



OFFICE of
INSPECTOR GENERAL
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UNITED STATES DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT

Neighborhood Loans, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans

Audit Report Number: 2025-NY-1004

July 3, 2025

To: Matthew Jones
Deputy Assistant Secretary for Single Family Housing, HU

//signed//

From: Kilah S. White
Assistant Inspector General for Audit, Office of Inspector General, GA

Subject: Neighborhood Loans, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans, Downers Grove, IL

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of Neighborhood Loans, Inc.'s quality control program for originating and underwriting Federal Housing Administration (FHA)-insured loans.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, as amended, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at <https://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call Kimberly S. Dahl, Audit Director, at (202) 617-6886.

Highlights

Neighborhood Loans, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans | 2025-NY-1004

What We Audited and Why

We audited Neighborhood Loans, Inc., to evaluate its quality control (QC) program for originating and underwriting Single Family FHA-insured loans. Our audit covered the period October 2020 through September 2022. We selected Neighborhood Loans for review based on its increasing loan volume and delinquency rate and because its rate of self-reporting loans to HUD when it identified fraud, material misrepresentations, and other material findings that it could not mitigate was below average for 5 of the last 6 years.

What We Found

Neighborhood Loans' QC program for originating and underwriting FHA-insured loans was not sufficient. Specifically, Neighborhood Loans (1) did not select the proper number of loans for review and maintain complete data to document its loan selection process; (2) did not complete all loan reviews in a timely manner; (3) did not always complete key review steps and sometimes missed material deficiencies; and (4) did not adequately assess, mitigate, and report loan review findings, which included self-reporting loans to HUD when required. These issues occurred because Neighborhood Loans had insufficient controls over its QC program, was not always familiar with HUD requirements, and experienced staffing constraints. As a result, HUD did not have assurance that Neighborhood Loans' QC program fully achieved its intended purposes, which included, among other things, protecting the FHA insurance fund and lender from unacceptable risk, guarding against fraud, and ensuring timely and appropriate corrective action.

What We Recommend

We recommend that HUD require Neighborhood Loans to (1) update its QC plan and related procedures to align with HUD requirements; (2) provide training to its staff and management on HUD requirements for lender QC programs; (3) review the loans that it had not selected and take appropriate actions when applicable; (4) review its QC files for loans in which it may not have performed complete reverifications and reverify information where appropriate; (5) evaluate its QC files for reviews in which it did not yet assess the risk of findings identified; and (6) evaluate its QC files for the loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that it did not acceptably mitigate.

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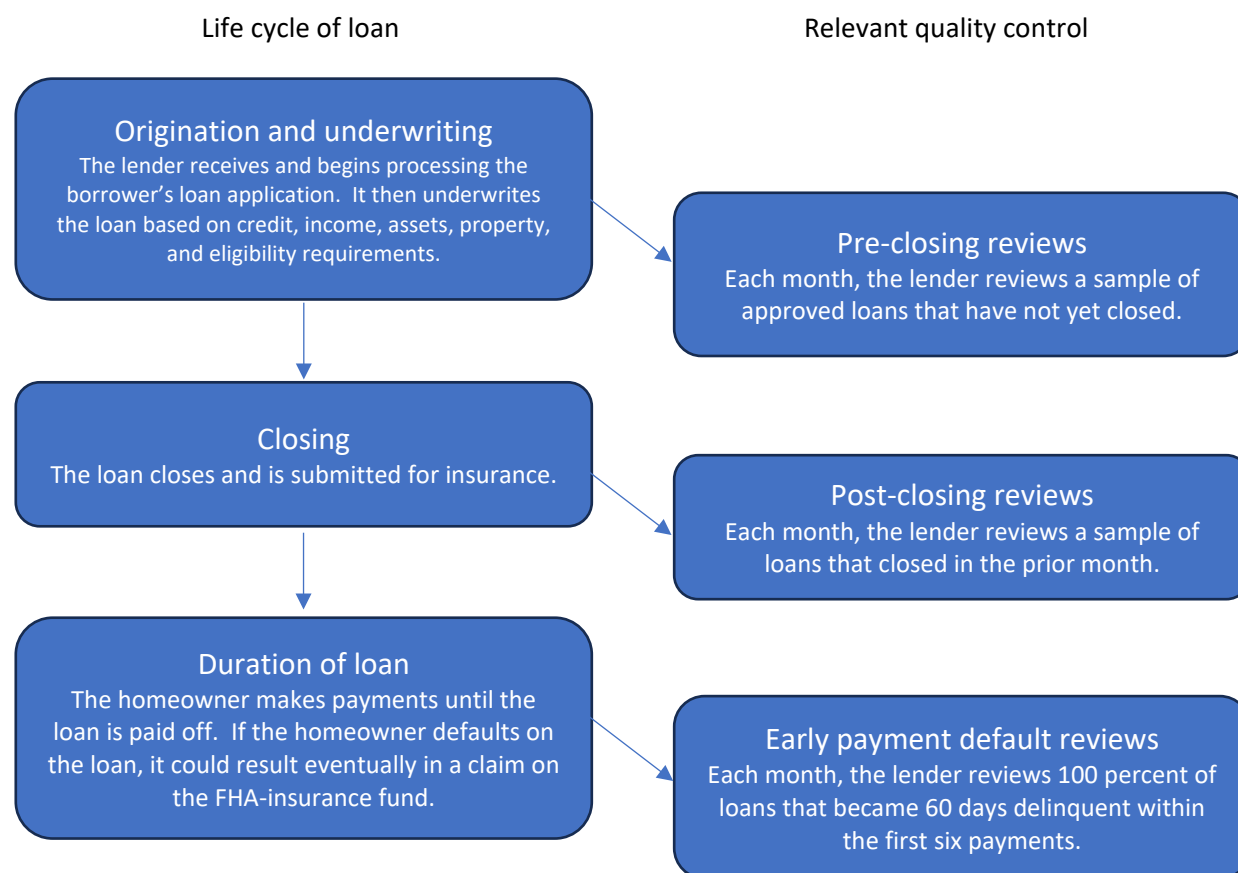
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Background and Objective

FHA, a part of HUD, provides mortgage insurance on single family loans made by FHA-approved lenders throughout the United States and its territories. This insurance protects lenders against losses as a result of homeowners' defaulting on their mortgage loans. The lenders bear less risk because HUD will pay a claim to the lender in the event of a homeowner's default.

HUD monitors a number of lenders each year and performs random and targeted reviews of loans throughout the year. Further, HUD requires each lender to implement a quality control (QC) program to (1) ensure compliance with policy and guidelines; (2) protect FHA and the lender from unacceptable risk; (3) guard against errors, omissions, negligence, and fraud; (4) determine the root cause of any deficiencies and identify potential internal and external control weaknesses; (5) alert lender management to patterns of deficiencies; (6) ensure timely and appropriate corrective action; (7) ensure the existence of required documentation that is the basis of underwriting decisions; (8) ensure that loans are secured by properties with values sufficient to support the loan; and (9) ensure compliance with fair lending laws.

Lender QC programs must cover the life cycle of an FHA-insured loan for any functions that the lender performs. As shown below, lenders who originate and underwrite loans must review samples of loans before closing, after closing, and if they default early in the life of the loan.



To help ensure that lender QC programs meet their intended purpose, Section V of HUD's FHA Single Family Policy Guidebook requires lenders to have written QC plans setting forth the procedures they will use. It also sets parameters for how many loans lenders must review each month and requires them to document the results of each loan review performed, including any corrective actions taken. Lenders must review all loan files selected for compliance with the handbook's requirements related to debts, employment, income, sources of funds, the property, how documents were handled, underwriting accuracy and completeness, etc. Further, they must do additional analysis when conducting post-closing and early payment default (EPD) reviews by obtaining new credit reports, reverifications of borrower information, and appraisal field reviews if relevant based on the type of loan.

As shown below, lenders must also meet key requirements when their reviews identify findings.

Requirement	Description
Loan sample risk assessment	Loans must be evaluated based on the severity of the violations found using prescribed risk categories, and lenders must use this information to conduct trend analyses over time.
Reporting to lender management	Initial findings and final reports must be shared with senior lender management. The lender must respond to each instance of fraud, material misrepresentation, or other material finding.
Reporting to HUD	Lender management must self-report to HUD all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.

Neighborhood Loans, Inc., is a nonsupervised lender based in Downers Grove, IL, with offices in 14 States.¹ It is a nonbank entity and has been approved to conduct business with FHA since 2014. Over the past 5 years, Neighborhood Loans has originated or underwritten more than 7,900 FHA-insured loans. It currently conducts pre-closing, post-closing, and EPD reviews in-house but used a contractor to perform its EPD reviews until June 2022.

Our objective was to evaluate Neighborhood Loans' QC program for originating and underwriting FHA-insured loans.

¹ Nonsupervised lenders are lending institutions that have as their principal activity the lending or investing of funds in real estate mortgages, consumer installment notes, similar advances of credit, or the purchase of consumer installment contracts. In contrast, supervised lenders are banks, savings banks, or credit unions that are members of the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), or the National Credit Union Administration (NCUA). Nonsupervised lenders do not fall under the supervision of the FDIC, OCC, or NCUA.

Results of Audit

Neighborhood Loans' Quality Control Program Did Not Fully Achieve Its Purpose

Neighborhood Loans' QC program for originating and underwriting Single-Family FHA-insured loans was not always sufficient. Specifically, Neighborhood Loans (1) did not select the proper number of loans for review and maintain complete data to document its loan selection process; (2) did not complete all loan reviews in a timely manner; (3) did not always complete key review steps and sometimes missed material deficiencies; and (4) did not adequately assess, mitigate, and report loan review findings, which included self-reporting loans to HUD when required. These issues occurred because Neighborhood Loans had insufficient controls over its QC program, was not always familiar with HUD requirements, and experienced staffing constraints. As a result, HUD did not have assurance that Neighborhood Loans' QC program sufficiently protected the FHA insurance fund and lender from unacceptable risk, guarded against fraud, and facilitated timely and appropriate corrective action.

Neighborhood Loans' Loan Selection Process Was Insufficient

While Neighborhood Loans selected a sufficient number of loans for pre-closing and post-closing reviews, it did not always select and review all EPD loans. Further, while it maintained sufficient data to document its pre-closing and post-closing selection process, it did not maintain complete data to document its EPD loan selection process.

EPD Loans Were Not Always Selected for Review

HUD requires lenders to review 100 percent of EPD loans when they become 60 days delinquent within the first six payments.² These reviews are important because they can provide valuable insight into what caused the borrowers to default on their loans and identify underwriting weaknesses. From October 2020 through September 2022, Neighborhood Loans reviewed only 24 of the 141 loans in which borrowers went into early payment default.³ Neighborhood Loans did not perform approximately 83 percent of the required EPD reviews because its prior QC manager selected for review only EPD loans with certain default status and reason codes instead of selecting all EPD loans. As a result, Neighborhood Loans was unable to develop relevant and timely insights on 117 loans with original mortgage amounts totaling more than \$25.8 million that could have been used to mitigate risks and strengthen its operations over time.⁴

² HUD Handbook 4000.1, section V.A.3.a.iv.(B)

³ Neighborhood Loans reviewed an additional 38 loans that had gone into default but did not meet HUD's definition for EPD. While lenders may choose to conduct reviews on additional loans that do not meet HUD's definition and could count such loans as part of their discretionary sample, these would not satisfy its responsibility to review all EPD loans. Further, Neighborhood Loans reviewed an additional three EPD loans that met the definition for EPD, which we did not count in the 24 of the 141 figures because the loans should have been selected for review before our audit period based on when they became EPDs.

⁴ Although Neighborhood Loans indicated that it had performed 16 additional EPD reviews, the loans were selected and reviewed after our audit period.

EPD Selection Data Were Inadequate

Neighborhood Loans did not maintain complete data to document its EPD loan selection process as required by HUD.⁵ For example, Neighborhood Loans did not maintain the monthly delinquency data obtained from HUD's Neighborhood Watch system, although its selection was made from these data. This condition occurred because Neighborhood Loans had insufficient controls over its QC program. Therefore, it was unable to fully demonstrate how it selected EPD loans and why it selected additional loans that did not meet HUD's definition of an EPD.

Neighborhood Loans Reviews Were Sometimes Delayed

While Neighborhood Loans generally completed preclosing reviews within established timeframes, it completed 276 of its 489 post-closing reviews between 1 and 57 days late (averaging around 23 days) and 16 of its 65 EPD reviews between 3 and 34 days late (averaging around 18 days).⁶ The table below summarizes the delays.

Number of days late	Number of post-closing reviews	Number of EPD reviews
1-14 days	100	10
15-45 days	155	6
More than 45 days	21	
Total	276	16

HUD requires post-closing reviews to be completed within 60 days from the end of the prior 1-month period of the loans' selection and EPD reviews to be completed within 60 days from the end of the month in which the loans were selected.⁷ The untimely EPD reviews could generally be attributed to Neighborhood Loans' increase in loan volume, combined with staffing constraints, such as staff on leave and layoffs, which impacted both its in-house post-closing reviews and its EPD reviews conducted by a contractor. Neighborhood Loans acknowledged this weakness and stated that under new leadership, productivity and staffing had increased, although it was still working through its backlog. As a result of the issues described above, Neighborhood Loans was unable to quickly identify deficiencies and take appropriate corrective actions to prevent similar issues.

Neighborhood Loans Reviews Were Inadequate

Neighborhood Loans' loan-level reviews were not always of sufficient quality. Lenders must review selected loans for compliance with requirements, such as those related to debts, employment, income, sources of funds, the property, how documents were handled, and underwriting accuracy and completeness. Further, for post-closing and EPD reviews, HUD requires lenders to conduct a deeper analysis using new credit reports, reverifications of borrower information, and appraisal field reviews

⁵ HUD Handbook 4000.1, section V.A.4.a

⁶ The 65 EPD reviews cited includes the 24 EPD reviews Neighborhood Loans performed on EPD loans during our audit period and the 41 additional EPD reviews discussed in footnote 3 that were for loans it should have selected before our audit period or that it chose to complete.

⁷ HUD Handbook 4000.1, section V.A.3.a.i.(B) and (C)

when relevant based on the loan type. However, Neighborhood Loans' loan reviews sometimes missed these key steps or failed to identify material compliance deficiencies that would have affected loan approval and insurance eligibility.

Complete Reverifications Were Obtained for 75 Percent of Loans Sampled

While Neighborhood Loans complied with HUD's reverification requirements for 75 percent of the 20 loans sampled, it failed to obtain complete reverifications for the remaining 5 loans, which had all undergone post-closing QC reviews. Neighborhood Loans used a re-verification checklist to show due diligence in documenting reverifications. However, its post-closing QC files for the five loans did not include completed reverification checklists for income or source of funds. For example, three loan files did not contain evidence showing that borrowers' income was reverified during the QC review, and two files did not contain evidence showing that borrowers' source of funds was reverified. This condition occurred because Neighborhood Loans did not follow its QC policy used for in-house reviews, which required income to be reverified by employers or third-party vendors. Therefore, Neighborhood Loans missed opportunities to confirm that the documentation used to approve the five loans was valid and sufficient and to evaluate any discrepancies between the original and new documents. Further, it may have missed these opportunities for the post-closing reviews it completed during our audit period for an additional 475 loans with original mortgage amounts totaling approximately \$116 million.

Appraisal Field Reviews Were Not Obtained

While Neighborhood Loans generally obtained appraisal field reviews or allowable substitutions for the appropriate percentage of loans with post-closing reviews each month,⁸ it failed to obtain them for 13 EPD loans with QC reviews. Appraisal field reviews are in-person reviews of both the interior and exterior of a property to verify an appraiser's conclusions. HUD requires lenders to obtain appraisal field reviews for at least 10 percent of the EPD loans reviewed, and 100 percent of EPD loans selected for QC review before July 2021.⁹ However, Neighborhood Loans did not meet appraisal field requirements for 13 of 15 months in which it performed QC reviews of EPD loans. This issue occurred because Neighborhood Loans incorrectly believed that a waiver in place through June 2021 removed the appraisal field review requirement for EPD Loans, and because it did not properly implement the updated requirement that went into effect in July 2021. As a result, Neighborhood Loans could not thoroughly evaluate the value of the 13 properties and their eligibility for FHA insurance.

Material Deficiencies Were Missed in a Small Percentage of Loans

Neighborhood Loans did not always detect origination and underwriting deficiencies that would have affected loan approval and insurance eligibility during its QC reviews. Although its QC reviews identified findings in 11 of the 20 loans sampled, Neighborhood Loans missed material deficiencies in at least 1 loan, or 5 percent of the loans sampled.¹⁰ Specifically, its QC review missed that underwriters did not

⁸ Although Neighborhood Loans was short one appraisal field review each in four months for loans with post-closing reviews, this generally correlated to rounding errors.

⁹ For the first 9 months of our audit period (through June 2021), HUD allowed lenders to use an alternative third-party valuation tool as a substitution for appraisal field reviews.

¹⁰ It is important to note that the QC reviews for 5 of the 20 loans sampled were missing required verification steps. Therefore, the number of loans in which Neighborhood Loans missed material deficiencies could be understated.

validate a nonborrowing spouse's Social Security number and include her debts in the borrower's qualifying ratios, although this was required because the property was located in a community property jurisdiction. However, the QC review did not identify them as deficiencies. In addition, a comparison of Neighborhood Loans' QC data with data from HUD's quality assurance reviews found three loans in which HUD identified material deficiencies that resulted in indemnification agreements, but Neighborhood Loans' reviews had failed to detect the deficiencies.¹¹ These issues occurred because Neighborhood Loans did not adequately review some files for compliance with requirements. Therefore, HUD did not have assurance that Neighborhood Loans' loan reviews sufficiently supported compliance with underwriting requirements and protected the FHA insurance fund and lender from unacceptable risk.

Neighborhood Loans' Assessment, Mitigation, and Reporting of Review Findings Were Inadequate

While Neighborhood Loans established a risk assessment methodology for its pre-closing and post-closing QC reviews, it did not adequately assess the risk of findings identified during EPD reviews. Further, it did not adequately report and respond to findings internally, and did not adequately mitigate or report findings to HUD when necessary.

Findings Were Not Adequately Assessed

HUD requires lenders to establish a risk assessment methodology to evaluate violations found during QC reviews. At a minimum, lenders must include low, moderate, and material risk categories in their risk assessment methodology and use that information to conduct trend analyses.¹² Neighborhood Loans used nonmaterial, significant, and material risk categories in its risk assessment methodology for pre-closing and post-closing reviews. However, for EPD reviews, Neighborhood Loans did not assess the risk associated with findings or conduct trend analysis. This occurred because Neighborhood Loans incorrectly believed that findings identified during EPD reviews did not require the same treatment as those identified during other QC reviews. As a result, HUD did not always have assurance that Neighborhood Loans adequately assessed findings using HUD's minimum risk categories. In total, Neighborhood Loans did not have data documenting violations and their associated risk and related trend analysis for 65 EPD reviews on loans with original mortgage amounts totaling approximately \$13.1 million.¹³

Internal Reporting and Response to Findings Was Inadequate

HUD requires all QC findings to be reported to lender senior management, including sharing initial findings with senior management within 30 days of the initial findings report, followed by providing final findings reports within 60 days.¹⁴ Further, HUD requires the lender to discuss all findings with the

¹¹ Indemnification agreements protect HUD against loss associated with a loan should it result in a claim against the FHA insurance fund. We identified 35 loans that had both a QC review by Neighborhood Loans during our audit period and a HUD quality assurance review as of May 2023. HUD identified material deficiencies that resulted in indemnification agreements for 3 of the 35 loans. However, as noted above, Neighborhood Loans did not detect these material deficiencies during its QC reviews.

¹² HUD Handbook 4000.1, section V.A.2.d.i and V.A.3.b

¹³ Refer to footnote 6.

¹⁴ HUD Handbook 4000.1, V.A.2.d.iii.(A) & (B)

responsible parties to ensure corrective actions and prevent similar findings from occurring in the future.¹⁵ However, Neighborhood Loans did not provide adequate documentation showing how initial findings were reported to its senior management and that all findings were discussed with the responsible parties. In addition, Neighborhood Loans' final reports did not always contain required information such as the corrective and curative actions taken, the timetable for completion, and any planned followup activities for each material finding. The reports also sometimes incorrectly listed the number of loans it had reviewed and the rate of defects identified. These issues occurred because Neighborhood Loans had insufficient controls over its QC program. For example, the QC plans in effect during our audit did not include all of HUD's requirements related to reporting.¹⁶ Therefore, HUD did not have assurance that Neighborhood Loans' QC program ensured compliance with documenting and reporting requirements, along with timely and appropriate corrective actions.

Material Findings Were Not Adequately Mitigated and Reported

HUD requires lenders to self-report to HUD all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.¹⁷ Findings are considered material if disclosure of them would have altered the lender's decision to approve the loan or seek FHA endorsement for it.¹⁸ Material findings are considered mitigated only if the deficiencies have been remedied so that the loan approval and insurance endorsement decisions are considered acceptable.¹⁹ Further, HUD requires lenders to retain all QC results and documentation, including actions taken to mitigate findings.²⁰ Neighborhood Loans did not adequately mitigate findings or report them to HUD when necessary.

While Neighborhood Loans identified material findings in 11 of the 20 loans we sampled, it only complied with HUD's requirement to mitigate or self-report the findings for 8 of these 11 loans, or approximately 73 percent. For the remaining 3 of 11 sampled loans with material findings, Neighborhood Loans' records did not show that it acceptably mitigated the findings or self-reported the loans to HUD. For example, for one loan, its QC review discovered that a monthly automobile payment was omitted without verification, and Neighborhood Loans did not mitigate this issue or self-report the loan to HUD as required, despite the findings representing suspected material misrepresentation.

These issues occurred because Neighborhood Loans did not follow its QC plan and HUD requirements for mitigation and self-reporting. As a result, HUD did not have assurance that Neighborhood Loans' QC program guarded against fraud, ensured appropriate corrective action, and protected the FHA insurance fund and lender from unacceptable risk, including for the three loans with original mortgage amount totaling more than \$700,000. In addition, we identified 103 other loans with original mortgage amounts totaling more than \$24 million, which were reviewed by Neighborhood Loans and contained material findings that may not have been adequately mitigated or required self-reporting to HUD.

¹⁵ HUD Handbook 4000.1, V.A.2.d.iii.(C)

¹⁶ In August 2022, Neighborhood Loans added an addendum covering HUD's requirements.

¹⁷ HUD Handbook 4000.1, section V.A.2.d.iv

¹⁸ HUD Handbook 4000.1, section V.A.2.d.i.(B)

¹⁹ HUD Handbook 4000.1, section V.A.2.d.i.(C)

²⁰ HUD Handbook 4000.1, section V.A.2.d.v

Conclusion

Neighborhood Loans' QC program did not fully achieve its intended purposes, which included, among other things, protecting HUD and itself from unacceptable risk, guarding against fraud, identifying patterns of deficiencies, and facilitating timely and appropriate corrective action. The table in appendix C summarizes the issues identified above. These issues occurred because Neighborhood Loans had insufficient controls over its QC program, was not always familiar with HUD requirements, and experienced staffing constraints. If Neighborhood Loans updates its QC plan and related procedures, and provides training to its staff and management, it will help ensure that its QC program complies with requirements and better achieves its intended purposes going forward.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Neighborhood Loans to

- 1A. Update its QC plan and related processes and procedures to align with requirements for loan selection, including documenting how loan selections were determined.
- 1B. Update its QC plan and related processes and procedures to align with requirements for (1) loan file reviews, including requirements to reverify borrower information, obtain appraisal field reviews, and complete reviews in a timely manner; (2) assessment of findings; (3) reporting findings internally and documenting response to findings; (4) mitigation of findings; and (5) reporting findings to HUD when required.
- 1C. Provide annual training to its staff and management on HUD requirements for lender QC programs and provide proof of training to HUD.
- 1D. Review the 101 EPD loans not previously selected for review and submit the results to HUD, including any findings of fraud, material misrepresentations, or other material findings that it is unable to mitigate.²¹ If required, Neighborhood Loans should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.
- 1E. Review its QC files for up to the 432 loans with post-closing reviews in which it may not have performed complete reverifications of borrower information and reverify information where appropriate.²² Neighborhood Loans should then evaluate the risk of any new findings identified, and if required, it should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

²¹ While we identified 117 EPD loans that Neighborhood Loans did not review during our audit period as required, we reduced this figure to 101 to account for 16 loans that were terminated without a claim, such as when a loan is paid in full.

²² While we identified 475 loans with post-closing reviews in which Neighborhood Loans may not have performed complete reverifications of borrower information, we reduced this figure to 432 to account for 43 loans that were terminated without a claim, such as when a loan is paid in full.

1F. Evaluate its QC files for the 59 loans with EPD reviews in which it did not assess the risk of findings identified to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its records did not show had been acceptably mitigated.²³ If required, Neighborhood Loans should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1G. Evaluate its QC files for the 96 loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its records did not show have been acceptably mitigated.²⁴ If required, Neighborhood Loans should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1H. Provide indemnification agreements or documentation to support the one loan in which it missed material deficiencies and the three loans in which it identified material misrepresentations or other material findings that it did not acceptably mitigate or self-report to HUD. Implementation of this recommendation will protect the FHA insurance fund from an estimated loss of \$339,186.²⁵

Management Response

Management acknowledged and generally concurred with the recommendations and explained some of the circumstances that led to the issues cited for the period covering October 2020 through September 2022. Management highlighted updates made since the audit period through 2025. For example, it updated the QC plan, strengthened its leadership structure, expanded its team, and enhanced its systems. Further, Management stated that it would develop an annual training course; review the loans cited in recommendation 1G to confirm whether findings were self-reported to HUD when required; and provide supporting documentation or indemnification agreements for the loans cited in recommendation 1H. Management expressed that Neighborhood Loans had learned valuable lessons from past experiences, made significant improvements, and was committed to preventing similar oversights.

Management's full comments are in Appendix B.


OIG Evaluation of Management Response

We appreciate Neighborhood Loans' commitment to maintaining high standards of QC in its operations and found Management's response receptive to our recommendations. We encourage Neighborhood Loans to work with HUD through the audit resolution process to ensure that the corrective actions taken fully address each recommendation, including those requiring review of EPD loans not previously

²³ While we identified 65 loans with EPD reviews, we reduced this figure to 59 to account for those loans that were terminated without a claim, such as when a loan is paid in full.

²⁴ While we identified 103 QC reviews in which Neighborhood Loans had identified material findings and might need to self-report them, we reduced this figure to 96 to account for those loans that were terminated without a claim, such as when a loan is paid in full.

²⁵ This amount was based on the unpaid balances of the loans, which totaled approximately \$1 million, and FHA's average loss experience of about 34 percent.



selected, completion of reverifications where appropriate, and evaluation of QC reviews in which it had not assessed the risk of findings identified.

Scope and Methodology


We performed our audit work between February 2023 and June 2024. We did not conduct onsite fieldwork for this audit. Our audit covered the period October 2020 through September 2022 and was expanded to include loan status as of January 2025.

To accomplish our objective, we

- reviewed relevant requirements, including handbooks and mortgagee letters;
- reviewed the lender's QC plan and related policies, procedures, and other relevant documentation to obtain sufficient background information on the program and lender;
- reviewed monthly QC summary reports from both the lender and the third-party contractor covering the 2-year audit period;
- reviewed the lender's QC data for pre-closing, post-closing, and EPD reviews;
- compared the lender's QC data and data from HUD's Single Family Data Warehouse (SFDW) to determine whether the lender reviewed the correct quantity of loans; whether the reviews were performed in a timely manner; and whether the lender obtained new credit reports, reverifications, and appraisal field reviews for the correct quantity of loans each month;
- compared the lender's QC data and data from HUD's Loan Review System (LRS) to identify loans in which the lender could have missed material deficiencies during its QC reviews, failed to properly categorize or correct deficiencies identified, or failed to self-report the loans to HUD;
- reviewed loan data from Neighborhood Watch;
- reviewed training records, including logs listing training received by staff and management;
- interviewed key lender officials to obtain an understanding of its operations, data, and documentation and to discuss potential issues identified during the audit; and
- reviewed Neighborhood Loans' contract with its previous QC contractor.

For the period October 2020 through September 2022, Neighborhood Loans performed QC reviews on 896 loans. We selected a targeted sample of 20 loans based on various factors, such as whether the loans were currently or previously in default, especially those 90 days or more delinquent or in foreclosure; the default reason listed in HUD's SFDW system; and the highest lender finding level. For each of the 20 loans, we reviewed the lender's QC and loan files to determine whether Neighborhood Loans looked at all required QC elements, missed any significant deficiencies, reasonably categorized deficiencies identified, mitigated deficiencies, took appropriate corrective action, self-reported loans to HUD if required, and completed its review and followup in a timely manner. When considering whether deficiencies identified or missed by Neighborhood Loans would have affected loan approval and insurance eligibility, we considered information in FHA's Defect Taxonomy. Our results were limited to the loans in our sample and cannot be projected to the universe. When determining the funds to be put to better use for the one loan in which Neighborhood Loans missed material deficiencies and the three loans in which it identified material misrepresentations or other material findings that it did not acceptably mitigate or self-report to HUD, we used the unpaid balances of the loans, which totaled approximately \$1 million, and FHA's average loss experience of about 34 percent.

Of the 896 loans that Neighborhood Loans originated or underwrote and for which it conducted QC reviews, HUD had reviewed 35 loans as of May 2023. We identified three loans in which HUD found indemnifiable deficiencies despite the lender's not having self-reported the loans. We performed limited



scope reviews of the three loans to confirm whether the lender found the deficiencies identified by HUD, how it categorized and corrected the findings, and whether it self-reported the loans to HUD.

We relied on computer-processed data provided by Neighborhood Loans and data contained in HUD's Neighborhood Watch system, SFDW, and LRS. We assessed the reliability of the computer-processed data and determined that the data were sufficiently reliable to achieve our audit objective. We also assessed the relevant internal controls to the extent necessary to determine whether they were logical, reasonably complete, and likely to deter or detect potential problems or indicators.

We conducted the 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 objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendixes

Appendix A – Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
1H	\$339,186

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this case, if HUD implements our recommendation, it could avoid potential losses on one loan in which Neighborhood Loans missed material deficiencies and three loans in which it identified material misrepresentations or other material findings that it did not acceptably mitigate or self-report to HUD. The amount above reflects that upon paying a claim on defaulted loans, FHA's average loss experience is about 34 percent based on statistics provided by HUD.

Appendix B – Management Response



June 6, 2025

U.S. Department of Housing and Urban Development
Office of Inspector General
451 7th Street, SW, Room 8256
Washington, DC 20410

RE: Neighborhood Loans, Inc
HUD OIG Draft Audit Report

Dear Kilah White,

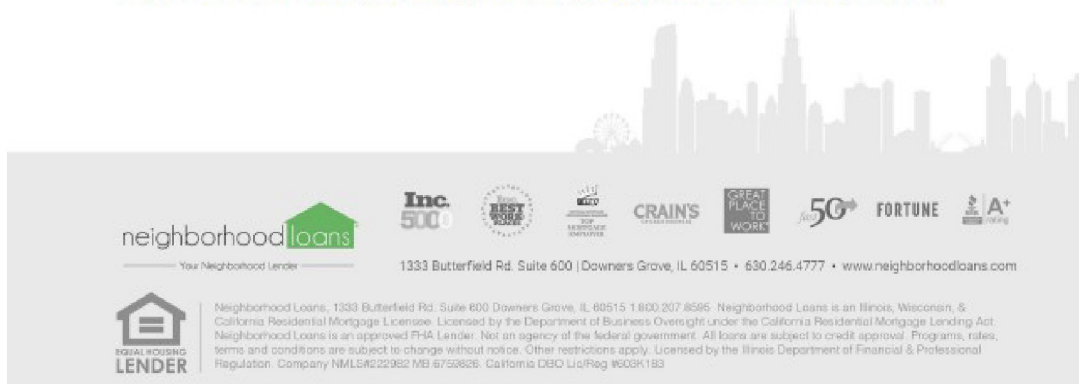
We thank you for the opportunity to review our QC Plan. In response to the HUD OIG Draft Report issued May 2025, please find Neighborhood Loans, Inc.'s comments below.

Recommendation 1A:

Update its QC plan and related process and procedures to align with requirements for loan selection, including document how loan selections were determined.

Neighborhood Loans Response 1A:

As acknowledged in the HUD OIG report, "Neighborhood Loans selected a sufficient number of loans for pre-closing and post-closing reviews..." Neighborhood Loans is proud of its commitment to sufficient loan selections for both pre- and post-closing quality control reviews. As it relates to early payment default (EPD) quality control reviews, there was transition from utilizing a third-party vendor to bringing EPD reviews in-house in second quarter of 2022. During this transition, there were EPD file reviews that were inadvertently omitted from the review process. Because the HUD OIG review was from 10/1/2020 – 9/30/2022, the review included this transitional period where some EPD reviews were inadvertently omitted during. Neighborhood Loans has updated its QC Plan to fully align with loan selection requirements,





clearly documenting the methodology and criteria used for determining loan selection. This ensures a systematic and compliant approach to our quality control sampling process.

To demonstrate how loan selections are made for EPD loans, Neighborhood Loans has implemented the following processes and procedures to align with requirements for loan selection:

- All loans that went into Early Payment Default (“EPD”), i.e., became sixty (60) days past due within six (6) or fewer payments made by the mortgagor, regardless of who services the loan or who insured the loan will undergo a full QC review. The loans selected for EPD review are obtained via [HUD.gov.com](https://www.hud.gov), Neighborhood Watch website (entp.hud.gov/clas/index.cfm). The QC review is to determine a root cause and complete reverifications of credit, income, and/or assets, as applicable. Material findings are subject to review by Underwriting Managers and require a written response to the deficiency. Loans reported as EPDs on FHA Neighborhood Watch will be trended, reviewed by QC, and distributed to senior management monthly via email on a separate report. Copies and trend analysis will be retained in the Compliance network drive.

Recommendation 1B:

Update its QC plan and related process and procedures to align with requirements for (1) loan file reviews, including requirements to reverify borrower information, obtain appraisal field reviews, and complete reviews in a timely manner; (2) assessment of findings; (3) reporting findings internally and documenting response to findings; (4) mitigation of findings; and reporting findings to HUD when required.

Neighborhood Loans Response 1B:

Because the HUD OIG audit review period included loans from 10/1/2020 – 9/30/2022, it did not consider processes that have been updated within the past 3 years. Because this time period included the time period of the COVID pandemic, there were additional factors that impacted operations in a manner that no longer exist. Updates to the QC plan and related process and procedures have been updated to align with requirements, as follows:

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1. **Loan File Reviews**

- a. All reverifications must be documented and completed for income and source of funds.
- b. Field reviews are completed for 10% of the EPD loans reviews. The loans selected for a Field Review will be performed by Appraisers listed on the FHA's Roster of Appraisers and will be reported on the applicable Residential Appraisal Field Review Report forms. At least 10% of the mortgages selected for monthly post-closing QC will receive a field review. Neighborhood Loans will select mortgages for targeted field review based on the factors used for discretionary targeting, as well as the following characteristics:
 - Property complaints from the borrower(s);
 - Discrepancies found during QC;
 - Large adjustments or variances to value;
 - Comparable sales more than six months old;
 - Excessive distances from comparables to the subject property;
 - Repetitive sales activity for the subject property;
 - Investor-sold properties;
 - Identity of interest conflicts between the borrower and seller;
 - Seller identity differs from owner of record;
 - HUD REO sales financed with an FHA-insured mortgage;
 - Vacant properties; and/or
 - Soft markets.
- c. The following processes must be completed timely:
 - i. **Loan File Selection:** Loans selected for Post-Closing Review or Discretionary Review are identified within 30 days of the month in which they are closed and go through the reverification review process. Post-closing reviews must be completed within 60 days from the end of the prior 1-month period of the loans' selection and EPD reviews must be completed within 60 days from the end of the month in which the loans were selected.





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- ii. **Reverification Process Completion:** Execution and completion of all required reverification procedures.
 - iii. **Comprehensive Quality Control Review:** Performance of thorough loan file analysis and documentation review.
 - iv. **Monthly Reporting to Management:** Summary reports are distributed to senior management within 30 days of the initial findings report, followed by a final report 60 days after the review process is completed.
2. **Assessment of Findings**
Neighborhood Loans requires a risk assessment methodology to evaluate violations based on whether they are low, moderate, or material for all file reviews, including EPD file reviews.
3. **Reporting Findings Internally and Documenting Responses**
Neighborhood Loans management reviews both initial and final findings to senior management. These reports contain required information, such as the corrective and curative actions taken, the timetable for completion, and any planned follow-up activities for each material finding. The reports also include the number of loans reviewed and the rate of defects identified.
4. **Mitigation of Findings**
Appropriate staff are responsible for documenting steps taken to mitigate any QC finding. Material findings are considered mitigated only if the deficiencies have been remedied so that the loan approval and insurance endorsement decisions are considered acceptable.
5. **Reporting Finding to HUD, When Required**
All findings of fraud, material misrepresentation, or other unmitigated material findings must be self-reported to HUD by Neighborhood Loans management. Findings of fraud or misrepresentation are also escalated to the AML Officer.





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Recommendation 1C:

Provide annual training to its staff and management on HUD requirements for lender QC programs and provide proof of training to HUD.

Neighborhood Loans Response 1C:

Current Training Approach:

- **Regular QC Meetings:** The Neighborhood Loans QC Manager holds routine training sessions with the QC and Reverification Team. These meetings focus on all updates or changes from various investors and agencies—not limited solely to HUD.
- **HUD Webinars:** Whenever available, the QC Team attends HUD webinars to ensure they stay informed on regulatory updates and best practices.

Upcoming Initiatives

- **Annual HUD-Specific Training Course:** The QC Manager is set to develop an annual course that concentrates on HUD requirements. This course will be published on Neighborhood Loans SharePoint, making it accessible to all Neighborhood Loans managers and staff.

Recommendation 1D:

Review the 101 EPD loans not previously selected for review and submit the results to HUD, including any findings of fraud, material misrepresentations, or other material misrepresentations findings that it is unable to. If required, Neighborhood Loans should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

Neighborhood Loans Response 1D:

Neighborhood Loans acknowledges that during the transition from a third-party QC vendor to our in-house QC Team, certain procedural gaps were identified and self-corrected in 2023.

Current Corrective Measures

- **Monthly EPD Review:** The current QC Manager now pulls EPDs monthly regardless of the HUD delinquency code.

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- **Complete QC Reverification:** All loans, irrespective of the delinquency code, go through the full QC reverification and review process.

This revised protocol ensures that every loan is thoroughly reviewed, enhancing our oversight and compliance standards.

Recommendation 1E:

Review its QC files for up to the 432 loans with post-closing reviews in which it may not have performed complete verifications of borrower information and reverify information where appropriate. Neighborhood Loans should then evaluate the risk of any new findings identified, and if required, it should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

Neighborhood Loans Response 1E:

During the examination period of October 2020 through September 2022, which included the onset of the COVID pandemic, Neighborhood Loans identified the need for additional staffing capacity. Since the review period, Neighborhood Loans expanded the Reverification Team from a single individual to three dedicated QC Reverifiers. Alongside this team growth, the company continues to actively explore and enlist advanced tracking resources and reverification vendor tools to further support the team's work.

To consolidate these improvements, the QC Manager regularly conducts periodical reverification training sessions for both the QC and Reverification Teams. This ongoing training initiative has been instrumental in reinforcing best practices, thus contributing to enhanced turnaround times and high-quality standards across the board.

The comprehensive changes in the reverification process have led to:

- **Greater Efficiency:** Streamlined procedures that accelerate turnaround times.
- **Enhanced Effectiveness:** Robust quality checks maintain superior quality standards throughout the review process.
- **Improved Compliance:** Updated policies and regular training ensure that all processes consistently meet current regulatory guidelines.





Neighborhood Loans remains committed to continuous process refinement by leveraging new tools, expanding its team, and fostering an environment of ongoing learning and adjustment.

Recommendation 1F:

Evaluate its QC files for the 59 loans with EPD reviews in which it did not assess the risk of findings identified to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its record did not show had been acceptably mitigated. If required, Neighborhood Loans should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

Neighborhood Loans Response 1F:

From 2023 - 2024, the QC Team underwent significant improvements through a management change and substantial team expansion, growing from two to six experienced QC specialists. The team has modernized its processes by transitioning to a comprehensive Quality Control program, which included an investment in software solutions to replace tasks that were previously manual. This new system features specialized QC checklists that align with federal, state, and specific loan program guidelines, ensuring thorough loan file reviews that meet all investor and agency requirements, including risk assessment. Neighborhood Loans is fully committed to ensuring that all EPD reviews are assessed for risk. Neighborhood Loans will report to HUD any fraud, material misrepresentation, or other unmitigated material findings.

Recommendation 1G:

Evaluate its QC files for the 96 loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its record did not show had been acceptably mitigated. If required, Neighborhood Loans should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.





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Neighborhood Loans Response 1G:

Neighborhood Loans will complete a full review of the loans in which material findings were identified to confirm whether findings of fraud, material misrepresentation, and other unmitigated material findings were self-reported to HUD. If the review indicates that there were loans that were erroneously omitted from being self-reported, Neighborhood Loans will ensure HUD is properly notified.

Recommendation 1H:

Provide indemnification agreements or documentation to support the one loan in which it missed material deficiencies and the three loans in which it identified material misrepresentation or other material findings that it did not acceptably mitigate or self-report to HUD. Implementation of this recommendation will protect the FHA insurance fund from an estimated loss of \$339,186.

Neighborhood Loans Response 1H:

Neighborhood Loans follows a structured process for handling material findings. Neighborhood Loans will execute the required indemnification agreements when the QC Manager determines that a material finding is valid and an attempt to mitigate has been completed. If both the QC and Underwriting Managers are unable to mitigate the material finding, the QC Manager will implement the Self Report policy and proceed with the indemnification agreement. In cases where the QC Manager successfully mitigates a finding, comprehensive supporting documentation will be provided to substantiate the resolution.

In furtherance of its commitment to quality loans, Neighborhood Loans is pleased to share that its robust compliance management system has resulted in several improvements to the QC plan since the review period of 10/1/2020 – 9/30/2022. From 2022 – 2025, we have implemented comprehensive improvements to our QC operations, including:

1. Leadership Enhancement

- Hired an experienced QC Manager to oversee operations.
- Restructured the QC department for improved oversight.

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2. Team Expansion

- Increased QC staff from 2 to 6 team members
- Expanded reverification staff from 1 to 3 specialists

3. Process Modernization

- Implemented a sophisticated Quality Control software platform.
- Invested in automated software solutions

These strategic investments and operational enhancements demonstrate our commitment to maintaining rigorous quality control standards that fully align with HUD requirements. The transformation of our QC operations demonstrates our serious commitment to loan quality.

The QC Manager maintains a proactive approach in keeping both the Reverification and QC Teams current with investor and agency requirements through regular updates and mandatory training sessions. This organizational structure ensures consistent quality standards, promotes professional growth within the department, and maintains robust oversight of all quality control processes. As part of our ongoing commitment to team development, the QC Manager has recently promoted an experienced QC specialist to the position of QC Team Lead. This strategic promotion provides additional leadership resources and support to both the Reverification and QC Teams, further strengthening our quality control infrastructure.

Neighborhood Loans has learned valuable lessons from past experiences and is firmly committed to preventing similar oversights. Our transformed Quality Control operations reflect our dedication to excellence and compliance. Through substantial investments in personnel, technology, and processes, we have built a robust QC infrastructure that consistently meets and exceeds investor and agency guidelines.

We respectfully ask HUD to recognize these significant improvements and our unwavering commitment to maintaining the highest standards of quality control in our operations. Our enhanced systems, expanded team, and strengthened leadership structure demonstrate that we are a fundamentally different organization, well-equipped to ensure ongoing compliance and excellence in all aspects of our quality control processes.





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If you have questions, please feel free to contact me directly at 630-523-9392 or email jsperry@neighborhoodloans.com.

Thank you,

Jennifer Sperry

Digitally signed by Jennifer
Sperry

Date: 2025.06.06 17:00:42 -04'00'

Jennifer Sperry
VP of Compliance



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Appendix C – Summary of Significant Issues Identified

The table below summarizes the significant issues identified in key areas of Neighborhood Loans' QC program.

Key area		Issue identified
Loan selection	Pre-closing reviews	
	Post-closing reviews	
	EPD reviews	X
	Selection data	X
Loan reviews	Timeliness of reviews	X
	Document review and reverification	X
	Identification of material deficiencies	X
Loan review findings	Assessment of risk	X
	Mitigation and reporting of findings	X