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**Audit Related Memorandum
98-CH-184-1805**

January 14, 1998

Memorandum For: Shirley Bryant, Director of Housing, Grand Rapids Area Office

From: Dale L. Chouteau, District Inspector General for Audit, Midwest

Subject: Hotline Complaint
Section 203(k) Rehabilitation Home Mortgage Insurance Program
Grand Rapids, Michigan

We completed a limited review of the Section 203(k) Rehabilitation Home Mortgage Insurance Program in the Grand Rapids Area. The review was performed in response to a citizen's complaint to the HUD Hotline. The complainant alleged: (1) lenders in the Grand Rapids area used the same consultant/inspector for most of their Section 203(k) loans; and (2) the consultant/inspector being used did not do proper inspections. The objective of our review was to determine if the complaint was valid and if HUD's rules and regulations were violated.

The 203(k) Program allows a borrower to obtain a single mortgage at a long-term (or adjustable) rate, to finance both the acquisition and the rehabilitation of a property. To provide funds for the rehabilitation, the mortgage amount is based on the projected value of the property when the work is completed, taking into account the cost of the work. A HUD-approved consultant prepares the work write-ups and cost estimates for the rehabilitation of a property to be insured under the 203(k) program. A HUD-approved fee inspector inspects the property to verify that the work was properly completed according to the work write-ups. The lender uses the results of the inspections as the basis to release funds from the rehabilitation escrow account to pay for the work.

To achieve our objectives, we interviewed HUD personnel and officials from the four lenders with the highest volume of loans in the Grand Rapids area. The four lenders were: Norwest Mortgage Company; Mortgage Corporation of America; DMR Mortgage Corporation; and Van Dyk Mortgage Corporation. We reviewed nine properties whose mortgages were funded by these companies. We evaluated the work write-ups and cost estimates, and the quality of the inspections. We also interviewed the owners of all nine properties.

We found that the complaint was valid. The lenders used the same consultant/inspector for most of their Section 203(k) loans. However, this did not violate any HUD rules. The consultant/inspector who was the subject of the complaint, however, did not always prepare adequate work write-ups and cost estimates, and did not always perform proper inspections. The consultant/inspector certified that work was completed when the work either was not done or was unsatisfactory. Additionally, the HUD Grand Rapids Office was aware that the consultant/inspector was not doing proper inspections, but HUD did not take any action against him. Details of our review are contained in the attached finding.

Within 60 days, please provide us, for each recommendation made in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why corrective action is unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (312) 353-7832.

RESULTS OF REVIEW

The consultant/inspector who was the subject of the HUD complaint did not always prepare adequate work write-ups and cost estimates, and perform proper inspections. The lenders in the Grand Rapids area used this same consultant/inspector for most of their Section 203(k) loans. HUD did not take any action against the consultant/inspector although the Chief of Single Family Production was aware that the consultant/inspector had not performed adequately. As a result, HUD may have insured loans for excessive amounts and the low or moderate income person who purchased a property may have paid for rehabilitation work not completed or improperly completed.

HUD's Requirements

Mortgagee Letter 95-40, explains the responsibilities of a consultant. The responsibilities include preparing work write-ups and cost estimates for the rehabilitation of a property.

HUD Handbook 4240.4 REV-2, 203(k) Handbook, Chapter 1, Paragraph 1-9 (D), requires a HUD-approved fee inspector to perform all the inspections during construction and after the rehabilitation work is completed. The consultant is also allowed to act as a fee inspector.

Chapter 5, Paragraph 5-2 (C) states that the lender who controls the Rehabilitation Escrow Account should only release funds to a borrower after the lender has received a properly executed draw request and inspection report. Permits from the local or State building authority are required where necessary and under no circumstances is a draw request to be approved for work that is not yet complete.

Paragraph 5-2 (C)(2) requires that improvements must be satisfactorily completed in compliance with industry standards, local practices and to the satisfaction of the fee inspector.

HUD Handbook 4060.01 REV-1, Mortgagee Approval Handbook, Chapter 6, requires all lenders to have and maintain a Quality Control Plan. The Plan must be a prescribed function of the mortgagee's operations and assure that the mortgagee maintains compliance with HUD-FHA requirements and its own policies and procedures.

We Reviewed Nine Properties

We randomly selected nine recently rehabilitated properties that had Section 203(k) loans originated by the four lenders with the biggest volume in the Grand Rapids area, and for which the consultant/inspector who was the subject of the complaint did

the rehabilitation work write-ups, cost estimates, and inspections. We obtained the services of a HUD inspector to reinspect the properties and evaluate the quality of the original inspections.

Three of the nine loans were originated by Van Dyk Mortgage Corporation, three by Mortgage Corporation of America, two by DMR Mortgage Corporation, and one by Norwest Mortgage Company.

The Lenders Used The
Same Consultant/Inspector
For Most Loans

The four lenders used the same consultant/inspector for the majority of their loans in the Grand Rapids area. Officials from the lenders said they developed a working relationship with the consultant/inspector and referred most homebuyers to him.

Van Dyk used the consultant/inspector for 22 of 22 loans they processed in 1997, Mortgage Corporation of America used him for 19 of 21 loans, and Norwest used him for 21 of 31 loans. DMR Mortgage Corporation was unable to provide the exact number of loans they used him for, but said it was the majority of approximately 100 loans they originated in 1997.

Seven of the property owners we interviewed, said the lenders referred them to the consultant/inspector, and two said someone from HUD recommended the consultant/inspector. The Vice President of Van Dyk Mortgage said the consultant/inspector did an acceptable job, and his costs were less than other inspectors.

We found that the consultant/inspector charged about \$300 to do the work write-ups. We called another consultant who was on HUD's approved list and he said he charged between \$400 and \$700 depending on the amount of work required.

HUD regulations do not dictate which consultant/inspector(s) a lender/homebuyer uses. The regulations also do not specifically require reinspection of a sample of a consultant/inspector's work to assure its quality. However, the regulations require a mortgage company to maintain a quality control plan that assures a mortgagee maintains compliance with HUD-FHA requirements. Proper and accurate work write-ups and inspections are a HUD-FHA requirement.

Work Write Ups And Inspections Were Not Adequate

The consultant/inspector did not prepare adequate work write-ups for four of the nine properties. Specifically, all health and safety and city code violation items requiring correction were not included. Additionally, for three of the nine properties, the cost estimates were excessive. The three properties were owned by two non profits. The Presidents of the non profits said that because of the methods they used to accomplish and pay for the repairs required by the work estimates, they could not provide records that showed the actual cost of completed work.

The consultant/inspector also did not always perform proper inspections of the repairs made under the 203(k) program before he certified the repairs were completed and funds could be released from the rehabilitation escrow account. For five of the properties, the consultant/inspector certified that all repairs were completed. He approved draw requests of funds from the escrow account when the work was either not completed or was unsatisfactorily completed. For example:

Inadequate Work Write Up

For the dwelling at 1307 Wealthy, the write-ups did not include: a hand rail at the front steps; the replacement of the old unsafe roof on the second story deck; the replacement of an unsecured and unsafe guard rail on the roof deck; replacement of substandard electrical wiring in the basement; and the repair of a porch ceiling. The work write-ups only required the patching of the roof on the second story deck which was not safe to walk on. The porch ceiling had rotted and was sagging in one place.

Excessive Cost Estimates

For the dwelling at 1050 Dickenson, the HUD inspector determined that the cost estimates were excessive for the following items:

Item	Consultant/Inspector's Estimate	HUD Inspector's Estimate
House Roof	\$5,425	\$3,500
Garage Roof	1,920	1,400
Kitchen Cabinets	800	300
Kitchen Floor	680	400
Paint Windows	450	175

Inadequate Inspections

For the dwelling at 1307 Wealthy, the inspector certified the exterior entry door and storm doors were replaced; the exterior windows, trim, and garage were painted; a large hole in the stairwell ceiling was patched; and the heat run in the foyer was boxed. None of this work was done.

The following chart shows the results of the consultant/inspector's work for the nine properties we reviewed:

Lender	Address	Inadequate Write Up	Excessive Estimate	Inadequate Inspection
Mortgage Corporation	10785 Lovers Ln	X		X
Mortgage Corporation	3908 Milan SW			
Mortgage Corporation	2056 College			
Van Dyk	544 Westway NW			
Van Dyk	1135 Benjamin	X		X
Van Dyk	1050 Dickenson	X	X	X
DMR	908 Nagold NW		X	X
DMR	131 Rose SW		X	
Norwest	1307 Wealthy SE	X		X

The lenders depended on the consultant/inspector to provide adequate work write-ups, accurate cost estimates and assure that the work was properly completed. However, the lenders did not ensure the consultant/inspector did adequate work. One of the lenders did not have a quality control plan. The other three had quality control plans, but the plans were not effective. Additionally, HUD did not review the adequacy of the consultant/inspector's work and did not take appropriate action when it was noted the consultant/inspector's work was not adequate.

Quality Review Plans Did Not Exist Or Were Not Adequately Implemented

The Chief Underwriter at DMR Mortgage Corporation said that DMR did not have a quality control plan for Section 203(k) loans and did not do quality control reviews of these loans.

Mortgage Corporation of America had a quality control plan but did not perform any quality control reviews. Its plan did not require reinspection of any rehabilitated properties.

Norwest Mortgage Company's quality control plan required reinspections, but it only did file reviews as part of its quality control reviews.

Although, Van Dyk Mortgage Corporation's quality plan did not call for reinspections, they did reinspections on 9 properties between December 1995 and January 1997 to verify that the original inspections were adequate and the work was properly completed. Van Dyk found that for 7 of the 9 properties the inspections were not adequate because all the work was not completed as certified on the HUD fee inspector's inspection reports. Van Dyk assured the problems noted during the reinspections were corrected; however, they did not take corrective action against the consultant/inspector, and continued to use him.

Van Dyk's Underwriting Manager said he had conversations with the Chief of Single Family in the HUD Grand Rapids Office and told him the consultant/inspector was not doing thorough inspections. He said he and the Chief agreed that all the items on the work write-ups did not need to be corrected as long as the health and safety items were corrected. It is important for all items in the work write-ups to be satisfactorily completed, since the mortgage amount is based on the projected value of the property with these items corrected.

HUD Did Not Take Any
Action Against The
Inspector

The Chief of Single Family Production and Real Estate Owned Branch in the Grand Rapids HUD Office told us that his Office did not monitor the 203 (k) program because of a lack of staff. However, we found that the HUD Office was aware that this consultant/inspector's work was inadequate and should have taken action against him.

In September 1996, in response to concerns about the properties being rehabilitated nationwide by Faith Housing Inc., a HUD inspector inspected three properties in the Grand Rapids area that were owned and rehabilitated by Faith Housing. For each of the three properties, the consultant/inspector who is the subject of the Hotline complaint did the inspections. The HUD inspector found that the repairs that had been certified as complete were either not

completed or unsatisfactorily completed for all of the properties. For example for the dwelling at 2017 Melita:

- Damaged siding was supposed to have been replaced but was not.
- The crawl space to the rear addition was supposed to have been ventilated but no ventilation was installed.
- No interior doors were replaced as required by the work write-up.
- The entire house was to have been scraped, primed and repainted. The HUD inspector found the property was only spray painted with no scraping or priming, and work was of poor quality.

We asked the Chief of Single Family Production and Real Estate Owned Branch about what actions HUD took as a result of the Faith Housing reinspections. He said Faith Housing was suspended as a non-profit organization; however, he could not remember if any action was taken against the consultant/inspector. We could not find any evidence of any action. We believe, at a minimum to protect HUD's interests both Faith Housing and the consultant/inspector should have been suspended or debarred from further participation in HUD's programs.

Recommendations

We recommend that the Director of Housing, Grand Rapids Area Office:

- 1A. Issue a Limited Denial of Participation against the consultant/inspector and initiate debarment proceedings.
- 1B. Require all mortgage companies doing business under Section 203(k) to reinspect each property for which they used the services of the subject consultant/inspector and ensure all items that were not completed or were not properly completed are repaired.
- 1C. Require DMR Mortgage Corporation, Mortgage Corporation of America, Norwest Mortgage Company, and Van Dyk Mortgage to demonstrate that they have

implemented an effective quality control plan within six months. For the entities that can not show they have an effective plan, take action to prevent them from participating in HUD's programs.

- 1D. Take action deemed appropriate against any HUD employee who did not adequately fulfill his/her responsibility to protect HUD's interests.

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