



*Date:* May 3, 2005

*To:* Ed Kitchen, City Manager

*From:* Internal Audit Division

*Subject:* Housing & Community Development Loans Written-Off

Attached you will our report of loans reviewed in the Housing & Community Development Department. These loans are maintained under the Affordable Home Loans Program to provide assistance to families that qualify. H&CD has replied to our report and we have replied to their responses. We are in agreement with H&CD that standard written procedures should minimize any issues that may arise moving forward. H&CD is developing a procedures manual that we will review upon its completion. If you have any questions please let us know. Thanks.

A handwritten signature in black ink, appearing to read 'Len Lucas', with a long horizontal stroke extending to the right.

Len Lucas  
Internal Audit Director

Cc: Ben Brown, Assistant City Manager for Economic Development  
Andy Scott, Director of Housing & Community Development



*Date:* November 17, 2004

*To:* Andrew Scott, Director of Housing & Community Development

*From:* Internal Audit

*Subject:* Department of Housing and Community Development (HCD) Loan Foreclosures

The Internal Audit Division has performed a compliance review of the HCD Loan Foreclosures provided to them for the period 1997 through October 2004. HCD has 25 different codes for type of loans. Not all the data fields for each file on the foreclosed spreadsheet were complete. Type 66 loan is called Greensboro Affordable Home Loans (AHL). This type of loan is for first time homeowners or for owners who have not owned property within the past 3 years. The potential borrower has to complete an application and go through an approval process by HCD. After the borrower completes an application, they participate in homeowner counseling. There is a maximum loan approval based on the borrower's household size and income. HCD requires a credit report, job verification and reference on the borrower. Also, HCD hires a licensed contractor from North Carolina to do a building inspection of the property. After the loan has been approved, HCD's staff is involved in the closing of the loan with the borrower's attorney, first mortgagee and real estate broker.

Per the AHL brochure, the HCD range for AHL loans is between \$2,000 to \$5,500. However, 24 AHL loans that were written-off were for more than \$5,500. Borrowers under the AHL loan system do not have to pay anything on the loan principal or interest to HCD until the first mortgage lender's loan matures or is paid off which is typically 30 years. Presently there is no procedure to follow up periodically by HCD personnel with the borrower during the term of the loan. For the review period, AHL loans foreclosed amounted to \$483,827 or 59% of the total foreclosed amount of \$824,977.

The other types of HCD loans are those which the borrower immediately begins paying interest and principal when the loan is made. These types of loans are followed up with the borrower by sending correspondence such as periodic statements on account. HCD stated since the Construction Loan Control System (CLCS) went on-line on November 1, 2001, that no statements have been sent out to any AHL borrower. Excluding Multi-Family loans, the total loan balance outstanding at October 31, 2004 amounted to \$13.8 million. AHL loans amounted to \$2.9 million or 21.0%. All other loans amounted to \$11.0 million or 79.0%. For the review period, HCD foreclosures amounted \$824,977 about 3.5% of total present loans outstanding. Even though this percent is low, AHL foreclosure percent to the total of all foreclosures is high at 59%.

After discussing foreclosures with HCD personnel, we concluded there are no standard written procedures for the processing of foreclosed loans. Of the 13 files examined from the HCD Foreclosed spreadsheet, documents in the files ranged from 2 to 8 documents. The average days it took for the HCD outside attorney to notify HCD from the Foreclosure sale to write-off the loan was 432 days and the average days HCD took to write-off the loan from the attorney memo was 223 days. HCD advised us that they try to write off the loans within 30 to 45 days. HCD does not write-off a loan until they receive a memorandum from their outside attorney.

The Greensboro City attorney for HCD stated that even though there might be a lack of written procedures or an abnormal length of time to write-off loans the loss is small at \$5,000 to \$10,000 per loan. Per the HCD Foreclosure worksheet the average amount per foreclosure was \$6,395 and the range was from

\$1,095 to \$50,083. Also, the City attorney mentioned the City does not have to cancel their loans from record once the foreclosure sale has taken place. As per the attorney, if the City were to decide to purchase a foreclosed property, the City would have the expense to pay the 1<sup>st</sup> lender, if any, for its investment; rehab the property to government standards; and incur carrying and selling cost.

Internal Audit reviewed and did an abstract of file #73; Barbara J. Williams's foreclosure because the total loan was for \$50,083 compared with the average of the other foreclosed loans of \$6,054. HCD loaned Ms. Williams an AHL loan in the amount of \$4,875 when she purchased the property in 1992. After she purchased the property, Ms. Williams advised HCD of major repairs that needed to be done to the property both land and building. The inspector who the City hired to do the inspection for the AHL loan turned out not to be licensed by the state of North Carolina. The City loaned Ms. Williams an additional \$45,208 to have the repairs done. Ms. Williams purchased the property in 1992 in the amount of \$48,750. The 1<sup>st</sup> lender loan amount was for \$45,350 and the HCD loans were for \$50,083. Together all loans outstanding in 1995 were for \$95,433. However, the appraisal the City requested in 1995 was only for \$53,000 conditioned on completion of repairs. This made an over funded amount of \$42,433 in the property. There was a clause in paragraph 4 of the note dated November 27, 1995 that said the City would forgive the \$43,900 if Ms. Williams decided to sell the property after January 1, 2000. On February 18, 2003 the 1<sup>st</sup> lender, National City Mortgage purchased the property at Foreclosure Sale for \$44,722.58 even though the City had more invested at \$50,083. Since the loan payments on the HCD loans were not due until October 1, 2022, the loans were not periodically reviewed by HCD.

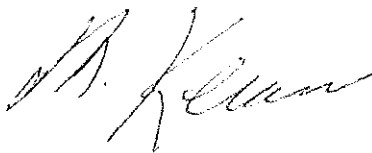
AHL's present loan balance at October 31, 2004 is \$2.9 million. The largest number of foreclosures per year for AHL loans was 38 in 2002 and the greatest amount was \$217,000 in 2003. Because of the amount of AHL loans (21% of Total Loans) and since these loans are essentially not monitored during the term of the loan, Internal Audit would suggest that HCD undertake the following recommendations regarding foreclosures:

1. HCD should formulate written procedures to monitor all outstanding loans. AHL loans should be followed up in writing with borrower at least once per year.
2. HCD should develop written procedures to track the process of each foreclosure and its write-off. The process, the documents, and the approvals needed should be consistent from foreclosure to foreclosure. Suggested documents could include but not limited to:
  - a) Notice of foreclosure
  - b) Check list of procedures to follow
  - c) Notice of foreclosure sale
  - d) Current appraisal
  - e) Engineering inspection
  - f) Write-off recommendation memo from outside attorney
  - g) Pay-off form
  - h) Journal entry
  - i) Notice of periodic follow-up with borrower by HCD
  - j) Checking obituaries, City Collections; Guilford County Tax records and deeds of records
  - k) Certificate of insurances
  - l) Approvals from city attorney, finance department and HCD manager.
3. In order for the City to not overstate its assets or understate its expenses, loans, which have been determined by HCD to be uncollectible, should be written off in a timely manner.

4. Since HCD originates the loans and has custody of the loans, final approval of the write-off should be the responsibility of someone outside of the HCD department.
5. Concerning File #73, Barbara J. Williams, HCD should follow up on the \$20,000 due the City for the Assigned Judgment against Malik, wife and Malik's company.
6. Reference file #73, if not too late, the City should consider bringing a civil suit against Ms. Williams and all other parties involved as suggested by Scott Brannan's memorandum dated April 24, 2003.
7. Currently HCD does hire a N. C. licensed contractor to perform a building inspection of the property for their AHL loans. After review of the needed repairs in the inspection report, we suggest that HCD should require only bids from N. C. licensed General Contractors. When the repairs have been completed to satisfaction of all parties then the parties should sign a document agreeing to that fact. Also, on the building inspection report submitted from the contractor, there should be disclaimer from liability as was suggested by attorney James Turner in his letter to Andrew Scott dated November 24, 1993.
8. Each HCD outstanding loan should have a current Certificate of Insurance in its file.
9. HCD should try and maintain the Foreclosed spreadsheet they prepare as complete and current as possible.
10. Internal Audit makes the recommendation that AHL loan payment deferrals not exceed five years rather than the present thirty years or when the 1<sup>st</sup> Lender's final payment is due.

Internal Audit requests a written response to our recommendations by December 1, 2004.

We would like to thank Ms. Linda Jones, Ms. Linda Wilson, Ms. Von Patrick and Ms. Rhonda Enoch for their courtesy and cooperation shown to us during this compliance review. If you should have any questions or comments we can be reached at 373-2821.

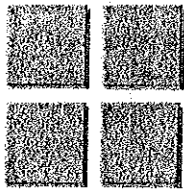


Mickey Kerans  
Internal Auditor



Len Lucas  
Internal Audit Director

Cc: Ben Brown, Assistant City Manager for Economic Development



# HCD

Department of Housing & Community Development

## MEMORANDUM

Date: February 23, 2005

To: Len Lucas, Mickey Kerans

From: Andy Scott *AS*

Re: HCD Loan Foreclosures

This is in response to your Memorandum of November 15, 2004, a review of the policies, procedures, loans and dollars involved with City loan foreclosures. We have reviewed the report and offer the following comments.

The foreclosed property spreadsheet that you noted had some missing data was created after the fact and the data fields mentioned that are not complete are for data that was not available from the foreclosure attorney in the early years. It is not important information to our tracking of foreclosed properties. The type of data missing included foreclosure purchase price and who purchased the property; this is not information that is important to the City's record base but has been provided by our current outside legal counsel and is now included on the spreadsheet.

In your review of the Affordable Home Loan (AHL) Program, our first time home buyer's soft second mortgage, the following information needs to be corrected:

- (1) a licensed home inspector not a licensed contractor prepares the home inspection report for which the program pays.
- (2) The correct amount of AHL foreclosures is \$473,827 and the total foreclosures on all loan in the portfolio is \$816,727.
- (3) The first mortgage loan is approved by the private first mortgage lender. This information should be added to the description.
- (4) The AHL program began operation in 1991 and loan terms at its inception were: 10% of the selling price was lent as a 30 year, 0% interest, balloon payment loan due at payoff of the first mortgage and a 2% grant that could be used as needed for closing costs and/or down payment expense. The terms of the AHL program were designed in conjunction with the underwriting criteria of Freddy Mac, First Union National Bank and United Guaranty. These loan and grant amounts terms have changed over the years; the grant has been eliminated and the loan amounts have decreased based on a sliding scale of family size and income. To verify if

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there were any foreclosures for improper amounts, you would need to review the cases cited above with the then current loan/grant program terms. Staff would be glad to assist you with this review.

The report noted that there was not a current plan in place for HCD personnel to follow up with the borrower during the term of the loan. Annually, maintenance of insurance coverage is verified for each property, a current copy of coverage is maintained for the property; the owner is contacted if there is no current insurance. The City's prior loan system, Fiserv, allowed us to send an annual statement to each loan client. Since the City went on the CLCS system in November 2001, we have not been able to print off a statement for non-performing (no monthly and/or annual payment) loans. Being aware that this is a problem, we are working with a consultant to assist with creating a post-closing education program and looking at possible financial assistance for these borrowers. The North Carolina Housing Finance Agency (NCHFA) has recently created a program called the NC Home Protection Program, being administered in Greensboro by Consumer Credit Counseling and Self-Help Credit Union, designed to assist lower income first-time home buyers to avoid foreclosure through an education and loan program. This program was created because of the high foreclosure rate among low income borrowers due to job losses and economic downturn in NC over the last few years. Set out below is data on Greensboro's foreclosures which shows the same kind of higher foreclosure over the past few years.

The City's foreclosed property list was analyzed by date of foreclosure. The results are:

- 38 foreclosures between 1991 and 2000 (10 year period)
- 19 foreclosures in 2001
- 32 foreclosures in 2002
- 34 foreclosures in 2003
- 9 foreclosures in 2004

Data from United Guaranty has been requested for NC foreclosures; when received we will compare with Greensboro's foreclosed loans to see how our percentages compared to the balance of NC. We did secure information from the Mortgage Bankers Association on the foreclosure inventory over the past few years. From the period of quarter 3, 1998 to quarter 3, 2000 the foreclosure inventory tracked along between .8% and .9% and then rose in quarter 1 of 2001 to 1%. By quarter 1 of 2003 it had risen to 1.8% and stayed there until quarter 1 of 2004; by quarter 3 of 2004 it had fallen to 1.5%. Clearly, this data support the economic downturn in NC during those years.

Processing of foreclosed loans is done in accordance with our internal procedures. Loans are not written off until we receive a memorandum from our outside attorney advising us that the foreclosure has been consummated. This can be a lengthy process and may account for the time noted in your memo regarding the time it takes to process foreclosures.

At the time of the home inspection for Barbara Williams, the state did not require that home inspectors be state licensed; hence, we would not have required that the inspector be state licensed. The home inspector, Malik, did a very poor inspection, missing some significant structural problems that were later discovered. Staff relied on his report to proceed with the AHL. When the need for repairs was brought to our attention, it was determined that the program should be responsible for completing the repairs as Ms. Williams relied on a home inspection report that we had prepared in the purchase of her home. A judgment against Mr. Malik, the inspector, for his negligence in this inspection was secured but is still outstanding. Ms. Williams lost her home to foreclosure in 2003; the City note stated that if she sold the property after January 1, 2000, the City would forgive the loan. She met the time stipulation for forgiveness and the loan was forgiven and written-off.

Staff would be glad to meet with Internal Audit staff to review our written procedures and would appreciate input on how to improve the foreclosure process. Regarding your suggestions on program and policy changes, staff will discuss the changes with the City's Legal Department in conjunction with research on programs carried out by other cities. Please advise of a time that your staff would like to meet to discuss these matters.



Date: May 2, 2005

To: Andy Scott, Director of Housing & Community Development

From: Internal Audit Division

Subject: Loan Foreclosures in H&CD

We have reviewed your responses to our report issued on the H&CD loan foreclosures and have evaluated your comments in our follow-up meeting held on April 26, 2005. We are in agreement that written procedures developed by you and your staff will minimize future issues, if any arise, as we move forward with the loans administered by H&CD. We realize this is a tedious and sometimes time consuming process. We look forward to reviewing the procedures manual upon its completion.

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Mickey Kerans  
Internal Auditor

A handwritten signature in cursive script, appearing to read 'L. Lucas'.

Len Lucas  
Internal Audit Director

Cc: Ben Brown, Assistant City Manager for Economic Development