This report was initially published on May 30, 2013, and contained a mathematical error in adding the GSE and HUD inventories; the correct total is 1,708,033. The underlying data are accurate and have not changed; the error was an adding mistake only. The total inventory number was corrected on pages 3 and 11.

In addition, a discrepancy with how “shadow inventory” is indicated was adjusted on page 10. And, an example used to demonstrate a trend between seriously delinquent mortgages and REO inventories was removed from page 12 after it was brought to our attention that the example was incorrect. The adjusted report was reposted on June 3, 2013.

Joint Report on Federally Owned or Overseen Real Estate Owned Properties

May 2013

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

Federal Housing Finance Agency Office of Inspector General

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Executive Summary

The Offices of Inspector General for the U.S. Department of Housing and Urban Development and the Federal Housing Finance Agency (HUD-OIG and FHFA-OIG) have produced this report on "real estate owned" (REO) properties. REO are residential properties that have been foreclosed upon and transferred into an REO inventory for management and ultimately disposition. This report addresses REO properties held by or on behalf of either HUD or the Government-Sponsored Enterprises (GSEs or enterprises) for which FHFA serves as conservator—the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

HUD and the GSEs have created infrastructures to manage and sell REO properties. Though those infrastructures differ somewhat from one another, they all rely heavily on contractors to perform tasks central to effective REO management: (1) securing properties to avoid theft, vandalism, and unauthorized use; (2) maintaining and repairing properties as needed; (3) pricing properties appropriately through broker price opinions or appraisals and satisfactory promotional efforts; and (4) selling properties to homeowners or investors within a reasonable period.

As of September 30, 2012, HUD held 37,445 REO properties while the GSEs held 158,138. In addition, the "shadow inventory"—residential loans at least 90 days delinquent—totaled 1,708,033 properties, roughly 8.7 times the size of the HUD and GSE REO inventories combined. Even a fraction of the shadow inventory falling into foreclosure could considerably swell HUD and GSE inventories of REO properties.

This report reviews recent initiatives by HUD and the GSEs to shrink their respective REO inventories, as well as steps taken by HUD-OIG and FHFA-OIG to assess and address their respective agencies' REO activities.

Background on REO

Default and Foreclosure

Most residential real estate purchases in the United States are financed through loans provided by banks or other lenders, which typically require a secured interest or mortgage on the property in exchange for financing the purchase. Among other promises, a borrower agrees to repay the mortgage over time in accordance with its terms. A borrower's failure to do so is called default.

Once a borrower defaults, the creditor holding the mortgage—the originating lender, a subsequent institution that purchased the mortgage, or some other entity such as a mortgage insurer—may foreclose on the property in an effort to recoup the amount due under the mortgage. Foreclosure is a legal process by which the creditor might mitigate its losses by acquiring and selling the property. Once foreclosure is completed, the property enters into the creditor's REO inventory until it can be sold.

The current housing crisis has seen a significant increase in the incidence of mortgage defaults and foreclosures. Foreclosed and vacant properties can have profoundly negative consequences in the neighborhoods and communities in which they are located, including but not limited to reduced property values. According to the U.S. Government Accountability Office, vacant, foreclosed properties can reduce prices of nearby homes by $8,600 to $17,000 per property.[1] In addition, vacant residential properties may attract crime, cause blight, and threaten public safety. Public policy and financial market observers have attributed delinquency and foreclosure increases to a wide range of causes and have offered varying policy prescriptions for what remains a continuing problem.

Managing REO Inventory

A creditor typically takes possession of a foreclosed property to preserve its value until it can be sold. Such efforts are referred to as "REO management." Creditors may take the following steps to manage REO inventories successfully:

1. Hire qualified REO contractors—law firms, property maintenance companies, real estate brokers, and others—to secure, maintain, market, and sell REO properties.

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1 Government Accountability Office, *Vacant Properties: Growing Number Increases Communities Costs and Challenges*, GAO-12-34 (November 4, 2011).

2. Provide contractor training.

3. Establish standard policies and procedures for key REO maintenance activities, such as the number of times per month lawns must be cut.

4. Establish budgets and reimbursement schedules for routine property maintenance activities. In some cases, repairs may enhance a property's value and thereby maximize returns. Without an effective way of making such determinations, a creditor could reimburse contractors for repairs that are unnecessary and increase property management costs. However, a creditor must also be mindful that foreclosed properties located in economically distressed areas may be particularly difficult to sell. In some cases, demolishing rather than rehabbing the property may be more cost effective.

5. Require multiple bids or reviews for proposed repairs that exceed pre-established dollar thresholds.

6. Conduct onsite inspections of selected properties to ensure that they are secured, maintained, and repaired according to established standards.

7. Require multiple broker price opinions or appraisals to establish each foreclosed property's fair market value.

8. Audit bills submitted by contractors to ensure their appropriateness and screen for potential fraud.

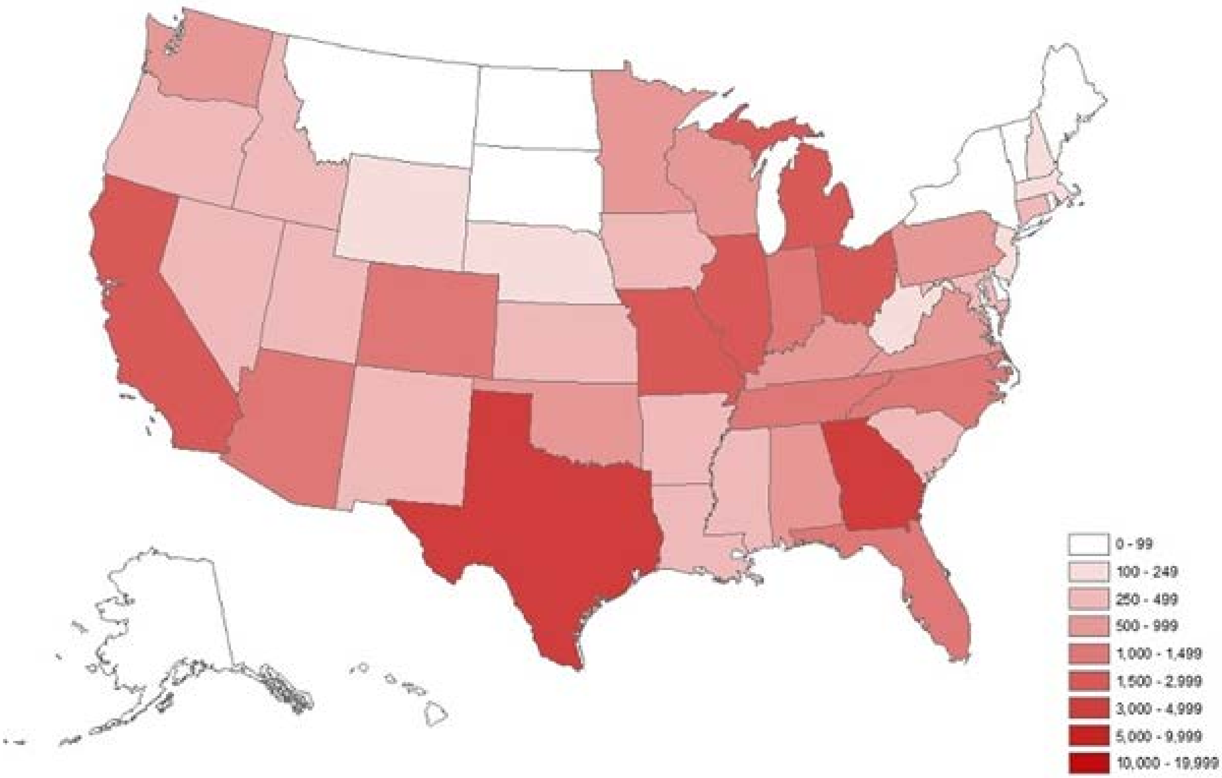
9. Conduct account reviews and performance management audits and monitor contractors using established metrics, including contractual obligations.

10. Withhold payments to contractors for services rendered until such services have been completed satisfactorily and suspend or terminate unsatisfactory contractors.

Large national REO inventories present significant challenges to accomplishing these tasks. HUD, FHFA, and the GSEs are particularly sensitive to such risks, given the size of their respective REO inventories.

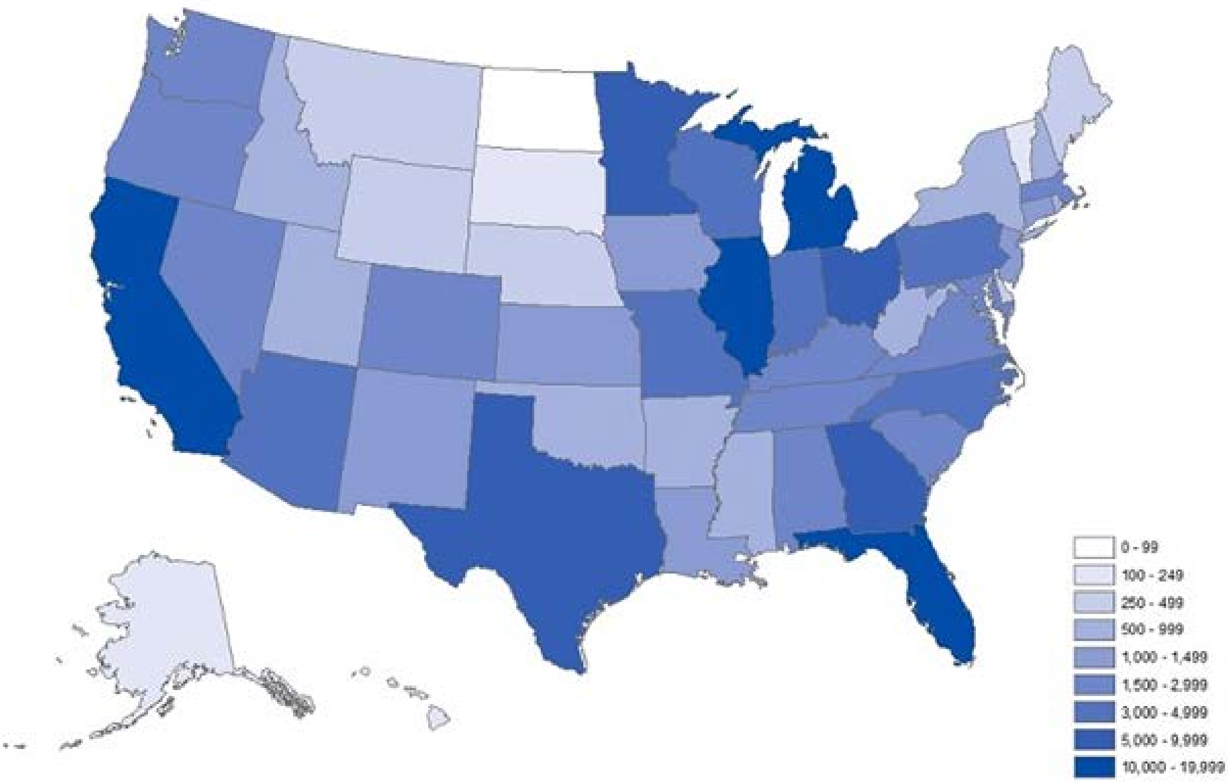
As of September 30, 2012, HUD's nationwide REO inventory totaled 37,445 properties, while the GSEs' totaled 158,138 (Figures 1 and 2).[2]

Figure 1: HUD REO Properties by State, as of September 30, 2012



2 HUD, *Month End Acquisition Property Report* (September 30, 2012); FHFA, F*oreclosure Prevention Report for Third Quarter 2012*. Accessed April 10, 2013, at http://www.fhfa.gov/webfiles/24858/3q12FPR_final.pdf.

Figure 2: GSE REO Properties by State, as of September 30, 2012



HUD and the GSEs generally rely on extensive networks of contractors and subcontractors to maintain and sell their properties. These networks require significant oversight to ensure that they perform effectively and that they mitigate both REO-related expenses and foreclosure's negative effects.

HUD's REO Contractor Structure

The Federal Housing Administration (FHA), which is part of HUD, insures both single-family and multifamily mortgage loans made by approved lenders. If a buyer defaults on an FHA-insured loan, the lender acquires the title to the property by foreclosure, a deed in lieu of foreclosure, or other acquisition method. The lender then files a claim for insurance benefits and conveys the property to the Secretary of HUD.

Since 1999, HUD has outsourced the disposition of its REO inventory to private contractors under its Management and Marketing (M&M) program. In June 2010, HUD awarded contracts under the third generation of M&M. M&M III consists of the following major processes: (1) preconveyance activity, (2) conveyance activity, (3) postconveyance activity, (4) property management activity, (5) marketing activity, (6) accounting and reconciliation, and (7) oversight monitoring. REO disposition efforts are administered through HUD Homeownership Centers located in Atlanta, Georgia; Denver, Colorado; Philadelphia, Pennsylvania; and Santa Ana, California. Each center is responsible for a designated geographic area. The disposition structure's key elements include:

- **Mortgage compliance manager (MCM)**: MCMs perform a variety of pre- and postconveyance services to ensure that HUD's interests are protected. These services include reviewing property inspections to ensure that the property is in conveyance condition, resolving conveyance exceptions, providing guidance to lenders related to pre- and postconveyance responsibilities, and leveraging HUD's software and information systems to execute and complete the tasks within this contract.

- **Field service manager (FSM)**: FSM companies provide property maintenance and preservation services such as inspecting, securing, maintaining, and repairing the property.

- **Asset manager (AM)**: AMs handle REO property marketing and sales.

- **Oversight monitor**: Oversight monitors focus on overall portfolio analysis and oversight of the disposition process.

The Single Family Insurance System (SFIS) is HUD's primary system for recording insurance and claim payments for all FHA-insured single-family loans. SFIS utilizes P260, a web-based system of record for all REO case management transactions. P260 assigns each HUD-owned property to FSMs and AMs and tracks the disposition activity from conveyance to sale. AMs and FSMs are required to scan and upload documents relating to properties, such as inspection reports and photographs. The system also tracks preconveyance activities. It integrates data from SFIS, FHA Connection, and the Single Family Accounting Monitoring System (SAMS). FHA Connection is a web-based system by which lenders report the status of insured loans. Also, FHA Connection allows HUD to post information of interest to lenders. SAMS is HUD's automated system for managing, processing, and monitoring acquired and custodial single-family properties. It is HUD's primary system of record for tracking financial information and accounting data for properties acquired by HUD.

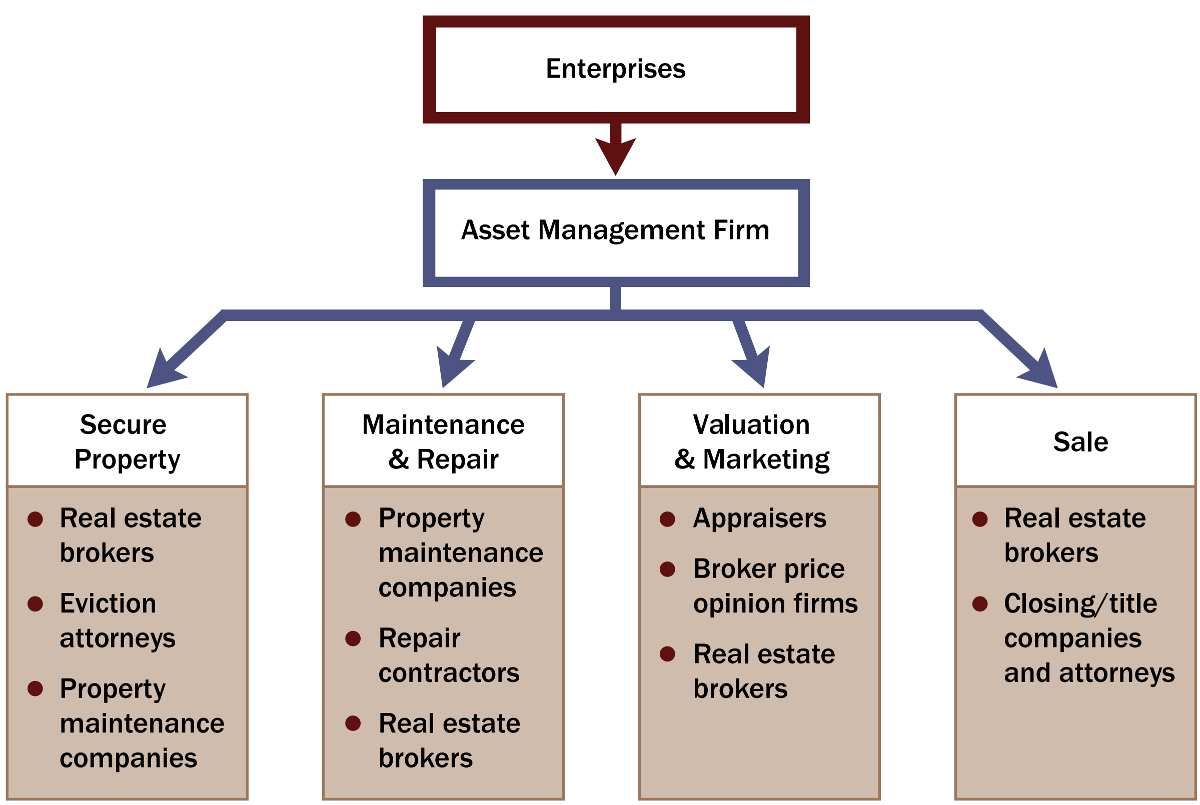
P260 automatically assigns an FSM to the property. The assigned FSM completes required inspections and cleanout services. An AM, also assigned automatically, completes the required inspection and orders an appraisal.

The AM receives the appraisal and conducts an inspection before listing. If the property needs to be reconveyed to the lender for whatever reason, the property may be held off the market. The AM conducts a direct sale if the property is eligible for special programs. If it is not, the AM establishes the property's value and validates that the property is ready to list. The general list period is 180 days. If the property is not sold within this timeframe, the AM offers the property to local governments. If there is an acceptable offer, the AM accepts it and ratifies the contract. The closing agent orders a title search. If the property is sold with FHA insurance and meets certain requirements, testing of lead-based paint or wood-destroying organisms may be ordered. Finally, the AM closes the property through a closing agent and reconciles the sales transaction.[3]

The GSEs' REO Contractor Structure

The GSEs also manage their REO inventories using a series of contractors (Figure 3).

Figure 3: GSEs' REO Oversight Structure



3 HUD, *Management & Marketing III Overview: Video Participant Guide* (2010). Accessed April 5, 2013, at http://www.hud.gov/offices/hsg/sfh/reo/slides/Management_Marketing_III_Overview.pdf.

- **Asset management firms**: These firms direct certain REO contractors in the performance of day-to-day property management responsibilities.

- **Real estate brokers**: Instead of or in addition to hiring asset management firms, the GSEs may contract brokers to manage portions of their REO inventory. Their contractual duties could include identifying and mitigating hazardous conditions at the properties, developing and implementing marketing plans, listing properties, and evaluating offers.

- **Attorneys**: The GSEs contract attorneys in the states in which their properties are located to accomplish a variety of legal tasks, such as managing evictions. Designated attorneys and national title companies are employed to ensure that the GSEs obtain title to foreclosed properties and manage the closing process upon resale.

- **Property maintenance companies and repair contractors**: These contractors secure and maintain properties by removing interior and exterior debris, cleaning houses, cutting lawns, inspecting and repairing plumbing, and winterizing structures, among other things. They also make repairs, such as fixing leaking roofs, repairing or replacing appliances, and installing major systems, such as heating and air conditioning units.

- **Appraisers and broker price opinion firms**: These contractors help the GSEs determine the value and listing prices of foreclosed properties by reviewing comparable sales and conducting appraisal reviews.

The "Shadow Inventory"

While the burden of managing their respective REO inventories successfully is significant enough, Fannie Mae, Freddie Mac, and HUD must also pay close attention to "shadow inventory." This inventory consists of properties with mortgages that are over 90-days delinquent, but which have not yet completed the foreclosure process and therefore have not yet hit the active real estate market. As of September 30, 2012, shadow inventory properties vastly outnumbered properties already in the REO inventories (Figure 4).

Figure 4: Single-Family REO Inventories and Mortgages over 90 Days Delinquent, as of September 30, 2012

Creditor	Shadow Inventory	REO Inventory	Ratio of Shadow to REO Inventory
Fannie Mae	598,490	107,225	5.6 to 1
Freddie Mac	368,159	50,913	7.2 to 1
Enterprises Total*	966,649	158,138	6.1 to 1
HUD	741,384**	37,445***	19.8 to 1
Overall Total	1,708,033	195,583	8.7 to 1

* GSE figures are derived from FHFA's *Foreclosure Prevention Report for Third Quarter 2012.* Accessed February 27, 2013, at http://www.fhfa.gov/webfiles/24858/3q12FPR_final.pdf.

** HUD's Single Family Data Warehouse as of September 30, 2012. This is a collection of database tables structured to provide HUD users easy and efficient access to single-family housing case-level data on properties and associated loans, insurance, claims, defaults and demographics.

*** HUD's Month End Acquisition Property Report from Single Family Asset Management System as of September 30, 2012.

FHA-approved lenders must report the status of all delinquent loans to HUD each month until final resolution. In the event of foreclosure, which results in FHA-insured properties entering HUD's REO inventory, the final resolution is the insurance claim paid after the foreclosure auction is completed and the marketable title is transferred to HUD. FHA's Quarterly Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund provides information on serious delinquency trends and numbers of REO dispositions and associated loss rates.[4] The average loss rate on REO properties for the quarter ending September 30, 2012, was 62.1 percent.[5] Of the 741,384 active 90-day delinquent loans as of September 30, 2012, 219,699 were in foreclosure.[6]

The serious delinquency rate (more than 90 days delinquent) held steady at 9.4 percent in the third quarter. This level is about 1.4 percent higher than this time a year ago. Three factors appear to be driving this result. The first is the persistence of loans in serious delinquency as lenders attempt to craft workout

4 HUD, *Quarterly Report to Congress: FHA Single-Family Mutual Mortgage Insurance Fund Programs*, FY 2012 Q3. Accessed April 10, 2013, at http://portal.hud.gov/hudportal/documents/huddoc?id=fhartc_q3_2012.pdf.

5 The loss rate was used in a HUD-OIG report published on February 5, 2013, and can be accessed at http://www.hudoig.gov/Audit_Reports/Final%20Audit%20Memorandum_Standard%20Pacific%20Mortgage_02-05-13_signed.pdf.

6 Calculation by HUD-OIG from data in HUD's Single Family Data Warehouse.

plans. The second is the duration of loans in foreclosure processing.[7] The third is that the historically large books of business for fiscal years 2009 and 2010 are at the age at which their serious delinquency rates are increasing toward their lifecycle peaks.

FHFA-OIG has not independently estimated the extent to which the level of seriously delinquent mortgages could increase the GSEs' REO inventories over time. However, the GSEs' data suggest that the numbers could be significant given the extent to which many borrowers are behind on their mortgage payments. Fannie Mae has stated that due to elevated numbers of delinquent borrowers, among other challenges in the housing sector, it does not expect its REO inventory to return to pre-financial crisis levels for years.[8]

HUD & GSE Actions and Initiatives

HUD and the GSEs have taken steps to shrink their REO inventories.

FHA Note Sales Program and Distressed Asset Stabilization Program

The FHA Office of Asset Sales was established December 1, 2001, by the HUD Deputy Assistant Secretary for Finance and Budget to coordinate the disposition of FHA-held single-family and multifamily mortgage notes. The FHA note sales program began as a pilot in 2010 and has resulted in the sale of nearly 2,400 single-family loans as of April 2013. Under the program, FHA-insured notes are sold competitively at a market-determined price generally below the outstanding principal balance. Once the note is purchased, foreclosure is delayed for at least 6 months as the borrower gets direct help from his or her servicer to find an affordable foreclosure alternative. The investor purchases the loan at a discount and then takes additional steps to

7 Such duration can be affected by multiple factors, including state laws governing homebuyers' rights of redemption. In general, redemption laws permit homeowners to "redeem" foreclosed properties by paying off the outstanding debt within a specified time after foreclosure. These laws may have the effect of tying up the property after foreclosure and rendering it more difficult to sell. This, in turn, results in additional carrying costs for the GSEs as well as lost income on the mortgage.

8 Fannie Mae, *2011 10-K Report*, at 16. Accessed February 27, 2013, at http://phx.corporate-ir.net/phoenix.zhtml?c=108360&p=irol-SECText&TEXT=aHR0cDovL2FwaS50ZW5rd2l6YXJkLmNvbS9maWxpbmcueG1sP2lwYWdlPTc0MzQ5MzkmRFNFUT0wJlNFUT0wJlNRREVTQz1TRUNUSU9OX0VOVElSRSZzdWJzaWQ9NTc%3d.

help the borrower avoid default, whether by modifying the loan terms or helping the borrower through a short sale, to maximize the return on the sale.[9]

A servicer can place a loan into the loan pool if the following criteria are met:

- Borrower is at least 6 months delinquent on his or her mortgage,
- Servicer has exhausted all steps in the FHA loss mitigation process,
- Servicer has initiated foreclosure proceedings, and
- Borrower is not in bankruptcy.

In September 2012, FHA enhanced its single-family note program to include pools of expanded size and use criteria with the goal of yielding better outcomes for troubled borrowers, neighborhoods, and taxpayers. This revamped program is referred to as the Distressed Asset Stabilization Program. HUD recognizes that thousands of FHA borrowers who are delinquent on their loans and have exhausted the loss mitigation interventions available through FHA. By strategically selling notes to new servicers rather than carrying out foreclosure, FHA can reduce costs while helping to stabilize communities. Beginning with the September 2012 sale, FHA will increase the number of loans available for purchase from about 1,800 a year up to 5,000 a quarter and add a new neighborhood stabilization pool to encourage investment in communities hardest hit by the foreclosure crisis.[10] The offerings from the Distressed Asset Stabilization Program first occurred in September 2012 with the latest offering conducted in March 2013. As of April 2013, the program has resulted in the sale of nearly 26,000 mortgages. Another offering is planned for June 2013 with an anticipated sale of 15,000 to 20,000 loans.

FHFA and Fannie Mae REO Pilot Program

In August 2011, FHFA, HUD, and the Department of the Treasury issued a Request for Information, soliciting public comment on new and advantageous ways to sell single-family REO properties held in their inventories. In February 2012, FHFA directed Fannie Mae to launch an REO Pilot Program, as a result of public feedback, in which bids were solicited from qualified investors to purchase and then rent for a specified number of years about 2,500 of Fannie Mae's foreclosed single-family properties. These properties were located in

9 HUD, *HUD to Expand Sale of Troubled Mortgages through Program Designed to Help Borrowers Avoid Costly, Lengthy Foreclosures*, HUD No. 12-096 (June 8, 2012). Accessed April 5, 2013, at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2012/HUDNo.12-096.

10 *Id*.

geographically concentrated areas across the United States. Investors were qualified to bid after an extensive review process that evaluated their financial strength, asset management experience, property management expertise, and experience in the geographic area.

FHFA has targeted metropolitan areas hit hardest by foreclosures: Atlanta, Chicago, Las Vegas, Los Angeles, Phoenix, and parts of Florida. In September 2012, FHFA announced that Pacifica Companies, LLC was the first winning bidder in the REO Pilot Program, in which the investor purchased 699 properties in Florida. Subsequently, the Cogsville Group, LLC purchased 94 Fannie Mae REO properties in Chicago in October 2012. FHFA also announced in November 2012 that Colony Capital, LLC purchased 970 properties in California, Arizona, and Nevada.[11]

OIG Efforts on REO

HUD-OIG

In its continuing efforts to improve the integrity of the single-family insurance program, HUD-OIG has proactively sought to identify high-risk areas within FHA's REO program for audit opportunities. Specifically, in 2011 HUD-OIG conducted an auditability survey of HUD's REO program and identified audit opportunities in the areas of oversight, field service management, and asset management. HUD-OIG subsequently completed four audits: (1) HUD's oversight of its REO M&M III program;[12] (2) Innotion Enterprises (an FSM contractor)'s performance;[13] (3) the reasonableness of certain Innotion pass-through costs;[14] and (4) Ofori and Associates, PC (an Asset Manager)'s compliance with case processing requirements and timeframes.[15] Below is a summary of the audit objectives and results from those four issued reports.

1. Audit of HUD's Oversight of Its REO Management and Marketing Program III

HUD-OIG audited HUD's oversight of its REO M&M III program. This audit work focused on HUD's oversight of the Asset Managers (AMs) and Field

11 Properties in Atlanta were not awarded and will be evaluated for disposition through Fannie Mae's retail REO sales operation or through future transactions.

12 http://www.hudoig.gov/Audit_Reports/2012-LA-0003.pdf, issued September 18, 2012.

13 http://www.hudoig.gov/Audit_Reports/2012-LA-1010.pdf, issued September 12, 2012.

14 http://www.hudoig.gov/Audit_Reports/2013-LA-0801.pdf, issued October 3, 2012.

15 http://www.hudoig.gov/Audit_Reports/2013-BO-1001.pdf, issued February 19, 2013.

Service Managers (FSMs), as well as enforcement of contract requirements, including listing prices, bid thresholds, valuation, maintenance, inspections, and payments. The objective was to determine whether HUD's policies and procedures provided for efficient and effective oversight of AMs and FSMs under M&M III program.

The audit identified that HUD did not have adequate procedures in place to ensure consistent and adequate enforcement of AM and FSM contracts. Specifically, (1) list prices were not always reduced according to the marketing plans, (2) bids were approved that did not meet HUD's flexible threshold, (3) bids were rejected that met the marketing plan thresholds, (4) bids that met applicable thresholds were not always counteroffered or forwarded to the government technical representative for approval, and (5) properties were not assigned to field service managers based on performance even when HUD identified performance issues.

In addition, HUD did not always pay FSMs in accordance with their contracts, resulting in an estimated net underpayment of $553,784 to FSMs. This condition occurred because HUD did not develop national standard procedures and did not implement a performance scorecard to assign properties to FSMs based on performance. As a result, HUD's REO properties may not have always been competitively valued, holding time may not have always been minimized, sales may not have always achieved the highest net return, and properties may have been assigned to contractors that did not perform at a satisfactory performance level.

2. Audit of Innotion Enterprises, Inc.

HUD-OIG audited one of HUD's REO M&M III FSMs. This audit work focused on how well Innotion Enterprises, Inc. met the six primary objectives of its FSM contract. Specifically, HUD identified six primary objectives for the FSM contract, which are to ensure that (1) FHA-insured properties are maintained in a manner that preserves communities, (2) HUD has real-time access to all property-related information, (3) properties are secured and safe from hazardous conditions, (4) property values are preserved, (5) properties are maintained in a manner that reflects a high standard of care, and (6) there is a high level of customer satisfaction with HUD's property disposition program. The overall audit objective was to determine whether Innotion performed property preservation and protection services according to contract requirements.

The audit identified that Innotion did not always perform property protection and preservation services according to contract requirements. Specifically, 38 of 96 (39.6 percent) properties selected materially failed to meet contract requirements because homes were not secured or properly maintained. As a result of Innotion not always following HUD's and its own policies and procedures, compounded by its inadequate quality control, HUD did not have assurance that Innotion maintained REO homes at the high standard of care required in the performance of work statement. HUD paid Innotion $11,210 for monthly services for 38 homes that did not reflect a high standard of care. If Innotion does not implement adequate controls and procedures to address property protection and preservation deficiencies, HUD will spend approximately $1 million for inadequate services over the next year.

3. Audit of Innotion Enterprises, Inc. Pass-through Costs

In conjunction with the external audit of Innotion, HUD-OIG reviewed the termite inspection pass-through costs that it submitted to HUD for payment as part of its REO M&M III program FSM contract. The objective was to determine whether Innotion's Las Vegas, Nevada, branch met administrative requirements concerning pass-through cost reasonableness.

HUD-OIG determined that HUD paid for unnecessary administrative costs of Innotion's subcontractor under HUD's FSM contract. This condition occurred because of the unclear definitions of actual and administrative costs in HUD's contract with Innotion. Although the contract stated that Innotion could pay only the amount billed and not add its own administrative costs, it did not specifically disallow the payment of administrative costs incurred by a subcontractor, such as One Stop, that subcontracted Innotion's work to other termite inspection contractors. As a result, 30 percent of the termite inspection costs paid by HUD in the sample were for administrative costs of Innotion's subcontractor. If HUD does not revise its FSM field contracts, it may continue to pay for unnecessary administrative costs for termite inspections and other pass-through costs submitted by its FSM contractors.

4. Audit of Ofori and Associates, PC

HUD-OIG audited one of HUD's REO M&M III AMs. This audit work focused on determining whether or not Ofori complied with case processing requirements and timeframes to obtain the highest net return for HUD's REO inventory and minimize holding time.

The audit identified that Ofori did not always comply with case processing requirements and timeframes for the disposition of REO properties assigned to them. Specifically, it did not always perform all case processing requirements in a timely manner to minimize holding time and costs to HUD. They did not adequately document information in case files and in the HUD P260 computer system.[16] This condition occurred because Ofori officials did not always follow contract and marketing plan requirements; they did not have adequate controls in place to ensure that case processing requirements were completed and documented; and they did not always adequately address procedures, processes, and timeframes they would follow. As a result, HUD did not have assurance it always received the highest net return on its REO inventory and that holding time was minimized.

Ofori officials have begun addressing the deficiencies identified during our audit, including a checklist for Ofori's marketing specialists to use to improve the review of appraisals and for hard to sell properties; had updated their inspection and closing procedures; and were revising their marketing plans. Ofori officials also began notifying HUD of amounts paid at closing that were not previously reported to HUD, however, Ofori needs to ensure that the added controls address the deficiencies identified in the report, including conflicts of interest, and are followed.

FHFA-OIG

Given the risks associated with the GSEs' REO management, FHFA-OIG is implementing a proactive audit and evaluation strategy under which it will assess FHFA's related oversight and conservatorship efforts. It is intended to determine whether FHFA and the GSEs manage REO to maximize financial recoveries and minimize the negative effects of foreclosures on affected communities. In this regard, FHFA-OIG will analyze the potential effectiveness of these REO management activities, and determine whether proper risk management controls are in place to prevent fraud and abuse.

FHFA-OIG's REO strategy consists of the following:

1. Audit of FHFA's Oversight of the Enterprises' REO Management Programs

Since 2008, FHFA has consistently listed the GSEs' large REO inventories as contributing to "critical concern" ratings in their quarterly risk assessments. However, in spite of FHFA's identification of REO as a prominent and

16 P260 is an internet based system that serves as a primary system of record for all REO case management transactions.

ascending risk, FHFA did not conduct targeted examinations or similar focused reviews of REO until 2011. FHFA-OIG subsequently audited FHFA's oversight of the GSEs' REO management programs.[17] This audit focused on FHFA's supervision of the GSEs' management and marketing of REO properties.

FHFA-OIG found that FHFA's targeted examinations, which were completed in 2012, were positive supervisory steps that the agency can supplement in the future by closely assessing other REO risk areas that need focused supervision (i.e., areas in addition to contractor management and the management of unmarketable homes and canceled foreclosures). For example, the GSEs' sizable shadow inventory may stress their systems for cost-effectively managing, marketing, and disposing of REO. FHFA-OIG also found that FHFA will benefit from using a more comprehensive REO risk assessment and from using this assessment to enhance its planning of supervisory activities. According to FHFA's Supervision Handbook, risk assessment is the process of developing a comprehensive, risk-focused view of a GSE in order to formulate and articulate a current understanding of its emerging and existing risk characteristics, to be used as a blueprint for planning supervisory activities.[18] However, until early in 2011, FHFA's supervisory planning did not focus on the significant and increasing risks associated with the GSEs' REO. FHFA-OIG recommended that FHFA implement a more comprehensive performance risk assessment of REO and link the results to supervisory plans that address those risks through specific supervisory activities.

2. Assessments of FHFA's Oversight of the Enterprises' REO Management Programs

In pending and planned FHFA-OIG activities, FHFA-OIG intends to cover the key steps in the REO management process, including matters such as securing the property, maintenance and repair, valuation and marketing, and sale. FHFA-OIG is considering several evaluations of FHFA's oversight of the GSEs' planning, monitoring, and management of REO, with a focus on their ability to handle future workloads and mitigate adverse effects on homeowners and communities. The specific objectives of these REO activities are or will be to assess FHFA's oversight of the GSEs':

17 FHFA-OIG, *FHFA's Supervisory Risk Assessment for Single-Family Real Estate Owned*, AUD-2012-005 (July 19, 2012).

18 FHFA, *FHFA Division of Enterprise Regulation Supervision Handbook 2.1* (June 16, 2009), at 40. Accessed February 27, 2013, at http://www.fhfa.gov/webfiles/2921/DERHandbook21.pdf.

- Management systems, risk controls, and capacity to deal with any surge of foreclosures in their REO inventories due to seriously delinquent mortgages; and

- Efforts to mitigate the effects of concentrations of REO inventories and abandoned or vacant foreclosed properties in economically distressed areas of the country.

3. Assessments of Any Expanded REO Program

FHFA-OIG also plans to assess FHFA's and Fannie Mae's REO Pilot Program should FHFA decide to implement the sale-rental commitment model on a wider scale. The areas that FHFA-OIG may cover include:

- Whether the program is achieving key expected outcomes and the quality of the data and analytics FHFA and Fannie Mae use to make such determinations. For example, the evaluation could cover FHFA's and Fannie Mae's basis for determining whether, in certain cases, it is more cost-effective to proceed with the bulk sale with rental commitment model than it is to make sales through the traditional retail channel.

- The quality of the controls that are established to ensure that investors have sufficient expertise and financial resources to meet their rental commitments, as well as Fannie Mae's and FHFA's efforts to ensure compliance with these controls.

- The quality of the processes by which Fannie Mae monitors investor compliance with their rental commitments and the restrictions on the number of properties that may be sold annually, as well as FHFA's oversight of the GSEs' processes; FHFA's and Fannie Mae's program enforcement efforts to ensure compliance with program requirements; and, where necessary, their efforts to penalize or sanction investors for noncompliance.

- FHFA's general oversight of Fannie Mae's efforts to implement the program, as well as its technical expertise and the sufficiency of the resources allocated to these efforts.

4. Assessment of FHFA's Oversight of Enterprise Controls over Single-Family Property Inspections for REO

FHFA-OIG also plans to assess FHFA's oversight of single-family property inspections at the GSEs, which view property inspections as essential to the successful management of their REO inventories. Property inspections are required at various points in the mortgage servicing process, including upon delinquency, in foreclosure, and while managing and disposing of REO. These inspections should determine the overall condition of the property, security of the house, occupancy status, maintenance and capital repair requirements, neighborhood conformity, and other related information. Inspectors must be qualified to perform the inspections.

With this audit and evaluation strategy, FHFA-OIG believes that it will be well positioned to:

- Determine whether FHFA is ensuring that the GSEs are effectively mitigating REO risks and costs and the negative impacts of foreclosures on communities and

- Evaluate the effectiveness of the controls associated with selling in bulk foreclosed properties with rental commitments.

Further, FHFA-OIG will be in a position to make recommendations, as necessary, to strengthen FHFA's REO-related oversight and conservatorship efforts.

Conclusion

This report is the latest effort from the Federal Housing Inspectors General, a joint initiative consisting of Offices of Inspector General (OIGs) for Federal agencies that play central roles in supporting housing in the United States: the U.S. Departments of Agriculture, Housing and Urban Development (HUD), Veterans Affairs, and the Federal Housing Finance Agency (FHFA). These OIGs are working to protect the U.S. taxpayer by eliminating fraud, waste, and abuse in federal housing programs.

REO management and disposition are challenging tasks, likely to become more so as shadow inventory is foreclosed upon and becomes REO properties. HUD-OIG and FHFA-OIG have undertaken significant work to ensure that their respective agencies address REO-related issues effectively and efficiently. Substantial attention must continue to be paid to the manner in which HUD, FHFA, and the GSEs handle such issues.

Appendix A
Participating Offices of Inspectors General

U.S. Department of Housing and Urban Development

HUD has its origins in the National Housing Act of 1934, which created the Federal Housing Administration (FHA). Since 1934, the FHA has helped more than 41 million families to become and remain homeowners.[19] The Office of Housing within HUD oversees the FHA, the largest mortgage insurer in the world, as well as regulates housing industry business. HUD's Single Family programs include mortgage insurance on loans to purchase new or existing homes, condominiums, manufactured housing, houses needing rehabilitation, and for reverse equity mortgages to elderly homeowners.[20] HUD was established in 1965 through the Housing and Urban Development Act and continues to administer federal programs that provide assistance for housing and community development. HUD-OIG was established by the Inspector General Act of 1978. Over the years, HUD-OIG has forged an alliance with HUD personnel in recommending ways to improve departmental operations and in prosecuting program abuses. HUD-OIG strives to make a difference in HUD's performance and accountability.

HUD-OIG is committed to the statutory mission of detecting and preventing fraud, waste, and abuse and promoting the effectiveness and efficiency of government operations. While organizationally located within the Department, HUD-OIG operates independently with separate budgetary authority. It seeks to:

- Promote efficiency and effectiveness in programs and operations,
- Detect and deter fraud and abuse,
- Investigate allegations of misconduct by HUD employees, and
- Review and make recommendations regarding existing and proposed legislation and regulations affecting HUD.

HUD-OIG's audits, inspections and evaluations, and investigations continue to complement the Department's strategic initiatives, and its employees continue

19 http://www.huduser.org/portal/publications/hsgfin/fha_singlefamily2012.html, accessed April 8, 2013.

20 http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/hsgabout, accessed April 8, 2013.

to work with the Department to improve HUD's effectiveness. As a result, HUD-OIG has developed and implemented better and more effective audit recommendations.

During the public reporting period from April 1 through September 30, 2012, HUD-OIG's audit work identified more than $827 million in funds that could be put to better use and more than $1.2 billion in questioned costs, and accumulated nearly $34 million in collections. HUD-OIG reported more than $538 million in recoveries and receivables, 354 indictments and informations, 285 convictions, pleas, and pretrial diversions, and 280 arrests.[21]

Federal Housing Finance Agency

FHFA was established by the Housing and Economic Recovery Act of 2008 (HERA) in the midst of the worst economic crisis in decades. HERA created FHFA by consolidating into one agency HUD's Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board, and the GSE mission office within HUD. FHFA's mission is to provide effective supervision, regulation, and oversight of Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks. FHFA is charged with promoting their safety and soundness, supporting housing finance and affordable housing, and fostering a stable and liquid mortgage market. In September 2008, FHFA became the conservator of Fannie Mae and Freddie Mac. At that time, both GSEs began to receive federal support and, to date, have received a combined total of $187.5 billion from the Treasury. As conservator, FHFA has the authority to ensure that they are preserving and conserving their assets.

HERA also established FHFA-OIG. FHFA-OIG began operating in October 2010, following Senate confirmation of its first Inspector General. FHFA-OIG works to promote the economy, efficiency, and effectiveness of FHFA's programs; prevent and detect fraud, waste, and abuse; and seek sanctions and prosecutions against those who are responsible for such fraud, waste, and abuse. FHFA-OIG also provides independent and objective reporting to the FHFA Director, Congress, and the American people through audits, evaluations, and investigations. Among the effects of FHFA-OIG's reporting efforts is Freddie Mac's likely recovery of approximately $1 billion in added income in 2012 and up to $3.4 billion in later years, due to Freddie Mac broadening the scope of loans reviewed for potential repurchase claims after FHFA-OIG determined that its prior loan review scope was too narrow.

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21 An information is a charging document in which the defendant foregoes his or her constitutional right to have the facts of the case presented to a grand jury. Usually, an information is accompanied by a plea agreement.

FHFA-OIG has had several key accomplishments since it began. From its start, with limited staff and resources, FHFA-OIG commenced operations and has issued 32 reports through September 30, 2012. For additional information on any of FHFA-OIG's published reports, visit www.fhfaoig.gov/Reports. FHFA-OIG has also initiated and participated in criminal, civil, and administrative investigations. Notably, FHFA-OIG made significant contributions to the investigation, prosecution, and conviction of seven individuals connected to Taylor, Bean & Whitaker Mortgage Corporation and Colonial Bank, who defrauded Freddie Mac and other victims out of $2.9 billion, making it among the largest mortgage frauds in U.S. history. Further, FHFA-OIG has made over 80 recommendations to date in order to improve the transparency, efficiency, and effectiveness of FHFA's operations and aid in the prevention and detection of fraud, waste, and abuse.

Appendix B
Acronyms and Abbreviations

Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
FHFA-OIG	Federal Housing Finance Agency Office of Inspector General
Freddie Mac	Federal Home Loan Mortgage Corporation
GAAP	Generally Accepted Accounting Principles
GSE	Government-Sponsored Enterprise
HERA	Housing and Economic Recovery Act of 2008
HUD	U.S. Department of Housing and Urban Development
HUD-OIG	U.S. Department of Housing and Urban Development Office of Inspector General
M&M	Management and Marketing
MCM	Mortgage Compliance Manager
REO	Real Estate Owned
SAMS	Single Family Accounting Monitoring System
SFIS	Single Family Insurance System

Appendix C
Glossary

Claims

A request or demand for payment on a guaranteed loan by the loan holder due to default by the borrower. The guarantor will generally issue the payment to the loan servicer, who will be responsible for forwarding the funds to the loan holder in accordance with its servicing agreement.

Debt

A specific sum of money due by agreement or otherwise.[22] Obligations can be incurred by households (consumer debt) or corporations (corporate debt). Corporate debt may also refer to securities issued by a corporation, each an individual obligation owed by the corporation to the investor.

Deed in lieu

A voluntary transfer of property from the borrower to the loan holder for a release of all obligations under the mortgage.

Default

Failure to comply with an obligation's terms.

Equity

In the context of residential mortgage finance, the difference between the fair market value of the borrower's home and the outstanding balance on the mortgage (and any other debt secured by it, such as home equity loans).

Federal Home Loan Mortgage Corporation (Freddie Mac)

A federally chartered corporation that purchases residential mortgages, securitizes them, and sells them to investors; this provides lenders with funds that can be used to make loans to homebuyers.

Federal Housing Administration (FHA)

Part of HUD, provides mortgage insurance on loans made by approved lenders throughout the United States and insures residential mortgages against payment losses. It is the largest insurer of mortgages in the world, having insured more than 34 million properties since its inception in 1934.

Federal National Mortgage Association (Fannie Mae)

A federally chartered corporation that purchases residential mortgages and

22 Garner, Bryan A., ed., *Black's Law Dictionary*, 7th ed., p. 300 (2000).

converts them into securities for sale to investors. By purchasing mortgages, Fannie Mae supplies funds to lenders so they may make loans to homebuyers.

Foreclosure

A legal procedure in which a mortgaged property is sold in a legal process to pay the outstanding debt in case of default.[23] Foreclosure laws vary according to each state's statutes on the topic. Generally, foreclosures are either judicial (i.e., conducted primarily through court proceedings) or nonjudicial (i.e., conducted largely outside of the state's judicial system).

Government-Sponsored Enterprises (GSEs)

Business organizations chartered and sponsored by the federal government, such as Fannie Mae and Freddie Mac.

Guarantee

An agreement to repay a loan or ensure performance. It may be limited in time and amount.[24] With respect to mortgage-backed securities, a guarantee takes the form of assurance of timely principal and interest payments to security holders.[25]

Insurance

Indemnification one obtains against loss from a specific hazard or peril.[26] Mortgage insurance is one such example. A federal agency may insure private lenders against the risk that a particular borrower will default on his or her mortgage. By offering to insure the borrower's mortgage, the federal agency reduces the risks those private lenders might incur and thereby encourages those lenders to extend credit to borrowers who might not otherwise qualify for mortgages in the private market.

Loan Modification

A loan modification alters the original loan's terms to make it comparatively easier for the borrower to pay back what is owed. A loan modification may extend the period in which the borrower must repay the amounts due, reduce those amounts, or take some other step to make the obligation less burdensome on the borrower.

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23 Mortgage Bankers Association, *Mortgage Banking Terms*, 10th ed., p. 67 (2004).

24 Esty, Benjamin C., *Glossary of Project Finance Terms and Acronyms* (2004). Accessed August 30, 2011, at www.people.hbs.edu/besty/projfinportal/glossary.htm#Top.

25 HUD, *Glossary*. Accessed August 30, 2011, at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/buying/glossary.

26 Institute of Financial Education, *Glossary of Financial Services Terminology*, p. 40 (1990).

Loss Mitigation

Steps taken by the mortgage lenders to avoid the need to foreclose on properties subject to a mortgage upon which the borrower is at risk of going into default. Such steps may benefit both the lender and the borrower. Examples of loss mitigation activities include but are not limited to loan modifications and short sales.

Real Estate Owned (REO)

A class of real property owned by the lender. The term REO is derived from the Generally Accepted Accounting Principles (GAAP) category, "Other Real Estate Owned." Under GAAP, REO properties are booked as nonperforming assets due to the lender's lack of recourse against the borrower. The lender may acquire the property through a forcible repossession or foreclosure or by the borrower's voluntary award, such as a deed in lieu of foreclosure.[27]

Servicing

Certain activities undertaken in connection with loans. Servicing a mortgage loan means taking those steps that are necessary to maintain the loan from when it is made until when the last payment is received, at which point the mortgage instrument is canceled. Servicing steps are varied and may include billing the borrower, collecting mortgage payments, and escrowing real estate tax and fire and casualty insurance payments.[28]

Short Sale

The sale of a mortgaged property in which the lender permits the property to be sold for less than the full amount owed on the loan. However, a lender's permitting a short sale does not necessarily entail acceptance of this lesser amount as full payment on the loan or otherwise waiving the remaining deficiency.

Underwater

Term used to describe situations in which the homeowner's equity is below zero (i.e., the home is worth less than the balance of the loan(s) it secures).

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27 Washington State Department of Financial Institutions, *Managing Your Credit Union's OREO Property: Guidance and Best Practices* (2010). Accessed August 31, 2011, at www.dfi.wa.gov/cu/pdf/oreo-best-practices.pdf.

28 Institute of Financial Education, *Glossary of Financial Services Terminology*, p. 46 (1990).

Appendix D
Contact Information

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