

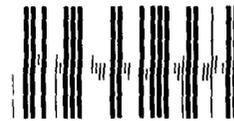
GAO

Briefing Report to the
Honorable Frank R. Lautenberg
United States Senate

June 1986

HOUSING PROGRAMS

Agency Actions to Discourage Single Family Mortgage Insurance Fraud



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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-211508

June 3, 1986

The Honorable Frank R. Lautenberg
United States Senate

Dear Senator Lautenberg:

On April 9, 1986, you asked that we examine the Secretary of Housing and Urban Development's (HUD's) actions to determine if they address the internal control issues and recommendations discussed in our May 13, 1985, report entitled Stronger Internal Controls Over HUD Single Family Mortgage Insurance Programs Would Discourage Fraud (GAO/RCED-85-4). You also asked that we examine the actions the Secretary of HUD announced on April 3, 1986, in response to allegations of abuse of HUD insured mortgage loans. The actions were taken on the basis of recommendations of a Single Family Task Force.

On May 9, 1986, we briefed your office on our analysis of HUD's actions and the Task Force recommendations. As requested by your office, we are providing you with this briefing report.

In summary, we found that HUD has taken a number of significant actions, consistent with our earlier recommendations, that should discourage fraud and abuse in its single family mortgage insurance program. However, we noted several areas where HUD did not fully adopt our earlier recommendations to identify and discourage fraud and abuse. Details concerning HUD's actions and planned improvements and our analysis of them are provided in this report.

In performing our work, we obtained documentation on HUD's actions to determine whether they adequately cover the issues and recommendations in our report. We also discussed the issues with the Chairman of HUD's Single Family Task Force and with the Director of HUD's Office of Insured Single Family Housing. We performed our work between April and June 1986.

B-211508

As agreed with your office, we did not obtain official agency comments; however, we obtained the views of HUD officials and included their comments where appropriate. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Should you need additional information on this briefing report, please call me at 275-6111.

Sincerely yours,



John H. Luke
Associate Director

GAO'S OBSERVATIONS ON HUD'S ACTIONS TO
DISCOURAGE SINGLE FAMILY MORTGAGE INSURANCE FRAUD AND ABUSE

BACKGROUND

In assisting individuals in financing home purchases, HUD operates single family mortgage insurance programs to protect lenders against borrowers who default and subsequently lose their homes through foreclosure. As of September 30, 1985, HUD had insurance-in-force on over 5 million loans totaling about \$135 billion.

News media reports of an alleged fraudulent housing scheme involving several hundred HUD-insured home loans in Camden, New Jersey, raised questions about the program's integrity and its vulnerability to fraud and abuse--a condition that could cost the government and ultimately the taxpayers millions of dollars. The series of news media articles, published in January 1984, alleged that extensive fraud, abuse, and profiteering had plagued HUD's program in Camden. The articles stated that

- borrowers' incomes were overstated by falsifying employment verification documents;
- borrowers' credit reports often were incomplete;
- borrowers' bad debts were not fully disclosed because credit bureau's were given misleading data that resulted in credit reports showing no debts; and
- property defects were not disclosed, which resulted in inflated property values.

On May 13, 1985, we issued a report entitled Stronger Internal Controls Over HUD Single Family Mortgage Insurance Programs Would Discourage Fraud (GAO/RCED 85-4) in response to a joint request from Senators Lautenberg, Riegle, Bradley, and Baucus. In the report, we made several recommendations to HUD to improve its internal controls and to take steps to help discourage fraud, which, as alleged we found had occurred in Camden. HUD promised to take corrective actions regarding implementing a monitoring system and verifying credit reports that show no credit history, but it did not agree with our other recommendations mainly dealing with methods to verify lender data.

On August 5, 1985, however, HUD stated in its response to the Senate Governmental Affairs Committee concerning our report that it established a Task Force to look into the management of HUD's single family programs. HUD said that the Task Force would

consider our report's recommendations and complete its work by April 1986.

The Task Force issued its report on March 28, 1986. It contains recommendations which the Task Force believes, if implemented, should improve HUD's internal controls over its single family mortgage insurance program and discourage fraud and abuse. The thrust of the recommendations are generally in line with ours and should discourage fraud and abuse. Following is information on each of the major internal control issues discussed in our May 13, 1985, report and the recommendations we made; the related Task Force recommendations and HUD actions, if any; and our analysis of the adequacy of the actions taken.

MONITORING EARLY DEFAULTS

GAO recommendation

Develop monitoring procedures to identify homeowners who defaulted on their mortgages within a specified time after loan origination (perhaps all defaults during the first 12 months) so that alleged fraudulent loan practices are identified and evaluated.

Task Force recommendation

The Task Force recommended that HUD require mortgagees to submit written reports on all loans that go into default with three or fewer payments being made and develop and implement an ongoing system to monitor early payment defaults, focusing specifically on loans in which three or fewer payments have been made. According to the Task Force, this system would complement the proposed mortgagee report and ensure that field offices, regions, and headquarters are constantly aware of early default problems. It also stated that this process should include regular quarterly reports to the regions and field offices concerning early defaults and that headquarters should monitor field performance regarding early defaults, and field offices with high rates of early defaults should describe what actions are being taken to address the problem.

HUD actions and GAO analysis

As our earlier report stated, monitoring of mortgages that go into default shortly after loan origination would allow HUD to evaluate how well its insurance commitment system is working while also providing a basis for improving existing controls. We stated that such a monitoring system may have disclosed the alleged fraudulent activities in Camden. In our report, we suggested that one way such a monitoring system could be implemented would be to

require (1) lenders to notify the local HUD office about homeowners who default shortly after loan origination, (2) lenders to report the reasons for default and efforts made to resolve it, and (3) HUD to attempt to contact the delinquent homeowners to verify the reasons for the default.

HUD has subsequently taken several measures, consistent with the Task Force findings, to improve its monitoring system. For example, it has (1) implemented a system to identify mortgagees with high default rates, (2) implemented a system to monitor early defaults by office, mortgagee, and mortgagor, (3) instructed field staff to determine reasons for loans defaulting, and (4) instructed its Monitoring Division to target lenders with high and early default rates for review. These HUD monitoring actions, if properly implemented, should help in identifying fraudulent and abusive practices.

HUD's monitoring system, however, allows a certain level of early defaults per lender before it will take action to determine the reasons for the defaults. In contrast, our suggested system would provide information to HUD on the reasons for each default soon after they occur. Accordingly, fraudulent and abusive practices should be identified more frequently and earlier than under HUD's system. Therefore, we continue to believe that the monitoring system we suggested in our report would provide better and more timely data on early defaults.

In addition, we noted that, subsequent to our report, HUD field staff have been instructed to contact lenders to determine reasons for defaults. However, they have not been instructed to also contact borrowers directly and as soon as possible, as we suggested in our report. As pointed out in the Task Force report, it was not possible to determine the cause of default in 40 percent of its sample cases because the servicing mortgagee was unable to provide this information. This illustrates the need to contact delinquent borrowers to obtain information on the basis for the defaults. In addition, as we pointed out in our prior report, unless the borrower is contacted, HUD may not be able to determine if the reason for default given by the lender was valid. If HUD followed our suggested procedures, it could determine if fraudulent and abusive underwriting occurred and also determine what type of assistance the borrower needs to resolve the current delinquency and possibly take steps to avoid foreclosure.

VERIFYING LENDER DATA

GAO recommendation

Verify, by sampling, data submitted by lenders.

Task Force recommendation

None.

HUD actions and GAO analysis

As discussed in our earlier report, independent verification of data submitted to HUD by lenders is an important part of an effective internal control system. In response to our recommendation in our earlier report, HUD said that it had implemented a similar requirement in the mid-seventies. HUD officials said its field offices indicated that the cost did not justify the limited benefits that were provided by this verification. HUD said that it relied on its Monitoring Division to verify lender data during its reviews. Most lenders, however, were not reviewed annually. Each year, about 800 of the 6,000 lenders are reviewed with emphasis given, at the time of our prior report, to high volume lenders and field office referrals. In responding to HUD's comments, we stated in our prior report that verification of a sample of lender's data before or shortly after loan origination was less costly than other verification procedures HUD was using such as verifying data submitted by property appraisers and credit bureaus and was, in our view, more effective in preventing fraudulent behavior.

Subsequent to our report, HUD has reported that its Monitoring Division has improved its targeting of reviews of mortgagee origination practices. According to HUD's Director of its Monitoring Division, attention is now focused on lenders with high claim/default rates, high incidence of "early defaults," and a high volume of business. During on-site reviews more attention is reportedly placed on programmatic problems, early defaults, investor issues, and processing deficiencies. Other types of cases selected by the Monitoring Division will include loans to investors and loans that were assumed by another mortgagor shortly after the loans were made.

Although we continue to believe that the most effective internal control procedure to reduce lender fraud is to independently verify data submitted as soon as possible, not during later Monitoring Division reviews, we believe that HUD's recent actions should help in controlling fraudulent and abusive practices.

APPRAISALS OF INVESTOR-OWNED PROPERTIES

GAO recommendation

Independently verify appraisals involving investor-owned properties if the investor had recently purchased the property.

Task Force recommendation

None.

HUD actions and GAO analysis

In accordance with our prior recommendation, HUD has taken action to verify appraisals involving investor-owned properties that were previously owned by HUD. It has not, however, taken similar action on investor-owned properties not previously owned by HUD because it believes it cannot identify the seller as being an investor. We believe that this identification can be made in some cases and that in those cases HUD should take action similar to that it is taking on investor-owned property previously owned by HUD.

HUD has modified its procedures to compare all property addresses on new applications to a file showing the addresses of HUD-owned properties and those previously rejected by HUD. If a match occurs and the new appraised value exceeds the HUD sales price by more than 10 percent, a field review is required, to make sure the property is properly valued, before a commitment can be issued.

As we previously reported, investor-owned property that has not been previously owned by HUD is also subject to fraudulent and abusive conditions and may be appraised and sold at a price greater than its actual value. For example, an investor could buy property for a low price, get a fraudulent appraisal, and then sell the property with HUD insurance for a substantial profit.

HUD Task Force and Office of Insured Single Family Housing officials said they agree that investor-owned property could be appraised and sold for an excessive amount, but HUD cannot identify those cases in which an investor is the seller from cases where the occupant is the seller. We believe, however, that the seller can be identified. For example, investors are sometimes known to HUD field office personnel, investors in some cases are identified by appraisers as investors, or the seller may be an investor if he/she files a statement of occupancy of less than 2 years. After discussing this issue with us, a HUD Task Force official agreed that in some cases such sellers can be identified as investors. Therefore, we believe that as a measure of additional control over inflated property appraisals, whenever it is possible to do so, HUD should verify questionable appraisals for previously owned HUD property as well as investor-owned properties that were not previously owned by HUD.

VA PROPERTY APPRAISALS

GAO recommendation

Ensure that Veterans' Administration (VA) property appraisal data are included as part of the file documentation when HUD uses it in making insurance commitments.

Task Force recommendation

Require that copies of VA's Certificate of Reasonable Value, with the appraisers' names, are included in all HUD loan packages.

HUD actions and GAO analysis

In March 1986 VA stopped issuing Certificates of Reasonable Value if there is not a VA buyer. Therefore, neither the Task Force nor the GAO recommendation is applicable.

CREDIT REPORTS

GAO recommendation

Independently verify credit reports that show no credit history.

Task Force recommendation

None.

HUD actions and GAO analysis

One of the key components of insurance commitment monitoring is determining why borrowers--who only a short time previously were determined to have the ability to make their monthly house payments--stopped making the payments. Based on our prior work, we noted that one of the main reasons for borrowers not making the payments was that some borrowers had extensive debt obligations. However, in some cases, credit reports in the HUD insurance commitment file showed no previous credit history for the borrowers because either the borrower, real estate broker, or lender may have provided misleading information to the credit bureaus, such as social security numbers of the borrower's children rather than the borrowers. We reported that such abuses may have been identified had HUD questioned credit reports showing no previous credit history.

HUD responded to our draft report by saying that appropriate instructions would be issued on this matter. As of May 1986, HUD had not issued the instructions. In a May 5, 1986, meeting with the Director of Insured Single Family Housing, he assured us that these instructions would be issued shortly.

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