

Executive Summary

The Texas Department of Housing and Community Affairs' (Department's) single-family loan process includes multiple divisions that review the loan applications received by third-party administrators and determine program eligibility, as well as other divisions that provide quality assurance, prepare loan documents and set up loans for servicing. We reviewed the single-family loan processing function from program approval of the loan application through receipt of the trailing documents after loan closing. However, we did not review the process for determining applicant eligibility. We judgmentally selected 30 files each from the HOME Homeowner Rehabilitation Assistance (HOME HRA), HOME Homebuyer Assistance (HOME HBA), and the Bootstrap Loan programs to test whether the Department processes single-family loans according to federal regulations, state rules and Department policies, and whether information in the Department's loan origination and servicing system (MITAS) is accurate and complete.

The Department should consistently obtain the trailing documents required as evidence that a loan is valid and that the Department's lien position is properly recorded. Of the 90 loan files we tested, 10 (11.1%) were missing evidence of the recorded deed of trust, five (5.6%) were missing evidence of a title policy, and two (2.2%) were missing evidence of a final HUD-1 settlement statement. This does not mean that these documents do not exist elsewhere, but rather that the Department does not have copies of these documents in its files. This creates a risk if:

- the documents are later needed to support the Department's lien position,
- insurance coverage is needed due to problems with the title commitment, or
- the Department needs to prove that all parties were informed of the charges involved in the transaction.

In addition, the Department should ensure that all title commitments are current and that all federal disclosures are provided during the loan closing process as required. We tested 90

Loan Processing

Single-family loans are processed in multiple divisions of the Department, which review the loan applications and determine eligibility for their individual programs. Also:

- The Program Services Division reviews loan documents for quality assurance. Program Services also follows up on and reviews the post-closing trailing documents.
- The Legal Division prepares closing documents and loan closing instructions for the title companies.
- The Loan Servicing section of the Financial Administration Division is responsible for setting up each loan in the Department's MITAS loan origination and servicing system.

The Department implemented a loan tracking database (called the Loan Window) in the fourth quarter of fiscal year 2012 to track and facilitate loan processing through each division.

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closed loan files and found that 13 (14.4%) loans were closed without evidence of current title commitments and six (6.7%) loan files were missing evidence that the Department provided certain disclosures to the borrower as federally required. A title commitment contains information on the encumbrances affecting the property and provides assurance that the title is clear of other liens. The Texas Administrative Code (for the HOME rules) requires that a title commitment is current prior to the execution of closing documents.

For the 90 single-family loans we tested, we compared information in the hard copy loan files to information in the Department's MITAS loan origination and servicing system and found that the information in MITAS is generally complete and accurate.

The Department has made changes to its procedures that appear to have shortened the amount of time it takes to process some loans. We measured loan processing time as the number of business days from a program area's approval of the loan application to the loan closing date. Although not all of the loans we tested were entered into the tracking system (called the Loan Window) as required by standard operating procedure, for the 90 loans we tested, the average loan processing times have significantly decreased from fiscal year 2012 to fiscal year 2013 for the HOME HBA and HOME HRA programs. Because the Bootstrap Loan Program includes a self-help construction period that is beyond the Department's control, we were unable to determine the average loan processing times for the Bootstrap Loan Program.

Summary of Recommendations

The Department should:

- obtain and review all of the required trailing documents from the title companies after closing, run the outstanding trailing document report monthly and follow up on any missing documents as required by the loan closing policy, and ensure consistency in the requirements for the return of trailing documents to the Department.
- ensure that an updated title commitment is received prior to closing.
- maintain evidence that disclosures required by the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act were provided to the borrower.
- ensure that the Legal Division periodically reviews the templates used by the HOME HBA loan closer to determine if they should be revised, and reviews the loan documents on a sample basis to ensure they are being completed accurately and used as intended.
- ensure that loans are entered into the Loan Window as required so that loan processing times can be tracked.

Summary of Management's Responses

Management has indicated that they are in agreement with the recommendations in this report and they are working to implement them.

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Detailed Results

Chapter 1

The Department Should Obtain All Trailing Documents

The Department does not consistently obtain the trailing documents required to evidence that a loan is valid and that the Department's lien position is properly recorded. This does not mean that these documents do not exist, but rather that the Department does not have copies of these documents in its files. This creates a risk if the documents are later needed to support the Department's lien position or the terms of the loan. Trailing documents are documents that are received after a loan is closed and funded. They include: evidence of a recorded deed of trust, a title policy, and an approved settlement statement (called a HUD-1.)

We tested 90 closed loan files, 30 each for the HOME Program's Homeowner Rehabilitation Assistance (HOME HRA) Program, HOME Homebuyer Assistance (HOME HBA) Program and the Bootstrap Loan Program. We found that:

- 10 (11.1%) of the 90 closed loan files tested did not contain evidence that the deed of trust was recorded by the title company. If a deed of trust is not recorded, the Department's lien position, as stated by the deed of trust, could be superseded by other liens recorded prior to the recording of the Department's lien.
- 5 (5.6%) of the 90 closed loan files tested did not contain evidence of a title policy. Without evidence of a title policy, the Department does not have assurance that it is protected against damages resulting from problems with the title.
- 2 (2.2%) of the 90 closed loan files tested contained approved final HUD-1 settlement statements that were not the original document or a certified copy. In addition, one of those two was not signed by a representative of the title company. Without evidence of a certified, executed final HUD-1 settlement statement, the Department does not have assurance that all parties to the loan transaction have been informed of the charges involved in the transaction.

The Department's loan closing policy requires staff in the Program Services Division (Program Services) to follow up each month on any trailing documents that have not yet been received from the title companies. However, Program Services does not run the reports necessary to identify missing trailing documents on a monthly basis.

In addition, closing instructions from the Department to the title companies direct the title companies to return certain trailing documents to Program Services. However, the deadlines for

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returning the trailing documents vary by program and are sometimes not consistent within the same program. For example, the HOME HRA program guidance sometimes requires trailing documents to be returned to the Department within 20 days and sometimes within 60 days. This can create confusion for both the title companies and the Department's staff in tracking the due dates of trailing documents.

Recommendation

The Department should:

- obtain and review all of the required trailing documents from the title companies after closing,
- run the outstanding trailing document report monthly and follow up on any missing documents as required by the loan closing policy, and
- ensure consistency in the requirements for the return of trailing documents to the Department.

Management's Response

Management concurs with the recommendations. The Program Services Division, working with the Loan Servicing Section and the program areas, as appropriate, will ensure that deadlines for submission of trailing documents are made consistent and that there is systematic follow-up for the trailing documents to ensure they are received and reviewed for all closed loans. In addition, the Program Services Division will ensure that policies and procedures, including checklists, and monthly reporting, are updated and implemented by December 31, 2013, and that except as programmatic requirements may dictate otherwise, these are consistent from program to program.

Responsible person: Brenda Hull

Corrective action date: December 31, 2013

Chapter 2

The Department Should Ensure that All Loan Documents are Processed According to Rules and Policies

The Department should ensure that all title commitments are current and that all federal disclosures are provided during the loan closing process as required. We tested 90 closed loan files and found that 13 (14.4%) loans were closed without evidence of current title commitments and six (6.7%) loan files were missing evidence that the Department provided certain disclosures to the borrower as federally required. In addition, we found that the Department's HOME HBA loan documents are not prepared or reviewed by the Legal Division (Legal).

A title commitment contains information on the encumbrances affecting the property and provides assurance that the title is clear of other liens. Title commitments expire 90 days from their stated effective date. The Texas Administrative Code (for the HOME rules) requires that a title commitment is current prior to the execution of closing documents.

The federal Truth in Lending Act and the Real Estate Settlement Procedures Act (RESPA) require multiple forms of disclosure to be provided to borrowers at various times throughout the lending process. We tested for two of these disclosures in the loan files, one required by the Truth in Lending Act and one required by RESPA. We found that six (6.7%) of the 90 files we tested were missing at least one of these disclosures. This does not mean that these documents do not exist, but rather that the Department does not have copies of these documents in its files. Without these disclosures on file, the Department does not have evidence that it has complied with the federal requirements for these disclosures.

In addition, the Department's HOME HBA loan program documents are not prepared or reviewed by Legal staff. Program Services staff use templates approved by Legal to prepare the loan documents. Legal prepares or reviews the loan documents for the other single-family loan programs we tested (HOME HRA and Bootstrap). We were unable to determine why the HOME HBA program is different.

Chapter 2-A

Ensure that Title Commitments are Current at Loan Closing

The Department should obtain current title commitments at the time of loan closing. A title commitment is a report of the status of the property being sold. It contains information on the recorded owner, proposed buyer and lender, the property's legal description, and encumbrances affecting the property. Thirteen (14.4%) of the 90 closed loan files we tested did not contain evidence of a current title commitment when the loan was closed.

Title commitments expire 90 days from their stated effective date. According to the Texas Administrative Code, Title 10, Part 1, Chapter 23, Subchapter C, §23.32 (b)(1) and Subchapter D, §23.42(b)(1), a title commitment or title policy that expires prior to execution of closing must be updated at closing. At the time of closing, these 13 expired title commitments were between 92 and 438 days old. Without updated title commitments, the Department does not have assurance that the property's title is clear from all other liens outside of the commitment's effective date and expiration date.

Recommendation

In instances where the title commitment has expired, the Department should ensure that an updated title commitment is received prior to closing.

Management's Response

Management concurs with the recommendation and will immediately implement policies and procedures to ensure that the Department verifies that each loan has a current title commitment on file at the Department at the time of loan closing to demonstrate compliance with the Texas Administrative Code.

*Responsible person: Jennifer Molinari, Brenda Hull
Corrective action date: November 5, 2013*

Chapter 2-B

Maintain Documentation of All Required Federal Disclosures

The Department should maintain documentation of all required federal disclosures. The federal Truth in Lending Act and the Real Estate Settlement Procedures Act (RESPA) require that multiple forms of disclosure be provided to borrowers at various times throughout the lending process.

We tested 90 closed loan files for two disclosure statements, one required by the Truth in Lending Act and one required by RESPA. These disclosures must be provided to the borrower prior to loan closing. Six (6.7%) of the 90 files we tested were missing evidence of these disclosures. Five of the six files were missing both disclosures and one file was missing only the RESPA disclosure. This does not mean that these documents do not exist, but rather that the Department does not have copies of these documents in its files. Without these disclosures on file, the Department does not have evidence that it has complied with the federal requirements for these disclosures.

Recommendation

The Department should maintain evidence that disclosures required by the Real Estate Settlement Procedures Act and the Truth in Lending Act were provided to the borrower.

Management's Response

Management concurs with recommendation and will implement processes to ensure disclosures are maintained in the files.

*Responsible person: Jennifer Molinari, Homero Cabello, Brenda Hull
Corrective action date: December 1, 2013*

Chapter 2-C

Re-Visit the Process for Preparing HOME HBA Loan Documents

The process for preparing HOME HBA loan documents is different from the process used by the other single-family programs we tested. The loan closing documents for HOME HBA loans are not prepared or reviewed by Legal staff. Instead, the loan closing documents are prepared by staff in Program Services using templates approved by Legal. However, these templates have not been reviewed or updated by Legal since 2011. As a result, errors or irregularities in the prepared loan documents could occur and may go undetected.

Recommendation

The Department should ensure that the Legal Division:

- periodically reviews the templates used by the HOME HBA loan closer to determine if they should be revised, and
- reviews the loan documents on a sample basis to ensure they are being completed accurately and used as intended.

Management's Response

Management has reviewed the process for the preparation of HOME HBA loan documents and determined that the process will include a review by the Legal division. The updated process, including a Legal review for all loans, will be implemented by November 15, 2013. In addition, the HOME, Legal and Program Services divisions will ensure that the loan document templates are periodically reviewed and updated.

*Responsible person: Jennifer Molinari, Brenda Hull
Corrective action date: November 15, 2013*

Chapter 3

Information in the Loan Servicing System is Generally Accurate and Complete

Information in the Department's loan origination and servicing system (MITAS) is generally accurate and complete. We tested 90 single-family loans to determine if the information in MITAS matched the information in the hard copy loan files. We compared the information in MITAS to the information in the hard copy files for the following data (depending on the type of loan):

- note date
- loan maturity date
- loan term
- type of loan (repayable, forgivable, deferred forgivable, etc.)
- loan amount

We noted only two minor data entry errors in the 90 loans we tested. These errors were promptly corrected by management after they were identified.

Chapter 4

Loan Processing Times are Improving for Some Programs

The Department’s average loan processing times for some programs are improving. The Department implemented a loan tracking database (called the “Loan Window”) during the last quarter of fiscal year 2012 to track and facilitate the progress of loans. For the 90 loans we tested, we compared loan closing times during fiscal year 2012 to loans closing times during fiscal year 2013. We measured loan closing time as the number of business days between a program area’s approval of the loan application and the loan’s closing date. This was measured as the date listed in the Department’s Housing Contract System when the loan setup was approved by the accounting section – the last step in the Housing Contract System’s activity setup.

We tested 30 loans each from the HOME HRA, HOME HBA, and Bootstrap single-family loan programs. The Bootstrap Loan Program includes self-help construction activities between the time of loan approval by the program staff and the loan’s closing date. The pace of these construction activities is beyond the Department’s control. Consequently, we were unable to reliably measure the closing times for Bootstrap loans using the available data.

Loan Processing Times (in Business Days)	HOME HRA Average	HOME HRA Longest	HOME HRA Shortest	# of HRA Loans	HOME HBA Average	HOME HBA Longest	HOME HBA Shortest	# of HBA Loans
Fiscal Year 2012	81.7	160	30	15	21.3	191	1	16
Fiscal Year 2013*	35.7	65	20	15	10.9	36	1	14

*Through July 15, 2013

We also noted that 12 (13.3%) of the 90 loan files we tested were not recorded in the Department’s Loan Window. These loans were closed after the implementation of the Loan Window on June 9, 2012. The Department’s loan closing policies and procedures require Department staff to input information into the Loan Window at various points in the loan processing cycle. When staff does not update the Loan Window, staff members in other divisions who participate in the loan processing cycle are unable to track a loan’s progress through the Department. In addition, information used to determine the loan processing time is not readily available.

Recommendation

The divisions involved in loan processing should ensure that loans are entered into the Loan Window as required so that loan processing times can be tracked.

Management's Response

Management appreciates the information regarding improved processing times and will ensure that loans are consistently entered and tracked in the Loan Window.

*Responsible person: Jennifer Molinari, Homero Cabello, Brenda Hull
Corrective action date: November 5, 2013*

Appendix A

Objectives

The objectives of the audit were to determine whether:

- 1) single-family loans are processed according to federal regulations, state rules, and Department policies, and
- 2) information in the Department's loan servicing system is accurate and complete.

Scope

The scope of this audit was state fiscal years 2012 and 2013 through July 15, 2013.

Methodology

The following methodology was developed and was used to answer the audit objectives:

- We interviewed program staff in the HOME, Bootstrap, Program Services, Loan Servicing, and Legal divisions and reviewed checklists, standard operating procedures, Texas Administrative Code, and federal code and regulations related to processing loans for the HOME HBA, HOME HRA, and Bootstrap single-family loan programs.
- We tested a sample of HOME HBA, HOME HRA, and Bootstrap loan files to determine if they are prepared according to established criteria. As part of the assessment we determined if the key documents (or acceptable copies) are obtained and retained by the Department as required.
 - Based on discussions with the Legal Division and reviews of the Texas Administrative Code, divisional checklists, and divisional processes, the key documents tested for the HOME HRA, HOME HBA, and Bootstrap programs were the:
 - promissory note,
 - deed of trust,
 - Truth in Lending statement,
 - HUD-1 settlement statement
 - title commitment, and
 - title policy.
 - For the HOME HBA program and the Bootstrap Loan program we tested the RESPA disclosure.
 - For the HOME HRA program we tested the:
 - mechanic's lien note,

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- mechanic's lien contract, and
- construction loan agreement.
- For the Bootstrap Loan program we tested the real estate lien note.
- We determined if the trailing documents were tracked, received or followed-up on. Based on discussions with the Legal Division and reviews of the Texas Administrative Code, divisional checklists, and divisional processes, the trailing documents we tested were the:
 - title policy
 - recorded deed of trust, and
 - certified, final HUD-1 settlement statement.
- We determined the actual timeframes for loan processing based on the time between the program's approval of a loan application and the loan closing date.
- We determined if the loans were setup in the loan origination and servicing system (MITAS) accurately and completely by comparing the data in MITAS to information in the hard copy files. We verified that the information in the system and the loan files agreed for the:
 - borrower's name,
 - loan program,
 - loan type,
 - loan amount,
 - loan term,
 - loan closing date, and
 - maturity date.
- We did not evaluate the process used to determine an applicant's eligibility for a loan.

Type of Audit

This audit was a performance audit of the Department's single-family loan processing.

Report Distribution

As required by the Texas Internal Auditing Act (Texas Government Code, Chapter 2102), this report is distributed to the:

- Texas Department of Housing and Community Affairs' Governing Board
- Governor's Office of Budget and Planning
- Legislative Budget Board
- State Auditor's Office
- Sunset Advisory Commission

Project Information

We conducted audit fieldwork from July 2013 through October 2013. We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was also conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

The following staff performed this audit:

Betsy Schwing, CPA, CGMA, CFE, Project Manager

Nicole Kludt, CFE, CICA

Derrick Miller

Appreciation to Staff

We would like to extend our sincere appreciation to the management and staff of the HOME, Program Services, Office of Colonia Initiatives, Legal, and Financial Administration divisions for their cooperation and assistance during the course of this audit.

Appendix B

Background

The single-family loan processing function crosses multiple divisions of the Department. The loan application's intake is handled by a subrecipient who then submits the application to the applicable program area within the Department. A performance specialist in the program area reviews the application and sends it to the Program Services Division where a loan specialist will perform a quality assurance review. The loan specialist then moves the loan application to a loan closer in the Program Services Division who prepares the loan documents for review and signature by an attorney in the Legal Division. The Legal Division prepares loan closing documents to be provided to the title company for execution. However, if the loan application is for the HOME HBA program, then the loan closer prepares all of the loan documents. The Legal Division then returns the documents to the loan closer who forwards the documents to the title company. The title company closes the loan. The title company returns the loan documents to a post-closer in the Program Services Division for review. The post-closer then collects the reviewed loan packet and sends it to the Loan Servicing Section of the Financial Administration Division. The Loan Servicing Section uses the loan documents to set up the loan in the Department's MITAS loan origination and servicing system.