



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

July 23, 2014

MEMORANDUM NO:
2014-FW-1803

Memorandum

TO: Kathleen Zadareky
Deputy Assistant Secretary for Single Family Housing, HU

FROM: //signed//
Gerald Kirkland
Regional Inspector General for Audit, 6AGA

SUBJECT: Southwest Stage Funding, LLC, dba Cascade Financial Services, Took Corrective Action on Loans That Did Not Meet All HUD and FHA Requirements

INTRODUCTION

We reviewed Southwest Stage Funding, LLC, dba Cascade Financial Services, based on our goal to improve the integrity of Federal Housing Administration (FHA) single-family insurance programs. We selected Southwest Stage because it originated 1,841 loans totaling more than \$244 million during calendar years 2012 and 2013. Further, it had received more loan endorsements on manufactured housing loans than any other lender in Texas since January 1, 2009. Our objective was to determine whether the lender complied with U.S. Department of Housing and Urban Development (HUD) and FHA requirements when originating single-family FHA loans.

METHODOLOGY AND SCOPE

We performed the audit work at our offices in Fort Worth and San Antonio, TX between February and April 2014. In an effort to determine the integrity of loans made in a defined area, we selected all 18 loans originated during calendar years 2012 and 2013 by Southwest Stage in two zip codes in Bexar County. The mortgages for the 18 loans totaled \$2,052,152.

To accomplish our objective, we

- Reviewed applicable HUD regulations, requirements, and mortgagee letters;

- Reviewed reports and information on HUD’s Neighborhood Watch system;¹
- Obtained loan data from HUD’s Single Family Data Warehouse system to determine the universe of loans selected;²
- Reviewed the lender’s quality control plan and internal policies and procedures;
- Reviewed quality control reviews on loans that were included in our review;
- Obtained electronic loan files for all 18 loans that were originated in the two zip codes selected;
- Reviewed eight loans with mortgages totaling \$961,361; and
- Interviewed two appraisers.

After completing eight file reviews, we only identified a total of three material deficiencies and three technical deficiencies in four loans. As a result, we determined that additional review was not warranted.

We did not evaluate the reliability of HUD’s Single Family Data Warehouse or Neighborhood Watch systems because we were not auditing the systems and used them only to select an auditee and to determine the current loan status. During the file review, we tested documents, assets, income, credit history, appraisals, borrower eligibility, etc., against the automated underwriter system approval and HUD requirements.

BACKGROUND

FHA offers various mortgage insurance programs, which protect approved lenders against losses on mortgage loans. FHA-insured mortgages may be used to purchase homes, improve homes, or refinance existing mortgages. Under FHA’s Direct Endorsement program, approved lenders may underwrite and close mortgage loans without FHA’s prior review or approval. All of FHA’s single-family programs are authorized by Title II of the National Housing Act.

Southwest Stage Funding, LLC, dba Cascade Financial Services, was approved to originate FHA mortgages on April 23, 2003, as a nonsupervised direct endorsement lender. It has two FHA-approved active branch offices. According to its Web site, it was 100 percent dedicated to providing manufactured housing financing options, and it had tailored specific products to the needs of manufactured housing. Also, according to its Web site, Southwest Stage was the leading lender in manufactured housing government lending.

RESULTS OF REVIEW

Southwest Stage originated and approved four loans that had material underwriting deficiencies or had technical deficiencies with appraisals. These deficiencies occurred because Southwest Stage did not exercise due diligence when reviewing documents and appraisals. Southwest Stage took corrective action to resolve the deficiencies. Specifically, it corrected the deficiencies

¹ Neighborhood Watch is Web-based software that displays loan performance data for FHA-insured single-family loans. The system is designed to highlight exceptions so that potential problems are readily identifiable.

² The Single Family Data Warehouse is a large collection of database tables organized and dedicated to support analysis, verification, and publication of FHA single-family housing data.

identified in the draft report, and stated that it had addressed the deficiencies with all underwriters and property compliance personnel. We reviewed the information supplied by the lender along with other information and revised our conclusions.³

RECOMMENDATIONS

The lender corrected the deficiencies identified in the draft report, and stated that it addressed the deficiencies with all underwriters and property compliance personnel. Therefore, no further recommendations are warranted.

³ See OIG Evaluation of Auditee Comments on page 7.

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



June 30, 2014

US Department of Housing and Urban Development
Office of Inspector General
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

ATTN: GERALD KIRKLAND

SUBJECT: Southwest Stage Funding LLC dba Cascade Financial Services
Draft Audit Report

Dear Mr. Kirkland,

Thank you for providing the Draft Audit Report dated June 19, 2014 and allowing Lender the opportunity to respond to the deficiency findings. Lender is ever vigilant in maintaining high standards to comply with government backed financing program guidelines and the myriad of federal regulations that this industry operates within. Although audits can bring angst among the ranks, it benefits us to learn from our mistakes and continue to improve on lessening risks involved with lending for all parties concerned.

Lender makes every effort to follow HUD and FHA requirements when originating FHA-insured loans—which is contrary to the statement identified under “What We Found”. As long as humans continue to have a hand in the production of financing loans, mistakes will happen. Human errors are what were found by the OIG auditors and not a blatant disregard by Lender of HUD’s written guidelines and policies. Based on the outcome of the audit, it is our belief that our practices speak volumes of a company built on integrity and adherence to program guidelines.

OIG has made recommendations for HUD to require Lender to indemnify two case numbers: 514-0027733 and 495-9429656. Lender wants to take the opportunity to address the recommendations based on deficiencies cited and actions taken by Lender to remedy the perception of risk.

514-0027733

The Case Narrative for the above referenced case number indicates that the property did not comply with HUD’s requirement for the finished grade beneath the manufactured home unit in a flood hazard zone. The fact that the property was in a flood hazard was well known by the lender and requirements were put in place for evidence that the elevation beneath the home was at or above the Base Flood Elevation (BFE) prior to closing. An Elevation Certificate was received by lender and reviewed by a Property Compliance Trainee. It was subsequently reviewed by a DE Underwriter that signed off. The human error that occurred is that the DE Underwriter was also in the process of learning how to read Elevation Certificates and became confused about the diagram number used by the surveyor and what it represented. The DE believed that she had an acceptable Elevation Certificate that confirmed the pad below the home was above the BFE based on the information populated in C2a and C2e of the report. In the end, elevation below the manufactured home had been built according to specifications that the Lender required in order to conform to FHA standards. The surveyor that completed the Elevation Certificate was contacted as a result of OIG’s findings in order to substantiate the elevation of the grade below the home. The surveyor added the appropriate commentary to the report on page 2 stating that the elevation below the home was at 616.2’ and the BFE as originally stated on page 1 stood at 615.5. The Elevation Certificate as updated by surveyor [REDACTED] is attached (see Exhibit 1). The DE Underwriter that made this mistake is now very well versed on Elevation Certificates to ensure agency compliance is adhered to.

Comment 1

Comment 2

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Comment 3

The second deficiency cited on the same case number is based on debris littering the crawlspace under the home. This was revealed by the second appraisal completed by TX-1334602-R and was captured by a photo in the report content. The DE that reviewed the appraisal completely missed what the photo revealed and failed to require that the debris be removed. The primary appraiser, the secondary appraiser (where photo resided), nor the home inspector set out any requirements for the debris to be removed and the DE followed suit. This should not have happened and the debris should have been removed and re-inspected as a result of what the photo revealed.

In an effort to remedy the deficiency, Lender contacted the borrower and described the circumstances present. The borrower did not know if there was still debris located under the home because he had never opened the crawlspace access, but he was amenable to allowing an inspection to determine what was present. Lender was more than willing to remedy the deficiency at our expense due to the oversight by the DE. Lender made arrangements with TX-1334602-R on 4/4/14 to re-inspect the property based on the owner's consent. The appraiser was able to complete the inspection on 4/18/14 and took a photo of the crawlspace that had previously revealed the debris. It is my belief that the inspection photo was provided to OIG based on a conversation that took place between the auditor and the appraiser. Lender recently followed up on this with the appraiser to request the evidence that the re-inspection took place (see Exhibit 2.) Based on the borrower stating he had never opened the access to his crawlspace, it is believed that the seller actually cleaned up the debris prior to this loan closing. That will remain an unknown. In the meantime, the inspection and photo of the crawlspace indicate that there is extra skirting that was left behind and junk was removed at some point in time. Lender does not consider spare skirting as debris as there is usefulness in having replacement available. The appraiser has confirmed that there is no earth wood contact that would create an environment suitable for pest infestation. Lender is still more than willing to remove the extra skirting if HUD feels that this is a risk to the insurance funds.

495-9429656

The appraisal contained a photo of the back of the home and OIG determined that there was a hole in the skirting. Lender sees this with some frequency because some appraisers tend to open the crawlspace access, take a photo of the crawlspace, and then step back and take a photo so as to capture the entire view of the home. They forget that the photo will depict a hole in the skirting when in reality it is just where they opened the access. As stated, Lender does see this with regularity and requires the appraiser to address the skirting to determine if repairs need to be made. When this event occurs, either the appraiser adds commentary to the report confirming that the access was opened for viewing or goes back to the property to capture a new photo reflecting no gaps. In this case, the DE failed to see the gap and did not condition accordingly to address what the photo revealed.

At Lender's request, the appraiser re-inspected the property on 3/31/14 to establish whether the skirting was intact or not. The findings were that the skirting was in place and had been all along. The appraiser revised the appraisal report and added commentary indicating that the gap in the siding present as of the effective date of the appraisal was in fact where she opened the crawlspace access to inspect. The appraiser also provided a present day photo evidencing the facts of the matter. The revised appraisal report was provided to OIG [REDACTED] in its entirety on 4/10/14 as supporting evidence and is not being presented again with this response.

Three Loans Contained Appraisals With Technical Deficiencies

Lender agrees with two of the three technical difficulties cited by the OIG auditors. An appraisal identifying an owner of record other than what has been established as factual is not an acceptable practice and was simply an oversight by the underwriter. This has been a topic of appraisal training on several occasions with all underwriters and they know the protocol to be followed.

The appraisal that contained a comp photo that was not the sold property described in the analysis was rather disconcerting and harder to detect by an underwriter. In order to uncover such a fact, underwriters would have to conduct searches on all comps used on every appraisal reviewed. There is a certain amount of assumption that goes into every appraisal completed and it is the underwriter's responsibility to determine that the appraisal complies with regulations, makes sense in all respects, contains accurate information, and that value is supported as stated. To physically research every comp used in every appraisal reviewed such as has been done by the OIG auditors is not the norm with any lender due to the burden of maintaining an army of staff for such research. Lender believes strongly that if the underwriter

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Comment 4

has reason to believe that a comp is not as purported, it should be researched fully to rule out any discrepancies present. In the case where an erroneous comp photo was used, the appraiser was contacted for an explanation. The appraiser was confounded on how she managed to use a photo that did not belong to the report intended; however, the analysis grid contained accurate information of the comp used. The appraisal was revised to contain the true comp photo that belonged with the report and was submitted in the entirety on 4/10/14 to the auditors [REDACTED]. The updated appraisal is not being submitted again with this response.

In regards to the appraisal in which the appraiser made adjustments to one of the comp sales for both square footage and room count, Lender strongly disagrees with the auditor's interpretation of the adjustments and did so at the time the auditor described the circumstance to Lender. Lender has believed all along that the adjustments made were self-explanatory based on the differences between the subject and the comp property in question. The subject unit contains 2108 GLA made up of 8 rooms, 4 bedrooms and 2 baths. The adjustment to the comp property in question contains 2138 GLA made up of 8 rooms, 4 bedrooms, and 3 baths. The appraiser adjusted for the differences in the bath count and for the nominal difference in GLA on said comp. The adjustment for the bath count was self-explanatory without further commentary being necessary by the appraiser. Lender still stands firm that the adjustments were self-explanatory especially when considering that the other 4 comps used in the report all contained 6/3/2 with no adjustments made for room count. In Appendix D of 4150.2 (pg. D-69) for appraisal protocol, it is stated that the appraiser is to "Explain comparable selection and any necessary explanation of adjustments".

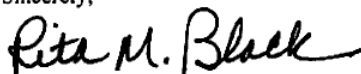
Conclusion

As stated previously, Lender makes a concentrated effort to follow FHA and regulatory requirements in all areas of our lending processes. Training is an essential part of keeping our staff up-to-date as requirements change or as deficiencies occur under routine audits—whether done internally or externally by any agency. The deficiencies identified by OIG as they surfaced were being discussed with underwriting staff for training purposes/reminders to deter reoccurrences of the same deficiencies in the future. Company mandated FHA appraisal training has taken place several times as the various HOC's offer such training. This type of training is good, but not excellent. Appraisal training offered by FHA is not as in-depth as it should be to cover all possibilities that can and do exist in appraisal reviews. In addition, there are still inconsistencies across the HOC's that have not been eradicated and training always seems to be geared towards a "new to FHA" audience. Regardless, Lender will still continue to require employees to attend training functions conducted by the agencies we operate under and our own in-house training that is routinely scheduled. The deficiencies cited in the OIG report have been addressed with all underwriters and property compliance personnel.

Significant Deficiency

Although Lender agrees with the majority of deficiencies cited in the content of this report, Lender's belief is that the risks identified have been remedied. Again, we do appreciate the opportunity to respond. Should you need anything further in regards to these matters, please feel free to contact us at your earliest convenience.

Sincerely,



Rita M. Black
CCO

Attachments

[REDACTED]

OIG Evaluation of Auditee Comments

- Comment 1** We recognize the lender for its efforts to resolve this matter. While the lender should have resolved this “deficiency” before approving the loan, we removed the issue because the lender was able to provide sufficient documentation that it was not a deficiency, but rather a mistake.
- Comment 2** We did not include the exhibits, but they are available for review upon request.
- Comment 3** The lender stated the only remaining debris in the crawlspace was extra skirting material. Based upon the lender’s response and actions, and our review of applicable criteria, we removed the issue from the audit report.
- Comment 4** HUD Handbook 4150.2, CHG-1, appendix D-2 required the appraiser to explain comparable properties with adjustments in both square feet and room count.