



OFFICE OF INSPECTOR GENERAL

Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

July 24, 2015

The Honorable Elijah E. Cummings
Ranking Member
Committee on Oversight and Government Reform
House of Representatives
Washington, DC 20515

Dear Ranking Member Cummings:

This letter responds to your request to the Federal Housing Finance Agency (FHFA) Office of Inspector General (OIG) regarding management of real estate owned (REO) properties by Fannie Mae and Freddie Mac (collectively, “the Enterprises”). Specifically, you asked us to report on the controls Fannie Mae and Freddie Mac “have in place to prevent violations of the Fair Housing Act” by REO maintenance vendors; whether the Enterprises “conduct regular reviews to ensure that [REO maintenance vendors] are complying with the requirements of the Fair Housing Act;” and whether such reviews have “identified any type of disparate impact,” and, if so, what “corrective actions have [the Enterprises] implemented.”¹

Both Enterprises are required to maintain all REO properties, regardless of their location, without “regard [to] race, color, religion, sex, handicap, familial status, or national origin,” and both impose contractual requirements on their REO vendors to maintain REO properties in the same condition across the country.² To respond to your request, we conducted an

¹ By letter dated June 23, 2015, to seven federal regulators with oversight responsibilities for housing issues, 15 U.S. senators asked these regulators to investigate whether REO properties in communities of color had a higher number of maintenance and marketing deficiencies than REO properties in comparable white communities.

² The Department of Housing and Urban Development’s regulations implementing the Fair Housing Act prohibit “[f]ailing or delaying maintenance or repairs of sale or rental dwellings because of race, color, religion, sex, handicap, familial status, or national origin.” See 24 C.F.R. §100.65(b)(2).

audit survey to (1) understand the requirements imposed by the Enterprises on REO vendors for the initial and ongoing maintenance of REO properties and the differences, if any, in these requirements between the Enterprises; (2) determine whether the Enterprises adopted internal controls to monitor work performed by their vendors; and (3) assess whether the Enterprises took remedial actions against their REO vendors when their internal controls identified deficiencies. The following summarizes our findings.

Background

If a borrower defaults on his/her obligation to repay a mortgage owned or guaranteed by one of the Enterprises, that Enterprise (or one of its authorized representatives) may seek to foreclose on the underlying property in an effort to recoup the amount due. Once a foreclosure has occurred, the property typically becomes part of the Enterprise's REO inventory. Each Enterprise has a financial interest in maintaining and securing its inventory of REO properties in order to preserve value until the property is sold and to reduce the credit losses incurred from the defaults. At year-end 2014, the Enterprises collectively owned approximately 113,000 homes and,³ according to Enterprise officials, spent about \$557 million on REO maintenance in that calendar year. To break the numbers down further, as of December 31, 2014, Fannie Mae owned approximately 87,000 REO properties and had spent \$280 million on maintenance, while Freddie Mac owned nearly 26,000 REO properties and spent \$277 million on maintenance.

Each Enterprise has announced virtually identical strategic goals for the maintenance of its REO properties: to secure and maintain them so that they are appealing to prospective buyers and ready for sale. Specifically, Fannie Mae's strategy is to "maintain each property in [its] inventory at a level of market-readiness both inside and outside of the property, supporting neighborhood stabilization,"⁴ and Freddie Mac's strategy is for its homes to be in "comparable or better condition than the other homes for sale in the immediate market."⁵

Both Enterprises retain vendors to maintain their REO properties but use different approaches to select their vendors. Historically, Fannie Mae followed a "national" approach for REO maintenance. Fannie Mae officials informed us that as of August 2014, Fannie

³ Fannie Mae, *2014 Annual Report on Form 10-K* at 131 (February 20, 2015), online at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2014/10k_2014.pdf, and Freddie Mac *2014 Annual Report on Form 10-K* at 177 (February 19, 2015) online at http://www.freddiemac.com/investors/er/pdf/10k_021915.pdf.

⁴ Fannie Mae, *REO Sales Guide*, at 80 (February 2015).

⁵ Freddie Mac, 2014 HomeSteps Guidebook for Brokers and Vendors, at 89 (March 2014).

Mae contracted with five vendors nationwide to perform maintenance work: three of its vendors were assigned to service its REO properties in 47 states, the District of Columbia, and some additional U.S. territories; and two of its vendors were assigned to service its REO properties in the remaining three states. The five vendors, in turn, contracted with a number of local subcontractors to perform a good deal of the REO maintenance work. These same officials advised us that Fannie Mae is continuing its transition from its historic “national” approach to a hybrid approach. As of July 2015, Fannie Mae has contracted with a total of nine vendors. Some of these vendors will continue to service many states and some will service smaller geographic areas. Freddie Mac has long used a “regional” approach. According to Freddie Mac officials, Freddie Mac contracts with 22 vendors in markets that generally have high concentrations of REO and relies on real estate brokers to manage maintenance of REO properties in markets with lower REO concentrations.

Findings

1. Both Enterprises have established requirements and standards for the initial and ongoing maintenance of REO properties.

Each Enterprise imposes requirements and establishes standards for the maintenance of REO properties in its respective vendor contracts. Among other things, contracts used by both Enterprises require REO maintenance vendors to comply with anti-discrimination laws, including the Fair Housing Act.⁶

The Enterprises’ vendor contracts establish the standards each vendor must follow to maintain the respective Enterprise’s REO properties. These standards require vendors to perform “initial” and “ongoing” maintenance activities.⁷ Both Enterprises confirmed that contract requirements, standards, and timing metrics are reinforced through corresponding mandatory training provided by the Enterprises to their vendors.

The first set of standards for “initial” maintenance, which are triggered when an REO property is assigned to a vendor, impose on that vendor the obligation to perform four

⁶ In addition, Freddie Mac’s contracts include a vendor code of conduct that requires vendors to work “without respect to the race, color, religion, sex, national origin, handicap or marital status, age, familial status, source of income, or sexual orientation.”

Both Enterprises require real estate brokers marketing REO properties to sign master listing agreements in which they agree to comply with fair housing laws.

⁷ Freddie Mac permits the real estate broker assigned to market the REO property with authority to add or remove maintenance services required by Freddie Mac’s vendor contract.

general categories of maintenance activities within a specified number of days upon receiving that assignment.

Table 1 provides examples of the requirements and timing metrics for initial maintenance.

TABLE 1. ENTERPRISE REQUIREMENTS FOR VENDORS' INITIAL MAINTENANCE OF REO PROPERTIES

Initial Maintenance	Contractual Requirements for Performance
Remove debris/trash from interior and exterior, including: disposal of inoperable appliances, window dressings, play sets, and above ground pools	Fannie Mae: 5 days [†] Freddie Mac: 3 business days [‡]
Clean interior⁸	Fannie Mae: 5 days [†] Freddie Mac: 3 business days [‡]
Landscaping/exterior, including: cutting grass, weeding, trimming trees and shrubs near entryways, and edging walkways and driveways	Fannie Mae: 5 days [†] Freddie Mac: 3 business days [‡]
Securing the property/re-keying⁹	Fannie Mae: Vendors are required to identify and resolve safety hazards and security issues as part of initial services. Brokers are required to re-key the property within two days.

⁸ Both Enterprises impose comprehensive requirements for the initial interior cleaning in their contracts. See Fannie Mae, *Field Services Checklists* (accessed June 15, 2015) (online at https://homepath-activated.netdna-ssl.com/content/pdf/Field_Services_Checklist.pdf) and Section 1.4 “Initial Services” of its services agreements with maintenance vendors; Freddie Mac, Section 5(e)(i) “Initial Interior Cleaning” of its services agreements with preservation and maintenance vendors. The requirements cover such tasks as vacuuming or sweeping and mopping floors; cleaning bathroom cabinets, sinks, tubs, and toilets; cleaning out kitchen appliances; and wiping down ceiling fan blades, light fixtures, and switch plates.

⁹ Both of the Enterprises’ maintenance vendors perform property security tasks as part of their initial maintenance activities. These tasks include securing exposed windows, doors, and openings; securing or replacing loose stairway handrails; capping exposed wiring; replacing broken or missing switch plates; replacing light bulbs; removing nails and hooks from walls; securing pools and hot tubs; and placing padlocks on outbuildings. The broker assigned to market an REO property bears responsibility for the initial re-keying of that property.

Initial Maintenance	Contractual Requirements for Performance
	Freddie Mac: Vendors are required to secure the property within 1 day to 3 business days, depending on the activity. [‡] Brokers must re-key the property before completing the property condition certificate informing Freddie Mac of the condition of the property.

[†] Fannie Mae's contracts require maintenance vendors to maintain a monthly average timeline of completing initial services within five calendar days or less across all assigned properties.

[‡] Freddie Mac allows vendors 5 business days to complete certain initial maintenance activities in states where foreclosure sales occur on the first Tuesday of every month, such as Georgia and Texas.

While both Enterprises impose obligations on their REO vendors to perform initial maintenance in each of these four general categories, the specificity of the contractual requirements differs between the Enterprises. For example, the initial maintenance requirements imposed by Fannie Mae's contract specify that loose cabinets, drawers, and countertops be secured; Freddie Mac's contract does not include those specifications. Conversely, Freddie Mac's contract requires REO vendors to cover all pools on REO properties; Fannie Mae's contract does not include that specification.

The second set of contractually imposed requirements for “ongoing” maintenance arises after the initial maintenance has been completed. Examples of those requirements and timing metrics are summarized in Table 2.

TABLE 2. ENTERPRISE REQUIREMENTS FOR VENDORS' ONGOING MAINTENANCE OF REO PROPERTIES

Ongoing Maintenance	Contractual Requirements for Performance
Clean interior¹⁰	Monthly for both Enterprises

¹⁰ The Enterprises' vendors are required to maintain the interior cleanliness of their REO properties through monthly cleaning visits. Both Enterprises have similar comprehensive requirements for monthly interior cleaning, which include dusting; sweeping; mopping; vacuuming; cleaning of surfaces, fixtures, appliances, doors, and windows; and replacing light bulbs, smoke detector batteries, and air fresheners, if necessary.

Ongoing Maintenance	Contractual Requirements for Performance
Maintain yard¹¹	Fannie Mae: Weekly regardless of the season Freddie Mac: Weekly during the appropriate seasons
Re-secure property, should additional security measures be required¹²	Fannie Mae: Vendors are required to identify and resolve safety hazards and security issues during monthly interior cleaning and weekly yard maintenance Freddie Mac: 1 day
Remove snow¹³	Fannie Mae: 2 days or in compliance with local codes and ordinances, whichever is less Freddie Mac: Within 24 hours
Winterize¹⁴	Fannie Mae: 2 days ¹⁵ Freddie Mac: 3 business days

Again, the specificity of the required contractual tasks in each of the on-going maintenance categories differs between the Enterprises. For example, Fannie Mae's contractual ongoing interior cleaning requirement specifies ceiling cobweb removal, wiping down walls, cleaning the interior of all appliances, and attic and crawlspace cleaning on a monthly basis;

¹¹ Vendors are required to maintain the yards of Enterprise REO properties on a weekly basis during the appropriate seasons. The Enterprises generally require their vendors to perform the same landscaping activities covered under initial services. For Fannie Mae, mail is removed as part of the weekly maintenance of the yard. Freddie Mac includes this task in its requirements for monthly interior cleaning.

¹² Both Enterprises require vendors to re-secure the REO property in the event of a break-in or vandalism.

¹³ The Enterprises' vendors are expected to remove snow from driveways, walkways, entrances, and public sidewalks, and to apply salt to cleared areas, within specified timeframes.

¹⁴ In regions that experience freezing temperatures, the Enterprises' vendors winterize REO properties to protect them from freezing pipes and other damage. For Fannie Mae, this includes all steps necessary to maintain and protect a property for damages caused by changes in temperature. Steps include prevention of the freezing or breakage of the plumbing system. For Freddie Mac, vendors must perform services prior to freezing weather to protect the property from damage. Services include disconnecting water sources, draining water heaters, and draining pipes throughout the property.

¹⁵ Fannie Mae expects vendors to achieve overall winterization within 2 calendar days.

Freddie Mac's does not. Whereas Freddie Mac's contractual on-going cleaning requirement specifies HVAC filter replacement, if needed, and trash compactor cleaning on a monthly basis, Fannie Mae's does not.

Both Enterprises permit real estate brokers assigned to market REO properties to request additional maintenance services, such as cleaning gutters and washing windows, and allow REO vendors to seek authorization for similar types of services.

2. Both Enterprises have established internal controls to monitor work performed by REO maintenance vendors.

Each Enterprise has adopted a number of complimentary internal controls to monitor vendor compliance with contractual requirements and maintenance standards.

- *Controls imposed by broker inspection of vendors.* Each Enterprise requires the real estate brokers who have listed REO properties for sale to inspect those REO properties weekly for maintenance deficiencies and to document findings with date-stamped pictures. Additionally, Fannie Mae requires brokers assigned to market REO properties to inspect the initial services performed by the maintenance vendor and approve the work in order for the maintenance vendor to be paid.
- *Controls imposed by anonymous complaint hotlines.* Each Enterprise also maintains hotlines for neighbors or bystanders to report concerns and complaints about REO properties. Freddie Mac posts its hotline numbers on the front windows of its REO properties. Fannie Mae's hotline is available on its HomePath website.
- *Controls imposed by quality control inspections performed by independent inspection contractors.* Each Enterprise has hired independent contractors (three for Fannie Mae and two for Freddie Mac) to assess whether the maintenance activities performed by REO vendors comply with established contractual standards for approximately 30% of eligible REO properties every month: those independent contractors are required to submit written reports of those assessments.¹⁶ Beginning in September 2014, Fannie Mae directed its

¹⁶ Both Enterprises' vendors perform quality control inspections on 30% of eligible REO property each month. Fannie Mae defines eligible REO property as those that have received the broker inspection approval of initial services. Officials informed us that Freddie Mac's definition is: REO property that is available listed inventory—assets in a listed status and

independent inspection contractors to perform inspections on 100% of its REO properties located in majority minority areas so that Fannie Mae could compare the quality of REO maintenance work performed in majority minority areas to the work performed in other communities to determine whether there was any difference in the quality of the REO maintenance efforts. For the period September 2014 through June 2015, Fannie Mae's analysis of independent quality control inspections showed the average final grade of REO inspections of homes located in majority minority communities was 90.87% and the average final grade of REO inspections of homes located in non-minority communities was 90%. That analysis found less than a 1% difference in average quality score between REO properties in majority minority communities and in non-minority communities.

- *Controls imposed by internal Enterprise review of the independent quality control inspection reports.* Each Enterprise has assigned full-time employees (eight at Fannie Mae and one at Freddie Mac) to review each month the written assessments by the independent quality control inspectors. Fannie Mae requires its eight employees to review 400 written assessments each month, approximately a rate of 2.5 reviews each day. When a written assessment flags maintenance deficiencies that Fannie Mae considers to be a high risk (like an unsecured pool), Fannie Mae requires the affected vendor to remediate the deficiencies immediately. For deficiencies not considered high risk, Fannie Mae notifies its vendors of the deficiencies and provides them seven days in which to remediate. Pursuant to its vendor contracts, Fannie Mae can seek chargeback fees from vendors for specific deficiencies and/or for the severity of deficiencies. Freddie Mac requires its one employee to review 300 written assessments each month, a rate of approximately 15 each day. Any issues flagged in the written assessments are discussed in monthly meetings between Freddie Mac and the affected maintenance vendor or listing broker. Officials informed us that depending on the severity of the failure, they will require the vendor to remediate the issue by reperforming the work.
- *Controls imposed by onsite assessments of REO properties by Enterprise employees.* Each Enterprise has assigned full-time employees (the same eight

awaiting offer, negotiating an offer, or awaiting contract. Both Enterprises exclude properties located in Alaska, American Samoa, Guam, Puerto Rico, and the Virgin Islands due to the nominal inventory and the elevated cost of inspection completion due to difficulty of access. Further, Freddie Mac excludes property types that have an exceptionally high likelihood of restricted access, such as condos, condotels, co-ops, vacant land, and townhomes.

Fannie Mae employees reviewing written assessments from the independent quality control contractors and six Freddie Mac employees separate from the one employee reviewing the written assessments) to make onsite visits to REO properties to assess the quality of maintenance work by REO vendors. Fannie Mae requires each of its eight employees to conduct roughly 150 inspections per month.¹⁷ Freddie Mac requires its six employees to perform 300 onsite assessments each quarter,¹⁸ or roughly 16 to 17 assessments per employee per month.

OIG conducted an audit survey to respond to this Congressional request, therefore we do not have an adequate basis on which to render an opinion about the overall effectiveness of each of these internal controls.

OIG recognized that there was a significant risk that the volume of monthly reviews of the independent quality control inspection reports and onsite assessments of the quality of REO maintenance activities could not be sustained over time, on a robust basis, by the limited number of assigned Enterprise employees. For that reason, we conducted limited testing of both metrics.

OIG reviewed Freddie Mac's desk reviews of the written independent inspection company reports and onsite assessments for the second quarter of 2015 against its established metrics and found that Freddie Mac met both metrics for that quarter. Freddie Mac officials reported to us that the one Freddie Mac employee assigned to conduct desk reviews completed reviews of 900 inspection company reports on REO maintenance performed nationwide for the second quarter ending June 30, 2015, meeting the goal of 300 reviews per month. The same officials advised that Freddie Mac employees completed 344 onsite

¹⁷ Fannie Mae's procedures state that when a Field QC specialist completes one caravan (which are informational training events that increase awareness of expectations) they are given credit for the three properties that they actually inspect from the caravan, plus seven to accommodate for the time spent during the caravan versus inspecting. This may result in less than 150 actual inspections by a field QC specialist but with the accommodation, the 150 would be met.

¹⁸ Freddie Mac allocates the 300 quarterly onsite assessments to each of its six staff based on, among other things, the volume of REO properties in the states that make up each of its six regions, the location of the regional office, and time and budget.

assessments of the maintenance quality of REO properties nationwide for that quarter, exceeding the target of 300.¹⁹

Because Fannie Mae has assigned more employees to complete desk reviews and onsite assessments and imposes greater completion requirements on each employee, OIG reviewed the output for April 2015 from two of the eight Fannie Mae employees assigned to complete desk reviews and onsite assessments. OIG found that one of the two employees met the metrics established by Fannie Mae during this month and one did not. For April 2015, the one Fannie Mae employee responsible for the Florida and Alabama territory completed 65 desk reviews of the written independent inspection company reports, exceeding the metric of 50 desk reviews. Because of approved leave in April, that employee's on-site assessment target was reduced from 150 to 100: that employee conducted 119 on-site assessments for that month, in excess of the reduced target. For that same month, a second Fannie Mae employee, responsible for seven southwestern/southern states (Arizona, New Mexico, Texas, Oklahoma, Arkansas, Louisiana, and Mississippi), completed no desk reviews. Fannie Mae officials reported to OIG that this employee completed 136 desk reviews in May, which met her April and May 2015 targets. However, that employee completed only 91 (60.7%) of the required onsite assessments in April and 22 (14.7%) of the required on-site assessments in May, for a total of 113 (37.66%) of the 300 required onsite assessments for both months. Fannie Mae officials advised OIG that this employee did not meet the goals because of the press of other work.

The Enterprises report that they use additional tools to monitor vendor performance including:

- Scorecard reviews
- Periodic meetings
- Audits
- Surveys
- Account reviews
- Operational reports.

¹⁹ While Freddie Mac employees achieved 114% of the second quarter goal, seven Freddie Mac employees, rather than the current complement of six employees, conducted onsite assessments for two of the three months during this quarter and six employees performed the onsite assessments for one month.

3. Both Enterprises have identified material deficiencies with the maintenance performed by several REO vendors and imposed remedial measures

Freddie Mac officials reported to us that it found 1 of its 22 REO vendors failed to meet contractual requirements in both 2013 and 2014 and placed that vendor on informal probation in 2013 and formal probation in 2014. They further advised that Freddie Mac identified a second contractor in 2014 who failed to meet contractual requirements and placed that vendor on probation. According to these officials, a vendor's probationary status can result in reduced assignments, additional training, imposition of a performance improvement plan, and/or additional monitoring. Both vendors were removed from probationary status in the second half of 2014 by Freddie Mac.

Fannie Mae officials reported to OIG that it found that 3 (of its 5) REO vendors failed to meet contractual requirements in 2014. While Fannie Mae does not place its vendors on "probation," it can impose the same measures that Freddie Mac can impose for vendors on probationary status. Fannie Mae reduced the assignments for one of the three REO maintenance vendors and placed it on a performance improvement plan; it placed the other two vendors on specific improvement plans to address the identified deficiencies ranging from work quality to timeliness.²⁰ Table 3 summarizes the vendor failures to meet contractual requirements and remedial actions taken by each Enterprise.

**TABLE 3. ENTERPRISE RESULTS OF QUALITY CONTROL REVIEWS
OF REO MAINTENANCE VENDORS**

Vendor Performance Issue	Remedial Actions
Freddie Mac vendor not meeting service level requirements in contract	Freddie Mac placed the vendor on informal probation in 2013 and formal probation in 2014. ²¹ The vendor's action plan indicated that it hired more

²⁰ Fannie Mae had placed one of those vendors on an action plan in 2013. Fannie Mae officials informed us that it places REO maintenance vendors on performance improvement plans when performance issues warrant consequences related to the vendors' continued employment. The performance improvement plans reiterate contractual requirements and notify the vendor that if metrics are not met, the contract will be terminated or work load will be reduced. Fannie Mae places REO maintenance vendors on action plans as a result of a noted need for improvement. Fannie Mae considers action plans to be a first step in requiring a vendor to bring its performance in line with contractual requirements.

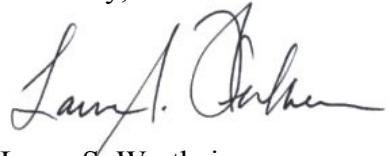
²¹ Freddie Mac officials informed us that informal probation involves monitoring by the business unit of the vendor's performance. If performance issues continue, the vendor will be referred to the Vendor Services Disciplinary Committee and placed on formal probation.

Vendor Performance Issue	Remedial Actions
	staff, retrained subcontractors, and reinforced standard quality control measures. Freddie Mac removed the vendor from probation in August 2014.
Freddie Mac vendor not meeting contract requirements in the areas of communication, timeliness, quality of work, and billing; reported broker dissatisfaction with vendor's work	Freddie Mac placed the vendor on probation in 2014. The vendor's action plan indicated that it created a broker liaison position, conducted vendor training and scorecard reviews, and terminated several subcontractors. Freddie Mac officials informed us that the vendor was removed from probation in September 2014.
Fannie Mae vendor not meeting contract requirements in the areas of communication, timeliness, quality, and reporting	Fannie Mae officials informed us that they reduced the vendor's work and placed the vendor on a performance improvement plan in 2014. The vendor decided not to renew the contract in March 2015.
Fannie Mae vendor not meeting contract requirements in the areas of quality, timeliness, and delivery	Fannie Mae placed the vendor on an action improvement plan with a target completion date of October 2015. Fannie Mae officials informed us that actions completed include implementation of an incentive program. Ongoing actions include increasing broker communication and adopting numerous changes to its vendor management department.
Fannie Mae vendor not meeting contract requirements in the areas of quality, timeliness, and delivery	Fannie Mae placed the vendor on an action improvement plan with a target completion date of October 2015. Fannie Mae officials informed us that actions completed include adoption of a photo direct application, which is a mobile application used to streamline reception of photos and implementation of quality reviews. Ongoing actions include participating in broker caravans (which are informational training events that increase awareness of expectations), encouraging communication between vendors and brokers, and conducting vendor training.

Freddie Mac officials informed us that, as of June 2015, its internal controls and monitoring identified no performance issues with any of its top five vendors (based on the dollar value of the contract) that required remediation plans. Through its internal controls and monitoring, Fannie Mae reached a different result during the first half of 2015: two of its five vendors were placed on performance improvement plans in May 2015 for a number of issues including failing to resolve safety concerns requiring immediate attention and failing quality control routine inspections.

Thank you for asking OIG to report on the Enterprises' efforts to secure compliance with the Fair Housing Act by their REO vendors. I hope this information is helpful to you. Should you have any further questions, please feel free to contact me at (202) 730-0880 or Tewana Wilkerson, OIG's Director of External Affairs and Risk Analysis, at (202) 730-0888. We look forward to continuing to work closely with you and your staff.

Sincerely,

A handwritten signature in black ink, appearing to read "Laura S. Wertheimer".

Laura S. Wertheimer
Inspector General