James B. Nutter & Company
Kansas City, MO

HUD's Loss Mitigation Program

Office of Audit, Region 7
Kansas City, KS

Audit Report Number: 2016-KC-1003
May 16, 2016

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

//**signed**//

From: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

Subject: James B. Nutter & Company, Kansas City, MO, Did Not Always Follow HUD's Rules and Regulations for Loss Mitigation

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of James B. Nutter & Company.

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, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.

Audit Report Number: 2016-KC-1003
Date: May 16, 2016

James B. Nutter & Company, Kansas City, MO, Did Not Always Follow HUD's Rules and Regulations for Loss Mitigation

Highlights

What We Audited and Why

We audited James B. Nutter & Company, a Federal Housing Administration (FHA) lender located in Kansas City, MO. We selected James B. Nutter based on data analysis showing that the servicer might be completing foreclosures faster than the industry standard, which would suggest that it might not be fully using the U.S. Department of Housing and Urban Development's (HUD) loss mitigation tools. Our audit objective was to determine whether James B. Nutter complied with HUD's Loss Mitigation program requirements.

What We Found

James B. Nutter did not always comply with HUD's Loss Mitigation program requirements. Specifically, it did not always (1) properly evaluate loans for loss mitigation, (2) properly determine the borrower's ability to support the mortgage payment, (3) calculate the borrower's cash reserve contributions for loans approved for standard preforeclosure sale, and (4) start foreclosure in accordance with HUD requirements. We found significant deficiencies in 11 of 25 (44 percent) FHA loan files reviewed. These deficiencies occurred because James B. Nutter's loss mitigation policy (1) did not implement all of HUD's requirements and (2) lacked detailed operating procedures that included steps for implementation, such as detailed checklists. As a result, HUD incurred losses of $287,922, and the FHA Mutual Mortgage Insurance Fund faced an increased risk of $289,960.

What We Recommend

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing require James B. Nutter to (1) reimburse HUD $287,922 for the loss incurred on five loans that did not receive active and proper loss mitigation or were improperly denied loss mitigation; (2) indemnify HUD for six loans that were not properly evaluated for loss mitigation, with a potential loss of $289,960; (3) update its policies and procedures for loss mitigation to include requirements found in HUD's mortgagee letters; (4) update its procedures to implement checklists to ensure that it considers all loss mitigation options before starting foreclosure and follows all HUD requirements for those options; and (5) provide training to loss mitigation staff on the new policies and procedures.

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Background and Objective

James B. Nutter & Company, a nonsupervised lender based in Kansas City, MO, received approval as a Federal Housing Administration (FHA) lender on July 22, 1957. On February 17, 1984, J.B. Nutter became an unconditional FHA direct endorsement lender, which permits a lender to underwrite Single Family Mortgages without FHA's prior review and submit them directly for FHA insurance endorsement. J.B. Nutter also originates and services the U.S. Department of Veteran Affairs and conventional loans. J.B. Nutter services more than 17,000 FHA loans.

As an agency within the U.S. Department of Housing and Urban Development (HUD), FHA provides mortgage insurance on loans made by FHA-approved lenders. This insurance provides lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet certain requirements established by FHA to qualify for insurance.

HUD established the Loss Mitigation program in 1996 to provide relief to borrowers in default. Participation in the Loss Mitigation program is not optional. HUD requires servicers to (1) evaluate all defaulted borrowers for loss mitigation options eligibility, (2) quickly activate appropriate loss mitigation options, (3) provide housing counseling availability information, (4) consider all reasonable means to assist the borrower in addressing the delinquency, and (5) retain written documentation of compliance with loss mitigation requirements. The program consists of reinstatement options to promote retention of home ownership and disposition options, which assist borrowers in default transition to lower cost housing.

The reinstatement options are special forbearance, loan modification, partial claim, and the Home Affordable Modification Program (HAMP). A special forbearance is a written repayment agreement between a lender and borrower, containing a plan to reinstate a delinquent loan. A loan modification is a permanent change in one or more of the terms of a loan, allows the loan to be reinstated, and results in a payment the borrower can afford. A partial claim consists of an interest-free loan to the borrower in the amount needed to reinstate the mortgage, thereby becoming a subordinate mortgage payable to HUD. The FHA-HAMP loss mitigation, which became effective August 15, 2009, combines the loan modification and partial claim loss mitigation options.

The disposition options are preforeclosure sale and deed in lieu of foreclosure. The preforeclosure sale option allows a borrower in default to sell his or her home and use the sale proceeds to satisfy the mortgage debt, even if the proceeds are less than the amount owed. A deed in lieu of foreclosure allows a borrower to turn over his or her home to HUD in exchange for a release from all mortgage obligations.

Our objective was to determine whether James B. Nutter complied with HUD's Loss Mitigation program requirements.

Results of Audit

Finding: J.B. Nutter Did Not Always Comply With HUD's Loss Mitigation Program Requirements

J.B. Nutter did not always comply with HUD's Loss Mitigation program requirements. Specifically, it did not always (1) properly evaluate loans for loss mitigation, (2) properly determine the borrower's ability to support the mortgage payment, (3) calculate the borrower's cash reserve contributions for loans approved for standard preforeclosure sale, and (4) start foreclosure in accordance with HUD requirements. We found significant deficiencies in 11 of 25 (44 percent) FHA loan files reviewed. These deficiencies occurred because J.B. Nutter's loss mitigation policy (1) did not implement all of HUD's requirements and (2) lacked detailed operating procedures that included steps for implementation, such as detailed checklists. As a result, HUD incurred losses of $287,922, and the FHA Mutual Mortgage Insurance Fund faced an increased risk of $289,960.

J.B. Nutter Did Not Always Comply With HUD's Loss Mitigation Program Requirements

J.B. Nutter did not always comply with HUD's Loss Mitigation program requirements. We found significant deficiencies in 11 of 25 (44 percent) FHA loan files reviewed. Summary details for these 11 loans are contained in appendix E of this report.

<u>J.B. Nutter Did Not Always Properly Evaluate Loans for Loss Mitigation</u>

For six loans, J.B. Nutter did not properly evaluate the loans for loss mitigation. Specifically, it did not properly

- Evaluate two borrowers for disposition options after denying the borrowers loss mitigation home retention alternatives. Mortgagee Letter (ML) 2000-05 states that participation in the Loss Mitigation program is not optional. Servicers may not start foreclosure until all loss mitigation options have been considered.
- Evaluate one borrower for loss mitigation home retention alternatives before approving the borrower for the preforeclosure sale program. ML 2008-43 requires the servicer to consider home retention alternatives and determine them unlikely to succeed before approving the borrower for the preforeclosure sale program.
- Evaluate one borrower for an FHA-HAMP loss mitigation action when the analysis of the borrower's current financial condition resulted in the borrower's inability to support the current mortgage payment. According to ML 2000-05, in no case may a partial claim be used if the borrower's surplus income percentage is 0 percent or less. The borrower had a negative surplus income percentage with the original mortgage payment. The modified payment reduced the borrower's payment by only $16, which still produced a negative surplus income.
- Evaluate one borrower for the preforeclosure sale program by the 90th day of delinquency. ML 2000-05 states that servicers are required to evaluate each loan no later

than the 90th day of delinquency to determine which loss mitigation options, if any, are appropriate. As nonoccupant owner, the borrower qualified only for a streamlined preforeclosure sale or deed in lieu of foreclosure. According to ML 2014-15, there are only two criteria for a nonoccupant owner to qualify for a preforeclosure sale. The owner must be 90 days or more delinquent on his or her FHA-insured loan and have a credit score of 620 or below. As of July 2, 2015, the owner met this criterion but was not evaluated and approved for preforeclosure sale until October 2015. The borrower submitted a preforeclosure sale application in May 2015. The servicing file did not support that the application had been evaluated, and J.B. Nutter did not request new information from the borrower until July 29, 2015. The borrower reached the 90th day of delinquency on July 2, 2015.

- Evaluate one borrower for a deed in lieu of foreclosure after an unsuccessful preforeclosure sale. According to ML 2000-05, the servicer must consider all loss mitigation options, including deed in lieu of foreclosure, before foreclosure. In this case, J.B. Nutter did not determine the borrower ineligible for a deed in lieu of foreclosure before starting foreclosure. As a nonoccupant owner, the borrower qualified only for a streamlined preforeclosure sale or deed in lieu of foreclosure. According to ML 2008-43, the servicer has 90 days following the end of a failed preforeclosure sale marketing period (in this case until January 27, 2016) to either use another loss mitigation alternative or start foreclosure. The marketing period for the preforeclosure sale ended October 29, 2015, and the borrower contacted J.B. Nutter on October 31, 2015, stating that she was interested in a deed in lieu of foreclosure. J.B. Nutter sent the borrower an email on November 4, 2015, with the requirements to complete a deed in lieu of foreclosure but then approved a foreclosure on November 5, 2015. J.B. Nutter did not follow up with the borrower concerning the deed in lieu of foreclosure or give the borrower adequate time to respond to its information request to complete a deed in lieu of foreclosure. Appendix C contains more information on related criteria.

<u>J.B. Nutter Did Not Always Properly Determine the Borrower's Ability To Support the Mortgage Payment</u>

For three loans, J.B. Nutter did not properly determine the borrower's ability to support the mortgage payment. Specifically, it did not

- Consider the coborrower's expenses after using the coborrower's income to qualify a borrower for a loan modification.
- Evaluate the borrower's financial condition before approving a borrower for a special forbearance plan (a plan for reinstating a delinquent loan).
- Evaluate the borrower's ability to pay the modified payment for an FHA-HAMP partial claim loan modification.

According to ML 2000-05, regardless of the option under consideration, the servicer must analyze the borrower's current and future ability to meet the monthly mortgage obligation by estimating the borrower's assets and surplus income. The steps include estimating the borrower's normal monthly living expenses (food, utilities, etc.). Further, the mortgagee letter states that if the financial analysis determines that the borrower does not have the ability to support the modified monthly payment, the modification option may not be used. Appendix C contains more information on related criteria.

J.B. Nutter Did Not Always Calculate the Borrower's Cash Reserve Contribution
For three loans, J.B. Nutter did not calculate the borrower's cash reserve contribution before approving the borrower for a standard preforeclosure sale. According to MLs 2013-23 and 2014-15, before approving the borrower to participate in a standard preforeclosure transaction, the servicer must calculate and disclose to the borrower the amount of the borrower cash reserve contribution that must be applied toward the standard preforeclosure transaction. The borrower is required to contribute 20 percent of its available cash reserves (all non-retirement liquid assets) greater than $5,000 toward the unpaid principal balance. In two instances, it did not collect the information necessary to compute the borrower's cash reserve contribution. In the third instance, it had the necessary documentation to make the determination but did not determine the contribution amount. Based on the financial information provided in the loan file, the borrower would have been required to contribute approximately $2,700 toward principal at closing. Appendix C contains more information on related criteria.

J.B. Nutter Did Not Always Start Foreclosure in Accordance With HUD Requirements
For one loan, J.B. Nutter did not start foreclosure in accordance with HUD requirements. According to ML 2008-43, if no offer is made on the property at the end of the preforeclosure sale marketing period, the servicer has 90 days to either use another loss mitigation alternative or start foreclosure. If the servicer does receive a preforeclosure sale offer on the property, it qualifies the servicer for a 60-day extension to the marketing period before beginning the 90-day period to start foreclosure or complete the deed in lieu of foreclosure. In this instance, the marketing period expired on May 9, 2015, but J.B. Nutter had received an offer at the end of the marketing period, which qualified it for a 60-day extension. Therefore, the marketing period expired on July 9, 2015, and J.B. Nutter had an additional 90 days (October 7, 2015) to complete the deed in lieu of foreclosure or start foreclosure. Although J.B. Nutter had attempted to complete a deed in lieu of foreclosure, it was not completed by October 7, 2015, and J.B. Nutter did not start foreclosure until November 6, 2015. Appendix C contains more information on related criteria.

The following table summarizes the identified loan deficiencies.

FHA case number	Failure to properly evaluate for loss mitigation	Failure to evaluate borrower's ability to pay	Failure to determine cash reserve contribution	Failure to start foreclosure in required timeframe
482-4115523	X			
441-9334966	X			
093-7288660	X			X
292-6467627	X			
482-4388971	X	X		
292-6513318	X			

FHA case number	Failure to properly evaluate for loss mitigation	Failure to evaluate borrower's ability to pay	Failure to determine cash reserve contribution	Failure to start foreclosure in required timeframe
492-8118666		X		
201-4241857		X		
093-7785357			X	
291-4844789			X	
105-6801323			X	

J.B. Nutter's Loss Mitigation Policy Did Not Implement All of HUD's Requirements and Lacked Detailed Operating Procedures

J.B. Nutter's loss mitigation policy did not include the general program requirements for evaluating loans for all loss mitigation options found in ML 2000-05, including evaluating the borrower's financial condition. The policy also did not include the requirement found in ML 2008-43 to consider HUD's home retention alternatives and determine them unlikely to succeed before approving a loan for preforeclosure sale. Further, the policy did not include the requirements for a standard preforeclosure sale found in ML 2013-23 and ML 2014-15. The policy addressed requirements for the streamlined preforeclosure sale only.

J.B. Nutter's loss mitigation policy did include guidance that a deed in lieu of foreclosure must be completed within 90 days of a failed preforeclosure sale. However, the policy did not include detailed procedures to implement its policy. In the loan files reviewed, J.B. Nutter's loss mitigation representatives did not consistently use a checklist to ensure that program requirements were met. The representatives sometimes used checklists found in the appendixes of ML 2000-05 that did not incorporate changes to Loss Mitigation program requirements issued after this ML, including FHA-HAMP guidance and requirements for a standard preforeclosure sale. Additionally, the policy did not provide procedures to ensure that J.B. Nutter's representatives reviewed and documented each loan for all loss mitigation options before starting foreclosure.

HUD Incurred Losses and the Insurance Fund Faced Increased Risk

As a result of the servicing deficiencies identified above, HUD incurred losses of $287,922 on five loans and faced an increased risk of $289,960 on six loans (appendix A). The following table describes the loans with significant loss mitigation deficiencies cited above and the actual or estimated loss amounts associated with the deficiencies (appendix D).

FHA case number	Unpaid principal balance	Loss incurred	Claim paid
482-4115523		$77,180	
441-9334966		118,939	
093-7288660	$115,106		
292-6467627	115,405		

FHA case number	Unpaid principal balance	Loss incurred	Claim paid
482-4388971	64,864		
292-6513318	97,919		
492-8118666		43,758	
201-4241857	65,504		
093-7785357	121,121		
291-4844789			$11,256
105-6801323			36,789
Totals	**$579,919**[1]	**$239,877**	**$48,045**

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing require J.B. Nutter to

1A. Reimburse HUD $287,922 for the loss incurred on five loans that did not receive active and proper loss mitigation or were improperly denied loss mitigation.

1B. Indemnify HUD for up to six loans that were not properly evaluated for loss mitigation, reducing the amount by the loss determined for recommendation 1F. The potential loss on those loans is estimated to be $289,960 (appendix A).

1C. Update its policies and procedures for loss mitigation to include requirements found in ML 2000-05 (including general requirements for all loss mitigation options, such as the 90-day review requirement, monthly evaluation, evaluation of the borrower's financial condition, and requirements for the borrower's ability to support mortgage payments for loan modification and partial claim), ML 2008-43 (including requirements to consider loss mitigation home retention alternatives before evaluating the borrower for disposition options and requirements for loss mitigation review after a failed preforeclosure sale), and ML 2014-15 (including requirements for the standard preforeclosure sale). Effective March 2016, these MLs have been superseded by HUD Handbook 4000.1, and the servicer should update its policies in accordance with the new Handbook requirements.

1D. Update its procedures to include checklists to ensure that it considers all loss mitigation options before starting foreclosure and follows all HUD requirements for those options.

1E. Provide training to loss mitigation staff on the new policies and procedures updated as a result of 1C and 1D.

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[1] This number appears as $579,919 here due to rounding each number in the table. The actual sum with no rounding is $579,920.38. Therefore, we reported this number as $579,920 throughout the report.

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing

1F. Determine the loss for FHA loans 093-7288660, 292-6467627, 292-6513318, and 093-7785357 that went to claim after our review and seek reimbursement for the loss from J.B. Nutter.

Scope and Methodology

Our audit period generally covered June 1, 2012, through July 31, 2015. We performed our audit work from August 2015 through January 2016 at J.B. Nutter's office located at 4153 Broadway, Kansas City, MO, and our office located in Kansas City, KS.

To accomplish our objective, we

- Reviewed HUD handbook 4330.1, REV-5 and mortgagee letters,
- Reviewed J.B. Nutter's loss mitigation and collection policies and procedures,
- Reviewed J.B. Nutter's hardcopy loan servicing files,
- Interviewed J.B. Nutter's employees, and
- Interviewed HUD staff from the National Servicing Center and Homeownership Center.

During our review, we selected two different samples using data maintained in HUD's Single Family Data Warehouse system. Single Family Data Warehouse is an integrated data warehouse that contains critical Single Family business data from 14 sources, mostly from FHA Single Family automated systems.

We based our conclusions on our review of 25 sample items. For our preliminary sample, we randomly selected 5 of 109 foreclosed-upon FHA loans, which J.B. Nutter serviced during our audit period, that received only one type of loss mitigation; 3 of 362 foreclosed-upon loans that received no loss mitigation, and 2 of 798 loans that went into delinquency between January 1, 2014, and July 30, 2015. For our secondary sample, we randomly selected 15 of 134 FHA loans that J.B. Nutter serviced during our audit period. We narrowed our audit universe to 134 loans by (1) focusing on loans that initially went into default on or after July 1, 2013, (2) excluding loans for which the default was due to the death of the principal borrower or the inability to contact the borrower, (3) excluding bankruptcies since the loss mitigation options available are limited, (4) including only those loans that had 62 days or fewer between the first time the loan was reported 1 month delinquent and 3 months delinquent, and (5) including only those loans in which the unpaid principal balance was greater than $50,000.

Due to the small universe and the time needed to review the loan files, we did not use a statistical sample. Therefore, our results apply only to the items reviewed and cannot be projected to the portion of the population we did not test.

We based all of our conclusions on our review of original source documents found in the servicer's FHA case files. We relied on electronic data in the Single Family Data Warehouse only to select our sample and determine the costs associated with the loans detailed in our finding. Therefore, we performed limited testing to determine the reliability of the data. We found the data to be sufficiently reliable to meet our objectives.

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.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls over loss mitigation.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- J.B. Nutter's loss mitigation policy (1) did not include all of HUD's Loss Mitigation program requirements and (2) lacked detailed operating procedures to ensure that it adequately implemented HUD's loss mitigation program (finding).

Separate Communication of Minor Deficiencies

We reported minor deficiencies to the auditee in a separate management memorandum, dated May 16, 2016.

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	$287,922	
1B		$289,960
Totals	**$287,922**	**$289,960**

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ 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 the lender indemnifies HUD for the six loans that J.B. Nutter did not properly evaluate for loss mitigation, HUD will avoid any potential losses on those loans. The potential loss on those loans is estimated to be $289,960 (50 percent loss severity rate applied to the unpaid principal balance of $579,920).

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

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April 15, 2016

Ronald J. Hosking
Regional Inspector General for Audit
400 State Avenue, Suite 501
Kansas City, KS 66101

Re: James B. Nutter & Company
Loss Mitigation Program Draft Audit Report Response
Audit Report Number: 2016-KC-XXXX

Dear Mr. Hosking:

On behalf of our client, James B. Nutter & Company ("JBNC" or "the Company"), we provide our responses and comments to the U.S. Department of Housing and Urban Development ("HUD") Office of Inspector General's ("OIG") draft audit report into JBNC's loss mitigation program.

The draft report suggests that JBNC did not always:

(1) Properly evaluate loans for loss mitigation;
(2) Properly determine the borrower's ability to support the mortgage payment;
(3) Calculate the borrower's cash reserve contributions for loans approved for standard preforeclosure sale; and
(4) Start foreclosure in accordance with HUD requirements.

The draft report further suggests that these deficiencies were caused by:

(1) JBNC's loss mitigation policy not implementing all of HUD's requirements; and
(2) JBNC lacking detailed operating procedures that included steps for implementation, such as detailed checklists.

At the outset, it is important to note that JBNC takes this review very seriously, and everyone at JBNC understands the importance of being fully cooperative with the examination and to be open and forthcoming with information. If you have any concerns that JBNC's level of cooperation has been anything less than 100%, please let us know so that we can address them immediately. JBNC has a long and positive history working with HUD. JBNC believes that its commitment to helping its customers is evident.

Auditee Comments and OIG's Evaluation

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JBNC also recognizes that there is always room for improvement and, as described below, JBNC is taking proactive steps to do so. Although JBNC strives to identify and remediate potential issues as soon as possible, the Company knows that despite its best efforts, mistakes can and will occur. JBNC accepts responsibilities for its errors. To the extent that errors occurred, however, the Company submits that such errors were not the product of knowing or reckless conduct on the part of JBNC. While JBNC acknowledges that some areas could be improved, JBNC respectfully requests reconsideration of some of the loss and risk calculations, given the circumstances described more fully below and JBNC's full cooperation with HUD OIG's examination.

JBNC is proactively taking steps to address issues identified to ensure not only that no harm has come to the borrower at issue or to HUD, but also to ensure similar situations do not arise on a going-forward basis. Among others,

Comment 1

- JBNC has undertaken a thorough review of its Default Management Policies and Procedures Manual and is implementing revised procedures and checklists. JBNC is still in the process of revising these documents, to ensure they include all of the applicable HUD requirements, including handbooks and mortgagee letters currently in effect.

- JBNC has conducted individualized training in response to some of the topics identified for review by HUD OIG and once JBNC completes the revisions to its Default Management Policies and Procedures and updates to its checklists, JBNC will conduct more formalized training, including educational courses, to make sure all applicable employees are informed of any changes in practice. Additionally, JBNC will be implementing additional testing to ensure that changes in practice are actually being followed.

JBNC recognizes the importance of establishing, implementing, and maintaining a robust loss mitigation process to avoid all unnecessary foreclosures and to ensure compliance with all applicable loss mitigation requirements. This process includes full evaluation for all possible loss mitigation options, including both reinstatement options and disposition options. JBNC also understands the need to verify the borrower's financial circumstances as stated in the loss mitigation application and to properly determine the borrower's ability to support the payment and whether and how much a borrower may need to contribute from their cash reserves. When the borrower has exhausted their loss mitigation options or does not qualify for loss mitigation, JBNC is committed to respecting HUD's timelines for proceeding with foreclosure.

Below, JBNC addresses each of the eleven (11) loans that HUD identified in the draft audit report as having significant findings.

Auditee Comments and OIG's Evaluation

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Comment 2

FHA case number: 482-4115523
Status as of April 15, 2016: Foreclosed and conveyed to HUD.
Alleged Servicing Deficiency: JBNC did not evaluate the loan for all loss mitigation options.

JBNC understands that participation in the FHA Loss Mitigation Program is not optional. JBNC also recognizes that the purpose of loss mitigation efforts is to bring the loan current as quickly as possible. In accordance with 24 C.F.R. § 203.600, JBNC is required to "collect amounts due from mortgagors to minimize the number of accounts in a delinquent or default status. Collection techniques must be adapted to individual differences in mortgagors and take account of the circumstances peculiar to each mortgagor." Here, in September 2012, JBNC was successful in obtaining a lump sum payment from the borrower so that the loan was made current and the delinquency was cured. JBNC thereafter closed the existing loss mitigation review as JBNC had no information indicating that the borrower was experiencing a continued hardship that would place them at risk of an imminent default under the definition in ML 2010-04, and believed that the borrower would be able to make the next required payment and keep the loan current. Unfortunately, the borrower became delinquent again when JBNC did not receive the October 2012 payment.

JBNC thereafter made several attempts to contact the borrower, in accordance with HUD Handbook 4330.1, Rev-5, Chapter 7.[1] For example, JBNC called the borrower as early as October 9, 2012 to discuss possible loss mitigation options and subsequently followed up with several letters and phone calls to the borrower in October through December 2012. The borrower did not respond until December 2012, when the borrower stated he did not know whether he wanted to try to retain or dispose of the property. JBNC provided a new loss mitigation application, but the borrower never returned the application. JBNC foreclosed on the property in March 2013, which was within the 6-month timeframe required by ML 2000-05. Therefore, JBNC did attempt to work with the borrower on loss mitigation options after the borrower re-defaulted; however, the borrower was unresponsive to JBNC's efforts. As a result, JBNC respectfully submits that it did comply with HUD's requirements for this loan and should not be required to reimburse for the loss incurred.

Moreover, it is unclear how HUD reached its conclusion that the loss incurred was $77,180. There are no facts in the draft report supporting this calculation, and therefore, JBNC respectfully objects to HUD's alleged loss amount in connection with this loan.

Comment 3

FHA case number: 441-9334966
Status as of April 15, 2016: Foreclosed and conveyed to HUD.

[1] JBNC recognizes that Chapter 7 was later amended by ML 2013-39, after the collection activity on this loan took place.

Auditee Comments and OIG's Evaluation

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Alleged Servicing Deficiency: JBNC did not evaluate the loan for all loss mitigation options.

JBNC recognizes the importance of early intervention. To that end, and in compliance with 24 C.F.R. § 203.605 and ML 2000-05, JBNC began working with this borrower on loss mitigation options in early 2012, when the borrower was only two months delinquent. JBNC evaluated the borrower for retention options. However, each of the options require that the borrower have sufficient assets and surplus income to be able to support the mortgage obligation. *See* ML 2000-05, 2012-22, 2013-32. Due to the borrower's lack of income, JBNC denied the borrower for retention options in March 2012. After that time, the borrower made a total of seven payments until August 2012, which brought the borrower to being delinquent by only one month.

In accordance with the contact efforts required by ML 2000-05 and Chapter 7 of the Handbook, JBNC placed a combined 39 phone calls and letters to discuss all loss mitigation options, including disposition options, with the borrower. JBNC continued to send loss mitigation applications and letters to the borrower monthly, until the property was set for foreclosure in September 2013. Unfortunately, while the borrower confirmed receipt of the loss mitigation package in August 2012, the borrower never submitted updated financial information or a new loss mitigation application. After re-reviewing the existing information under ML 2000-05 and confirming that the borrower still did not qualify for any loss mitigation options, the property was referred to foreclosure within 6 months and was eventually foreclosed in 2015. As stated in ML 2000-05, "the lender cannot be responsible if a borrower fails to respond to repeated contacts." As is its practice, JBNC attempted to work with the borrower to get an updated loss mitigation application to re-evaluate the borrower for all loss mitigation options before initiating foreclosure. Therefore, JBNC respectfully submits that it complied with HUD requirements and as a result, indemnification is not required for this loan.

Moreover, it is unclear how HUD reached its conclusion that the loss incurred was $118,939. There are no facts in the draft report supporting this calculation, and therefore, JBNC respectfully objects to HUD's alleged loss amount in connection with this loan.

Comment 4

FHA case number: 093-7288660
Status as of April 15, 2016: Deed-in-lieu completed in February 2016.
Alleged Servicing Deficiency: JBNC did not evaluate the loan for all loss mitigation options and did not start foreclosure in accordance with HUD requirements.

During the initial loss mitigation evaluation for this property, JBNC did consider loss mitigation retention options; however, JBNC determined that significant repairs would need to be made to the property and the borrower would not be able to support payments needed to make repairs without significantly draining the borrower's monthly resources, which made the property unsuitable for retention under ML 2000-05. JBNC then proceeded through the priority order of loss mitigation options, in accordance with 24

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C.F.R. § 203.501 and ML 2009-23,[2] to consider disposition options and approved the property for the preforeclosure sale program. Once the marketing period expired, JBNC moved forward with pursuing a deed-in-lieu for the borrower, which was eventually completed in February 2016. JBNC acknowledges that it took 120 days to start foreclosure and understands that it only has 90 days to start foreclosure or use an alternate loss mitigation option or else qualify for an automatic extension or request an extension from HUD's National Servicing Center under ML 2008-43. In order to ensure timely evaluation and approval for a deed-in-lieu following the expiration of a preforeclosure sale marketing period in January 2016, JBNC revised its preforeclosure sale checklist to request an extension timely when appropriate, and conducted individualized training with its representatives to reinforce the need to proceed with a deed-in-lieu or foreclosure after the expiration of a preforeclosure sale marketing period.

Comment 5

FHA case number: 292-6467627
Status as of April 15, 2016: Foreclosed in February 2016.
Alleged Servicing Deficiency: JBNC did not properly evaluate the borrower for loss mitigation.

Recognizing the importance of early intervention, JBNC conducted an initial evaluation of the borrower's loss mitigation application in May 2015, when the borrower was only one month delinquent and clearly within the 90 days of delinquency required by ML 2000-05. At that time, the borrower did not qualify for a streamlined preforeclosure sale or deed-in-lieu because the borrower was not occupying the property and was only 30 days delinquent for the April 2015 payment. The borrower did not qualify for a streamlined pre-foreclosure sale or deed-in-lieu because she did not satisfy the requirement to be at least 90 days delinquent under ML 2014-15. In July 2015, JBNC re-evaluated the denial, at which time JBNC approved the borrower for a pre-foreclosure sale and contacted the realtor about a marketing period, since by that point the borrower was 90 days delinquent for the streamlined pre-foreclosure sale. The realtor was able to get one acceptable offer on the property during the marketing period, which led JBNC to postpone the previously scheduled foreclosure sale for 60 days, but the pre-foreclosure sale ultimately was not completed. The realtor brought a second offer on the home, which JBNC considered, but the buyer did not complete the sales contract. JBNC then set a new foreclosure sale date of December 8, 2015, which took place. The property reverted back to JBNC and the claim was paid in February 2016.

Comment 6

FHA case number: 482-4388971
Status as of April 15, 2016: Current and paid ahead through May 2016.
Alleged Servicing Deficiency: JBNC did not properly evaluate the loan for loss mitigation.

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[2] JBNC recognizes that HUD has issued subsequent updates to the priority order in ML 2012-22 and 2013-32, which were published after the loss mitigation evaluation on this loan occurred.

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JBNC submits there may be a misunderstanding regarding this loan, since no partial claim was actually used. JBNC evaluated this borrower, who was in imminent default, for loss mitigation. JBNC understands that a partial claim is only appropriate if the current rate is at or below the market rate and the payment will be at or below the target payment under ML 2000-05 and ML 2003-19. Here, the loan met the first condition since the initial interest rate of 3.875% was lower than the current market rate of 4.25%. However, the loan would not have met the second condition since the payment would not have been lower than the target payment. Therefore in accordance with the above HUD requirements, JBNC did *not* approve the partial claim and instead approved the borrower for a HAMP modification with a principal deferment to reach the target PITI payment amount. The interest rate was increased to the market interest rate of 4.25%, as is permissible for a loan modification under ML 2000-05, Section F. The borrower is now current and paid through May 2016 and close to being paid through June 2016. JBNC therefore respectfully submits that there is no risk of loss on this loan.

Comment 7

FHA case number: 292-6513318
Status as of April 15, 2016: Active. Foreclosure started.
Alleged Servicing Deficiency: JBNC did not evaluate the loan for all loss mitigation options.

JBNC informed the borrower on October 31, 2015 about the possibility of a deed-in-lieu, and the borrower was given until November 14, 2015 to have the property and paperwork ready for the deed-in-lieu. JBNC followed up the phone call with an email to the borrower on November 4, 2015; however the borrower never responded that the borrower wanted to proceed with the deed-in-lieu. JBNC acknowledges that the property was recommended for foreclosure on November 6, 2015, before the deed-in-lieu period expressed to the borrower had expired. In order to ensure that borrowers receive all of the time allowed for a loss mitigation option, JBNC is enhancing its checklists to make sure that the Default Manager checks the status of the loan and checks with the assigned representative to make sure that all loss mitigation options have been exhausted before moving the loan to foreclosure.

JBNC appreciates that, in accordance with ML 2000-05, loss mitigation options may not be extended to borrowers who have more than one FHA loan or have been the mortgagor on prior loans on which an FHA claim has been paid within the past three years. JBNC's revised loss mitigation manual makes clear that the CAIVRS search must be run prior to approving the borrower for a loss mitigation option, including a preforeclosure sale. JBNC also recognizes that it must request an appraisal variance through EVARS and obtain approval before authorizing the borrower for a preforeclosure sale marketing period under ML 2014-15. These understandings were incorporated into JBNC's preforeclosure sale checklist in January 2015 and will be reflected in JBNC's revised loss mitigation manual.

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Comment 8

FHA case number: 492-8118666
Status as of April 15, 2016: Foreclosed. Property conveyed to HUD.
Alleged Servicing Deficiency: JBNC did not properly determine the borrower's ability to support the mortgage payment for a loan modification.

JBNC acknowledges that the co-borrower's expenses were not considered along with the co-borrower's income in determining the ability to support the mortgage payment for a loan modification under ML 2000-05. However, JBNC believes this is an isolated occurrence under the supervision of the prior Loss Mitigation and Collections Supervisor. Since the new Loss Mitigation and Collections Supervisor joined in December 2013, JBNC has revised its loss mitigation retention checklist to ensure that expenses are considered for all borrowers and co-borrowers whose income will be considered to determine the current and future ability to meet the monthly mortgage obligation. After the loan modification was provided in August 2012, the borrower was able to maintain the loan for nine months, such that JBNC does not believe that the co-borrower's expenses significantly impacted the borrower's ability to repay. Unfortunately, the borrower did become delinquent again in April 2013. At that time, JBNC complied with the requirements to contact the borrower in Chapter 7 and ML 2013-39 and tried to solicit the borrower for further loss mitigation options, but the borrower never responded to JBNC's efforts to offer assistance. Therefore, the foreclosure was completed in November 2014. Given the isolated nature of this case, JBNC submits that this is not a systemic issue indicative of JBNC's regular practices.

Moreover, it is unclear how HUD reached its conclusion that the loss incurred was $43,758. There are no facts in the draft report supporting this calculation, and therefore, JBNC respectfully objects to HUD's alleged loss amount in connection with this loan.

Comment 9

FHA case number: 201-4241857
Status as of April 15, 2016: Active. Contested foreclosure.
Alleged Servicing Deficiency: JBNC did not determine the borrower's ability to pay before executing a special forbearance agreement.

JBNC understands that it must begin any evaluation for loss mitigation options, including a Type I special forbearance, by performing a financial analysis to determine the mortgagor's ability to meet the monthly mortgage obligation under ML 2000-05 and ML 2011-23. The borrower completed a full loss mitigation package, and JBNC verified the borrower's proof of unemployment and that she would be able to sustain 50% of the current payment amount. In order to comply with this requirement, JBNC requested additional documentation to verify the borrower's income. The borrower wanted to submit later paystubs that would not reflect some additional seasonal income she had earned, so she only provided one paystub. JBNC continued to request the additional information from the borrower to complete the application, but the borrower never submitted any further information. The borrower no longer occupies the property, and JBNC is performing maintenance and repairs to the property to prepare it for a

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foreclosure sale. JBNC acknowledges that it should have requested a CAIVRS report under ML 2000-05 to determine whether the borrower owned any other real estate subject to FHA insurance or has been the borrower on prior loans for which an FHA claim has been paid within the past 3 years. A current CAIVRS report shows that the borrower did not have any other real estate subject to FHA insurance and that the only claim within the past three years is related to the pending foreclosure on the present property. JBNC has since revised its checklists to ensure that a CAIVRS report is collected for all special forbearance applications.

Comment 10

FHA case number: 093-7785357
Status as of April 15, 2016: Active. Preforeclosure sale completed.
Alleged Servicing Deficiency: JBNC did not calculate the borrower's cash reserve contribution before approving the borrower for the preforeclosure sale program.

JBNC acknowledges that it should have calculated the borrower's cash reserve contribution before approving the borrower for the preforeclosure sale program, however, it respectfully disagrees with the suggested calculation. According to ML 2013-23, the borrower would have had to contribute 20% of the excess over $5,000. The cash reserve contribution is calculated by using the highest ending balance of the mortgagors: (i) 2 most recent monthly bank statements; (2) 3 most recent months of brokerage statements and (3) most recent federal tax return at the time the mortgagor requests approval for a preforeclosure sale. Here, the borrower had $18,416.36 in cash reserves, which would have resulted in a contribution of $2683.27 ($18,416.36 - $5,000 = $13,416.36 x 20% = $2683.27), rather than HUD OIG's suggested contribution of $2,703.

Comment 11

FHA case number: 291-4844789
Status as of April 15, 2016: Terminated. Preforeclosure sale completed and claim paid.
Alleged Servicing Deficiency: JBNC did not calculate the borrower's cash reserve contribution.

JBNC did in fact calculate the borrower's cash reserve contribution; however, JBNC acknowledges that it was based on the assets stated in the borrower's application and that JBNC should have instead verified the assets that were used to calculate the borrower's cash reserve contribution for the preforeclosure sale transaction, as required by ML 2013-23. JBNC has added this requirement to its preforeclosure sale checklists to ensure that it obtains the necessary supporting documentation to support the amounts listed in the application and has conducted additional training to ensure its representatives understand the need to verify the information provided in the application.

Comment 12

FHA case number: 105-6801323
Status as of April 15, 2016: Terminated. Preforeclosure sale completed and claim paid.
Alleged Servicing Deficiency: JBNC did not calculate the borrower's cash reserve contribution.

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JBNC did calculate the borrower's cash reserve contribution; however, JBNC acknowledges that it was based on the assets stated in the borrower's application, which showed that the borrower did not have enough assets to be required to make a contribution. JBNC did collect the borrower's statements, but it should have reviewed the statements and completed the preforeclosure sale checklist regarding calculating the cash reserve contribution. In investigating this file and reviewing the borrower's documentation, JBNC has confirmed that no cash contribution would have been necessary for this preforeclosure sale. Therefore, JBNC believes that it should not have to reimburse HUD for the amount of the claim paid, since the amount of the claim would have been the same.

Conclusion

While JBNC acknowledges that some areas could use enhancement, JBNC respectfully requests that HUD OIG reconsider some of its loss and risk calculations, given the additional context provided above and JBNC's continued cooperation and commitment to full compliance with all HUD requirements. Furthermore, JBNC would like to emphasize—and we hope that HUD would agree—that none of these findings were the result of fraud or misrepresentation, nor were they the result of any knowing or material failure to engage in loss mitigation under 24 C.F.R. § 203.605. JBNC is enhancing its policies and procedures and checklists where needed and ensure that its representatives are aware of any changes in practices. Therefore, JBNC submits that the amounts requested for reimbursement and indemnification on paid claims warrant reconsideration and reduction. JBNC would also request clarification of HUD OIG's request for 50% of the unpaid principal balance as the calculation for its expected losses for which it seeks indemnification, as well as its calculations of alleged loss amounts described in the earlier comments.

Comment 13

Sincerely,

ALSTON & BIRD LLP

Edward Kang

Edward Kang & Nanci Weissgold

ETK/kls

OIG Evaluation of Auditee Comments

Comment 1 OIG acknowledges that J.B. Nutter took our review seriously and made efforts to improve its loss mitigation program. We did not review changes made to J.B. Nutter's policies and procedures after our field work, and therefore, cannot comment on whether subsequent changes satisfy our recommended changes.

Comment 2 JB Nutter denied the borrower loss mitigation home retention options in April 2011 because the borrower did not meet income requirements. At the time of the denial, J.B. Nutter did not evaluate the borrower for disposition options. The borrower avoided foreclosure by withdrawing funds from her retirement accounts. Additionally, the notes in the loan diary state that the borrower was not receiving overtime payment opportunities and was taking care of her mother. Therefore, J.B. Nutter had no reason to believe that the borrower's financial circumstances had improved when the borrower brought the loan current in September 2012. We acknowledge that J.B. Nutter attempted to make contact with the borrower after the borrower defaulted in October 2012; however, J.B. Nutter did not properly evaluate this loan for disposition options in April 2011 or imminent default in August 2012. Therefore, the impact on the insurance fund could have been reduced. We took the loss amount included in this report from Single Family Data Warehouse (SFDW) because it took into consideration the loss resulting from the sale of the HUD property. The equation SFDW used to calculate the loss amount was Sales Price – [Acquisition Cost + Capital Income/Expense (rent, repair costs, taxes, sales expenses)] = Profit/Loss.

Comment 3 At the time the borrower was denied loss mitigation home retention options, the borrower should have been considered for disposition options. J.B. Nutter could not provide evidence that this occurred. While the borrower may have made additional payments, the borrower's financial condition did not improve, and the loan ended in foreclosure. Had a preforeclosure sale been successfully completed, the loss to the insurance fund could have been reduced. We took the loss amount included in this report from SFDW because it took into consideration the loss resulting from the sale of the HUD property. The equation SFDW used to calculate the loss amount was Sales Price – [Acquisition Cost + Capital Income/Expense (rent, repair costs, taxes, sales expenses)] = Profit/Loss.

Comment 4 J.B. Nutter could not provide documentation to show the loss mitigation home retention options were considered. In an email from J.B. Nutter, the auditors were told that the borrower had been approved for the preforeclosure sale based on the definition of imminent default and home retention options were not considered because the borrower had a negative surplus income. However ML 2008-43 states that J.B. Nutter must document that they determined home retention options were unlikely to succeed. Additionally, we received confirmation from HUD's National Servicing Center that option priority requires home retention options to be reviewed before disposition options are considered. J.B. Nutter did not complete the deed-in-lieu within the required timeframe as stated in the audit report. According to ML 2008-43, J.B. Nutter is required to request an extension if it cannot complete the deed-in-lieu within the required timeframe. In this case, J.B. Nutter did not request or receive approval of an extension. Based on the auditee comments, the deed-in-lieu has been completed, and the property was conveyed to HUD since our review. Therefore, we have added Recommendation 1F for HUD to determine the loss on the loan during the audit resolution process and seek repayment for the loss.

Comment 5 J.B. Nutter could not provide documentation to support that it conducted a timely review of the loss mitigation packet received in May 2015. Additionally, J.B. Nutter could not provide any communication with the borrower to support that it denied the borrower for a preforeclosure sale or the reasons for denial. Lastly, J.B. Nutter had all of the information necessary to approve the borrower for a preforeclosure sale as soon as the loan was more than 90-days delinquent (July 2, 2015). J.B. Nutter did not evaluate the loan until after it was more than 90 days delinquent (July 29, 2015). Based on the auditee comments, this property has been conveyed to HUD since our review. Therefore, we have added Recommendation 1F for HUD to determine the loss on the loan during the audit resolution process and seek repayment for the loss.

Comment 6 An FHA-HAMP modification combines the partial claim with a loan modification. ML 2013-32 references ML 2000-05 surplus income percentage requirements, which states that a partial claim option cannot be used if the financial analysis determines the borrower cannot support the normal monthly payment. It further states that in no case may partial claim be used if the borrower’s surplus income percentage is zero percent or less than zero percent. Because the FHA-HAMP modification was executed, the borrower will not be eligible for loss mitigation for two years. The purpose of an indemnification agreement is to protect the FHA insurance fund from a potential loss; if there is no loss on the loan, no payment would be required.

Comment 7 In e-mails to OIG, J.B. Nutter stated that it proceeded with foreclosure on November 6, 2015, because it had not received a response from the borrower. Further, a note in the diary stated no phone call was made to the borrower because the loan had been recommended for foreclosure. The FHA loan file contained no evidence to show J.B. Nutter placed a call to the borrower concerning the deed-in-lieu after the loan was recommended for foreclosure. While evaluating the auditee comments, we determined this property has been conveyed to HUD since our review. Therefore, we have added Recommendation 1F for HUD to determine the loss on the loan during the audit resolution process and seek repayment for the loss.

Comment 8 J.B. Nutter did not follow HUD requirements for a loan modification when it failed to consider the co-borrower’s expenses to support the mortgage payment, and the borrowers ultimately could not support the loan. We took the loss amount included in this report from SFDW because it took into consideration the loss resulting from the sale of the HUD property. The equation SFDW used to calculate the loss amount was Sales Price – [Acquisition Cost + Capital Income/Expense (rent, repair costs, taxes, sales expenses)] = Profit/Loss.

Comment 9 In communication with J.B. Nutter to the audit team, J.B. Nutter admitted that it did complete the analysis of the borrower's financial condition and did not run a credit report as required. The documentation in the FHA loan file did not support statements made by J.B. Nutter that it determined the borrower's ability to pay prior to executing the special forbearance agreement. Further, ML 2000-05 requires that a CAIVRS search be performed on all FHA loans for all loss mitigation options prior to approval, and J.B. Nutter did not conduct the search until OIG brought the matter to its attention.

Comment 10 OIG's cash reserve contribution calculation is based on four bank accounts held by the borrower, in which the largest month's balance totaled $18,517 (1,444 + 1,159 + 3,853 + 12,061). However, the issue in this case is not the exact amount of the cash reserves. The issue is that J.B. Nutter failed to determine the amount the borrower would be required to contribute prior to approving the borrower for a preforeclosure sale, and therefore, the borrower did not make the required cash reserve contribution. While evaluating the auditee comments for this loan, we determined J.B. Nutter submitted a claim for this loan following our initial review. Therefore, we added Recommendation 1F for HUD to determine the loss on this loan during the audit resolution process and seek repayment of the loss.

Comment 11 J.B. Nutter did not provide documentation to support that it calculated the borrower's cash reserve contribution. Further, J.B. Nutter did not collect the documentation required by ML 2013-23 to make the appropriate calculation; therefore, it cannot make the determination that the borrower would not have been required to make a cash contribution.

Comment 12 J.B. Nutter did not provide documentation to support that it calculated the borrower's cash reserve contribution. Further, J.B. Nutter did not collect the documentation required by ML 2013-23 to make the appropriate calculation; therefore, it cannot make the determination that the borrower would not have been required to make a cash contribution.

Comment 13 The 50 percent loss severity rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2015. We use this percentage to estimate the future impact of indemnified loans that have not yet resulted in a final insurance claim.

Appendix C

Criteria

Mortgagee Letter 2000-05
This mortgagee letter states that loss mitigation is not optional. While each option has specific eligibility requirements, there are some policies that apply to all of the options and some lender requirements, which must be met whether or not any of the loss mitigation strategies are used.

General Program Requirements

C. Prohibition on Other FHA Loans
The mortgagor [borrower] may not own other real estate subject to FHA insurance, or have been the mortgagor on prior loans which an FHA claim has been paid within the past three years. The Credit Alert Interactive Response System (CAIVRS) must be used to assist in this determination, prior to use of any of the loss mitigation options.

E. 90 Day Review Requirement
No later than when 3 full monthly installments are due and unpaid, lenders must evaluate each defaulted loan and consider all loss mitigation techniques to determine which, if any, are appropriate.

G. Monthly Evaluation Requirement
As long as the account remains delinquent, the lender must reevaluate the status of each loan monthly following the 90-day review and is required to maintain documentation of the evaluations.

H. Evaluation of the Borrower's Financial Condition
The lender must independently verify the financial information by obtaining a credit report and any other forms of verification the lender deems appropriate. Regardless of the option under consideration, the lender must analyze the borrower's current and future ability to meet the monthly mortgage obligation by estimating the borrower's assets and surplus income in the following matter:

- Estimate the borrower's normal monthly living expenses (food, utilities, etc.) including debt service on the mortgage and other scheduled obligations. Make necessary adjustments to reflect increased or decreased expenses for each month of the proposed special forbearance agreement, or in the case of all other options, for a minimum of three months.
- Estimate the borrower's anticipated monthly net income for the same period, making necessary adjustments for income fluctuations.
- Subtract expenses from income to determine the amount of surplus income available each month.
- Divide the surplus income by total monthly expenses to determine the surplus income percentage.

J. Foreclosure

Lenders may not initiate foreclosure until all loss mitigation options have been considered. Written documentation of this review must be available in all conveyance claim review files (24 CFR [Code of Federal Regulations] 203.605).

Special Forbearance

D. Financial Analysis

The lender is required to assess the borrower's ability to repay the default as described in Section H, page 10. HUD expects the lender to project the borrower's surplus monthly income for the duration of the special forbearance period and to propose repayment terms consistent with the borrower's ability to pay.

Loan Modification

To qualify, borrowers must be able to support the monthly mortgage debt after the terms of the loan are modified.

D. Financial Analysis

The lender is required to assess the borrower's financial condition as described in Section H, page 10. HUD expects the lender to project the borrower's surplus monthly income for a minimum of three months and use good business judgment to determine if the borrower has the capacity to repay the arrearage through a repayment or special forbearance plan, before considering modification. If the financial analysis determines that the borrower does not have the ability to support the modified monthly payment, the modification option may not be used.

Partial Claim

D. Financial Analysis

The lender is required to assess the borrower's financial condition as described in Section H, page 10. HUD expects the lender to project the borrower's surplus monthly income for a minimum of three months and calculate the surplus income percentage. If the financial analysis determines that the borrower does not have the ability to support the normal monthly payment, the partial claim options may not be used. In no case may partial claim be used if the borrower's surplus income percentage is 0 percent or less than 0 percent.

Mortgagee Letter 2008-43

Pre-Foreclosure Sale Introduction

HUD's home retention alternatives such as Special Forbearance, Mortgage Modification, or Partial Claim must first be considered and determined unlikely to succeed due to the mortgagor's financial situation. Mortgagees [lenders] must maintain supporting documentation to demonstrate that a comprehensive review of the mortgagor's financial records was completed, and that the mortgagor did not have sufficient income to sustain the mortgage.

K. Duration of the Pre-Foreclosure Sale Period

Unless the National Servicing Center approves an extension, mortgagees have four months from the date of the mortgagor's approval to participate in the Preforeclosure Sale (PFS) program. Mortgagees have a pre-approved extension of two additional months to complete the PFS if one of the following exists:

- There is a signed Contract of Sale, but settlement has not occurred by the end of the fourth month following the date of the mortgagor's approval to participate in the PFS Program.

N. Failure to Complete a PFS
At the expiration of the PFS period, the mortgagee must re-evaluate available loss mitigation options. If the mortgagor's financial condition has improved to the point that reinstatement is a viable option, the mortgagee may undertake one of the home retention loss mitigation tools. If reinstatement is not feasible, the mortgagee should try to obtain a DIL [deed in lieu] of foreclosure before commencing foreclosure. An alternate loss mitigation option or first legal action to initiate foreclosure must be completed within 90 days of the expiration of the PFS period. If more than 90 days are needed to complete a DIL of foreclosure or initiate foreclosure or resume foreclosure, mortgagees must follow HUD's standard extension procedures and request an extension from the National Servicing Center.

Mortgagee Letter 2010-04
<u>Definition of "FHA Borrower Facing Imminent Default"</u>
FHA defines an "FHA borrower facing imminent default" to be an FHA borrower that is current or less than 30 days past due on mortgage obligation and is experiencing a significant reduction in income or some other hardship that will prevent him or her from making the next required payment on the mortgage during the month that it is due.

Mortgagee Letters 2013-23 and 2014-15[2]
<u>Calculating Cash Reserve Contributions for Standard PFS Transactions</u>
Prior to approving the mortgagor to participate in a standard PFS transaction, the mortgagee must calculate and disclose to the mortgagor the amount of the mortgagor's cash reserve contribution to be applied toward the standard PFS transaction. To determine the cash reserve contribution, the mortgagee must obtain the:

- mortgagor's three most recent monthly bank statements,
- three most recent months of brokerage statements,
- mortgagor's most recent federal tax return at the time the mortgagor requests an approval for a standard PFS.

<u>Streamlined Eligibility Requirements for PFS and DIL of Foreclosure</u>
Mortgagees may approve a mortgagor for a Streamlined PFS or DIL of foreclosure without verifying the hardship or obtaining a complete mortgagor workout packet if each of the conditions below exists:
For Non-Owner Occupants:

- Mortgagor(s) are 90 days or more delinquent on their FHA-insured loan as of the date of the mortgagee's review, and
- Each mortgagor has a credit score of 620 or below.

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[2] ML 2014-15 superseded ML 2013-23 in its entirety on October 1, 2014; however, both mortgagee letters contain identical criteria regarding the cash reserve contribution for standard preforeclosure sale transactions and Streamlined Eligibility Requirements for preforeclosure sales and deeds in lieu of foreclosure.

Mortgagee Letter 2013-32
FHA-HAMP
Surplus Income Percentage
The term "Surplus Income Percentage" is defined as surplus income divided by monthly net income (i.e., net take-home income). The Surplus Income Percentage is used in the mortgagee's financial analysis to determine which loss mitigation options are appropriate based on the mortgagor's income. See Mortgage Letter 2000-05 for further guidance on Surplus Income Percentage.

Mortgagee Letter 2014-15
Appraisal Validation Requirements for PFS Transactions
After its review of an FHA Roster appraisal, a mortgagee must submit a Request for Variance through the Extension and Variances Automated Requests Systems (EVARS) to approve a PFS transaction if one of the following conditions exists:

- The current appraised value of the property is less than the Unpaid Principal Balance by an amount of $75,000 or greater, *or*
- The appraised value is less than 50 percent of the Unpaid Principal Balance.

Minimum Marketing Period for all PFS Transactions
For all PFS transactions, the property must be marketed for a minimum period of 15 calendar days and all offers must be evaluated in accordance with the Requirements for Listing Agents set forth below in this Mortgagee Letter, even if the mortgagor has located a buyer.

Requirements for Listing Agents and Listing Brokers
The property must be listed in Multiple Listing Service for a period of 15 calendar days before offers are being evaluated. Following this initial listing period, offers may be evaluated as they are received.

Appendix D

Estimated Losses to HUD From Loss Mitigation Deficiencies

FHA case number	Unpaid principal balance	Loss incurred	Claim paid	Actual or estimated losses	
				Recommendation 1A	Recommendation 1B[3]
482-4115523		$77,180		$77,180	
441-9334966		118,939		118,939	
093-7288660	$115,106				$57,553
292-6467627	115,405				57,703
482-4388971	64,864				32,432
292-6513318	97,919				48,960
492-8118666		43,758		43,758	
201-4241857	65,504				32,752
093-7785357	121,121				60,560[4]
291-4844789			$11,256	11,256	
105-6801323			36,789	36,789	
Totals	**$579,919[5]**	**$239,877**	**$48,045**	**$287,922**	**$289,960**

[3] Unpaid principal balance * 50 percent

[4] This number appears to be rounded incorrectly here as $60,560 ($121,121 / 2 = $60,560.50, or $60,561 when rounded); however, with no rounding, it is $60,560.42 (the unpaid principal balance of $121,120.84 * 50% loss severity rate), so we have rounded down in the table above.

[5] This number appears as $579,919 here due to rounding each number in the table. The actual sum with no rounding is $579,920.38. Therefore, we reported this number as $579,920 throughout the report.

Appendix E

Case Narratives

FHA case number: 482-4115523
Loan amount: $233,354
Loss incurred: $77,180
Months delinquent: 9
Status as of September 3, 2015: Terminated. Property conveyed to HUD.

Servicing deficiency: J.B. Nutter did not evaluate the loan for all loss mitigation options.

J.B. Nutter did not properly evaluate the loan for the loss mitigation disposition options after denying the borrower the loss mitigation home retention options in April 2011. Although the borrower faced imminent default, J.B. Nutter sent the borrower a letter on September 7, 2012, closing the borrower's loss mitigation file because the loan was current. However, ML 2010-04 provides guidance on loss mitigation options available to borrowers facing imminent default. The borrower made no payments after September 2012.

FHA case number: 441-9334966
Loan amount: $163,747
Loss incurred: $118,939
Months delinquent: 36
Status as of September 3, 2015: Terminated. Property conveyed to HUD.

Servicing deficiency: J.B. Nutter did not evaluate the loan for all loss mitigation options.

J.B. Nutter did not consider all loss mitigation options to avoid foreclosure. It denied the borrower the loss mitigation home retention options due to lack of income and did not evaluate the borrower for the disposition options before starting foreclosure. ML 2000-05 requires the servicer to evaluate the borrower for all loss mitigation options before starting foreclosure.

FHA case number: 093-7288660
Loan amount: $126,499
Unpaid principal balance (as of February 2, 2016): $115,106
Months delinquent: 9
Status as of October 29, 2015: Active. Foreclosure started.

Servicing deficiency: J.B. Nutter did not evaluate the loan for all loss mitigation options and did not start foreclosure in accordance with HUD requirements.

J.B. Nutter did not evaluate the borrower for loss mitigation home retention options before approving the borrower for the preforeclosure sale program and did not start foreclosure in accordance with HUD requirements. According to ML 2008-43, HUD's home retention alternatives must first be considered and determined unlikely to succeed due to the borrower's financial situation. Additionally, at the end of the preforeclosure sale marketing period, if no offer is made on the property, the servicer has 90 days to start foreclosure or use an alternate loss mitigation option. The lenders have a preapproved extension of 2 additional months to complete the preforeclosure sale if there is a signed contract of sale but settlement has not occurred by the end of the fourth month following the date of the borrower's approval to participate in the preforeclosure sale program. The borrower's initial marketing period expired on May 9, 2015. However, J.B. Nutter had an automatic extension of 60 days because it had a signed contract offer on the end day of the marketing period. Therefore, the marketing period expired on July 9, 2015, and the borrower had an additional 90 days (by October 7, 2015) to complete the deed in lieu of foreclosure or start foreclosure. However, J.B. Nutter did not complete the deed in lieu of foreclosure by October 7, 2015, and did not start foreclosure until November 6, 2015. J.B. Nutter did not receive an approved extension from HUD's National Servicing Center.

FHA case number: 292-6467627
Loan amount: $121,557
Unpaid principal balance (as of February 2, 2016): $115,405
Months delinquent: 7
Status as of October 29, 2015: Active. Foreclosure started.

Servicing deficiency: J.B. Nutter did not properly evaluate the borrower for loss mitigation.

J.B. Nutter did not properly evaluate the borrower for loss mitigation. The borrower submitted an application to participate in a preforeclosure sale to J.B. Nutter in May 2015. J.B. Nutter did not properly evaluate the application. As a nonoccupant owner, the only loss mitigation options available to the borrower were a streamlined preforeclosure sale or deed in lieu of foreclosure. To qualify, the borrower needed to be 90 days delinquent and have a credit score at or below 620. Additionally, ML 2000-05 states that the servicer must evaluate each defaulted loan and consider all loss mitigation techniques no later than when three monthly installments are due and unpaid. The borrower was 90 days delinquent as of July 2, 2015, but J.B. Nutter did not evaluate the preforeclosure sale application sent in May 2015 or attempt to get information from the borrower until July 29, 2015, when J.B. Nutter mailed the borrower a second loss mitigation packet. In the meantime, J.B. Nutter's foreclosure review board recommended foreclosure on August 10, 2015. It took J.B. Nutter's appraiser approximately 1 month to provide an appraisal, which provided a marketing period of 12 days due to a previously scheduled foreclosure sale. However, based on the information obtained in J.B. Nutter's FHA case file, J.B. Nutter had all of the information needed to approve the borrower for the preforeclosure sale program on July 2, 2015.

FHA case number: 482-4388971
Loan amount: $69,087
Unpaid principal balance (as of February 2, 2016): $64,864
Months delinquent: 3
Status as of December 3, 2015: Active. Borrower approved for FHA-HAMP partial claim with loan modification.

Servicing deficiency: J.B. Nutter did not properly evaluate the loan for loss mitigation.

J.B. Nutter did not properly evaluate the borrower for loss mitigation. It analyzed the borrower's financial information and found that the borrower had a negative 51 percent surplus income percentage with the borrower's current mortgage payment. The analysis of the partial claim reduced the borrower's mortgage payment by only $16. J.B. Nutter did not analyze the borrower's ability to pay the modified payment, but based on information obtained in the FHA case file, a $16 reduction in payment would not have given the borrower a positive surplus income. According to ML 2000-05, if the financial analysis determines that the borrower does not have the ability to support the normal monthly payment, the partial claim option may not be used. It states further that in no case may partial claim be used if the borrower's surplus income percentage is 0 percent or less. J.B. Nutter should not have approved the borrower for the FHA-HAMP partial claim with loan modification in this instance.

FHA case number: 292-6513318
Loan amount: $102,235
Unpaid principal balance: $97,919
Months delinquent: 9
Status as of December 3, 2015: Active. Foreclosure started.

Servicing deficiency: J.B. Nutter did not evaluate the loan for all loss mitigation options.

J.B. Nutter did not properly evaluate the borrower for a deed in lieu of foreclosure when it did not give the borrower adequate time to respond to a request for information to complete a deed in lieu of foreclosure. The borrower participated in a preforeclosure sale, but she did not receive a successful offer before the end of the marketing period. The marketing period ended October 29, 2015, and the borrower contacted J.B. Nutter on October 31, 2015, stating that she was interested in a deed in lieu of foreclosure. J.B. Nutter sent the borrower an email on November 4, 2015, with the requirements to complete a deed in lieu of foreclosure, and the loan was presented and approved to the J.B. Nutter's foreclosure review board on November 5, 2015. The servicing file did not support that J.B. Nutter followed up with the borrower concerning the deed in lieu of foreclosure. According to ML 2008-43, J.B. Nutter had 90 days following the end of the preforeclosure sale marketing period to use another loss mitigation option or start foreclosure. Therefore, J.B. Nutter had until January 27, 2016, but started foreclosure in November 2015.

Additionally, J.B. Nutter did not determine whether the borrower owned other real estate subject to FHA insurance before approving the borrower for a preforeclosure sale as required by ML 2000-05. Further, the appraised value was less than 50 percent of the unpaid principal balance, and J.B. Nutter did not receive approval of the variance from HUD before approving the borrower for a preforeclosure sale as required by ML 2014-15.

FHA case number: 492-8118666
Loan amount: $83,641
Loss incurred: $43,758
Months delinquent: 19
Status as of September 3, 2015: Terminated. Property conveyed to HUD.

Servicing deficiency: J.B. Nutter did not properly determine the borrower's ability to support the mortgage payment for a loan modification.

J.B. Nutter did not properly determine the borrower's ability to support the mortgage payment for a loan modification. The coborrower lived in the home after the borrower suffered a stroke. The expenses submitted with the loss mitigation application were consistent with the borrower's expenses. However, the borrower's income could not support the loan amount. Therefore, J.B. Nutter used the coborrower's income to support the loan modification without taking into consideration the coborrower's expenses. ML 2000-05 states that J.B. Nutter must analyze the borrower's current and future ability to meet the monthly mortgage obligation.

FHA case number: 201-4241857
Loan amount: $72,973
Unpaid principal balance: $65,504
Months Delinquent: 26
Status as of December 3, 2015: Active. Contested foreclosure.

Servicing deficiency: J.B. Nutter did not determine the borrower's ability to pay before executing a special forbearance agreement.

J.B. Nutter did not evaluate the borrower's ability to pay before executing a special forbearance agreement. ML 2000-05 states that J.B. Nutter must analyze the borrower's current and future ability to meet the monthly mortgage obligation by estimating the borrower's assets and surplus income. J.B. Nutter did not collect the information necessary to make this determination. It collected information sufficient to verify only that the borrower was unemployed. Additionally, J.B. Nutter did not determine whether the borrower had other real estate subject to FHA insurance. ML 2000-05 states that to participate in the Loss Mitigation program, borrowers may not own other real estate subject to FHA insurance or have been the borrower on prior loans, for which an FHA claim has been paid within the past 3 years.

FHA case number: 093-7785357
Loan amount: $126,010
Unpaid principal balance: $121,121
Months delinquent: 5
Status as of October 29, 2015: Active. Preforeclosure sale completed.

Servicing deficiency: J.B. Nutter did not calculate the borrower's cash reserve contribution before approving the borrower for the preforeclosure sale program.

J.B. Nutter did not calculate the borrower's cash reserve contribution before approving the standard preforeclosure sale. Based on the financial information in the file, the borrower would have been required to contribute $2,703 toward the principal of the loan at closing. According to ML 2013-23, before approving the borrower to participate in a standard preforeclosure sale transaction, J.B. Nutter must calculate and disclose to the borrower the amount of the borrower's cash reserve contribution that must be applied toward the standard preforeclosure sale transaction.

FHA case number: 291-4844789
Loan amount: $71,333
Claim paid: $11,256
Months delinquent: 4
Status as of December 3, 2015: Terminated. Preforeclosure sale completed.

Servicing deficiency: J.B. Nutter did not calculate the borrower's cash reserve contribution.

J.B. Nutter did not calculate the borrower's cash reserve contribution before approving the borrower for a standard preforeclosure sale. It did not collect the proper documentation to make the determination. According to ML 2013-23, before approving the borrower to participate in a standard preforeclosure sale transaction, the lender must calculate and disclose to the borrower the amount of the borrower's cash reserve contribution that will be required to be applied toward the standard preforeclosure sale transaction.

FHA case number: 105-6801323
Loan amount: $113,546
Claim paid: $36,789
Months delinquent: 8
Status as of December 3, 2015: Terminated. Preforeclosure sale completed.

Servicing deficiency: J.B. Nutter did not calculate the borrower's cash reserve contribution.

J.B. Nutter did not calculate the borrower's cash reserve contribution before approving the borrower for a standard preforeclosure sale. It did not collect the proper documentation to make the determination. According to ML 2013-23, before approving the borrower to participate in a standard preforeclosure sale transaction, the lender must calculate and disclose to the borrower the amount of the borrower's cash reserve contribution that must be applied toward the standard preforeclosure sale transaction.