U.S. Department of Housing and Urban Development Office of Single Family Housing Washington, DC

Flood Insurance for FHA Loan Servicing

Office of Audit
Kansas City, KS

Audit Report Number: 2022-KC-0002
March 22, 2022

To: Julienne Y. Joseph
Deputy Assistant Secretary for Single Family Housing, HU

//**signed**//
From: Kilah S. White
Assistant Inspector General for Audit, GA

Subject: Approximately 31,500 FHA-Insured Loans Did Not Maintain the Required Flood Insurance Coverage in 2020

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Federal Housing Administration (FHA)-insured loans to determine whether borrowers of FHA-insured loans maintained proper flood insurance coverage.

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, appendix 8M, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at https://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call Patrick Anthony, Audit Director, at (716) 646-7056.

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

Highlights

Audit Report Number: 2022-KC-0002
Date: March 22, 2022

Approximately 31,500 FHA-Insured Loans Did Not Maintain the Required Flood Insurance Coverage in 2020

What We Audited and Why

We audited Federal Housing Administration (FHA)-insured loans serviced in calendar year 2020. We compared location data from FHA-insured loans to Federal Emergency Management Agency flood maps to identify a targeted universe of properties that appeared to be located in special flood hazard areas (SFHA). We reviewed a statistical sample of these loans.

We initiated this audit in response to audit report 2021-KC-0002, which found that FHA insured at least 3,870 loans that closed in 2019 that were not eligible for insurance because they were made for properties in SFHA flood zones without the required National Flood Insurance Program (NFIP) coverage. We believed the servicing universe of single-family FHA loans also included loans for properties in flood zones that did not obtain or maintain the required insurance. Our objective was to determine whether borrowers of FHA-insured loans maintained proper flood insurance.

What We Found

Borrowers of FHA-insured loans did not always maintain proper flood insurance. Based on a statistical sample, FHA insured at least 31,500 loans serviced during calendar year 2020 for properties in SFHA flood zones that did not maintain the required flood insurance coverage. We found loans that had private flood insurance instead of the required NFIP coverage, NFIP coverage that did not meet the minimum required amount, or no coverage during calendar year 2020. As a result, the FHA insurance fund was potentially exposed to greater risk from at least $4.5 billion in loans that did not maintain adequate NFIP coverage.

What We Recommend

We recommend that FHA require lenders to provide evidence of sufficient flood insurance coverage or execute indemnification agreements for the 21 loans in our statistical sample that did not have sufficient flood insurance at the time of our audit, develop a control to detect loans that did not maintain the required flood insurance to avoid potential future costs to the FHA insurance fund from inadequately insured properties, and consult with HUD's Office of General Counsel to review the language in the statutes, regulations, and handbooks and make any necessary adjustments to the forward mortgage and Home Equity Conversation Mortgage handbooks.

For more information, visit www.hudoig.gov or contact
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Background and Objective

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA mortgage insurance provides lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet certain requirements established by FHA to qualify for insurance.

The National Flood Insurance Act of 1968 (Public Law 90-448) established the National Flood Insurance Program (NFIP). The NFIP is a Federal program that enables property owners in participating communities to purchase flood insurance as protection against flood losses, while requiring State and local governments to enforce floodplain management ordinances that aim to reduce future flood damage. Approximately 23,000 communities in the United States participate in the NFIP, and more than 5 million NFIP policies are in force, providing $1.3 trillion in content and building coverage.

The NFIP is managed by the Federal Emergency Management Agency (FEMA). Policies can be obtained from NFIP direct flood insurance or through the NFIP Write Your Own Program. The Write Your Own Program allows participating property and casualty insurance companies to write and service NFIP flood insurance policies in their own names. The Federal Government retains responsibility for underwriting losses. FEMA maintains a database of policy data for NFIP direct policies and policies obtained through the NFIP Write Your Own Program.

The Flood Disaster Protection Act of 1973 (Public Law 93-234) made the purchase of flood insurance mandatory for federally insured loans in special flood hazard areas (SFHA). An SFHA is an area within a floodplain having a 1 percent or greater chance of flood occurrence in any given year. SFHAs are defined on maps issued by FEMA for individual communities. The National Flood Insurance Reform Act of 1994 directed regulated lending institutions not to make, increase, extend, or renew any loan secured by properties in SFHAs without meeting certain conditions. The Act also required development of a "Standard Flood Hazard Determination Form" that identified the type of flood-risk zone in which a property was located.

The Biggert-Waters Insurance Reform Act of 2012 (Public Law 112-141) further amended the Federal flood insurance statutes to allow private insurance for non-FHA loans. The Act required that those lenders provide borrowers a notice encouraging them to consider and compare private market flood insurance policies with NFIP policies and to accept such private flood insurance policies as satisfaction of purchase and flood insurance coverage requirements. It additionally stated that acceptance of private flood insurance policies could require verification that insurers met specific independent rating agency criteria relating to financial solvency, strength, or claims-paying ability, which indicated that the insurers could satisfy claims.

FHA's current rules regarding the requirement to maintain flood insurance coverage on property located in an SFHA do not permit private flood insurance as an option to satisfy the purchase requirement. Regulations at 24 CFR (Code of Federal Regulations) part 203 contain the borrower and lender requirements for flood insurance coverage. To qualify for FHA insurance, properties in an SFHA must be covered by NFIP insurance in an amount equal to either the outstanding balance of the mortgage, less estimated land costs, or the maximum amount of NFIP insurance available, whichever is less. FHA provides instructions to servicers about the flood insurance requirements in its handbooks. (See appendix C.)

Our objective was to determine whether borrowers of FHA-insured loans maintained proper flood insurance coverage.

Results of Audit

Finding: Approximately 31,500 FHA-Insured Loans Did Not Maintain the Required Flood Insurance Coverage in 2020

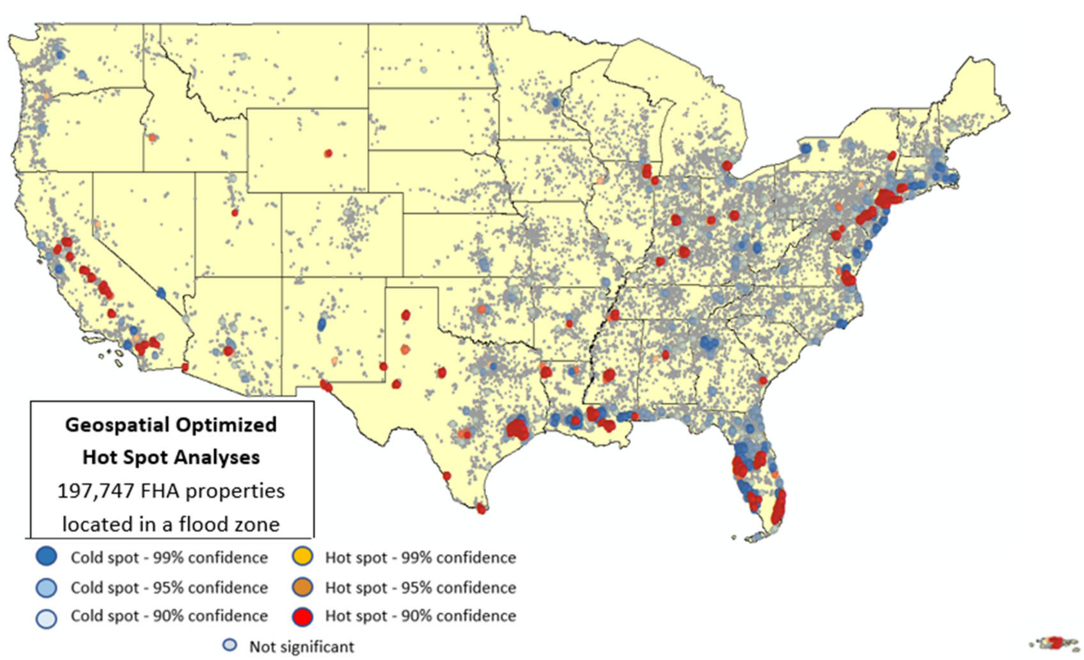
FHA insurance remained outstanding on an estimated 31,500 loans for properties in SFHA flood zones that did not have the required flood insurance during calendar year 2020. This condition occurred because FHA did not have adequate controls to detect loans that did not maintain the required flood insurance and its handbooks did not adequately guide servicers on the flood insurance requirements. As a result, the FHA insurance fund was potentially exposed to greater risk from at least $4.5 billion in loans that did not maintain adequate NFIP coverage.

Loans for Properties Without the Required Flood Insurance

During calendar year 2020, FHA insured at least 31,500 loans that were not eligible for insurance because the properties were in SFHA flood zones but did not carry the required amount of NFIP coverage. Federal regulations require NFIP insurance for FHA loans for properties in flood zones known as SFHAs. FHA's handbooks state that the servicer must ensure that flood insurance is in force for the life of the mortgage. The handbooks also establish minimum amounts of coverage. (See appendix C.)

We compared location data from FHA-insured loans to FEMA flood zones. From a total universe of nearly 8.3 million loans with FHA insurance throughout calendar year 2020, we identified 197,747 loans, which appeared to be in areas that required flood insurance.

Figure 1: Geographic representation of audit universe



We reviewed a statistical sample of 90 of these loans and determined that 21 loans in our sample were for properties in SFHA flood zones that did not have sufficient flood insurance. These loans included

- 13 loans that had private flood insurance instead of the required NFIP coverage (one of which did not meet the coverage minimum),
- 6 loans that had an NFIP policy that did not meet the coverage minimum, and
- 2 loans that did not have a flood insurance policy in place during 2020. (See appendix D.)

We used these results to project the total number and value of ineligible loans insured by FHA. (See appendix E showing statistical projection of at least 31,500 loans totaling $4.5 billion.)

Controls Lacking To Ensure Adequate Flood Insurance

FHA did not have adequate controls to detect loans that did not maintain the required flood insurance, and its handbooks did not clearly guide servicers on the flood insurance requirements as they did not address all provisions contained in the statutes and regulations.

Data Limitations

FHA did not require servicers to enter information into HUD systems to show compliance with Federal flood insurance requirements as neither the statute nor the regulation require entry of this type of information. Servicers reported certain information on defaulted loans to HUD in its default reporting system, but this information was unrelated to flood insurance, and servicers did not report servicing information on all loans in their portfolios. As a result, FHA did not have information on whether an NFIP flood insurance policy was in place or the coverage amount. It also did not have information on any flood zone updates that servicers received from their flood hazard determination services.

FHA also did not have a control to identify loans that did not comply with the flood insurance requirement. As discussed above, FHA did not have flood insurance information entered into its databases by servicers. In addition, it did not have an interface established with FEMA to verify whether NFIP policies existed for FHA-insured properties. Because flood insurance information was not in HUD databases, FHA was only able to detect loans with inadequate NFIP flood insurance through conducting servicing reviews. However, FHA's servicing reviews were unlikely to detect most flood insurance issues due to the inability to target loans for review that likely had NFIP deficiencies. If HUD had servicers enter the necessary data into its system or had data from NFIP, edit checks would be the most practical way to address this issue.

Guidance Issues

FHA's handbooks did not clearly guide servicers on the flood insurance requirements as they did not address all provisions contained in the statute and regulations. The flood insurance requirements as written in the handbooks were different in some respects from the statute (Act) and regulations (CFR). (See Appendix C.) Section 4012a of the Flood Disaster Protection Act of 1973 requires insurance equal to the least of three amounts: (1) an amount at least equal to the development of project cost, less estimated land cost; (2) the maximum limit of coverage made available with respect to the particular type of property under the NFIP of 1968; and (3) the amount of the outstanding principal balance.

For forward mortgages (a mortgage loan to purchase or refinance a principal residence), the regulation and handbook combined the first and third statutory amounts into something that appeared to be a combination of the two calculations. The regulation and handbook required the amount to be the lesser of (1) the outstanding balance of the loan, less land value, or (2) the maximum amount of NFIP available for property improvements. The handbook did not include a provision like the statute has, to calculate the minimum insurance coverage amount based on the development of project cost, less estimated land cost (e.g., replacement costs), nor did it instruct the servicer on how it should determine this cost and document the file if it was permitted to set insurance based on this method. Further, it did not state how land value should be determined.

Example comparing differences in calculation methods for forward mortgage

Sample item details			Land value per assessor	$ 136,700
Replacement cost per insurer	$ 188,000		Outstanding principal balance on 1/1/20	256,309
Statutory calculation			**Regulatory and handbook calculation**	
Development cost minus land value	188,000		Outstanding principal balance minus land value	119,609
Outstanding principal balance	256,309			
Minimum required insurance	188,000		Minimum required insurance	119,609

For home equity conversion mortgages (HECM, an FHA reverse mortgage program to withdraw a portion of the home's equity), there were differences between the regulation and handbook. The regulation (24 CFR 206.45(c)(3)) allowed for the same three calculations as the statute. The handbook allowed for the lesser of two calculations: (1) an amount at least equal to either the outstanding balance of the mortgage or (2) the maximum amount of NFIP insurance available with respect to the property. The handbook did not include a provision to calculate the minimum insurance coverage amount based on replacement costs, nor did it instruct the servicer on how it should determine the replacement cost and document the file if it was permitted to set insurance based on this method. Further, it did not state whether the insurance amount should be set based on the unpaid amount at the beginning of the policy period or at the end. Because HECM loans' unpaid balances increase over time, the policy amount will be sufficient throughout the policy term only if it is set based on the scheduled value at the end of the term.

Potential Risk From Ineligible Loans

The FHA insurance fund was potentially exposed to greater risk because the FHA portfolio included loans that did not meet FHA's standards for maintaining flood insurance in 2020, with a projected total value of at least $4.5 billion. The inclusion of these loans in FHA's portfolio negatively impacted FHA's achievement of Office of Management and Budget policies for Federal credit programs. Each department has a responsibility to make every effort to effectively target Federal assistance and mitigate risk by ensuring that lenders and servicers participating in Federal credit programs meet all applicable financial and program requirements.

Conclusion

FHA improperly insured loans for properties in SFHA flood zones without the required NFIP insurance. This condition occurred because FHA did not have adequate controls to detect loans that did not maintain the required flood insurance and its handbooks did not clearly guide servicers on the flood insurance requirements as they did not address all provisions contained in the statutes and regulations. By implementing our recommendations, HUD will be able to identify properties in its servicing portfolio that do not meet the flood insurance requirements and avoid risk from at least $4.5 billion in ineligible loans each year. The potential loss on these loans is $1.5 billion based on the FHA insurance fund average loss rate of 33 percent as of December 31, 2021.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

1A. Require lenders to provide evidence of sufficient flood insurance or execute indemnification agreements for the 21 loans in our statistical sample that did not have sufficient flood insurance at the time of our audit to put nearly $1.1 million to better use. (See appendix A.)

1B. Develop a control to detect loans that did not maintain the required flood insurance to put $1.5 billion to better use by avoiding potential future costs to the FHA insurance fund from inadequately insured properties.

1C. Consult with the Office of General Counsel to review the language in the statutes, regulations, and handbooks and if warranted, make adjustments to the forward mortgage handbook to ensure consistency with the statute.

1D. Consult with the Office of General Counsel to review the language in the statutes, regulations, and handbooks and if warranted, make adjustments to the HECM handbook to ensure consistency with the statute and regulation.

Scope and Methodology

We performed our audit work between May and December 2021. We did not conduct onsite fieldwork for this assignment. Our audit period covered January 1 through December 31, 2020.

To accomplish our objective, we

- reviewed relevant HUD requirements;
- interviewed HUD staff to gain an understanding of relevant monitoring controls to ensure that properties in flood zones maintain the required NFIP coverage and to monitor program compliance;
- selected and reviewed a statistical sample of loans to determine compliance with FHA flood insurance requirements; and
- reviewed records provided by FHA servicers, including standard flood hazard determination forms, evidence of flood insurance during our audit period, and other documents as needed to determine compliance with the insurance requirement.

We relied in part on data maintained by HUD in its Single Family Data Warehouse (SFDW) system. SFDW is a large and extensive collection of database tables, organized and dedicated to support the analysis, verification, and publication of single-family housing data. Specifically, we relied on the system to identify loans that were FHA insured throughout our audit period, the amount of the loans, and the location data (such as property address and latitude-longitude coordinates). Although we did not perform a detailed assessment of the reliability of the data, we determined that the computer-processed data were sufficiently reliable for our purposes because we verified the data with documentation provided by servicers in our sample.

Using data from SFDW, we identified an audit universe of more than 8.2 million single-family FHA loans totaling $1.3 trillion that were serviced continually during calendar year 2020. This universe included both forward and reverse (HECM) loans. We used the Environmental Systems Research Institute's ArcMap desktop tool to overlay the FEMA National Flood Hazard Layer geographic information system data as of November 13, 2020, against the universe of FHA loans to identify properties from the FHA loan universe located in areas that require flood insurance. This process identified a universe of 197,747 loans with mortgage amounts totaling $31.7 billion, which appeared to be located in an area that required flood insurance and were FHA-insured throughout calendar year 2020.

To project the results of our review to the audit universe, we selected a statistical sample of 90 loans totaling $14.2 million as described in appendix E. We contacted 30 servicers that serviced the loans to obtain documentation related to the special flood hazard determination and flood insurance in effect during calendar year 2020. When needed to determine whether the flood insurance amount was appropriate, we obtained information on the land value from the servicers or from county records. We evaluated the information provided to determine whether the loans met the FHA servicing requirements related to flood insurance.

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

Recommendation number	Funds to be put to better use 1/
1A	$1,090,636
1B	1,506,887,996
Totals	**1,507,978,632**

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. In this case, if HUD implements our recommendations, it will no longer provide FHA insurance for properties in SFHA flood zones without the NFIP flood insurance required by Federal regulations. Requiring corrective action for ineligible loans identified in our sample will reduce the risk of loss to the FHA insurance fund. The amount for recommendation 1A reflects that upon sale of the mortgaged property, FHA's average loss experience is about 33 percent, based on statistics provided by HUD ($3,304,957 x .33 = $1,090,636). In addition, improving controls to identify ineligible loans in the servicing portfolio will reduce the risk of loss to the FHA insurance fund. The amount for recommendation 1B reflects that upon sale of the mortgaged property, FHA's average loss experience is about 33 percent, based on statistics provided by HUD ($4,566,327,260 x .33 = $1,506,887,996). When FHA improves its controls, this will be a recurring benefit. Our estimate reflects only the initial year of this benefit, which we believe will be similar to the 2020 results because FHA activity is stable. These amounts do not include potential offsetting costs to implement our recommendation to revise controls.

Appendix B

Auditee Comments

We provided HUD a copy of the draft report for review on February 24, 2022. On March 7, 2022, we held an exit conference with staff from HUD's Office of Single Family Housing to discuss the results of our audit. HUD chose not to provide written comments for this report.

Appendix C

Criteria

Flood Disaster Protection Act of 1973

§ 4012a - Flood insurance purchase and compliance requirements and escrow accounts

(a) Amount and term of coverage
After the expiration of sixty days following December 31, 1973, no Federal officer or agency shall approve any financial assistance for acquisition or construction purposes for use in any area that has been identified by the Administrator as an area having special flood hazards and in which the sale of flood insurance has been made available under the National Flood Insurance Act of 1968 [42 U.S.C. 4001 et seq.], unless the building or mobile home and any personal property to which such financial assistance relates is covered by flood insurance in an amount at least equal to its development or project cost (less estimated land cost) or to the maximum limit of coverage made available with respect to the particular type of property under the National Flood Insurance Act of 1968, whichever is less: Provided, That if the financial assistance provided is in the form of a loan or an insurance or guaranty of a loan, the amount of flood insurance required need not exceed the outstanding principal balance of the loan and need not be required beyond the term of the loan. The requirement of maintaining flood insurance shall apply during the life of the property, regardless of transfer of ownership of such property.

Forward Mortgage Criteria

24 CFR Part 203
Single Family Mortgage Insurance Subpart A—Eligibility Requirements and Underwriting Procedures

§203.16a Mortgagor and mortgagee requirement for maintaining flood insurance coverage.

(a) If the mortgage is to cover property improvements (dwelling and related structures/equipment essential to the value of the property and subject to flood damage) that:

(1) Are located in an area designated by the Federal Emergency Management Agency (FEMA) as a floodplain area having special flood hazards, or

(2) Are otherwise determined by the Commissioner to be subject to a flood hazard, and if flood insurance under the National Flood Insurance Program (NFIP) is available with respect to these property improvements, the mortgagor [borrower] and mortgagee [lender] shall be obligated, by a special condition to be included in the mortgage commitment, to obtain and to maintain NFIP flood insurance coverage on the property improvements during such time as the mortgage is insured.

(b) No mortgage may be insured that covers property improvements located in an area that has been identified by FEMA as an area having special flood hazards, unless the community in which the area is situated is participating in the National Flood Insurance Program and such insurance is obtained by the mortgagor. Such requirement for flood insurance shall be effective

one year after the date of notification by FEMA to the chief executive officer of a flood prone community that such community has been identified as having special flood hazards.
(c) The flood insurance must be maintained during such time as the mortgage is insured in an amount at least equal to either the outstanding balance of the mortgage, less estimated land costs, or the maximum amount of the NFIP insurance available with respect to the property improvements, whichever is less.

Handbook 4000.1, FHA Single Family Housing Policy Handbook
II. Origination Through Post-Closing/Endorsement
A. Title II Insured Housing Programs Forward Mortgages
1. Origination/Processing
iv. Property Eligibility and Acceptability Criteria
(A) General Property Eligibility
(1) Special Flood Hazard Areas
The Mortgagee must determine if a property is located in a Special Flood Hazard Area (SFHA) as designated by the Federal Emergency Management Agency (FEMA). The Mortgagee must obtain flood zone determination services, independent of any assessment made by the Appraiser to cover the Life of the Loan Flood Certification.

A property is not eligible for FHA insurance if:

- A residential building and related improvements to the Property are located within SFHA Zone A, a Special Flood Zone Area, or Zone V, a Coastal Area, and insurance under the National Flood Insurance Program (NFIP) is not available in the community; or
- The improvements are, or are proposed to be located within a Coastal Barrier Resource System (CBRS).

(e) Required Flood Insurance Amount
For Properties located within an SFHA, flood insurance must be maintained for the life of the Mortgage in an amount at least equal to the lessor of:

- the outstanding balance of the Mortgage, less estimated land costs; or
- the maximum amount of the NFIP insurance available with respect to the property improvements.

III. SERVICING AND LOSS MITIGATION
A. Title II Insured Housing Programs Forward Mortgages
1. Servicing of FHA-Insured Mortgages
h. Insurance Coverage Administration
ii. Flood Insurance
For Properties located within a Special Flood Hazard Area (SFHA), the Mortgagee must ensure that insurance is in force for the life of the Mortgage or so long as such coverage remains available, unless the area in which the Property is located is no longer designated as an SFHA. If, due to rezoning, a Property securing an FHA-insured Mortgage becomes located in an SFHA, the Mortgagee must enforce HUD’s flood insurance requirements on coverage amounts and maintenance.

<u>Reverse Mortgage Criteria</u>

24 CFR Part 206
Home Equity Conversion Mortgage Insurance Subpart A—General
§206.45 Eligible Properties

(c) Borrower and mortgagee requirements for maintaining flood insurance coverage

(1) During such time as the mortgage is insured, the borrower and mortgagee shall be obligated, by a special condition to be included in the mortgage commitment, to obtain and to maintain National Flood Insurance Program (NFIP) flood insurance coverage on the property improvements (dwelling and related structures/equipment essential to the value of the property and subject to flood damage) if NFIP flood insurance is available with respect to the property improvements that:

(i) Are located in an area designated by the Federal Emergency Management Agency (FEMA) as a floodplain area having special flood hazards; or

(ii) Are otherwise determined by the Commissioner to be subject to a flood hazard.

(2) No mortgage may be insured that covers property improvements located in an area that has been identified by FEMA as an area having special flood hazards, unless the community in which the area is situated is participating in the NFIP and such insurance is obtained by the borrower. Such requirement for flood insurance shall be effective one year after the date of notification by FEMA to the chief executive officer of a flood prone community that such community has been identified as having special flood hazards.

(3) The flood insurance must be maintained during such time as the mortgage is insured in an amount at least equal to the lowest of the following:

(i) 100 percent replacement cost of the insurable value of the improvements, which consists of the development or project cost less estimated land cost; or

(ii) The maximum amount of the NFIP insurance available with respect to the particular type of the property; or

(iii) The outstanding principal balance of the loan.

Handbook 4235.1, Home Equity Conversion Mortgages Handbook
3-4. Eligible Properties
H. Requirements for maintaining flood insurance coverage

1) Flood insurance requirements must be met if the mortgage is to cover property that:
a. Is located in an area designated by the Federal Emergency Management Agency (FEMA) as a flood plain area having special flood hazards, or
b. Is otherwise determined by the Commissioner to be subject to a flood hazard.

2) No mortgage may be insured on such a property unless:

a. The community in which the area is situated is participating in the National Flood Insurance Program (NFIP), and
b. Such insurance is obtained by the mortgagor.

3) The requirement for flood insurance shall be effective July 1, 1975, or one year after the date of notification by FEMA to the chief executive officer of a flood prone community that such community has been identified as having special flood hazards, whichever is later.

4) The flood insurance shall be maintained during such time as the mortgage is insured, in an amount at least equal to either the outstanding balance of the mortgage, or the maximum amount of NFIP insurance available with respect to the property, whichever is less.

General Criteria

OMB [Office of Management and Budget] Circular No. A-129 Policies for Federal Credit Programs and Non-Tax Receivables

GENERAL INFORMATION

1. Purpose. This Circular prescribes policies and procedures for justifying, designing, and managing Federal credit programs and for collecting non-tax receivables. It sets principles for designing credit programs, including: the preparation and review of legislation and regulations; budgeting for the subsidy costs and administrative expenses of credit programs, and minimizing unintended costs to the Government; and improving the efficiency and effectiveness of Federal credit programs. It also sets standards for extending credit, managing lenders participating in Government guaranteed loan programs, servicing credit and non-tax receivables, and collecting delinquent debt.

I. **RESPONSIBILITIES OF DEPARTMENTS AND AGENCIES**

D. **Department and agencies.** Departments and agencies shall manage credit programs and all non-tax receivables in accordance with their statutory authorities and the provisions of this Circular to protect the Government's assets and to minimize losses in relation to social benefits provided. Specifically, agencies shall ensure that Federal credit program legislation, regulations, and policies are designed and administered in compliance with the principles of this Circular; the costs of credit programs are budgeted for and controlled in accordance with FCRA [Fair Credit Reporting Act]; and that credit programs are designed and administered in a manner that most effectively and efficiently achieves policy goals while minimizing taxpayer risk.

***To achieve these objectives, agencies shall*:**

5. Make every effort to effectively target Federal assistance, and mitigate risk by a) following appropriate screening standards and procedures for eligibility and determination of creditworthiness, and b) making sure that lenders and servicers participating in Federal credit programs meet all applicable financial and programmatic requirements.

Federal Housing Administration – Frequently Asked Question

https://www.hud.gov/FHAFAQ

Can I purchase private flood insurance instead of an NFIP policy?

No, private flood insurance will not satisfy FHA's National Flood Insurance Program (NFIP) flood insurance coverage requirement. The Department of Treasury published a final rule, effective July 1, 2019, that allows their regulated lending institutions to accept private flood insurance in lieu of an NFIP policy; however, this does not change FHA regulations.

Flood insurance coverage exceeding FHA's NFIP flood insurance coverage requirement can be obtained.

If FHA decides to make any changes to policy in this regard, any proposed or final rulemaking will be published in the Federal Register with an opportunity for public comment.

Appendix D

Exception Summary

Exception number	Case number	Deficiency description	Unpaid principal balance or maximum claim amount as of 12/31/2020
1	031-4997XXX	Private policy	$45,341
2	493-7086XXX	Private policy	18,295
3	501-8823XXX	Private policy	41,124
4	031-3893XXX	Private policy	56,873
5	156-2738XXX	Private policy	90,822
6	361-3463XXX	No flood insurance	69,022
7	501-7886XXX	No flood insurance	118,951
8	095-0741XXX	Private policy	176,187
9	201-6462XXX	Private policy	161,807
10	531-0378XXX	Private policy	134,492
11	095-3941XXX	Insufficient coverage	227,603
12	095-4364XXX	Insufficient coverage	206,295
13	095-5235XXX	Private policy	180,230
14	361-4194XXX	Private policy	181,875
15	352-9169XXX	Private policy	270,262
16	411-6128XXX	Private policy	271,152
17	351-6915XXX	Insufficient coverage	370,626
18	048-4406XXX	Insufficient coverage	210,000
19	093-5980XXX	Private policy and insufficient coverage	173,000
20	095-2550XXX	Insufficient coverage	180,000
21	495-9230XXX	Insufficient coverage	121,000
Total (See appendix A for funds to be put to better use calculation.)			**3,304,957**

Appendix E

Sampling and Projections

Scope of Audit

The purpose of this audit is to determine whether FHA single-family loans located in a FEMA-designated flood plain have proper flood insurance. We designed the statistical sample to project the dollars at risk and the count of loans in the FHA portfolio that meet the condition of insufficient flood insurance.

Methodology

We identified a stratified sample of 90 records for auditing among the universe of 197,747 loans. We designed the strata to group sampling units by the size of their valuation. Therefore, we rank ordered the sampling units by their valuation. We broke the strata up between forward and reverse mortgages. The strata breakpoints encompassed the following ranges by percentile for forward loans: 0-10, 10-30, 30-50, 50-70, 70-90, 90-98, and 98-100. We divided the reverse loans between those above and below $390,000. We employed a systematic sort in the final sample design to help control for differences across States and forward loan types. The table below lists the strata boundaries and other key data related to this sample design.

Sample design

Stratum label	Amount	Total count in stratum	Sample count	Probability of selection	Sampling weight
0-10pct	>0	17,736	8	0.00045	2217.0
10-30pct	≥ $52,200	35,482	16	0.00045	2217.6
30-50pct	≥ $91,364	35,485	16	0.00045	2217.8
50-70pct	≥ $129,800	35,477	16	0.00045	2217.3
70-90pct	≥ $178,408	35,480	16	0.00045	2217.5
90-98pct	≥ $265,180	14,191	7	0.00049	2027.3
98-100pct	≥ $365,486	3,548	2	0.00056	1774.0
Reverse1	>0	16,273	7	0.00043	2324.7
Reverse2	≥ $390,000	4,075	2	0.00049	2037.5
Totals		197,747	90		

We tested the sample design with various rates of error to confirm that we could obtain a reliable projection answer with this sample design and that the confidence intervals as specified would provide an accurate probabilistic statement. Based on the testing and simulated sampling distributions, we found a stratified sample of 90 to be more than sufficient, and we selected that sample size.

Statistical Estimates

We computed the percentage and number of loans that might be insufficiently insured based on the sampling results, and we extended this result to the population using the surveyfreq procedure provided by SAS®. We estimated the lower confidence interval using a Gaussian sampling distribution, which is appropriate for error rates in this range. We extended these percentages to the 197,747 records in the universe to get the total universe count of these records.

We used the surveymeans procedure in SAS® to estimate the total dollars of loans (for a forward loan, the unpaid balance and for a reverse loan, the maximum claim amount) that may be insufficiently insured. We reduced the average amount by the margin of error (that is, the standard error with a student's t factor) associated with this sample design. For complex sample designs, such as the stratified technique used for this review, the surveymeans procedure in SAS uses the Taylor expansion method to estimate sampling errors (standard errors). We then extended this result to the 197,747 records in the universe.

The basic estimation calculations are as follows:

$$Amount_{LCL} = N * (\mu - t_{\alpha/2}\, SE_{\$})$$
$$Count_{LCL} = N * (pct - t_{\alpha/2}\, SE_{\%})$$

$Amount_{LCL}$ = Total review-finding amount after deducting a margin of error
$Count_{LCL}$ = Total number of sampling units with the error after deducting a margin of error
N = Total number of sampling units in the sampling frame
μ = Weighted average value of the error per unit
pct = Weighted percentage of sampling units with the error in the sampling frame
$SE_{\$}$ = Standard error per unit, as applies to projecting dollars
$SE_{\%}$ = Standard error per unit, as applies to projecting proportions
$t_{\alpha/2}$ = Student's - t for projecting a one-sided confidence interval for a sample of this size

Findings
Our findings with mathematical demonstrations are as follows:[1]

Dollar Projection Results:
We found that 21 of 90 loan records reviewed had insufficient flood insurance. This amounts to a weighted average risk of $36,079.65 per loan as measured by the unpaid balance or maximum claim amount. Deducting for a statistical margin of error, we can say – with a one-sided confidence interval of 95 percent – that this amounts to at least $23,091.77 per loan that could be at risk. In the context of the universe of 197,747 loans, this amounts to at least $4.56 billion in FHA loans at risk due to insufficient flood insurance, and this dollar amount could be more.

Per loan calculation: $\$36{,}079.65 - (1.664 \times \$7{,}805.76) \approx \$23{,}091.77_{LCL}$
Universe projection: $197{,}747 \times (\$36{,}079.65 - (1.664 \times \$7{,}805.76)) \approx \$4{,}566{,}327{,}259.80_{LCL}$

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[i] See Wayne W. Daniel, James C. Terrell, Business Statistics, Houghton Mifflin Company, 1995, for more indepth calculation equations.

Percentage-Count Projection Results:

We found that 21 of 90 loan records reviewed had insufficient flood insurance. This amounts to a weighted average of 23.4 percent. Deducting for a statistical margin of error we can say – with a one-sided confidence interval of 95 percent – that at least 15.9 percent of the loans could be insufficiently insured. Extending this percentage to the universe of 197,747 loan records, at least 31,520 FHA loans could be insufficiently insured, and the count of loans could be more.

Percentage calculation: $23.4\% - (1.664 \times 4.5\%) \approx 15.9\%_{\text{LCL}}$

Total loans projection: $197{,}747 \times (23.4\% - (1.664 \times 4.5\%)) \approx 31{,}520_{\text{LCL}}$