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

HUD Can Improve Oversight of Its Temporary Endorsement Policy for Loans in COVID-19 Forbearance

Audit Report Number: 2023-NY-0002

May 15, 2023

Office of Audit | Office of Inspector General
U.S. Department of Housing and Urban Development

To: Sarah J. Edelman
Deputy Assistant Secretary for Single Family Housing, HU

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

Subject: HUD Can Improve Oversight of Its Temporary Endorsement Policy for Loans in COVID-19 Forbearance

Attached are the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of HUD's temporary policy for endorsement of loans with COVID-19 forbearance activity.

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 of 1978, as amended, 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 Kimberly S. Dahl, Audit Director, at (212) 264-4174.

Highlights

HUD Can Improve Oversight of Its Temporary Endorsement Policy for Loans in COVID-19 Forbearance| 2023-NY-0002

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) temporary policy for endorsement of loans with COVID-19 forbearance activity because an analysis of data in HUD's systems showed that there may have been loans that did not comply with the policy's requirements. The policy was one aspect of HUD's broader emergency response to COVID-19, which also included an eviction moratorium and loan forbearance for borrowers experiencing financial hardship. The objectives of the audit were to determine (1) whether HUD's temporary endorsement policy related to COVID-19 forbearance activity was properly followed by lenders, (2) whether HUD monitored and enforced indemnification agreements for loans that were subject to the temporary policy, and (3) HUD's reasons for ending the policy during the pandemic and its plans to evaluate and use such policies in the future.

What We Found

HUD could improve oversight of the temporary endorsement policy. Specifically, HUD did not ensure that (1) lenders consistently followed policy requirements and (2) indemnification agreement data and records related to the policy were complete and accurate. These deficiencies occurred or went undetected due to unclear guidance and because HUD did not update its oversight strategy to specifically cover the policy and reconcile relevant data and records. As a result, the Federal Housing Administration (FHA) insurance fund was exposed to greater risk from at least $83 million in loans for which lenders did not follow requirements, and HUD's ability to monitor and enforce indemnification agreements could be compromised until it corrects its data and records. Additionally, HUD terminated the policy due to limited use and did not have plans to further evaluate or use the policy in the future. As a result, HUD did not know whether using a similar policy during future disasters and emergencies or permanently could manage risk to the insurance fund while increasing lender participation.

What We Recommend

We recommend that HUD (1) require lenders to execute 5-year indemnification agreements for loans that were missing required agreements or were otherwise ineligible to put up to $1.8 million to better use by avoiding potential losses; (2) request and analyze data from lenders for loans at risk of noncompliance to identify loans that should have been subject to the policy or were otherwise ineligible for insurance and require lenders to protect HUD against losses on these loans to put up to $26.8 million to better use; (3) record indemnification agreement data in its system for agreements that were executed but not recorded to put up to $3.5 million to better use; (4) review and correct indemnification agreement data as needed in its system; (5) update indemnification agreements with incorrect or missing information; and (6) consider evaluating whether and how a similar policy could be used in the future. This should include studying lenders' use of the policy, the long-term performance of loans endorsed under it, and the compliance, guidance, and process issues discussed above to refine future policies.

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Background and Objectives

The U.S. Department of Housing and Urban Development's (HUD) 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 a 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. To protect FHA's insurance funds from unnecessary risk, loans must meet certain requirements established by FHA to qualify for insurance.

Origination → Underwriting → Closing → Endorsement

The Single Family mortgage process, including FHA loan refinancing, begins when a loan is originated and underwritten by a lender. The transaction then goes through a closing process, during which parties sign documents, mortgage proceeds are disbursed, and borrowers become legally responsible to repay the mortgage. After closing but before initiating endorsement, lenders prepare the case binder and complete a preendorsement review to ensure that it contains the documentation needed to show compliance with FHA and other requirements. The lender then initiates the insurance endorsement process by completing an insurance application in HUD's FHA Connection system.

Although lenders are generally required to submit loans for endorsement within 60 days of disbursement, the length of time between closing and endorsement can vary from days to several months. During this time, borrowers may have one or more payments come due. Borrowers may also experience financial hardships that affect their ability to pay back the loan after closing but before the loan is endorsed by FHA.

During the COVID-19 national emergency, HUD recognized that COVID-19 had wide-ranging impacts on many borrowers, including a combination of wage reductions, job losses or interruptions, and the inability to work for a variety of reasons – such as a lack of telework options or childcare – on top of potential impacts of contracting COVID-19. Several aspects of HUD's emergency response related to FHA's Single Family programs, including an eviction moratorium and loan forbearance. A forbearance allows for reduced or suspended payments without specific terms of repayment. Borrowers who, either directly or indirectly, suffered a financial hardship due to COVID-19 were eligible for forbearance under the Coronavirus Aid, Relief, and Economic Security (CARES) Act and subsequent guidance issued by HUD.

Before June 15, 2020, loans in forbearance were ineligible for endorsement. However, to provide ongoing liquidity to the industry during the pandemic, HUD issued a temporary endorsement policy giving lenders the ability to insure loans in forbearance due to COVID-19. See appendix D. Borrowers with loans that were eligible at the time of closing may have experienced financial hardship due to COVID-19 shortly after closing, resulting in forbearance of loan payments before endorsement. By implementing the temporary policy and allowing such loans to be endorsed, HUD mitigated the risk of lenders carrying the loans for periods of time, which allowed them to continue to provide affordable financing through FHA-insured programs.

Under the temporary endorsement policy, lenders could submit loans for endorsement so long as the following requirements were met under Mortgagee Letter 2020-16:

- the borrower had requested forbearance, or the mortgage was subject to a forbearance agreement for one or more payments due to relief provided to borrowers impacted by COVID-19;
- at the time the forbearance was initiated, the mortgage was current;
- at the time of the mortgage closing, the mortgage satisfied all requirements for FHA insurance; and
- the lender executed a 2-year partial indemnification agreement.

To implement the policy, HUD created a model partial indemnification agreement, a code to identify within FHA Connection that the loan is subject to a forbearance agreement, and instructions for lenders for completing the insurance application and indemnification agreement. According to the instructions, lenders were required to submit the indemnification agreement when they submitted the case binder for endorsement. According to the agreement, lenders were required to indemnify HUD for losses up to 20 percent of the initial mortgage amount if the borrower did not make two or more payments at any point within 2 years of endorsement and then remained in default until the filing of a claim for insurance. Once HUD received the indemnification agreements, it signed them, entered agreement data into FHA Connection, and uploaded them to a designated SharePoint site maintained by the Office of Single Family Housing. After extending the policy twice, HUD announced its expiration in March 2021.

Our audit objectives were to determine (1) whether HUD's temporary endorsement policy related to COVID-19 forbearance activities was properly followed by lenders, (2) whether HUD monitored and enforced indemnification agreements for loans that were subject to the temporary policy, and (3) HUD's reasons for ending the policy during the pandemic and its plans to evaluate and use such policies in the future.

Results of Audit

HUD Could Improve Oversight of the Temporary Endorsement Policy

HUD could improve oversight of the temporary endorsement policy. Specifically, HUD did not ensure that (1) lenders consistently followed policy requirements or (2) indemnification agreement data and records related to the policy were complete and accurate. These deficiencies occurred or went undetected due to unclear guidance and because HUD did not update its oversight strategy to specifically cover the policy and reconcile relevant data and records. As a result, the FHA insurance fund was exposed to greater risk from at least $83 million in loans for which lenders did not follow requirements, and HUD's ability to monitor and enforce these indemnification agreements could be compromised until it corrects its data and records. Additionally, HUD terminated the policy due to limited use and did not have plans to further evaluate or use the policy in the future. As a result, HUD did not know whether using a similar policy during future disasters and emergencies or permanently could manage risk to the insurance fund while increasing lender participation.

Lenders Did Not Always Comply with the Temporary Endorsement Policy

HUD did not ensure that lenders properly followed the temporary policy. Specifically, lenders did not always execute partial indemnification agreements when required or use accurate status codes when submitting loans for endorsement. In addition, loans submitted for endorsement under the policy were not always fully eligible.

Lenders Did Not Execute Indemnification Agreements and Properly Report Loan Status

Under the temporary policy, HUD issued updated instructions for lenders to follow when submitting loans for endorsement in which forbearance had been requested or granted. See appendix D. The guidance explained how to code loans that were (1) in COVID-19 forbearance at the time they were submitted for endorsement, (2) current and not in forbearance, or (3) not current. For loans subject to the temporary policy, lenders were required to select the forbearance option code, execute the required 2-year partial indemnification agreement, and submit the agreement with the case binder.

We reviewed 114 sampled loans that did not have an indemnification agreement recorded in HUD's data as of June 2021 but for which the lenders had reported the loans as being in forbearance when submitting them for endorsement or shortly after endorsement. We determined that 65 of the 114 loans were not subject to the temporary endorsement policy because they were not in forbearance at the time of endorsement. The remaining 49 loans were subject to the policy, and while lenders complied with the indemnification agreement requirement for 33 of these loans, they did not execute agreements for the remaining 16. For most of these 16 loans, the borrower's request for forbearance and the forbearance agreement effective date both occurred before the lender submitted the loan for endorsement (example A in table below). For other loans, either the borrower requested forbearance before the lender submitted the loan for endorsement (example B), or the lender retroactively set the forbearance effective date to on or before the day on which it submitted the loan for endorsement (example C).

Key milestones	Example A 138-0661464	Example B 512-4220106	Example C 422-3896475
Closing	08/03/2020	01/21/2021	12/14/2020
First payment due	10/01/2020	03/01/2021	02/01/2021
Loan submitted for endorsement	12/04/2020	03/26/2021	02/26/2021
Borrower requested forbearance	11/20/2020	03/11/2021	05/26/2021
Forbearance agreement effective	12/01/2020	04/01/2021	02/01/2021

Lenders also did not use accurate status codes for 18 of the 114 reviewed loans. They reported 3 loans as being in forbearance when they were current, and 15 as being current when they were either in forbearance or not current. This included two loans that, while not in forbearance, were ineligible for insurance because they were not current at the time they were submitted for endorsement.

The table below summarizes our results for the 114 sampled loans that did not have indemnification agreements recorded as of June 2021.

Loan status as of the date the loan was submitted for endorsement: Reported by lender	Based on HUD data and records[1]	Lender executed agreement as required	Lender did not execute required agreement	Loan was not subject to policy but was ineligible	Loan was not subject to policy and was current	Total
Forbearance	Forbearance	32	4			39
	Current				3	
Current (not in forbearance)	Forbearance	1	12			75
	Current				60	
	Not current			2		
Totals		**33**	**16**	**2**	**63**	**114**

Lenders Generally Submitted Eligible Loans Under the Temporary Policy

HUD Mortgagee Letter 2020-16 required loans submitted for endorsement under the temporary policy to satisfy all requirements for FHA insurance at the time of closing and to be current at the time forbearance was initiated. We found that 46 of 56 sampled loans were eligible, but that the remaining 10 loans had at least one significant deficiency and were not eligible under the policy. The table below summarizes the significant deficiencies related to the mortgagee letter and HUD Handbook 4000.1 that were found in the 10 ineligible loans.

[1] See Scope and Methodology for details on the methodology used.

Deficiency	Number of loans[2]
Inadequate verification of funds needed to close	5
Inadequate verification of borrower income	3
Inadequate verification of borrower debt	4
Inadequate verification of borrower employment history	2
Loan not current at time forbearance initiated	2
Lack of compensating factors for excessive debt-to-income ratios	1
Incorrect use of automated underwriting system	1
Prior loan delinquent at the time of refinance	1

For example, in one case, the loan had multiple significant underwriting issues, including that the file (1) did not contain complete tax returns or transcripts to support nearly $3,200 in monthly self-employment income; (2) did not contain documentation supporting the source of $14,000 in gift funds needed to close the loan and meet the minimum required investment; and (3) contained documentation indicating that one borrower may have owed up to $28,000 in Federal taxes, while less than $8,000 in tax debt was considered when underwriting the loan. In another case, a loan was ineligible under the temporary endorsement policy because it was not current at the time forbearance was initiated as the borrower had missed multiple payments before requesting forbearance.

Compliance Issues Increased the Risk to the Insurance Fund

In total, 28 of 170 reviewed loans had compliance issues that increased the risk to the insurance fund, including loans that were submitted for endorsement without the required partial indemnification agreement or were otherwise ineligible for insurance.

These deficiencies occurred or went undetected for several reasons, such as unclear guidance and because HUD did not update its normal oversight strategy to specifically cover the policy and reconcile relevant data and records. First, the guidance HUD provided to lenders did not thoroughly explain the scenarios and timelines they would encounter and how to handle each situation. For example, the instructions did not address whether HUD allowed the effective date of forbearance agreements to be retroactive to the first mortgage payment due date or the endorsement date. Second, HUD did not have a specific review process for ensuring that lenders complied with the temporary endorsement policy. While HUD regularly performs full underwriting reviews of loans, it did not update the methodology used for these reviews to cover the unique requirements posed by the temporary policy.[3] For example, while HUD performed full underwriting reviews on 4 of the 16 sampled loans that we found were missing

[2] Some loans had multiple deficiencies.

[3] HUD regularly selects endorsed loans for full underwriting reviews, which include a detailed analysis of the origination, credit underwriting, and postclosing documentation. It also performs more targeted reviews of loans self-reported by lenders for noncompliance. Although HUD created a protocol to use when lenders self-reported noncompliance with the policy, the protocol was announced only days before the policy's expiration and HUD did not update the methodology used for its full underwriting reviews to identify similar noncompliance not self-reported by lenders.

partial indemnification agreements, its reviews did not detect these deficiencies. Further, HUD's oversight strategy did not include a process to consistently use the data available in its systems to identify loans likely to be out of compliance with the policy, such as reconciling indemnification agreement data to forbearance data reported by lenders.

The FHA insurance fund may be liable for potential losses for 20 of these loans because they are still active. The remaining eight loans have been terminated and no longer represent an increased risk to the insurance fund. See appendix C.

Further, when projecting the results of the 170 loans reviewed to the 3,335 loans they were sampled from, we estimate that the FHA insurance fund was exposed to greater risk from at least 368 loans totaling more than $83 million. This includes loans submitted for endorsement without indemnification agreements when they were in forbearance as well as loans that were otherwise ineligible for insurance.

HUD Did Not Maintain Complete and Accurate Data and Records

HUD did not ensure that data and records related to the temporary policy were complete and accurate, limiting its ability to effectively monitor or enforce its indemnification agreements. We identified several issues related to the completeness and accuracy of HUD's data, as well as inaccuracies in the indemnification agreements themselves.

Data Were Not Complete or Accurate

HUD uses its single-family systems to enter, maintain, and track data on indemnification agreements. Having a system of record provides an essential, central point for HUD to monitor and enforce these agreements. Additionally, HUD has a data dictionary to help ensure it enters data accurately. However, HUD systems did not contain records about indemnification for 34 of the 387 loans (8.8 percent) for which the lenders had submitted partial indemnification agreements under the temporary endorsement policy.[4] Further, 260 loans contained incorrect or questionable information:[5]

- 195 records incorrectly indicated that the agreement term began on the agreement date instead of on the date when the loan was endorsed, which may impact the expiration date listed.
- 38 records incorrectly listed the billing lender identification number or did not follow the indemnification agreement number protocol.
- 28 records incorrectly indicated that the agreement was not transferrable should the loan be streamline refinanced into a new FHA loan.
- 48 records listed a term that was not 24 months, which may be incorrect unless HUD obtained a second agreement for these loans that was for a different term that superseded the first agreement.

[4] We identified 33 of these loans after requesting information for the 114 sampled loans that did not have an indemnification agreement recorded in HUD's data as of June 2021 but for which the lenders had reported the loans as being in forbearance when submitting them for endorsement or shortly after endorsement. We identified the 34th loan by comparing HUD's system data to agreements maintained in its designated SharePoint folder.

[5] Some loan records had multiple deficiencies.

Agreements Were Not Accurate and Complete

HUD maintains copies of the partial indemnification agreements received from lenders. Having a central location for the agreements ensures that HUD can locate an indemnification agreement should a lender file a claim for a loan. However, it is important that HUD also ensure that the agreements are accurate and complete. Of the 387 indemnification agreements HUD maintained, 30 contained inaccurate or missing information related to lender identification numbers, indemnification agreement numbers, loan numbers, and HUD signatures. Maintaining agreements that are accurate and complete helps ensure that HUD has legally enforceable agreements to protect the insurance fund in the event of a loss.

Monitoring and Enforcement Could Be Compromised

The deficiencies described above occurred or went undetected because HUD manually entered the 2-year indemnification agreement data and its oversight strategy did not include a process to reconcile the data and agreements to ensure that both were accurate and complete. HUD's controls are compromised when agreements are not captured in the system or contain inaccurate information. As a result, its ability to monitor and enforce agreements could be compromised until corrections are completed. For example, if a lender submits a claim for a defaulted loan for which the indemnification agreement data are not recorded, HUD systems will not suspend the claim for investigation and prevent HUD from paying the claim unnecessarily.

HUD Did Not Plan to Further Evaluate or Use the Policy in the Future

HUD indicated that it terminated the temporary endorsement policy due to its limited use by lenders and did not have plans to further evaluate or use a similar policy in the future. According to HUD's announcement ending the policy, fewer than 3 percent of FHA-approved lenders requested endorsement of loans under the policy during the 9 months when it was in effect. HUD stated that the temporary policy was implemented for the pandemic, which may have resulted in borrowers requesting or obtaining a COVID-19 forbearance before the loans were endorsed. It explained that one reason the policy may have been underused is that lenders may have imposed additional rules to screen out mortgage applications that were more likely to result in forbearance to avoid having to execute 2-year indemnification agreements. However, because HUD did not plan to further evaluate the policy, it does not know what would have encouraged its increased use, or whether using a similar policy during future disasters and emergencies or permanently could manage risk to the insurance fund while increasing lender participation.

Conclusion

HUD could have better ensured that lenders consistently complied with the temporary endorsement policy and protected its ability to monitor and enforce agreements if it had more thorough guidance and had updated its oversight strategy to specifically cover the policy. If HUD implements our recommendations, it will put up to $32 million to better use, and improve its ability to monitor and enforce compliance with the temporary policy going forward. Further, if HUD further studies lenders' use of the policy and the long-term performance of loans endorsed under it, as well as the compliance, guidance, and process issues discussed above, it will be in a better position to determine whether to use a similar policy in the future. This is particularly important due to research about the frequency of natural disasters and pandemics, and could help ensure the ongoing effectiveness and efficiency of HUD's Single Family mortgage programs in the changing environment.[6]

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

1A. Require lenders to execute indemnification agreements covering a period of at least 5 years for each of the 20 loans for which the lenders did not comply with the temporary endorsement policy and related instructions, including loans for which the lenders did not execute an agreement when required or that were otherwise ineligible for insurance, and properly store the agreements and record the agreement data to put up to $1,811,238 to better use by avoiding potential losses.

1B. Obtain guidance from the Office of General Counsel regarding the implications of allowing lenders to retroactively apply forbearance in cases in which the borrower requests forbearance after the lender submits the loan for endorsement to ensure that it consistently handles such cases.

1C. Request and analyze data from lenders for the 3,024 loans at risk of noncompliance to identify loans that should have been subject to the temporary endorsement policy or were otherwise ineligible for insurance. The data requested should include but not be limited to the dates when the borrower requested forbearance, the loan became subject to forbearance, and the loan was submitted for endorsement.

1D. For any of the 3,024 loans found to be subject to the temporary policy or otherwise ineligible for insurance, require the lenders to execute indemnification agreements covering a period of at least 5 years or reimburse HUD for any claims to put up to $26,840,071 to better use by protecting HUD against potential losses. For any indemnification agreements executed, HUD should properly store the agreements and record the agreement data.

1E. Update data in HUD's system for the three cases in which the lender incorrectly reported the loans as in COVID-19 forbearance at the time of endorsement to ensure that accurate data are maintained.

1F. Consider implementing a policy to review any of the 292 loans not reviewed as part of this audit that result in a request for claim to ensure that the loans qualified for endorsement under the temporary endorsement policy so that HUD can avoid unnecessary payments for loans that should not have been endorsed.

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[6] The Government Accountability Office's Standards for Internal Controls in the Federal Government discusses how effective internal control systems help entities adapt to shifting environments, evolving demands, changing risks, and new priorities. It explains that as programs change and entities strive to improve operational processes and implement new technology, management should continually evaluate its internal control system so that it is effective and updated when necessary. Further evaluating the temporary policy as part of HUD's ongoing work to assess risks, design controls, and monitor its programs could help ensure the ongoing effectiveness and efficiency of its Single Family mortgage programs in the future.

1G. Record indemnification agreement data in its system for the 34 loans for which the lender properly executed an indemnification agreement before endorsement and HUD had not recorded the agreement in its system to put up to $3,493,636 to better use by avoiding potential losses.

1H. Review and correct indemnification agreement data in HUD's computer systems as needed for all agreements currently classified as having 2-year terms and all agreements related to 2-year agreements contained on its SharePoint site to ensure that its systems contain accurate data for monitoring and enforcement of agreements. This recommendation includes but is not limited to reviewing the agreement number, agreement term, billing lender, expiration date, refinance indicator, and source indicator.

1I. Update indemnification agreements or obtain updated indemnification agreements for the 30 loans for which the indemnification agreements had incorrect or missing information or were not signed by HUD and upload them to its SharePoint site so that such agreements are properly executed and can be traced to HUD's computer systems for future use.

1J. Consider evaluating whether and how a similar policy for disasters or emergencies or a permanent version of the policy could be used to manage risk to the insurance fund while increasing lender participation. This should include further studying lenders' use of the policy and the long-term performance of loans endorsed under it. It could also include reviewing the compliance, guidance, and process issues identified during this audit and through the resolution of the other recommendations to refine any future endorsement policies related to forbearance.

Scope and Methodology

We performed our audit work between July 2021 and October 2022. We did not conduct onsite fieldwork for this audit. Our audit covered the period June 15, 2020, through March 31, 2021, and was extended through October 5, 2022, to review updated data and indemnification agreement records related to the temporary policy. This included review of updated indemnification agreement data as of September 9, 2022, and updated loan data and indemnification agreement records as of October 5, 2022.[7]

To accomplish our objectives, we

- reviewed relevant requirements, including handbooks, mortgagee letters, and policies and procedures related to the temporary endorsement policy;
- interviewed HUD staff to gain an understanding of the program and relevant controls;
- reviewed and compared data from HUD systems and the SharePoint site it established to maintain 24-month indemnification agreements;
- selected and reviewed samples of loans to determine compliance with the temporary endorsement policy and related instructions; and
- reviewed records provided by HUD and lenders.

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. We relied on the system to identify loans for which endorsement was processed during our initial audit period to review for compliance with the temporary policy. Specifically, we initially obtained SFDW data for loans with endorsement process dates from June 15, 2020, to March 31, 2021, including loan-level, default, and indemnification data. We analyzed the data to identify the following three groups of loans for review. From each of groups B and C, we selected and reviewed a separate statistical sample of loans. Appendix E describes the sampling selection for groups B and C.

- Group A included 39 loans that were reported by lenders as in COVID-19 forbearance at the time of endorsement but did not have 2-year partial indemnification agreement data in HUD's system. We selected 100 percent of the 39 loans for review to determine whether partial indemnification agreements were required, executed, and recorded in HUD's systems. For each loan selected, we reviewed data from HUD's systems and 2-year partial indemnification agreements.
- Group B included 3,024 loans that may have been subject to the temporary policy because they were reported by lenders as being current at the time of endorsement and did not have 2-year partial indemnification agreement data in HUD's system and then were reported as being in COVID-19 forbearance after endorsement with the oldest unpaid installment dates before, on, or shortly after the endorsement process dates. We selected a statistical sample of 75 of the 3,024

[7] We obtained updated data to assist in our evaluation of the accuracy and completeness of HUD's data and records. As of October 5, 2022, there were 387 unique loans with agreements stored on the Single-Family SharePoint site. This included the 292 loans identified in group C using June 2021 data; 33 loans that we found were not in HUD's data; and 62 loans that were either classified as having an agreement term longer than 2 years in the data as of June 2021, entered after we selected our samples in June 2021, or terminated before we selected our samples.

loans for review to determine whether partial indemnification agreements were required, executed, and recorded in HUD's systems. For each loan selected, we reviewed data from HUD's systems, mortgage payment histories, borrower requests for forbearance, and forbearance approval letters to determine whether the lenders properly reported the loan status when submitting the loans for endorsement and whether the loans should be subject to a partial indemnification agreement.

- Group C included 292 loans that had 2-year partial indemnification agreements reported in HUD's computer system. We selected a statistical sample of 56 of the 292 loans to determine whether the loans qualified for and were properly endorsed under the temporary policy. For each loan selected, we reviewed case binders and other documentation from the lender, which included mortgage applications; employment, income, debt, and asset documentation; mortgage payment histories; forbearance approval letters; and indemnification agreements.

The table below provides an overview of the significant lender compliance issues identified during our loan-level reviews.

Group	Lender did not execute required agreement	Loan was not subject to policy but was ineligible	Lender used policy for ineligible loan	Number of reviewed loans with lender compliance issues that increased risk
A	4			4
B	12	2		14
C			10	10
Totals	**16**	**2**	**10**	**28**

Based on the results of our review of 170 loans from the three groups, we estimate that the FHA insurance fund was exposed to greater risk from at least 368 loans with lender compliance issues.

Group	Number of loans in universe	Number of loans reviewed	Number of reviewed loans with lender compliance issues that increased risk	Estimated number of loans in three groups with lender compliance issues that increased risk
A	39	39	4	4
B	3,024	75	14	335
C	292	56	10	29
Totals	**3,355**	**170**	**28**	**368**

This number includes (1) the 4 loans from group A for which the lender correctly reported the loans as in forbearance at the time of endorsement but did not execute a partial indemnification agreement as required; (2) the group B projection that lenders incorrectly reported 335 loans as current at the time of endorsement when they were either in forbearance and missing the required indemnification agreement or were not current and, therefore, ineligible for insurance; and (3) the group C projection that there were at least 29 loans with a 2-year partial indemnification agreement reported in HUD's data as of June 2021 that did not qualify for endorsement under the temporary policy and should not have been endorsed. Appendix E describes the sampling projection results for groups B and C.

We assessed the reliability of computer-processed data and determined that the data were sufficiently reliable to achieve our audit objectives. We assessed HUD's controls related to its temporary endorsement policy for COVID-19 forbearance activities, indemnification agreements, reasons for ending the policy during the pandemic, and plans to evaluate and use such policies in the future. We also assessed the relevant internal controls to the extent necessary to determine whether HUD had developed and implemented procedures to ensure that lenders complied with the temporary policy and that indemnification agreement data were complete and accurate.

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 finding and conclusions based on our audit objectives.

Appendixes

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

Recommendation Number	Funds to be put to better use 1/
1A	$1,811,238
1D	26,840,071
1G	3,493,636
Total	32,144,945

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 could avoid potential losses for (1) loans for which the lenders did not comply with the temporary endorsement policy and related instructions, including loans for which the lenders did not execute an indemnification agreement when required or that were otherwise ineligible loans for insurance, and (2) loans for which the lender executed an indemnification agreement and HUD had not recorded the agreement in its system. The amounts above reflect that upon paying claims for defaulted loans, FHA's average loss experience is about 34 percent based on statistics provided by HUD.

Appendix B – Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation – Auditee Comments

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

OFFICE OF HOUSING

MEMORANDUM TO: Kilah S. White, Assistant Inspector General for Audit, GA

JULIE SHAFFER Digitally signed by: JULIE SHAFFER DN: CN = JULIE SHAFFER C = US O = U.S. Government OU = Department of Housing and Urban Development, Office of Administration Date: 2023.04.12 15:50:38 -04'00'

FROM: Julie A. Shaffer, Associate Deputy Assistant Secretary for Single Family Housing, HU

SUBJECT: Discussion and Comments on Draft Audit: HUD Can Improve Oversight of its Temporary Endorsement Policy for Loans in COVID-19 Forbearance *OIG Audit Report Number: 2023-NY-XXXX*

The Office of Inspector General (OIG) has audited the U.S. Department of Housing and Urban Development's (HUD) temporary policy for endorsement of loans with COVID-19 forbearance activity. Specifically, OIG reviewed whether HUD's temporary endorsement policy related to COVID-19 forbearance activity was properly followed by lenders; whether HUD monitored and enforced indemnification agreements for loans that were subject to the temporary policy; and HUD's reasons for ending the policy during the pandemic and its plans to evaluate and use such policies in the future. OIG has provided a draft audit report to the Office of Single Family Housing (Single Family) for comment.

Comment 1 > Single Family appreciates OIG's work on this audit. While we acknowledge opportunities for improvement in the delivery of FHA programs, we believe the draft report does not fully capture the unprecedented nature and complexity of the circumstances that preceded this temporary COVID-19 policy.

During the early days of the COVID-19 National Emergency, HUD became aware that many borrowers were encountering unexpected and unavoidable financial challenges which prompted their use of forbearance after closing in order to retain their homes. At that time, the economy was volatile, exemplified by the S&P 500 Index dropping in value by over 1000 points over the 30-day period preceding March 20, 2020.[1] Borrowers who, just weeks before the pandemic, had closed on loans eligible for FHA insurance were suddenly impacted by economic shutdowns, wage reductions, job losses, and health-related issues due the virus, necessitating forbearance on their new mortgages. As a result of these conditions, lenders were at risk of having to carry mortgages on their balance sheets for periods of time that challenged their liquidity and limited their ability to continue providing affordable mortgage financing through FHA.

To mitigate this economic risk and to provide stability to the market, HUD published Mortgagee Letter (ML) 2020-16. Under this temporary emergency guidance, if a mortgage closed in accordance with FHA requirements but the borrower requested or was granted a forbearance after closing due directly or indirectly to the COVID-19 National Emergency, FHA would endorse the

[1] Google Finance, S&P 500 Index Fund 5-Year Performance, https://www.google.com/finance/quote/.INX:INDEXSP?sa=X&ved=2ahUKEwiP8qeXraP-AhVcEFkFHRE-DUkQ3ecFegQIFxAg&window=5Y

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mortgage for insurance, contingent upon the lender's execution of a two-year partial indemnification agreement for 20 percent of the loan amount in the event the loan went to claim. This temporary policy expired in March 2021.

Comment 2 >

The COVID-19 National Emergency was an unprecedented economic event, and this guidance represented just one aspect of the broader emergency response from HUD. More than two million borrowers with FHA-insured mortgages became delinquent during the national emergency, and over 1.8 million borrowers took advantage of FHA's COVID-19 forbearance offering.[2] FHA helped over one million of these borrowers enter into a loss mitigation plan to avoid foreclosure and retain their homes.[3] Another 655,000 borrowers cured or paid off their mortgage without the need for a loss mitigation plan.[4] FHA issued a total of 40 Mortgagee Letters between March 2020 and October 20201 which articulated new guidance and extensions of COVID-19 policies for lenders and servicers, along with numerous additional regulatory and policy waivers requiring process and system adaptations from industry partners.[5]

Meanwhile, FHA maintained unusually strong performance during this period. As of the end of FY 2022, FHA's seriously delinquent rate for mortgages that had been under COVID-19 loss mitigation plans for more than one year was under 10 percent.[6] Historically, the redefault rate at one year for FHA loans under loss mitigation plans has been approximately 20 percent.[7]

Comment 3 >

Pending FHA's comprehensive review of the loan samples used in this audit, a preliminary review of the available data appears to show consistency with FHA's performance in facilitating successful outcomes for borrowers during the COVID-19 National Emergency while maintaining the historically strong capital positioning of the Mutual Mortgage Insurance Fund.

Comment 4 >

Single Family will propose and submit a Management Decision to respond to the audit recommendations after the issuance of the final audit report, which will include action plans and target dates for final actions.

[2] Department of Housing and Urban Development, Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund 19 (FY2022).
[3] *Id.*
[4] *Id.*
[5] *See* FHA Mortgagee Letters, https://www.hud.gov/program_offices/administration/hudclips/letters/mortgagee.
[6] *Id.* at 20-21
[7] *Id.*

OIG Evaluation of Auditee Comments

Comment 1 While HUD acknowledged that there are opportunities for improvement in the delivery of the FHA programs, it stated that that the draft report did not fully capture the unprecedented nature and complexity of the circumstances that preceded the COVID-19 temporary endorsement policy. HUD noted how borrowers were facing unexpected and unavoidable financial challenges; the economy was volatile; and lenders were at risk of having to carry loans on their balance sheets for periods of time, which could challenge their liquidity and limit their ability to continue providing affordable financing. We updated the background section to include more information about how borrowers with loans that were eligible at the time of closing may have experienced hardships shortly after closing, resulting in forbearance of loan payments before endorsement. Further, we noted that by implementing the temporary policy and allowing such loans to be endorsed, HUD mitigated the risk of lenders carrying the loans for periods of time, which allowed them to continue to provide financing through FHA-insured programs.

Comment 2 HUD stated that the COVID-19 National Emergency was an unprecedented economic event and that this guidance represented just one aspect of its broader emergency response. To acknowledge this, we added a statement in the highlights section explaining that the temporary policy was one aspect of HUD's broader emergency response to COVID-19, which also included an eviction moratorium and loan forbearance for borrowers experiencing financial hardship. We added similar information to the background section.

Comment 3 HUD stated that pending a comprehensive review of the loan samples used in this audit, a preliminary review of the available data appears to show consistency with FHA's performance in facilitating successful outcomes for borrowers during the COVID-19 national emergency. We agree with HUD's plan to perform a comprehensive review of the loan samples used in this audit and, as part of its response to recommendation 1J, we recommend that it further study the long-term performance of loans endorsed under the policy.

Comment 4 HUD agreed to propose a management decision responding to the report's recommendations, including action plans and target dates for final actions. We look forward to working with HUD during the audit resolution process.

Appendix C – Loans In Recommendation 1A

Case number	Lender did not execute required agreement	Loan was not subject to policy but was ineligible	Lender used policy for ineligible loan	Loan was active[8] and included in recommendation 1A (Y-N)	
023-8797566	x			N	
031-5329895			x		Y
049-1334614	x			N	
049-1490261	x			N	
094-8598750	x				Y
095-5410372			x		Y
106-3205069	x			N	
138-0558765			x		Y
138-0649895	x				Y
138-0661464	x				Y
197-9131550	x				Y
221-6112502			x	N	
221-6188984	x				Y
244-2257620			x		Y
244-2468450	x				Y
249-7089148			x		Y
264-3309534		x			Y
331-1967902	x			N	
361-4639681			x		Y
372-5232035			x		Y
374-8599534	x				Y
422-3896475	x				Y
461-7539419		x		N	
511-2349428			x	N	
512-3838605	x				Y
512-4220106	x				Y
523-0542855			x		Y
544-2470325	x				Y
Total	16	2	10	8	20

[8] "Y" represents a loan that is active as of October 5, 2022.
"N" represents a loan that has been terminated and no longer represents a risk to the insurance fund.

Appendix D – Portions Of Key Guidance

Mortgagee Letter 2020-16 (June 4, 2020)[9]

Subject

Endorsement of Mortgages under Forbearance for Borrowers Affected by the Presidentially Declared COVID-19 National Emergency consistent with the CARES Act

Purpose

The purpose of this Mortgagee Letter (ML) is to inform Mortgagees of endorsement processes for mortgages where a borrower has been granted a forbearance related to the Presidentially-Declared COVID-19 National Emergency prior to the loan being endorsed for FHA insurance.

Effective Date

The provisions of this ML are effective for endorsements submitted on or after June 15, 2020.

Affected Programs

This guidance applies to all FHA Title II Single Family forward mortgage programs, except for non FHA-to-FHA cash out refinances.

HUD Post Closing and Endorsement Requirements

A mortgagee may submit an eligible mortgage involving a borrower experiencing a financial hardship due, directly or indirectly, to COVID-19 who has requested or has been granted a forbearance agreement as a result of COVID-19 for insurance endorsement if:

- the borrower has requested forbearance, or the mortgage is subject to a forbearance agreement for one or more payments due to relief provided to borrowers impacted by COVID-19;
- at the time the forbearance was initiated the mortgage was current;
- at the time of the mortgage closing the mortgage satisfied all requirements for FHA insurance; and
- the mortgagee executes a two-year partial indemnification agreement.

Endorsement Processing

Where a Mortgagee seeks to obtain insurance endorsement of a mortgage involving a borrower experiencing a financial hardship due, directly or indirectly, to COVID-19 in accordance with the requirements in this ML, the Mortgagee must execute a two-year partial indemnification agreement.

FHA Connection (FHAC) is being modified to identify mortgages endorsed under the requirements in this ML. Where a mortgagee seeks to obtain insurance endorsement for a loan granted forbearance in accordance with the requirements in this ML, the mortgagee must indicate that the mortgage is subject

[9] https://www.hud.gov/sites/dfiles/OCHCO/documents/2020-16hsngml.pdf

to forbearance in FHAC by selecting the “forbearance” tab under the drop down for the “Current Payments” field.

Applications for insurance where the mortgage is subject to forbearance as indicated in FHAC will be issued a Severe Case Warning.

Mortgagees With Lender Insurance (LI) authority must submit the executed two-year partial indemnification agreement to the jurisdictional Homeownership Center in accordance with the Severe Case Warnings requirements in Handbook 4000.1. Mortgage without LI authority must submit the executed two-year partial indemnification agreement with the case binder in accordance with the requirements in Handbook 4000.1.

Instructions for Endorsement of Mortgages in Forbearance Due to COVID-19 - Completing the Insurance Application Screen in FHA Connection and Partial Indemnification Agreement[10]

Per Mortgagee Letter 2020-16, FHA Connection (FHAC) has been modified to allow endorsement of mortgages where a borrower has been granted a forbearance related to the Presidentially-Declared COVID-19 National Emergency prior to the loan being endorsed for FHA insurance.

Following is a description of the changes to the FHAC Insurance Application screen, and the steps Mortgagees must follow to complete the endorsement process for mortgages when a mortgagee enters an agreement with the borrower impacted by COVID-19 to reduce or temporarily suspend monthly mortgage payments.

Instructions for Completing the New Current Payments Field on Insurance Application

Current Payments data field

- Select either “Yes” or “No” as applicable from the drop down menu for cases where there is no COVID-19 related Forbearance.

  If “No” is selected, for all Mortgagees, a warning message will continue to be generated stating that the case is not eligible for FHA insurance.

- Select “Forbearance” for cases where the mortgage closed in accordance with FHA requirements and the Borrower is subsequently affected by a financial hardship due directly or indirectly to COVID-19 and the Mortgagee and Borrower have entered into a forbearance agreement.

  A Severe Case Warning message will be generated requiring the execution of a partial Indemnification Agreement as a condition of endorsement and submission of the case binder to the HOC [Homeownership Center] for further processing.

[10] https://www.hud.gov/sites/dfiles/SFH/documents/InstructionsCOVIDEndorseForbearance_6_4_20.pdf

At the time of case binder submission, the case binder must include the Partial Indemnification Agreement executed by the Mortgagee.

Instructions for Completing HUD's COVID-19 Partial Indemnification Agreement

Mortgagees may use the model Partial Indemnification agreement found at www.hud.gov/program_offices/housing/sfh/model_documents, or create their own agreement as long as it includes the language and data in the model document. At a minimum, each Partial Indemnification Agreement must contain the following information when submitted to the HOC:

- FHA Case Number: Enter the full FHA Case Number [999-9999999-999]
- Indemnification Number: Enter the number 9 followed by your 5-digit FHA ID [formatted as "9XXXXX"]
- Indemnification Type: Enter "Partial Indemnification for endorsement during COVID-19 Forbearance"
- Institution Name: Enter the full Legal Name of your Company
- FHA ID: Enter your Institution 5-Digit FHA Identification Number
- Signature Block: An Authorized Representative of the Mortgage must print, sign and date the Agreement where indicated his/her name, sign where indicated.

Lender must execute the partial indemnification and send to the jurisdictional HOC for HUD to review and sign. Lenders may use electronic signatures if needed provided the electronic signature complies with HUD policy.

If a lender creates their own Partial Indemnification agreement, it must also include the FHA Case Number, and an indemnification number that must be formatted as "9XXXXX". (X equals the lender's 5digit FHA ID Number.)

Protocol for Forbearance Endorsement Self-Reports (March 16, 2021)

Issue

FHA announced policy for endorsement of FHA loans under COVID-19 forbearance in Mortgagee Letter 2020-16, which became effective for endorsements submitted on or after 6/15/2020. Lenders have self-reported cases that did not comply with the updated policy.

The self-reports submitted for this issue represent a variety of scenarios, but we assume that all were under forbearance agreements at the time of endorsement, and none were submitted to Homeownership Centers with 2-year partial indemnification agreements or other required documentation.

Protocol

Homeownership Center Quality Assurance Divisions should apply a standard approach to determine the severity and appropriate remedy for each case based on endorsement date and delinquency status at the time of endorsement.

We assume that any self-reported loans submitted for endorsement or endorsed by LI lenders on or after 6/15/2020, were under forbearance agreements, but did not comply with one or more elements of Mortgagee Letter 2020-16. 5-year indemnification should be requested. Lender could have submitted the loans for endorsement with 2-year partial indemnification, but the violation of FHA policy warrants a more severe remedy.

Appendix E – Sampling And Projections

Group B Sample

Sample Selection

Our sampling objective was to determine whether, loans should be subject to an indemnification agreement since one or more of the following exceptions were found and there was not yet an agreement in place: (1) the borrower's request for forbearance and the forbearance agreement effective date both occurred before the lender submitted the loan for endorsement; (2) the borrower requested forbearance before the lender submitted the loan for endorsement; (3) the lender retroactively set the forbearance effective date to on or before the day on which it submitted the loan for endorsement; and (4) the lender submitted loans that were not current as reported and ineligible for insurance. The audit universe consisted of 3,024 FHA loans with more than $789 million in total unpaid balances and $800 million in original mortgage amounts reported in SFDW as of June 16, 2021.

Sample design table				
Stratum label	Amount	Total count in strata	Sample count	Sampling weight
0-10pct	> $0	302	7	43.1
10-30pct	≥134,012	606	15	40.4
30-50pct	≥193,050	604	15	40.3
50-70pct	≥239,916	604	15	40.3
70-90pct	≥295,150	605	15	40.3
90-98pct	≥414,512	243	6	40.5
98-100pct	≥621,154	60	2	30.0
Totals		3,024	75	

We identified a stratified sample of 75 records for auditing among the universe. We designed the strata to group sampling units by the size of their valuation. Therefore, we ranked and ordered the sampling units by the unpaid balance for each loan. The strata breakpoints encompassed the following ranges by percentile: 0-10, 10-30, 30-50, 50-70, 70-90, 90-98, and 98-100. We employed a systematic sort in the final sample design to help control for differences across States. The sample design table includes the strata boundaries and other key data related to this sample design.

We found that a sample size of 75 records consistently yielded accurate results and confidence intervals. The risk of overestimating the audit finding outside the 5 percent confidence level did not occur. However, there is a minimal risk of underestimating the audit finding.

Sample records were randomly selected, with the number of samples in each stratum being proportionally allocated based on the record size of each stratum. We selected the audit sample by means of computer routines written in SAS using the survey-select procedure and a seed of 7. To incorporate the systematic approach employed, we sorted each record within each stratum by the State in which the property is located.

Projection Results

In 14 out of 75 loan records reviewed, the audit team found that the loans should be subject to an indemnification agreement since one or more of the following exceptions were found and there was not yet an agreement in place: (1) the borrower's request for forbearance and the forbearance agreement effective date both occurred before the lender submitted the loan for endorsement; (2) the borrower requested forbearance before the lender submitted the loan for endorsement; (3) the lender retroactively set the forbearance effective date to on or before the day on which it submitted the loan for endorsement; and (4) the lender submitted loans that were not current as reported and ineligible for insurance. Measuring the unpaid balance of each loan found as an exception in the sample, this amounts to a weighted average of $47,736 per loan. 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 $26,105 per loan. In the context of the universe of 3,024 loan records, this amounts to at least $78.9 million in total unpaid balance, and this dollar amount could be higher. Further, since one or more exceptions were noted in 14 of the 75 mortgage records reviewed, this amounts to a weighted average of 18.86 percent of the sample. Deducting for a statistical margin of error, we can say - with a one-sided confidence interval of 95 percent - that at least 11.1 percent of the loans in the sample had an exception. Extending this percentage to the universe of 3,024 loan records, at least 335 loans met this condition, and the count of loans could be higher.

Group C Sample

Sample Selection

Our sampling objective was to determine whether loans in forbearance with a 2-year partial indemnification agreement qualified for HUD endorsement under HUD policy and whether the indemnification agreement between the borrower and lender contained the required language and data. The audit universe consisted of 292 FHA loans with 2-year partial indemnification agreements as of June 16, 2021.

We identified a simple random sample of 56 loans for auditing among the audit universe of 292 loans. We calculated a sample size using the classic formula for estimating proportions under conditions that the distribution is normal. The data were sampled using a computer program written in SAS using the survey select procedure with a random number seed value of 7.

Projection Results

In 10 of 56 loan records reviewed, we found that the loans did not qualify for endorsement under the temporary endorsement policy because they were either not current at the time forbearance was initiated or they were inadequately underwritten by the originating lenders. The 10 loans amounted to a weighted average of 17.86 percent. Deducting for a statistical margin of error, we can say - with a one-sided confidence interval of 95 percent - that at least 10.09 percent of the sample loans had an exception. Extending this percentage to the universe of 292 loan records, at least 29 loans met this condition, and the count of loans could be higher.