
AUDIT REPORT



**FOLLOW UP OF
DOWN PAYMENT ASSISTANCE PROGRAMS
OPERATED BY
PRIVATE NONPROFIT ENTITIES**

2002-SE-0001

SEPTEMBER 25, 2002

OFFICE OF AUDIT, REGION 10
SEATTLE, WASHINGTON



Issue Date September 25, 2002

Audit Case Number 2002-SE-0001

TO: Sean G. Cassidy, General Deputy Assistant Secretary for Housing, H

//Signed//

FROM: Frank E. Baca, Regional Inspector General for Audit, OAGA

SUBJECT: Final report of follow up audit of down payment assistance programs operated by private nonprofit entities

At your request, we performed an audit of Federal Housing Administration (FHA) loans in which down payment assistance was provided by private nonprofit entities. The audit resulted in two findings, discussed in this report.

Should you or your staff have any questions, please call me at (206) 220-5360.



Executive Summary

In a March 2000 audit report, we recommended that HUD implement a proposed rule to prohibit home sellers and builders from contributing to certain down payment assistance programs (DAPs), which are associated with any of their home sales transactions. These DAPs are operated by private nonprofit organizations. The General Deputy Assistant Secretary for Housing asked us for support in addressing potential opposing arguments to the proposed rule. We began with an analysis of FHA loan data from HUD's Single Family Data Warehouse (SFDW) and found that the SFDW data did not accurately identify if a down payment came from a DAP. As a result, we turned to a statistical sampling approach for this review.

DAP Participation is Widespread

We reviewed a statistical sample of 1,125 FHA case files to estimate the percentage of DAP-assisted loans that are currently in the Federal Housing Administration (FHA) loan inventory. Statistical analysis of the sample review results indicates that, with a confidence level of 90 percent, DAP-assisted loans account for between 2.9 percent and 4.8 percent of all FHA loans with beginning amortization dates from October 1, 1997 to March 31, 2001. The review results also indicate that, between October 1997 and March 2001, there has been a steady increase of FHA borrowers receiving down payment assistance from DAPs.

Loans with Down Payment Assistance have a Greater Risk of Default

We did not have a sufficient number of default occurrences in our sample to accurately project the default rate of the DAP-assisted loans. However the review found that the DAP-assisted loans had a greater tendency to default than the sampled loans not receiving down payment assistance from DAPs.

Additional evidence that the DAP-assisted loans tend to have higher incidences of default came from a re-evaluation of the default rate for 2,261 Nehemiah-assisted loans located in four cities. In the original DAP audit report, we stated that these loans had a 4.64 percent default rate. The defaults on these 2,261 loans have risen dramatically and, as of February 15, 2001, the default rate increased to 19.39 percent compared to a 9.7 percent default rate for FHA loans without Nehemiah assistance in the same four cities.

Lenders Do Not Always Submit Accurate Down Payment Assistance Information

HUD has taken steps toward developing a system to identify DAP-assisted loans, including requiring mortgagees to provide Taxpayer Identification Numbers of nonprofit organizations that give down payment assistance. HUD has also updated the Single Family Data Warehouse (SFDW) to include the nonprofit information from the Computerized Homes Underwriting Management System (CHUMS) and uses this information to develop ad hoc management reports to monitor and analyze the performance of loans for which gift funds are provided by nonprofit agencies.

Nonetheless, mortgagees do not always enter the correct down payment information into HUD's loan processing system, making it impossible for HUD to readily identify all loans with DAP assistance from the SFDW data. Stronger controls are needed to ensure that the originating mortgagees enter the required information so that HUD can accurately evaluate the performance of DAP-assisted loans and the associated risk to the FHA fund.

We are recommending that HUD implement (1) its proposed rule to prohibit nonprofit DAP assistance if the down payment funds come directly or indirectly from home sellers and builders, and (2) additional controls to ensure that mortgagees enter the correct source of down payment assistance into HUD's loan processing system.

Audit Results Discussed with the FHA Commissioner

We issued a discussion draft report on May 20, 2002, and discussed the audit results with the FHA Commissioner and other HUD officials at an exit conference on June 26, 2002. HUD officials were appreciative of the statistical sampling work we had performed, but unsure of what course of action should be taken since the sample could not be used to project default rates for DAP-assisted loans. HUD officials generally agreed with the finding and recommendations regarding controls over the Single Family Data Warehouse. The Office of Housing provided written comments to the draft report on September 9, 2002, generally agreeing with our findings. A copy of the Office of Housing's full response is included as Appendix A.

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Abbreviations

CHUMS	Computerized Homes Underwriting Management System
DAP	Down Payment Assistance Programs operated by private, nonprofit organizations
FHA	Federal Housing Administration
HART	Housing Action Resource Trust
HUD	Housing and Urban Development
ML	Mortgagee Letter
MCAW	Mortgage Credit Analysis Worksheet
OIG	Office of Inspector General
SFDW	Single Family Data Warehouse
TIN	Tax Identification Number

Introduction

In September 1999, HUD proposed a rule that would prohibit nonprofits from providing assistance to buyers where any of the assistance comes directly or indirectly from sellers and builders. At that time the OIG was performing a nationwide audit of down payment assistance programs. In March 2000, we issued a report (2000-SE-121-0001) that strongly supported HUD's proposed rule. The report disclosed that down payment assistance programs offered by private nonprofit organizations (DAPs) did not meet the intent of Federal Housing Administration (FHA) requirements for home purchaser down payments because the assistance is not a true gift and the seller or builder reimburses the nonprofit organization for the assistance. The report further noted that, for the period of August 1997 through May 1999, the default rate for the DAP-assisted loans was more than double that of other FHA loans. According to the report, this occurred because HUD did not have an established process to evaluate or approve new programs affecting the FHA insurance fund.

The March 2000 audit report recommended that HUD: (1) ensure that future down payment assistance programs are properly evaluated and approved; (2) implement a system that will identify FHA insured loans and providers under these programs, and a process to evaluate loan performance and risk; and (3) implement its proposed rule with minor changes. Instead, based on a legal opinion from its Office of General Counsel, HUD allowed the programs to operate. HUD officials said they never envisioned having to approve a specific down payment assistance program provided by a private nonprofit. To date, the proposed rule has not been implemented.

HUD responded that its staff uses the Single Family Data Warehouse (SFDW) to monitor and analyze the performance of loans for which nonprofit organizations provide down payment assistance. The SFDW receives loan information from the Computerized Homes Underwriting Management System (CHUMS) on a monthly basis. During the underwriting process, lenders use HUD's FHA Connection website to input borrower and loan information into CHUMS, including the amount and source of down payment gifts. Therefore, the accuracy of the identification and analysis of the DAP-assisted loans is dependent upon the accuracy of the information provided by the lenders. In March 2000, HUD issued Mortgagee Letter 00-08, instructing mortgagees to enter the Federal Tax Identification Number of nonprofit organizations that provide down payment assistance to a borrower.

In a March 2001 memorandum to the HUD Inspector General, the Deputy Federal Housing Commissioner requested that the Inspector General re-examine the higher default and claim rates of seller-derived down payment assistance program mortgages. HUD was again considering implementation of the proposed rule restricting seller-derived down payment assistance from DAPs and needed this information to support its proposed rule.

We began by reviewing the data in the SFDW and found that mortgage lenders are not always entering down payment assistance loan information into the CHUMS system when processing new loans. Thus the SFDW data cannot be relied upon as a source of information as to how many FHA borrowers received assistance from a DAP.

Since we could not use the SFDW to accurately identify DAP loans, an alternative plan for meeting HUD's request was needed. At a meeting in August 2001 with the HUD Assistant Secretary for Housing - Federal Housing Commissioner, the OIG proposed using a statistical sampling methodology to review FHA case files to determine the number of single family FHA financed homes that were purchased with down payment assistance from nonprofit corporations. The Assistant Secretary was familiar with statistical analysis and agreed with our methodology pending a review of the sampling plan by HUD's Office of Policy Development and Research. The sampling plan was reviewed and accepted with only a minor modification.

Audit Objectives

The purpose of our review was to determine the percentage of FHA borrowers receiving down payment assistance from nonprofit corporations. We also wanted to find out if the DAP-assisted loans are more likely to default than loans without DAP assistance.

Audit Scope and Methodology

To achieve our objectives, we:

- Conducted discussions with HUD Single Family Development staff;
- Prepared a statistical sampling plan documenting the sampling objectives, features to be tested, description of the sampling unit and universe, sample size calculation, sample selection process, and sample evaluation method;
- Randomly selected a sample of 1,125 FHA loans from all FHA loans used for home purchases with beginning amortization dates from October 1, 1997 to March 31, 2001;
- Obtained the FHA case files for each loan in the sample and reviewed the file documents to determine the source and amount of down payment toward the home purchase;
- Categorized the sampled loans by down payment source and projected the rates of occurrence of DAP-assisted loans to the universe from which the sample was drawn;
- Obtained and reviewed default information on the sampled loans from the SFDW; and
- Obtained recent default and claims information from the SFDW on the 2,264 Nehemiah-assisted loans discussed in the March 31, 2000 audit report and calculated the default and claims rate of these loans as of February 2002.

This review encompassed all FHA single family loans used for home and condominium purchases with beginning amortization dates from October 1, 1997 to March 31, 2001 and did not include any FHA-insured loans used for refinancing. This amounted to 2,840,549 insured loans with a total value of approximately \$280 billion. We used the EZ-Quant statistical sampling software package developed by the Defense Contract Audit Agency for this review. EZ-Quant performs statistical sampling calculations for attribute sampling and can use the results from the review of a sample to project rates of occurrence of specific attributes to the universe from which the sample was drawn. Using EZ-Quant, we were able to review a reasonably small number of FHA case files and project the percentage of FHA loans having DAP assistance with a high degree of accuracy to our entire universe of 2,840,549 loans. With the EZ-Quant software, we calculated that a sample of 1,125 loans needed to be reviewed. We calculated the sample for a 90 percent confidence level and based it on our preliminary test results, which estimated that 4 percent of the FHA loans in our universe were DAP-assisted loans. We set the maximum precision range at 2 percent for the sample size calculation.

The sample was selected at random without bias. We downloaded information from the SFDW for the 2,840,549 loans in our universe and listed the loans in the same order as they appear in the SFDW. We then assigned a sequential number to each loan as it appeared in the data beginning with 1 and ending with 2,840,549. Using the random number generator feature in the EZ-Quant software package, we generated 1,300 random numbers between a range of 1 and 2,840,549. We used the numbers selected to draw our sample of FHA loans. We used 1,300 numbers to provide replacements in the event that HUD could not locate any of the first 1,125 files in the sample. We obtained and reviewed the FHA case files for the loans selected in our random sample.

Audit work was performed in our Seattle, Washington office at various times from July 2001 to March 2002 and covered FHA single family loans with beginning amortization dates from October 1, 1997 to March 31, 2001 used for house and condominium purchases. The audit was conducted in accordance with generally accepted government auditing standards.



Use of Seller-Derived Nonprofit Down Payment Assistance is Widespread

The use of nonprofit down payment assistance programs (DAPs) has increased and is now widespread. Our review of a statistical sample of 1,125 FHA case files found that 3.73 percent of the loans received seller-derived down payment assistance. Based on these results, we are 90 percent confident that seller-derived DAP funds were used for between 2.9 percent and 4.8 percent of the 2,840,549 single family FHA loans (a total initial mortgage value of approximately \$280 billion) that have beginning amortization dates from October 1, 1997 through March 31, 2001. In addition, an analysis of the sampled loan files shows that the percentage of DAP-assisted loans has increased over time and constitutes a much higher percentage of the newer loans in the sample. The increase in DAP-assisted home purchases is due to HUD's decision to not implement a proposed rule that would restrict the use of seller-derived down payment assistance from DAPs. Allowing these programs to continue represents an increased risk to the FHA insurance fund as DAP-assisted loans have a greater tendency to default than loans in which the borrower did not receive seller-derived DAP funds.

Seller-Derived DAP Assistance was Used for Between 2.9 Percent and 4.8 Percent of Single Family Homes Purchased with FHA Loans

We obtained the FHA case files for the 1,125 FHA loans randomly selected for our sample. We reviewed the following documents from each case file:

- Uniform Residential Loan Application
- HUD-1 Settlement Statement
- Mortgage Credit Analysis Worksheet
- Insurance Application results printout
- Gift letters and copies of gift checks
- Bank statements
- Sales contracts
- Other miscellaneous documents

From these documents we were able to determine if the mortgagor received down payment assistance as well as the amount and source of the assistance.

Of the 1,125 case files reviewed, 42 (3.73 percent) had documentation showing that the borrowers received seller-derived down payment assistance from nonprofit DAPs. Based upon this result, we are 90 percent confident that seller-derived DAP assistance was used for between 2.9 percent (82,376) and 4.8 percent (136,346) of the 2,840,549 FHA insured single family loans used for home

Finding 1

purchases with beginning amortization dates from October 1, 1997 to March 31, 2001.

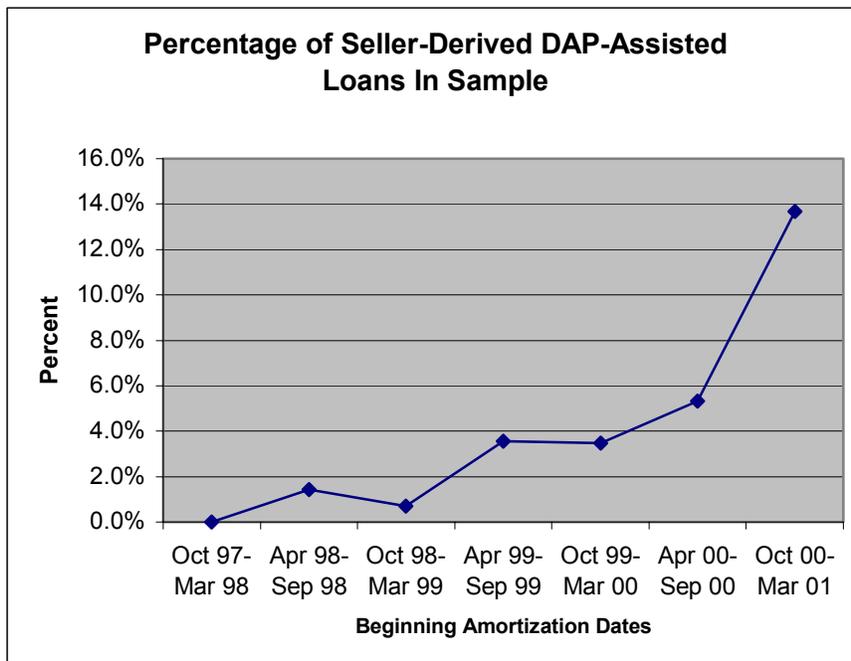
The seller-derived DAP assistance for the 42 loans in our sample came from the following nonprofit organizations:

DAP Name	Number of Loans in Sample
Nehemiah Progressive Housing Development Corporation	26
The Ameridream Charity Inc.	7
Housing Action Resource Trust (HART)	4
Homebuyers Assistance Foundation	2
Family Home Providers Inc.	2
Responsible Home Ownership Inc.	1

In all of the above cases, the home sellers contributed an amount to the nonprofit organization giving the down payment assistance to the buyer. The amount contributed was based upon the sales price of the home and was as high as 6 percent of the sales price. In each case, most of the amount contributed by the seller reimbursed the nonprofit for making the buyer's down payment. A portion of each contribution was retained by the nonprofit as a fee.

The Percentage of Loans with DAP Assistance has Increased Over Time

Our review of the 1,125 loans in our sample suggests that the use of seller-derived DAP assistance is growing at an increasing rate. The following graph shows the percentage of seller-derived DAP-assisted loans in our sample as a percentage of all 1,125 loans in the sample over the period from October 1, 1997 to March 31, 2001:



The above graph illustrates how the percentage of the DAP-assisted loans in our randomly selected sample has increased over time and constitutes a much higher percentage of the newer loans in our sample.

In March 2002, we reviewed loan default information in HUD’s Single Family Data Warehouse (SFDW) for the 1,125 loans in our sample. The small number of defaults in the sample prevents us from accurately projecting the overall default rates to the entire universe of 2,840,549 loans for the period reviewed. However, the following table shows that the DAP-assisted loans have a relatively high occurrence of default compared to the non-assisted loans:

	Number of Loans	Loans With Defaults
Entire Sample	1,125	117
Non-DAP Loans	1,083	110
DAP-Assisted Loans ¹	42	7

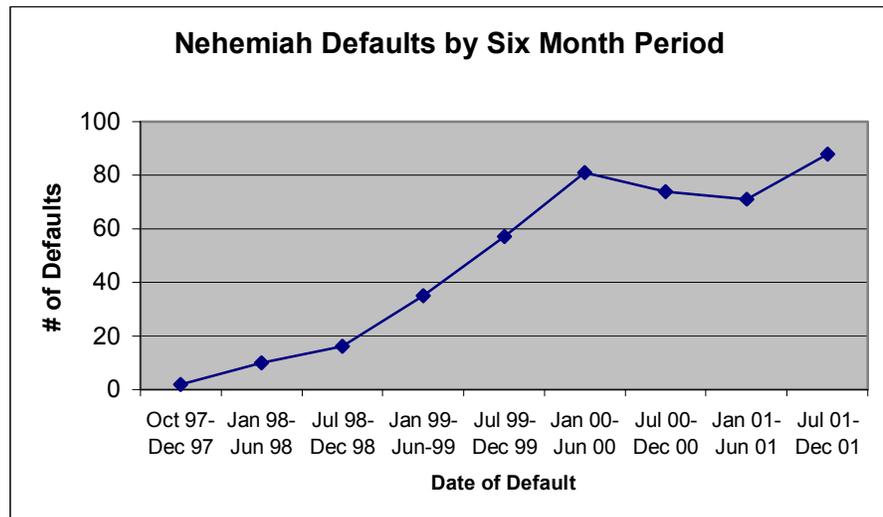
¹ In March 2002, we used SFDW default and claims information downloaded in February 2002. SFDW information downloaded in August 2002 for loans with down payment assistance in our sample of 1,125 loans shows that the number of defaults on these loans increased from 7 to 9 and the number of these loans in claims status increased from 2 to 4.

Finding 1

The Default Rate for Nehemiah-Assisted Loans has Quadrupled from October 1999 to February 2002

An indication that DAP-assisted loans represent an increased risk to the FHA insurance fund comes from an updated review of the performance of the 2,261² loans, discussed in our March 31, 2000 report, for which the Nehemiah Progressive Housing Development Corporation provided down payment assistance. The 2,261 loans were for home purchases in four selected cities with a high concentration of Nehemiah down payment assistance, and had origination dates between August 1997 and May 1999. We reported that by October 25, 1999, there were incidents of defaults on 105 of these loans for a default rate of 4.6 percent.

Over time, defaults on the 2,261 loans have quadrupled. According to HUD's Single Family Data Warehouse, as of February 15, 2002, 439 of the 2,261 loans have had at least one reported incident of default for a default rate of 19.42 percent. *This is double the default rate of 9.7 percent for all non-Nehemiah-assisted loans originated during the same time period in the same four cities.* The following graph illustrates the dramatic increase in Nehemiah-assisted loan defaults:



² In our March 31, 2000 audit report, we discussed the default rate of 2,264 Nehemiah-assisted loans. When we re-analyzed the default rate for these loans for this report, we found that 3 of the 2,264 loans appeared twice in the original data, thus there were actually 2,261 loans reviewed. None of the 3 duplicated loans were among the 105 defaults reported in our March 31, 2000 report.

HUD is also experiencing an extremely high claims rate for these Nehemiah-assisted loans. According to the SFDW, HUD processed insurance claims for 177 of the 2,261 Nehemiah-assisted loans discussed in our original report for a claims rate of 7.8 percent. As of February 19, 2002, HUD has paid over \$9,700,000 for 99 of these 177 insurance claims. In contrast, HUD processed claims for 3.2 percent for all non-Nehemiah-assisted loans originated during the same time period in the same four cities.

The statistical analysis clearly shows that seller-derived down payments provided by nonprofit down payment assistance programs have increased and are now used for a significant portion of FHA single family loans. Default information on loans in the audit sample and the high claims rate for the Nehemiah loans from the March 2000 audit report strongly suggest that loans with seller-derived down payment assistance are poor performers in comparison to loans without this type of assistance. The results of additional audit work described in this report support our original March 31, 2000 findings. Allowing the continuation of seller-derived down payments puts the FHA insurance fund at a greater risk and may result in higher mortgage insurance premiums to the detriment of homebuyers not receiving this type of assistance.

Auditee Comments and OIG Evaluation

The Office of Housing generally agreed with our recommendation and said that our work was beneficial in providing information on down payment assistance programs. The Office of Housing stated that, as noted in our report, the loan sample does not contain enough defaults to accurately project the default rate on loans with down payment assistance. Therefore, the FHA is contracting for a more extensive analysis using the framework developed by OIG and is confident that it will act on our findings no later than December 2003.

We agree with the Office of Housing's decision to perform an extensive analysis of the default rate of down payment assistance loans.

Finding 1



Recommendation

We recommend you:

- 1A. Consider implementing an amended proposed rule that: (1) prohibits nonprofits from providing assistance to buyers where any of the assistance comes directly or indirectly from sellers and builders, and (2) prohibits sellers and builders from contributing to nonprofit organizations who operate down payment assistance programs if the sellers/builders conduct sales transactions with or in association with those same nonprofit organizations including any affiliates of the nonprofit or the seller/builder.

Status of Recommendation

Based on the proposed actions outlined in the Office of Housing's response to the draft report, management is taking sufficient action to satisfy the recommendation and no additional response to this finding is necessary.

Information in the Single Family Data Warehouse Regarding the Source of Down Payment Assistance is Inaccurate

A review of 1,125 randomly selected FHA case files found that seller-derived DAP assistance was used for 42 of the 1,125 loans (see Finding 1). However, mortgagee-derived data from the Single Family Data Warehouse (SFDW) showed only 16 of these 42 loans as receiving down payment assistance from nonprofit organizations. HUD has already taken steps toward developing a system to identify DAP-assisted loans including requiring mortgagees to provide Taxpayer Identification Numbers of nonprofit organizations that give down payment assistance. Nonetheless, mortgagees do not always enter the correct down payment information into HUD's loan processing system, making it impossible for HUD to readily identify all loans with DAP assistance from the SFDW data. Stronger controls are needed to ensure that the originating mortgagees enter the required information so that HUD can accurately evaluate the performance of DAP-assisted loans and the associated risk to the FHA fund.

HUD Requires Mortgagees to Provide Information on Nonprofit Organizations that Give Down Payment Assistance

In an April 21, 1997 Mortgagee Letter (ML 97-14) the Federal Housing Commissioner required all Direct Endorsement lenders to use HUD's FHA Connection website to process all FHA-insured loans by October 20, 1997.

On March 3, 2000 the Federal Housing Commissioner issued a Mortgagee Letter (ML 00-8) to all approved FHA mortgagees. ML 00-8 requires lenders to obtain the Federal Tax Identification Number (TIN) of the nonprofit agency when the nonprofit agency provides down payment assistance in the form of a gift. ML 00-8 further states: "...If the nonprofit agency is providing down payment assistance in the form of a gift, lenders are to enter into the CHUMS system the Federal Tax identification number of the nonprofit agency in the field designated for a charitable organization's tax identification number. Failure to do this will result in the loan not being insured by FHA."

In our March 31, 2000 report, we recommended that HUD develop and implement a system to identify FHA insured loans with down payment assistance and the down payment assistance providers. By September 2000, HUD modified the FHA Connection to collect the nonprofit agency TIN. When a lender identifies that the source of the down payment gift is a nonprofit and the nonprofit TIN is not

entered, the FHA Connection will display an error message and the loan will not be endorsed for FHA insurance. When the lender completes the on-screen application, the TIN and other loan data goes directly from the FHA Connection into the Computerized Homes Underwriting Management System (CHUMS) and the lender is notified that the application was successfully completed.

We also recommended that HUD develop and implement a process to monitor performance of loans involving down payment assistance and assess loan performance and risk to the FHA insurance fund. In response, HUD updated the Single Family Data Warehouse (SFDW) to include the nonprofit information from the CHUMS. According to an August 20, 2001 memo from the Deputy Assistant for Single Family Housing, Single Family staff use this information to develop ad hoc management reports to monitor and analyze the performance of loans for which gift funds are provided by nonprofit agencies.

Incorporating these measures gives HUD the tools to monitor and evaluate the effects of nonprofit down payment assistance on the FHA fund. However, as discussed below, additional controls are needed to ensure the accuracy of the information being analyzed.

Lenders Can Process a Loan in the FHA Connection Without Entering Down Payment Gift Information

Lenders use the FHA Connection website to obtain FHA case numbers from CHUMS. While logged onto the FHA Connection, lenders enter the loan application data into the Insurance Application screen. The Insurance Application screen contains a section where lenders enter Mortgage Credit Analysis Worksheet (MCAW) data including the amount and source of down payment gifts. When the lender enters a gift amount, the system requires the entry of a gift source code corresponding to the applicable category of gift source. However, if a gift amount is not entered, the system defaults to a source code “0 – Not Applicable” and no other input as to the source of the down payment funds is required to process the loan.

Gift Source Codes in the SFDW are not Always Accurate

A comparison of the documentation in the 1,125 FHA case files in our randomly selected statistical sample with the data in the SFDW for these loans found that the SFDW does not always show the correct source of the down payment. The following table illustrates this discrepancy:

DOWN PAYMENT GIFT SOURCE CODE/CATEGORY	LOANS PER SFDW	%	LOANS PER FILE REVIEW	%
0 - No Gift	825	73.3%	638	56.7%
1 - Relative	227	20.2%	340	30.2%
2 - Nonprofit Religious/Community	18 ³	1.6%	43	3.8%
3 - Federal Program	8	0.7%	0	0.0%
4 - State Program	10	0.9%	13	1.2%
5 - Local Government	2	0.2%	19	1.7%
6 - Employer	0	0.0%	1	0.1%
7 - Own Funds ⁴	1	0.1%	0	0.0%
8 - Unsecured Loan	0	0.0%	2	0.2%
9 - Seller Contribution	15	1.3%	0	0.0%
10 - Other	18	1.6%	13	1.2%
11 - Premium fund	0	0.0%	0	0.0%
12 - Secondary Financing	1	0.1%	50	4.4%
Unable to Determine	NA	NA	6	0.5%
TOTALS	1,125	100.0%	1,125	100.0%

Per the file review, 42 of the 43 nonprofit loans in the above table were assisted by seller-derived DAPs; 1 loan was for a home purchased from a nonprofit organization, which also supplied the down payment assistance. Only 16 of these 42 loans were properly identified in the SFDW data (footnote 3); thus 26 were not identified by the SDFW as having received DAP-assistance.

Based upon documentation in our sample files, we determined that the SFDW information was inaccurate because originating lenders do not always input the correct information into the FHA Connection when processing new loans.

³ Our file review found that only 16 of the 18 loans identified in the SFDW as receiving nonprofit gifts actually received down payment assistance from nonprofit organizations. The remaining 2 consisted of a loan with assistance from a local government and a loan with secondary financing as the source of down payment.

⁴ This code is rarely used in the SFDW. The loan in our sample with a "7" Code in the SFDW actually used secondary financing as the source of down payment.

Inaccurate Identification of Source of Down Payment Assistance by Lenders Results in Imprecise Analysis of DAP-Assisted Loan Performance

As stated above, the case file review found that 26 of the 42 loans from our sample with seller-derived down payment assistance were not identified as receiving this type of assistance in the SFDW data. The case files for 17 of these 26 loans contained printouts of the FHA Connection Insurance Application Results screen. The following table shows the incorrect information on the source of the down payment assistance for these 17 loans that was input by the lenders:

CASE NUMBER	GIFT SOURCE INPUT BY LENDER
048-1544405	1 - Relative
091-3346828	0 - No Gift
098-0070822	0 - No Gift
101-8634394	3 - Federal Program
101-8753791	1 - Relative
101-9169909	10 - Other
101-9514649	3 - Federal Program
101-9623034	3 - Federal Program
121-1842354	3 - Federal Program
137-0896354	10 - Other
197-0905970	4 - State Program
241-5923339	0 - No Gift
249-3761627	0 - No Gift
271-8331658	4 - State Program
412-4401051	0 - No Gift
451-0648929	10 - Other
548-3600608	4 - State Program

When lenders input the incorrect information on down payment assistance, the incorrect information finds its way from the CHUMS into the SFDW data, making any conclusions drawn from an analysis of this data inaccurate and questionable. Further, inaccurate lender input into the FHA Connection defeats the controls requiring lenders to input the TIN of the nonprofits providing down payment assistance. If a lender does not identify that down payment assistance came from a nonprofit, the system allows the loan to be processed without an entry into the Gift Source TIN field in the FHA Connection. Additional controls are needed to ensure the correctness of the CHUMS information so that HUD can accurately monitor the

performance of loans for which gift funds are provided by nonprofit agencies.

Auditee Comments and
OIG Evaluation

The Office of Housing generally agreed with our recommendations. The Office of Housing stated they plan to reduce the gift source options from 13 to 5 to make the field less confusing to lenders and to eliminate the default setting of “no gift.” The Office of Housing will notify mortgagees by letter of these changes and that administrative action that may be taken against lenders not complying with instructions. The Office of Housing will also include data integrity checks during post-endorsement reviews to determine if lenders input the appropriate gift code.

We agree with the Office of Housing’s proposed course of action.

Recommendations

We recommend you:

- 2A. Modify the Gift Source field in the FHA Connection Insurance Application screen so that it does not default to the “no gift” code and requires the lender to input the applicable code.
- 2B. Inform lenders that administrative action will be taken against any lender for each loan processed where the appropriate gift code is not entered into the FHA Connection.
- 2C. Perform post-endorsement case file reviews to determine if the lenders are inputting the appropriate gift code. Take appropriate action, such as requiring pre-endorsement reviews on all loans submitted by lenders who fail to enter the appropriate gift codes into the FHA Connection.

Status of
Recommendations

The proposed actions outlined in the Office of Housing’s response to the draft report (to be completed by June 30, 2003) will satisfy our recommendations. No additional response to our office regarding this finding is necessary, however, the Office of Housing will need to coordinate with the appropriate Audit Liaison official to document Final Action and close the recommendations.



Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

We determined the following management controls were relevant to our audit objectives:

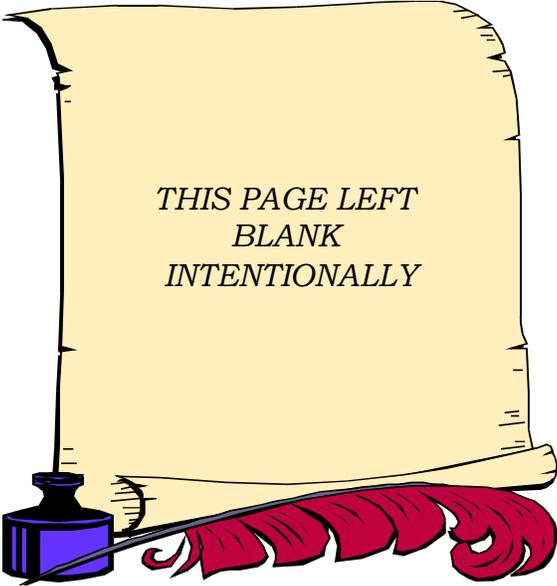
- Identifying the source of down payment assistance for FHA insured single family loans.
- Monitoring the performance of FHA single family loans in which seller-derived nonprofit organization down payment assistance was involved.

We assessed all of the relevant controls identified above. It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations, will meet an organization's objectives.

Significant Weaknesses

We identified the following significant weaknesses in HUD's management controls:

- Lenders can obtain approval for FHA insurance without entering the correct source of down payment assistance into the FHA Connection loan application screen. (Finding 2)
- HUD relies on incorrect data in the Single Family Data Warehouse for the assessment of the performance of loans in which seller-derived down payment assistance is involved. (Finding 2)





U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

RECEIVED

SEP 18 2002

HUD/OIG AUDIT
SEATTLE, WA

SEP 9 2002

MEMORANDUM FOR: Frank E. Baca, District Inspector General for Audit, OAGA

FROM: Sean G. Cassidy, General Deputy Assistant Secretary for Housing-
Deputy Federal Housing Commissioner, H

SUBJECT: Draft audit report/follow up audit of downpayment assistance
programs operated by private nonprofit entities

Thank you for your work on the draft report regarding downpayment assistance programs and our opportunity to comment. The responses to your recommendations and findings are listed below.

Responses to Recommendations/Significant Weaknesses:

Recommendation 1A. Consider implementing an amended Proposed Rule that: (1) prohibits nonprofits from providing assistance to buyers where any of the assistance comes directly or indirectly from sellers and builders, and (2) prohibits sellers and builders from contributing to nonprofit organizations who operate downpayment assistance programs if the sellers/builders conduct sales transactions with or in association with those same nonprofit organizations including any affiliates of the nonprofit or the seller/builder.

Office of Housing Response:

The Office of Housing believes that OIG's work has been beneficial in providing information on downpayment assistance programs, and appreciates the opportunity to work with OIG in developing the analytical framework for the audit. As your audit report notes, the loan sample does not contain enough defaults to accurately project the default rate on loans with downpayment assistance. Consequently, FHA is procuring the services of a contractor to conduct a more extensive analysis using the framework developed by OIG. This is necessary because of the effect that changes in these programs may have on all program participants. We anticipate that procurement action will be finalized by November 30, 2002. The final report should be submitted to the Department by September 30, 2003. The Department is confident that it will be able to act upon the report's findings no later than December 2003.

Recommendation 2A. Modify the Gift Source field in the FHA Connection so that it does not default to the “no gift” code and require the lender to input the applicable code.

Response: The Office of Housing plans to reduce the number of gift source options available to the lender from 13 to 5, and to eliminate the default setting of “no gift.” The Office of Housing believes that reducing the number of options will make the field less confusing to the lender and improve data quality.

Recommendation 2B. Inform lenders that administrative action will be taken against any lender for each loan processed where the appropriate gift code is not entered into FHA Connection.

Response: Mortgagees will be issued a letter informing them about changes to the Gift Source screen. This letter will include notice of administrative action the Office of Housing may take against lenders found not in compliance with these instructions.

Recommendation 2C. Perform post-endorsement case file review to determine if lenders are inputting the appropriate gift code. Take appropriate action, such as requiring pre-endorsement reviews on all loans submitted by lenders that fail to enter the appropriate gift codes into the FHA Connection.

Response: The Office of Housing will ensure that post-endorsement case file reviews will include data integrity checks that will include determining if the lender input the appropriate gift code.

Significant Weaknesses per OIG:

Lenders can obtain approval for FHA insurance without entering the correct source of downpayment assistance into the FHA Connection loan applications screen.

Response:

The Office of Housing does not believe failure to identify the *source* of downpayment assistance rises to the level to be classified as a *significant* weakness. Inputting an incorrect code was not fraud or an attempt by the Mortgagee to misrepresent the borrower’s employment, income, assets or liabilities. Rather, it appears that confusion over the 13 different code options available to the Mortgagees may be partially responsible. The Office of Housing will reduce the number of codes from 13 to 5 to eliminate this confusion. The system can accurately ascertain that the mortgage was associated with a gift and provide us with the ability to retrieve case binders to perform case level analysis.

Significant Weaknesses per OIG:

HUD relies on incorrect data in the Single Family Data Warehouse (SFDW) for the assessment of the performance of loans in which seller-derived downpayment assistance is involved.

Response:

As discussed in response to Recommendation 1A, the Office of Housing is in the process of procuring a contract to audit loan performance and data integrity using case binders. In addition, the changes to the CHUMS screen to eliminate the default setting to “no gift” as well as reducing the number of possible gift source options will reduce lender confusion and provide greater data accuracy. Further, while the Office of Housing has program information regarding most of the various nonprofits that provide gifts for the downpayment, it cannot ever be certain that the funds were in fact seller-derived.

Again, thank you for providing the opportunity for input on this report. If you have any questions, please feel free to call me or Vance T. Morris, (202) 708-2121.



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