TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
An Internal Audit of the Management of Nonperforming Loans
Audit Report # 21-002

Executive Summary

The Office of Internal Audit (OIA) reviewed delinquency rates for the Direct Loans managed by TDHCA. We reviewed loan balances as of 8/31/2020, the end of the audited fiscal year and as of 2/28/2021, the end of our audit period. We found that the highest delinquency rates reside in the Single Family Direct Loans, with 83% of those current and 17% in some state of delinquency for various reasons at 8/31/2020 and remained constant overall at 2/28/2021. The Multifamily Direct Loans had a current rate of 88% with 12% in delinquency as of 8/31/2020. As of 2/28/2021, 87% were current and 13% were in delinquency.

Based on our reviews the function of the Management of Nonperforming Loans is performing effectively overall with some suggestions for consistency and efficiency. OIA encourages embracing the new technology upgrades to the primary bonds and loans processing system, MITAS to enhance processing and customer service.

Observations and Recommendations

1. Because of the current economic environment and increased risk of delinquencies, Internal Audit recommends that management consider a dashboard to monitor loans and delinquency status to take action as necessary.
2. Internal Audit recommends forming a committee composed of management and senior staff from Loan Servicing, Asset Management and Financial Administration that will review all process changes from the MITAS systems upgrade for effectiveness and efficiency, as well as customer service functions including electronic payment processing and account access, and plan implementation accordingly along with additional capital budget requests. User documentation including definition of system codes and statuses, as well as SOPs and training materials should be updated.
3. OIA recommends that management review the mail and check posting system to determine if any changes could be made safely to streamline the process.
4. OIA recommends that the Program Controls and Oversight Division continue its current temporary holds on loan modifications and refinancing until eligible homeowners could be referred for any programs that would assist them as part of the CARES and American Rescue Plan acts. Actions and new policies should be fully documented and approved.
5. Internal Audit recommends that while coordinating processes during the MITAS upgrade, Asset Management updates its SOPs for consistency and reliability. At that time, the delinquent loans monitoring process and REO management should be formalized including guidelines for document storage for single family REOs.

Management Response

Management agreed with our recommendations. Detailed responses are included in the body of the report.

Objectives, Scope and Methodology

Our objectives included explaining the Management of Nonperforming Loans function across various loan types, both those funded by revenue bond issuance and direct loans from federal funds and state general revenues; and to evaluate the administrative and internal control procedures related to the function. Our scope included a review of applicable portions of the Texas Governmental Code, Texas Administrative Code, TDHCA Board resolutions, and the Standard Operating Procedures (SOP) of Divisions tasked with managing nonperforming loans. Based upon our preliminary understanding of the Management of Nonperforming Loans we identified critical points of risk to develop audit objectives and a methodology, reflected in the detailed audit program. We reviewed the controls related to the Management of Nonperforming Loans and tested certain transactions and controls described throughout the detailed report.

Mark Scott

Mark Scott, CPA, CIA, CISA, CFE, MBA	6/4/2021
Director, OIA	Date Signed

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Board Members of the Texas Department of Housing and Community Affairs ("TDHCA")

RE: INTERNAL AUDIT OF THE MANAGEMENT OF NONPERFORMING LOANS

Dear Board Members:

This report presents the results of the Office of Internal Audit ("OIA") "*Review of the Management of Nonperforming Loans*". This audit was conducted in accordance with applicable audit standards. It included the objectives to explain the Management of Nonperforming Loans function across various loan types, both those funded by revenue bond issuance and direct loans from federal funds and state general revenues, and to evaluate the administrative and internal control procedures related to the function.

The Management of Nonperforming Loans rated high on the risk assessment and was included in the approved Fiscal Year 2021 audit work plan due to the ongoing Pandemic and its potential effects on the risk of nonperformance for both single and multifamily loans.

This report includes the following sections:

A. Audit results
B. Background
C. Scope and methodology
D. Types of loans facilitated or made by TDHCA
E. Processes and flow of transactions
F. Testing and review
G. Other audit work

A) AUDIT RESULTS

OIA reviewed delinquency rates for the Direct Loans managed by TDHCA. We reviewed loan balances as of 8/31/2020, the end of the audited fiscal year, and as of 2/28/2021, the end of our audit period. We found that the highest delinquency rates reside in the Single Family Direct Loans, with 83% of those current and 17% in some state of delinquency for various reasons at 8/31/2020 and remained constant overall at 2/28/2021; however, as of 2/28/2021, the average number of days outstanding has increased.

The Multifamily Direct Loans had a current rate of 88% with 12% in delinquency as of 8/31/2020. As of 2/28/2021, 87% were current and 13% were in delinquency.

Single and Multifamily Bond-funded loan delinquencies are managed by external parties via contractual obligation. However, as an additional review, the Bond Finance Division has determined underlying delinquencies of loans funded by Single Family Bonds at 76% current with 24% delinquent as of January 2021 based on information provided by the loan servicer; the Multifamily Bonds are managed through trustee relationships under appropriate legal documentation or individual Trust Indentures for each Bond issue, however the Financial Administration Division performs a monthly review and accounting of payments and balances.

OIA notes that the Single Family Direct Loans, as discussed in detail below, are made to the most vulnerable and very low-income populations; default risk is high, but the Agency has put in place policies to manage and assist these borrowers. These financial products, their target borrowers, and the processes and controls surrounding the Management of Nonperforming Loans are included in the remainder of this report.

B) BACKGROUND

As the State's primary housing facilitator for the benefit of cost-burdened, low-income Texans, TDHCA provides financing to both create and preserve affordable housing rental stock and allow Texans who would otherwise be unable to do so, reach the dream of home ownership. Home ownership is the main wealth accumulation vehicle for most Americans, so bringing this ability to low and very low-income Texans can be transformative.

Texas Government Code § 2306 authorizes the TDHCA Board of Directors to issue revenue bonds for the purpose of making funds available for multifamily affordable rental developments, as well as to make loans available to individuals and families of low and very low-income.

TDHCA creates these opportunities by bringing together disparate investors, thereby spreading development and ownership default risk across the market. By both issuing and acting as a conduit issuer for Revenue Bonds, and making direct loans to both potential homeowners and affordable housing developers, TDHCA facilitates liquidity in the market in which these activities are funded.

TDHCA manages a portfolio of bonds that fund underlying loans for single family homeownership and facilitates loans for affordable multifamily developments; the Agency also makes direct loan funds available to individuals, families, and affordable rental property developers. All mortgage revenue bonds are issued within Trust Indentures and because of the protections placed within the revenue bond documents, they represent either limited or no liability to TDHCA. The single family bonds fund lending to moderate, low and very low-income individuals and families which are then pooled into mortgage backed securities (MBS) guaranteed by Ginnie Mae and Fannie Mae. The origination and servicing of these loans are outsourced to external parties. The single family bond trust indentures are only responsible for advancing delinquent payments, to the extent delinquencies exceed prepayments or unplanned payments on the loans. Prepayments (such as payoffs, early principal payments) in the underlying portfolio as of January 2021 were calculated at four times the delinquent amounts, so liquidity in those instances has not been affected. Fees received on the underlying mortgage loans and repayments of second loans are deposited to the single family indentures. Both single family indentures (SFMRB and RMRB) are rated AA+/Aaa. As of January 31, 2021, the SFMRB indenture had $37 million, and the RMRB indenture had $14 million, in excess assets, excluding second mortgage loans, which totaled $121 million and $139 million, respectively.

For both single and multifamily purposes, TDHCA provides direct loans to both potential homeowners and affordable rental property developers. TDHCA is often viewed as the lender of last resort, so these types of loans tend to have more delinquency risk than the average conventional loan. As such, TDHCA applies focused tactics to managing these loans and offering multiple options to make the affordable housing financing packages work whether for the developer, an individual or a family.

The Revenue Bond Program FY2020 audited financial statement that includes single and multifamily bonds reports total assets of $2.8 billion, most of which is held in trust. The statements report total liabilities of $2.4 billion. Direct loans, both single and multifamily, are included in the General Financial Statements and represent $753 million, with a loan loss allowance of $10 million. The following presents excerpts from the financial statements, representing the Single and Multifamily Revenue Bonds included in the proprietary fund and Direct Loans made from governmental and proprietary funds, that have been explored in the scope of this audit report.

Revenue Bonds from the Proprietary Fund
Loans from Proprietary and the Governmental Funds
$ in 1,000s 8/31/2020

		Source	***Funds***
Multifamily	**$751,793**	*Revenue Bonds financials*	*Proprietary (external investors)*
Single family	**$243,750**	*Revenue Bonds financials*	*Proprietary (external investors)*
RMRB	**$889,610**	*Revenue Bonds financials*	*Proprietary (external investors)*
Total Bonds	**$1,885,153**		
Loans and Contracts- government funds	**$464,358**	*Basic financials*	*HOME, NSP, TCAP RF, NHTF, SHTF, general funds (federal and state government funds)*
Loans and Contracts- proprietary	**$278,926**	*Basic financials*	*Single Family Bond residuals (Down Payment Assistance), Habitat for Humanity Bootstrap loans*
Loans and Contracts	**$743,284**		*Net of loan loss allowance ($10M)*

The following analyses provide delinquency information as of 8/31/2020 and 2/28/2021 specifically for those Direct Loans included in OIA's review. OIA discussed these categories with Financial Administration and determined that the difference between the totals presented here versus the above exhibit is reasonable due to differences in classification between fund sources. The balances and delinquency rates below are presented specifically for those multifamily or single family loans made and serviced directly by TDHCA or via the partnership with Habitat for Humanity and is intended primarily to provide context to the discussion within the report.

Delinquency Rates in TDHCA Direct Loans as of 8/31/2020
$ in 1,000s

	Total Principal			Amount and Percentage Delinquent**									
Type of Loan	Outstanding	Current	Percent	30-59 days	%	60-89 days	%	90-119 days	%	120-364 days	%	365+ days	%
Multifamily	$403,974	$357,763	88%	$13,194	3.3%	$14,887	3.7%	$5,456	1.4%	$9,202	2.3%	$3,491	0.9%
Single Family- non HFH*	$24,743	$19,026	77%	$2,356	9.5%	$899	3.6%	$578	2.3%	$1,400	5.7%	$483	2.0%
Single Family - HFH	$27,662	$24,602	89%	$2,212	8.0%	$700	2.5%	$53	0.2%	$0	0.0%	$94	0.3%
Total Single Family	$52,405	$43,628	83%	$4,568	8.7%	$1,599	3.1%	$631	1.2%	$1,400	2.7%	$577	1.1%
Totals	$456,379												

* Habitat for Humanity
** delinquency percentages calculated by amount principal outstanding per category by total principal outstanding
Source: MITAS reports as of 8/31/2020; compared to financial statements for reasonableness

Delinquency Rates in TDHCA Direct Loans as of 2/28/2021
$ in 1,000s

	Total Principal			Amount and Percentage Delinquent**									
Type of Loan	Outstanding	Current	Percent	30-59 days	%	60-89 days	%	90-119 days	%	120-364 days	%	365+ days	%
Multifamily	$411,340	$358,617	87%	$22,441	5.5%	$4,822	1.2%	$0	0.0%	$15,742	3.8%	$9,718	2.4%
Single Family- non HFH*	$24,146	$16,501	68%	$4,669	19.3%	$0	0.0%	$453	1.9%	$1,876	7.8%	$647	2.7%
Single Family - HFH	$27,938	$26,530	95%	$833	3.0%	$318	1.1%	$124	0.4%	$132	0.5%	$0	0.0%
Total Single Family	$52,084	$43,031	83%	$5,502	10.6%	$318	0.6%	$577	1.1%	$2,008	3.9%	$647	1.2%
Totals	$463,424												

* Habitat for Humanity
** delinquency percentages calculated by amount principal outstanding per category by total principal outstanding
Source: MITAS reports as of 2/28/2021; compared to financial statements for reasonableness

Overall, delinquencies have aged by both dollar amount and days outstanding primarily in Single Family Direct Loans- non HFH due to Pandemic conditions where borrowers are impacted by income losses and TDHCA has self-imposed forbearance and leniency for homeowners. Should funding become available via the CARES or American Rescue Act to these borrowers, delinquencies could be impacted favorably with homeownership preserved for eligible borrowers. Multifamily Direct Loans number of days outstanding has increased because some properties have moved to later stages in the process such as foreclosure or bankruptcy.

C) Scope and Methodology

Our scope included a review of applicable portions of the Texas Governmental Code § 2306 Texas Department of Housing and Community Affairs; Texas Administrative Code Title 10, Chapter 12 Multifamily Revenue Bonds Rule, Chapter 13 Multifamily Direct Loans Rule, and Chapter 20 Single Family Programs Umbrella Rule; TDHCA Board resolutions including those providing authority for single family workouts, and the Standard Operating Procedures (SOP) of Divisions tasked with managing nonperforming loans. Based upon our preliminary understanding of the Management of Nonperforming Loans we identified critical points of risk to develop audit objectives and a methodology, reflected in the detailed audit program.

We reviewed the Management of Nonperforming loans functionally and across divisions to determine the function's goals as well as the underlying processes, divisional roles and responsibilities; we included the review of workflow between divisions. We reviewed the controls related to the Management of Nonperforming Loans and tested certain transactions and controls described throughout Sections D, E and F. The Texas Internal Auditing Act, Tex. Gov't Code §2102.005 requires auditing of a state agency's major programs and systems.

D) Types of Loans Facilitated or Made by TDHCA

- **Multifamily Bond-Funded Loans**
  TDHCA acts as a conduit issuer of Multifamily Revenue Bonds that provide funding from external investors so that TDHCA can facilitate financing to developers that build and rehabilitate affordable rental housing for low and very low-income individuals and families. The underlying loans are structured in various ways to optimize available funding and are paired with housing tax credits. The bonds and loans maintain underlying agreements that ultimately leave TDHCA with no financial liability; therefore, any activities related to delinquency monitoring reside with trustees under the terms of an indenture agreement. TDHCA through its monthly accounting and reconciliation process can be aware of these situations but simply track through to resolution with no responsibility for ensuring payment. Reference *Multifamily Revenue Bond Audit #20-001* for further detail.

- **Single Family Bond-Funded Loans**
  TDHCA issues single family revenue bonds to finance mortgage loans and to provide down payment assistance to moderate, low, and very low-income borrower homebuyers. TDHCA takes investor capital from the market and makes it available to institutions to originate loans to homebuyers that have more favorable loan terms than those for which they would otherwise qualify for in the mainstream lending market, including, in most cases, down payment and closing cost assistance. These loans are originated by qualified lenders, sold to Idaho Housing Finance Agency where they are serviced, then packaged as mortgage backed securities (MBS) that are purchased with bond proceeds and are held in trust. In turn, Ginnie Mae or Fannie Mae guarantees payment on the MBS. Principal and interest received on the MBS is applied to principal and interest due on the underlying bonds. TDHCA has innovatively used tools available from the federal government and financial institutions to provide a market for bridging the gap to many individuals and families while minimizing risk from default. *Reference Bond Finance Audit #17-002 for further detail*.

- **Multifamily Direct Loans**
  TDHCA utilizes federal funding from HOME, HTF and TCAP to fund direct loans to multifamily property developers that have committed to providing rental housing to low and very low-income individuals and families. These funds are generally low interest, construction-to-permanent loans to assist the developer to complete construction. OIA reviewed the process of monitoring multifamily direct loan delinquencies within

the portfolio that has recently transitioned more fully to Asset Management. Each Asset Manager is assigned a region and is responsible for reviewing the loans within that scope and resolving delinquency concerns. Any complex situations that may lead to options such as modification, refinance, assumption or foreclosure are closely coordinated through the Legal Division with the Asset Manager Director review and approval. (The *Audit of Multifamily Direct Loans, #21-004* is included in the FY2021 Audit Plan; origination to closing and maintenance will be further reviewed, along with the MITAS system security, processing, recovery and reliability.)

- **Single Family Direct Loans**
  TDHCA designates program funds for various loan types that assist with building or rehabilitating a home. These loans are originated through an external party then serviced by either TDHCA or a branch of Habitat for Humanity. These loans are low to no interest bearing and have long maturity periods. TDHCA staff along with Habitat for Humanity servicers are highly involved with the management of nonperforming loans for this portion of the financing portfolio. TDHCA Loan Servicing section dedicates a Senior Collections Specialist to work with borrowers, additional staff support for the Habitat for Humanity coordination, along with extensive management time and oversight. When other options are exhausted, Legal Division services are required. The transition to Loan Services of these functions from 2016 to present has reduced delinquencies from an average days delinquent in the Single Family Direct Loans from 458 days in 2015 to 193 days in February 2021, noting that several of the oldest accounts are 2nd lien subject to 1st lien loan foreclosures; therefore, TDHCA has no way of resolving them until the 1st lien foreclosure is completed. The Board of Directors took various actions to provide Program Controls and Oversight the tools and authority for delinquency resolution in 2016, 2017 and 2018, which were implemented within the processes reviewed by OIA. *Reference Loan Servicing, Audit #19-001* for further detail.

E) Processes and Flow of Transactions

Revenue Bond-funded Loans

After the issuance of Single Family or Multifamily Revenue Bonds, operational processing for underlying loans is completed by outside trustees or other servicers. Therefore, these outside parties are responsible for monitoring and working out or making changes to the underlying loans; these responsibilities are addressed within the legal agreements between the parties. The TDHCA Financial Administration Division tracks all the activities on the Bonds to ensure accuracy and timeliness; they may receive and account for payments and transfers. Reconciliations of trustee statements to internal records on the system MITAS assures that bonds are funded and reported properly. The reconciliations are a final step in the cycle that can identify issues that may need to be reported to management.

The Bond Finance Division is primarily responsible for the relationships with servicers relative to any single family bond-funded loans. Bond Finance monitors the vendor relationship including delinquencies by meeting with vendor management and discussing any issues relative to liquidity within the underlying loans. They observe the delinquency rates on an overall basis by periodically reviewing whether prepayments consistently cover any underlying loan delinquencies. Over the past six months, prepayments have outweighed delinquencies even during the Pandemic; and while the single family bond indentures are ultimately responsible for making the servicer whole for underlying loan delinquencies, TDHCA has not had to do so, and does not anticipate having to do so in the future.

Bond Finance also works with Financial Administration to provide additional analysis to management and the Board through the Quarterly Investment Report (QIR). A supplemental management report included in the QIR shows the balances of all Bonds and their respective trust indentures to show that they balance. In addition, Bond Finance creates a Bond Parity schedule that represents the par value of the assets and liabilities underlying Bond issues to provide assurance that the assets held in trust meet or exceed the values within the liabilities. When these analyses relative to the Bonds are taken together by management, they provide a view of the overall stability of the portfolio.

Direct Loans by TDHCA

Direct loans made by TDHCA result from federal funding and/or general state revenue. The Multifamily Direct Loans are primarily federal HOME or TCAP funds, while Single Family Direct Loans can be either federal such as HOME, HTF or state general revenue for programs such as Bootstrap or Homebuyer's Assistance.

Direct loans made by TDHCA for both multifamily and single family loans are originated and processed on the MITAS system. The Programs Control and Oversight Division manages the post-issue processes along with the Habitat for Humanity servicers and relies on Financial Administration for posting payments, account reconciliation and reporting. Loan Servicing completes all transactional processing within the MITAS system and updates the history of accounts; however, for multifamily loans, the Asset Management section retains some servicing functions due to their knowledge of the properties and owners/managers. These processes relate to the communication and documentation of delinquent Multifamily Direct Loans and any further action through Legal as required, until such time that further transactions are required within MITAS. The Asset Management section manages all Real Estate Owned (REO) transactions for single family homes and multifamily developments. This includes rehabilitating and selling any foreclosed homes or multifamily developments. Within the scope of this audit, OIA reviewed the vendor relationship for these purposes, including contracts and invoicing reviews, approvals and payment.

Documentation for delinquent loan review activities is retained primarily on the shared network drives for Asset Management processes, while there is a mix of documentation on MITAS and on the shared network drive for Loan Servicing and Legal processes. Through discussions with the Loan Servicing Manager, OIA was advised of the planned upgrade to MITAS that will provide a centralized location for documentation for each transaction. Along with the system implementation, the duties and strategies for monitoring and making changes to loans as well as tracking any dispositions through to completion could be made consistent for single and multifamily, allowing for a single access point to information and history.

For the most part, once a single or multifamily loan is issued, the regular process is followed in which the borrower is invoiced or provided a loan coupon book. Payments are received through the mail from all borrowers, including property developers, because TDHCA does not currently have a method of processing electronic payments for all borrowers due to current system limitations. When payments are received, they are posted based on documented procedure unless the account is flagged or the payment contains a discrepancy from expected, in which case Financial Administration will reach out to Loan Servicing who handles the exception processing and communicates how to apply payment.

As long as payments are current, the process is straightforward as payments are applied as expected; at the time a loan becomes delinquent, it comes under more scrutiny. Both Loan Servicing and Asset Management run a report from MITAS that is set up for their individual needs to review delinquent loans. For direct single family loans serviced by TDHCA, the delinquent account report is reviewed by the Senior Collections Specialist who contacts all borrowers with delinquencies of over 45 days. These contacts have varied response rates from borrowers, so often the Senior Collections Specialist must attempt contact several times before any resolution. In tandem, the Asset Management Director will disseminate an Excel spreadsheet listing delinquent multifamily direct loans to the AM team to review the loans that are over 30 plus days overdue in their specifically assigned region. They document their actions on a spreadsheet and consult with the Asset Management Director when loan workouts are needed.

In order to avoid foreclosures, the Loan Servicing section manages the nonperforming loans for single family owners with the understanding that these borrowers are a vulnerable and very low-income population. Loan Servicing calls, emails, offers language translations, and effectively does all the section can to assist the homeowner retain ownership. Barring a lack of interest or effort on the borrower's part, there are many options available:

- Verbal repayment agreements
- Trial repayment agreements
- Written repayment agreements
- Loan modifications
- Loan refinancing, both interest rate reduction and longer maturity dates

However, outside the Pandemic conditions, the Loan Servicing Senior Collections Specialist follows a structured process of communication via mail and FedEx when the borrower does not respond:

- 120 day notice
- Loss mitigation package
- Final Demand Letter

Transaction Review

OIA reviewed transactions from the Single and Multifamily loan delinquencies reports from MITAS to select samples of loans in various conditions as noted above. In addition, OIA selected and reviewed transactions from MITAS reports during the audit period that had moved into other stages of the process such as charge-offs, foreclosures, short sales, modifications, and refinancing.

Although all of these details are tracked internally within Programs Control and Oversight, OIA noted there is no consolidated reporting to management about the overall delinquencies being experienced within the various financing vehicles. Given that delinquencies have gone up during this time despite efforts by TDHCA, these loans should have additional management review to determine how if any federally funded programs can be utilized to keep these borrowers in their homes, or determine next steps.

TDHCA self-imposed a moratorium from foreclosing on any single family properties as a superior lien holder. When in the position of a subordinate lienholder, TDHCA has little decision making ability and simply books excess proceeds when notified. Recently, the Senior Collections Specialist has heard feedback from borrowers that their first lien mortgages are foreclosing.

At year-end, Financial Accounting completes an analysis of the historical loan delinquencies to determine the appropriate loan loss reserve. This analysis includes all direct loans, single or multifamily. OIA reviewed the loan loss reserve analysis and underlying documentation; the balances were also verified and audited by the State Auditor's Office in tandem with the audit of the financial statements.

Review of Payment Posting Process

OIA reviewed the mail and check posting process within the context of loan payments. Due to the Pandemic, mail is delayed; not only from a US Post Office slowdown but also from processing mail two days a week due to safety concerns. This creates potential delays in posting checks, thereby requiring review of accounts that are not in fact delinquent, which OIA noted during its sample testing. Additionally, delays require Staff Services to make copies for various departments to alert them to check receipt.

OIA observed that there is a cash receipts system that lists payor names, check numbers and date of check receipt once Financial Administration inputs them, which is within the day after mail processing. Financial Administration has adjusted its deposit timeline to six from three days as a result. The system provides for an inquiry-only access to this information. Overall, OIA believes that mail processing is being completed as quickly as possible given the changes required due to the Pandemic; however, there may be ways to disseminate information and improve the process going forward and leveraging workflow components of MITAS.

Throughout the audit, OIA noted several manually intensive processes that require input and reconciliation between systems or handoffs between sections or Divisions. These included: manually performing Negative Escrow Analysis (for accounts delinquent over ninety days); all transactional input to the general ledger system; managing digital documentation across locations in the network; and manual input of payoffs.

Again, a MITAS systems upgrade should provide opportunities to further drive not only efficiencies, where it may replace heavy manual processes, but also effectiveness to allow staff to focus on analysis and assistance as opposed to manually duplicating transactional details. This will allow for a better understanding of when loan modifications and refinancing make sense, as these tend to be successful about half the time for single family loans but carry significant internal and external costs. In addition, there will be customer-facing functionality in the form of online account access and electronic payment, which may be identified as additional capital projects in future budget requests.

When requesting Standard Operating Procedures from each section, the Loan Servicing area was able to provide detailed SOPs for each process reviewed; however, the SOPs received from Asset Management needed to be updated as changes have occurred with delinquency monitoring and REO processing. Additionally, given the transitional nature of these processes into Asset Management, it is a good time to define and fully implement these processes consistently.

Observations:

Observation Number	Status Pertaining to the Recommendations and Action to be Taken	Target Completion Date	Responsible Party
21-002.01	Because of the current economic environment and increased risk of delinquencies, Internal Audit recommends that management consider a dashboard to monitor loans and delinquency status to take action as necessary.	8/31/2021	Program Controls and Oversight
21-002.02	Internal Audit recommends forming a committee composed of management and senior staff from Loan Servicing, Asset Management and Financial Administration that will review all process changes from the MITAS systems upgrade for effectiveness and efficiency, as well as customer service functions including electronic payment processing and account access, and plan implementation accordingly along with additional capital budget requests. User documentation including definition of system codes and statuses, as well as SOPs and training materials, should be updated.	12/31/2021 for the Customer Service Portal	Program Controls and Oversight; Financial Administration; Information Services
21-002.03	OIA recommends that management review the mail and check posting system to determine if any changes could be made safely to streamline the process.	7/31/2021	Staff Services; Financial Administration
21-002.04	OIA recommends that the Program Controls and Oversight Division continue its current temporary holds on loan modifications and refinancing until eligible homeowners could be referred for any programs that would assist them as part of the CARES and American Rescue Plan acts. Actions and new policies should be fully documented and approved.	12/31/2021	Program Controls and Oversight
21-002.05	Internal Audit recommends that while coordinating processes during the MITAS upgrade, Asset Management updates its SOPs for consistency and reliability. At that time, the delinquent loans monitoring process and REO management should be formalized including guidelines for document storage for single family REOs.	12/31/2021	Asset Management

Management Responses:

21-002.01: *Loan Servicing and Asset Management will create a report of delinquency data, trends and activities.*

21-001.02: *Currently any modification or upgrade to MITAS is conducted through a collaboration between Financial Administration, Information Systems, and Loan Servicing. They evaluate system upgrade needs, proposed changes, set timelines for the project and evaluate the impact on current processes. Management will work to formalize this process and incorporate any other section that may be impacted going forward.*

The MITAS upgrade project is a two-part project comprised of 1) implementation of a Customer Service Portal that provides customer online account access capabilities and an automated (ACH) payment option; and, 2) implementation of conversion from a Windows based MITAS version to the Web based MITAS version. Implementation of the Windows based MITAS to Web based MITAS is not planned until early 2022 after the annual financial statement audit is complete in December 2021.

The funding for the Customer Service Portal will be available September 1, 2021 at which time the Customer Service Portal will be implemented in a phased approach; the online account access will be available first and followed by the automated (ACH) payment option to be rolled out to a select portion of the loan portfolio, i.e. multifamily loans and a small population of single family loans, to ensure payment rules and processing are working properly before offering the ACH capabilities portfolio-wide. Financial Administration, Information Systems, Loan Servicing and external stakeholders such as Comptroller of Public Accounts will be involved in the decision making related to borrower account information and documentation that will be made available and the creation of payment rules and processes related to ACH capabilities.

21-002.03: *Management will review the mail and check posting system to determine if any changes can be made safely to streamline the process.*

21-002.04: *Loan Servicing will evaluate which loan modifications and refinances can continue on hold while CARES and American Rescue Plan program guidelines are finalized and implemented to determine a delinquent borrower's eligibility for mortgage assistance.*

21-002.05: *While coordinating processes during the MITAS upgrade, SOPs will be updated for consistency and reliability. At that time, the delinquent loans monitoring process and REO management will be formalized including guidelines for document storage for single family REOs.*

F) Testing and Review

As part of the audit, OIA held multiple interviews with management and staff and reviewed samples of transactions selected either randomly or judgmentally based on the ability to stratify and normalize the population. Detailed transactions were reviewed for timely monitoring and resolution within the various options by tracking them within the processes noted above and through to the accounting systems and reports, ensuring appropriate authorization and verification at key control points. In addition, as noted in Section B, OIA reviewed Texas Government Code, Texas Administrative Code, TDHCA rules, and Division level policy, procedures and SOPs to confirm uniformity. Based on our reviews the function of the Management of Nonperforming Loans is performing effectively overall with some suggestions for consistency and efficiency. OIA encourages embracing the new technology upgrades to MITAS to enhance processing and customer service.

G) Other audit work

OIA has conducted audits of Multifamily Revenue Bonds (2020), Bond Finance (2017), Loan Servicing (2019), and the Enforcement Committee (2019) that OIA relied upon in the context of reviewing the Management of Nonperforming Loans. This audit targeted the function's processes and controls that specifically pertain to managing nonperforming loans across TDHCA's portfolio. TDHCA contracts with the Texas State Auditor's Office ("SAO") to conduct annual financial statement audits of the Revenue Bond Program and the Agency as a whole. The latest audit was issued in December 18, 2020, and stated that the financial statements were presented in accordance with Generally Accepted Accounting Principles ("GAAP").

OIA extends our sincere appreciation to the Program Controls and Oversight, the Legal and the Financial Administration Divisions for their cooperation and assistance during the course of this audit.

Sincerely,

Mark Scott

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Internal Audit Director

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