April 10, 2006

MEMORANDUM FOR: Joseph McCloskey, Director
Office of Single Family Asset Management, HUF

FROM: Frank E. Baca
Regional Inspector General for Audit, 6AGA

SUBJECT: Review of Partial Claim Option to Foreclosure under
HUD’s Loss Mitigation Program

INTRODUCTION

In accordance with the Office of Inspector General’s (OIG) audit plan, we reviewed the partial
claim option to foreclosure under the U.S. Department of Housing and Urban Development’s
(HUD) loss mitigation program. The partial claim option is one of three home retention tools for
resolving defaults. HUD’s Office of Single Family Asset Management administers the program
through its National Servicing Center in Oklahoma City, Oklahoma.

The objective was to determine whether lenders’ use of the partial claim option has prevented
home foreclosures and as a result, reduced claims against HUD’s insurance fund.

SCOPE/METHODOLOGY

We reviewed Federal Housing Administration lenders’ use of the partial claim option. The
review included partial claim transactions over a 20-month period, December 1, 2003, through
July 31, 2005. Our fieldwork, conducted between August 4, 2005, and February 1, 2006,
included the following:

- Reviewing and analyzing information from the National Servicing Center and from its
  branch office and servicing contractor for partial claim loans in Tulsa, Oklahoma.
- Reviewing and analyzing partial claim information maintained by the servicing
  contractor and HUD payments for partial claim services.
- Interviewing officials of a servicing lender noted for successfully servicing troubled
  loans and reviewing its loss mitigation process for 21 loans that received partial claim
  assistance to better understand the process.
- Interviewing HUD officials from the Office of Single Family Asset Management, Office
  of Financial Analysis and Reporting, Office of the Chief Information Officer, and Office
  of Financial Services.
• Examining the National Servicing Center’s proposal to change the manner in which it secures and services partial claim loans.

In addition, we relied in part on data maintained by HUD in Strategy, HUD’s system of record for partial claim loans. We did not do a detailed analysis of the reliability of the system’s database. We concluded that Strategy was outdated and did not provide the necessary information to properly monitor partial claims; however, we did not report this issue as a finding because HUD plans to replace Strategy.

BACKGROUND

The National Servicing Center, a division of HUD’s Office of Single Family Asset Management, administers HUD’s loss mitigation program. The National Servicing Center has its main office in Oklahoma City, Oklahoma, with a branch office in Tulsa, Oklahoma. The National Servicing Center and its loan-servicing contractor, Morris-Griffin Corporation/First Madison Services, Inc., provide servicing and loss mitigation services to lenders and Federal Housing Administration-insured homeowners throughout the United States.

HUD delegates to approved Federal Housing Administration lenders the authority to assist borrowers in default in retaining their homes with the goal of reducing losses to HUD’s insurance fund. Because lender participation in the program is mandatory, HUD gives great latitude to its lenders and pays them an incentive fee for their participation. Without HUD approval but within HUD guidelines, lenders at their discretion may use any of the five loss mitigation options to foreclosure. The first three options provide means for the homeowners to keep their houses. These options are consistent with HUD’s goal to reinstate to current status as many loans as possible. The last two options help the homeowners dispose of their houses with reduced costs to the homeowner and to HUD’s insurance fund. HUD assumes that lenders will follow sound business practices in determining the option to foreclosure.

The partial claim, the third option, is for borrowers who can resume monthly payments but cannot pay a past-due amount. HUD advances its insurance funds to pay the past-due amount of principal, interest, insurance, and taxes owed by the delinquent borrower. The payment is in the form of a non-interest-bearing loan to the borrower. The partial claim loan is repaid when the primary mortgage is paid in full, which can be through either refinancing or sale of the property.
RESULTS OF REVIEW

Our review did not disclose any findings related to use of the partial claim tool to aid borrowers in default. Consequently, we have made no recommendations that would require follow up by your office. HUD and Federal Housing Administration-approved lenders have effectively used partial claim loans to keep borrowers in their homes. During the 20-month period that we reviewed, HUD paid partial claims totaling almost $208 million to keep 24,037 properties out of foreclosure, properties with more than $2 billion in HUD-insured mortgages. The lenders only had to foreclose on a small percentage of the insured mortgages. Out of 23,255 mortgages that received first-time partial claim assistance during the 20-month period, the lenders foreclosed on only 1.59 percent or 369 mortgages.