lenders and reviewed these documents to determine compliance with HUD's loan-servicing timeframe requirements. Applicable automatic extensions documented with the lenders' servicing files or extensions approved by HUD in accordance with its policies were considered in our analysis.

Our audit testing relied in part on data obtained from HUD's Single Family Housing Enterprise Data Warehouse system. Because this system includes information that is manually entered by lenders, such as claim form submission and default reporting data, it could be subject to errors or other data quality issues. We determined that the data were adequate for our audit testing purposes; however, we noted that some preforeclosure claims may have been excluded from our audit sampling universe and, thus, the audit findings, based on incorrect data. For example, if a lender mistakenly reported that a property was impacted by a natural disaster or foreclosure moratorium, such loans may have been excluded from the audit testing if these events were reported within the most recent default episode and appeared to extend an applicable servicing deadline. To account for potential data system errors and to better target loans with loan-servicing delays, our audit sample testing procedures included criteria, such as minimum interest amount thresholds, that could have excluded some loans from the audit sample universe that had servicing delays. For these reasons, the actual number of preforeclosure claims paid with unnecessary interest and other costs could be greater than indicated by our audit sample test results. The audit testing was intended only to establish an estimate of unnecessary interest and other costs that resulted from lender servicing delays and was not designed to identify all loans that may have included such costs.

In some cases, lenders missed multiple servicing deadlines. For example, a lender could have initiated a preforeclosure sale after the required deadline and also failed to ensure that the preforeclosure sale was completed in a timely manner after the borrower was approved to participate in the preforeclosure sales program. Therefore, the total number of deadlines reported as missed exceeds the number of claims reviewed.

HUD's criteria and procedures for conveyance-foreclosure type claims require that lenders curtail interest from the first missed servicing action forward. Although HUD does not apply these criteria to preforeclosure claims, we considered this standard for audit sample testing purposes to estimate the amount of unnecessary interest costs when the lenders failed to meet the required deadline to initiate foreclosure or implement an appropriate loss mitigation option. Although HUD previously issued guidance indicating an intention to curtail interest for preforeclosure claims, HUD officials confirmed that such procedures are not in place. HUD Mortgagee Letter 2008-43, issued on December 24, 2008, stated "Mortgagees [lenders] are subject to interest curtailment if they do not initiate the PFS [preforeclosure sale] transaction or report the initiation of the PFS transaction to HUD via SFDMS [Single Family Default Monitoring System] timely." For claims that did not miss the deadline to initiate foreclosure or loss mitigation, we determined the date on which the servicing process should have ended if the total period of delay had not occurred. For example, if the preforeclosure sale marketing period deadline was missed by 180 days, our testing estimated that 180 days of interest was unnecessary. For audit sample testing purposes, if the borrower had not been approved for a loss mitigation option and the preforeclosure process was initiated after the foreclosure process should have been completed based on the applicable State-specific reasonable diligence period, we estimated unnecessary interest for the period from the missed foreclosure completion date to the preforeclosure sale closing date.

Because HUD has implemented procedures designed to curtail interest based on requirements specified in 24 CFR 203.402(k)(3)(i)(B) related to the claim submission deadline, we estimated only unnecessary interest for periods before the preforeclosure sale closing date, effectively allowing interest applicable to the period from the preforeclosure sale closing to the claim payment date, regardless of the interest amount paid and whether the lender met the claim submission deadline. In this way, we excluded from testing the portion of interest paid related to the claim submission period, although this interest also could have been subject to curtailment under HUD's requirements applicable to conveyance type claims. We did not test the effectiveness of HUD's procedures for interest curtailment based on the preforeclosure claim submission deadline.

To estimate unnecessary and unreasonable other claim expenses, such as property taxes and hazard insurance, we determined the date on which the servicing process should have ended if the total period of delay had not occurred. For example, if the preforeclosure sale initiation was

180 days late and the preforeclosure sale closing was also 180 days late, we determined that expenses occurring later than 360 days before the actual preforeclosure sale closing were unnecessary. Similarly, if a borrower had not been approved for a loss mitigation option and the preforeclosure process was initiated after the foreclosure process should have been completed, based on the applicable State-specific reasonable diligence period, we determined that expenses incurred after the associated conveyance deadline were unnecessary. To determine claim cost dates for sample testing purposes, we used the date of service if identified in the lender claim file documentation and, otherwise, the payment dates. If a range of dates was shown in an expense's description, the first date of that range was used. Accordingly, some expenses were understated. For example, if the lender paid hazard insurance covering the period July through December and we determined that servicing should have been complete by August, our analysis excluded this entire cost based on the expense start date, although a portion of this expense (from August through December) was applicable to an identified period of delay. Because the purpose of the audit test was to provide an estimate and based on the availability of cost information within the servicing files, we determined that this was the most appropriate method for calculating estimated unnecessary costs for audit purposes and would provide an appropriate basis for the audit conclusions.

Other factors could have impacted the cost to HUD associated with lender servicing delays that were not considered in the audit estimate of unnecessary costs. For example, property values could have decreased due to inadequate maintenance or changed due to general housing market conditions during the periods of servicing delay. For this reason, our audit testing may have underestimated the actual cost associated with lender servicing delays. Recognizing the negative impact of late claim submissions, HUD previously proposed criteria that would have canceled a loan's FHA insurance entirely if a claim was submitted "more than 12 months after expiration of a period of time from the date of default that is equal to the amount of time provided in the reasonable diligence timeframe." Our audit did not estimate unnecessary or unreasonable amounts based on these proposed criteria. However, because our testing found that the preforeclosure sale closing date was more than 12 months past the reasonable diligence deadline for 35 of our sample claims, even including up to 6 additional months for the permitted time from default to initiate a first action, we note that application of such criteria could have substantially increased the estimated amount of unnecessary and unreasonable costs. For example, the total claim amounts for these sample cases were more than four times the estimated unnecessary claim costs calculated using our audit sample testing methodology. Because the purpose of the audit test was only to provide an estimate, we determined that the testing used was sufficient as a basis to support the audit conclusion and recommendations.

Because we estimated unnecessary claim expenses, such as property taxes and hazard insurance, based on the actual period of delay yet estimated unnecessary interest in some cases based on HUD's criteria applicable to conveyance claims, which requires curtailment from the missed deadline to initiate foreclosure or implement loss mitigation forward, the period associated with estimated unnecessary interest differed from the period of estimated unnecessary other claim costs for some loans. For example, if the lender missed the deadline to initiate the preforeclosure sale by 100 days and the preforeclosure sale closed 100 days after it was initiated, our testing concluded that 200 days of interest was unnecessary (based on HUD requirements for conveyance claims), and 100 days of other claim costs, such as property taxes and hazard insurance, were unnecessary (based on the actual period of delayed action).

HUD requirements allow a marketing period up to 4 months from the borrower's approval to participate in the preforeclosure program. This deadline is automatically extended to 6 months if the borrower has secured an acceptable property sale contract or if the involved lender qualified for an extension based on a servicing performance rating established by HUD. Also, HUD's policy regarding variance requests may allow an extension not to exceed 8 months total. Our audit testing considered HUD timeframe extensions that were approved in accordance with HUD's policy and submitted before expiration of the servicing deadline. In some cases, timeframe extensions were not documented within the lender-provided files, and we relied on HUD data to support that an extension applied.

Our audit testing did not classify certain expenses as unnecessary or unreasonable, regardless of the servicing delays identified. For example, the preforeclosure program borrower incentive payments and mortgage insurance premium costs were not included in our estimate of unnecessary costs because we determined that these did not represent an additional expense or loss to HUD that was attributable servicing delays. Additionally, expenses deducted from the preforeclosure sale proceeds at settlement (such as prorated property taxes due, past due homeowner associate fees, etc.) were not included in our calculated estimate of unnecessary expenses, although these expenses were often incurred as a direct result of servicing delays. Therefore, the actual amount of unnecessary other claim expenses was greater than indicated by our audit estimates.

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.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Program requirements and procedures to ensure that lenders comply with timeframe requirements for preforeclosure claims.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- HUD did not have adequate requirements and procedures to prevent unnecessary preforeclosure claim interest and other costs (finding).

Appendixes

Appendix A

Schedule of Funds To Be Put To Better Use

Recommendation number	Funds to be put to better use 1/
1A	$ 413,513,975
Total	**413,513,975**

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an 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. In this instance, implementation of recommendation 1A will reduce the risk that HUD will continue unnecessary and unreasonable interest and other cost payments. We determined that the payments made from the FHA insurance fund for costs incurred due to lender servicing delays were unreasonable and unnecessary and could have been avoided if lenders had complied with required servicing deadlines or if HUD had adequate procedures to curtail interest and other costs that resulted from lender servicing delays. We estimated these payments to be $413 million. (See the Scope and Methodology section for details on the statistical sample and related projections.)

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

SEP 2 4 2018

MEMORANDUM FOR: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

FROM: Gisele G. Roget, Deputy Assistant Secretary for Single Family Housing, HU

SUBJECT: Discussion and Comments on Draft Audit: HUD Paid an Estimated $413 Million for Unnecessary Preforeclosure Claim Interest and Other Costs Due to Lender Servicing Delays
OIG Audit Report: 2018-LA-000X
Draft Issue Date: September 10, 2018

Thank you for providing the Office of Single Family Housing the opportunity to comment on the Office of Inspector General's (OIG) draft audit report entitled Preforeclosure Claim Costs. The purpose of the audit was to determine if there were any unnecessary or ineligible preforeclosure claim interest and other costs that resulted from lender noncompliance with HUD's loan-servicing timeframe requirements.

Comment 1

The Office of Single Family Housing agrees with the OIG's determination that an additional review of 24 CFR 2013 is warranted. Enhancements to the regulations regarding the curtailment of claim expenses due to missed deadlines that are within the mortgagee's control are being considered.

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OIG Evaluation of Auditee Comments

Comment 1 HUD's response did not state any concerns with the audit finding and generally indicated agreement with the audit report recommendation. We look forward to continued cooperation during the audit resolution process.

Appendix C

Schedule of Unnecessary Preforeclosure Claim Costs

FHA loan	Unnecessary interest	Unnecessary claim costs	Missed deadline to initiate foreclosure or implement loss mitigation	Missed deadline to complete preforeclosure marketing period	Missed deadline to complete foreclosure
023-4216431	$ 1,796.22	$ 946.64		X	
043-7438248	29,115.28	12,044.49	X	X	X
045-6613412	25,079.89	9,448.48	X		X
045-7012788	6,909.07	2,628.39	X		
048-4840276	14,698.68	9,035.86	X		X
048-5489589	3,022.79	1,471.41	X		
052-2719268	6,995.30	703.99	X	X	
052-4357481	13,859.58	5,798.65	X	X	X
052-5978398	10,266.48	5,356.30	X		X
093-6196726	10,516.96	4,182.31	X		X
094-5328164	3,292.93	3,585.54	X		X
094-5540150	14,034.78	4,746.51	X		X
095-0334347	21,911.61	7,080.28		X	X
095-0402266	39,964.86	15,942.24			X
095-0465555	18,889.83	7,016.80	X		X
095-0815359	35,733.44	54,948.61	X		X
105-1206113	3,510.98	6,743.79	X		X
121-2380996	15,211.05	10,041.44	X		X
249-5109790	26,273.35	11,580.93	X	X	X
249-5335366	26,317.59	11,643.13		X	X
249-5512236	17,046.81	6,834.40	X	X	X
292-4725554	3,398.63	2,920.59	X	X	
331-1361238	11,535.08	2,710.83	X		X
332-5072219	10,856.96	4,251.09	X	X	
351-5355343	28,156.21	16,320.20		X	X
351-5386459	24,216.54	26,000.64		X	X
352-5550606	41,804.43	21,426.46	X	X	X
352-6939912	16,404.51	16,865.71	X		X
413-3799157	24,936.29	11,440.42	X		X
431-4510342	24,463.43	10,374.62	X	X	X
482-3878257	2,687.46	1,411.95	X		

FHA loan	Unnecessary interest	Unnecessary claim costs	Missed deadline to initiate foreclosure or implement loss mitigation	Missed deadline to complete preforeclosure marketing period	Missed deadline to complete foreclosure
483-4103908	5,764.83	505.00		X	
495-7710269	10,853.42	1,720.73	X		X
521-7030605	5,010.12	3,124.80	X		
521-7462000	9,571.67	2,298.31			X
581-3455058	8,214.64	4,734.28	X		X
381-7105218	15,298.48	8,405.63	X		X
548-4383543	45,113.96	24,752.66	X		X
331-1306333	32,933.92	8,748.19	X		X
052-5525487	7,485.03	793.52	X		X
052-5526873	6,762.70	7,241.27	X		X
095-0404504	39,771.77	19,292.28	X		X
105-1368364	6,492.25	3,733.44	X		X
156-0106482	11,839.09	3,354.00	X		X
197-3769467	25,792.75	10,676.44			X
241-8238648	26,188.02	14,163.69	X		X
561-8517951	16,055.06	7,373.01	X		X
561-8919405	10,605.49	5,798.78	X		X
351-5165089	24,875.02	21,751.55	X	X	
561-9489437	15,763.80	8,168.18	X		X
048-5276344	2,867.74	1,070.86	X		X
105-4874698	1,225.23	550.00		X	
092-9477113	6,446.52	4,743.43			X
491-9022928	973.38	500.00		X	
332-4876619	3,074.13	592.30	X		X
332-4917686	35,187.07	20,275.39			X
095-0093103	21,847.04	25,068.49			X
137-3711731	3,272.60	13,912.28		X	
137-4719970	3,359.78	3,217.54		X	
332-4512423	7,154.04	2,467.32	X	X	X
413-4650177	4,983.29	9,257.68	X	X	
052-3663273	2,838.73	1,239.95	X		X
332-4553513	2,522.11	129.07	X		
095-0431204	25,604.42	15,741.01			X
023-3200572	-	-			
045-7000368	-	-			

FHA loan	Unnecessary interest	Unnecessary claim costs	Missed deadline to initiate foreclosure or implement loss mitigation	Missed deadline to complete preforeclosure marketing period	Missed deadline to complete foreclosure
052-7222967	8,196.30	3,232.50		X	
137-5235771	28,695.75	19,005.90			X
241-8788372	2,744.48	1,411.58	X	X	
412-4545733	14,771.54	15,561.68	X		X
541-8485641	6,863.25	8,366.09	X		X
561-9707322	5,552.31	3,084.84	X		
Claim count			**51**	**24**	**51**

Appendix D

Criteria

24 Code of Federal Regulations (CFR) 203.355(a) – generally require that lenders initiate foreclosure or loss mitigation action within 6 months of loan default.

> "… the mortgagee [lender] shall take one or a combination of the following actions within six months of the date of default or within such additional time approved by HUD or authorized by §203.345 or 203.346:
>
> 1. Obtain a deed-in-lieu of foreclosure (see §§203.357, 203.389 and 203.402(f) of this part) with title being taken in the name of the mortgagee or the [HUD] Secretary;
> 2. Commence foreclosure;
> 3. Enter into a special forbearance agreement under §203.614;
> 4. Complete a modification of the mortgage under §203.616;
> 5. Complete a refinance of the mortgage under §203.43(c);
> 6. Complete an assumption under §203.512;
> 7. File a partial claim under §203.371; or
> 8. Initiate a pre-foreclosure sale under §203.370."

24 Code of Federal Regulations (CFR) 203.355(b), Vacant or abandoned property. "With respect to defaulted mortgages on vacant or abandoned property, if the mortgagee discovers, or should have discovered, that the property is vacant or abandoned, the mortgagee must commence foreclosure within the later of 120 days after the date the property became vacant, or 60 days after the date the property is discovered, or should have been discovered, to be vacant or abandoned; but no later than the number of months from the date of default as provided in paragraph (a) of this section. The mortgagee must not delay foreclosure on vacant or abandoned property because of the requirements of §203.606."

24 CFR 203.356(b) – provide that mortgagees "must exercise reasonable diligence in prosecuting the foreclosure proceedings to completion and in acquiring title to and possession of the property. A time frame that is determined by the Secretary to constitute 'reasonable diligence' for each State is made available to mortgagees."

24 CFR 203.355(g) – generally require that lenders complete a preforeclosure sale within 4 to 6 months.

"Within 90 days of the end of a mortgagor's [borrower] participation in the pre-foreclosure sale procedure, or within the time limit described in paragraph (a) of this section, whichever is later, if no closing of an approved pre-foreclosure sale has occurred, the mortgagee must obtain a deed in lieu of foreclosure, with title being taken in the name of the mortgagee or the Secretary, or undertake one of the actions listed at §203.355(a). The end-of-participation date is defined as:

1. Four months after the date of commencement of participation, if there is no signed Contract of Sale at that time, unless extended by the [Federal Housing] Commissioner;
2. Six months after the date of commencement of participation, if there is a signed contract but settlement has not occurred by that date, unless extended by the Commissioner;
3. The date the mortgagee is notified of the mortgagor's withdrawal from the Pre-foreclosure Sale procedure; or
4. The date of the letter sent by the mortgagee to the mortgagor prior to the expiration of the customary participation period, terminating the mortgagor's opportunity to participate in the Pre-foreclosure Sale procedure."

Mortgagee Letter 2008-43 (and updated guidance in HUD Handbook 4000.1) allows a marketing period between 4 to 6 months from the borrower's approval to participate in the preforeclosure program.

"K. Duration of the Pre-Foreclosure Sale Period. Unless an extension has been approved by NSC [National Servicing Center], mortgagees have 4 months from the date of the mortgagor's approval to participate in the PFS Program. Mortgagees have a pre-approved extension of 2 additional months to complete the PFS if one of the following exists:

- The mortgagee is in the Tier 1 category under the Department's [HUD] Tier Ranking System (TRS); or
- There is a signed Contract of Sale, but settlement has not occurred by the end of the fourth month following the date of the mortgagor's approval to participate in the PFS Program."

24 CFR 203.359(b) – require conveyance to HUD within 30 days.

1. "Conveyance by the mortgagee. The mortgagee must acquire good marketable title and transfer the property to the Secretary within 30 days of the later of:

    i. Filing for record the foreclosure deed;
    ii. Recording date of deed in lieu of foreclosure;
    iii. Acquiring possession of the property;
    iv. Expiration of the redemption period; or
    v. Such further time as the Secretary may approve in writing.

2. Direct conveyance. In cases where the mortgagee arranges for a direct conveyance of the property to the Secretary, the mortgagee must ensure that the property is transferred to the Secretary within 30 days of the reasonable diligence time frame specified in § 203.356 of this part."

24 CFR 203.365 (a) – require that lenders submit preforeclosure claims within 30 days after the closing of the pre-foreclosure sale:

> "… unless extended by the Commissioner, the mortgagee must forward to the Secretary: (1) A copy of the deed… (2) Fiscal data pertaining to the mortgage transaction. (3) Any additional information or data that the Secretary may require."

24 CFR 203.402(k)(3)(i)(B) – require preforeclosure claim interest curtailment, based only on the claim submission deadline created by 24 CFR 203.365, not the PFS initiation and completion deadlines of the following: **24 CFR 203.355(a) and (g)** or the reasonable diligence deadline of **24 CFR 203.356(b)**.

> "...except that if the mortgagee fails to meet any of the applicable requirements of § 203.365 within the specified time and in a manner satisfactory to the Commissioner (or within such further time as the Commissioner may approve in writing), the interest allowance in such cash payment shall be computed only to the date on which the particular required action should have been taken or to which it was extended."