



# Evergreen Home Loans, Las Vegas, NV

## Federal Housing Administration Single-Family Housing Mortgage Insurance Program

**Office of Audit, Region 9  
Los Angeles, CA**

**Audit Report Number: 2016-LA-1011  
September 12, 2016**

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**To:** Robert Mulderig, Acting Deputy Assistant Secretary for Single Family Housing, HU  
Dane Narode, Associate Counsel for Program Enforcement, CACC  
//SIGNED//

**From:** Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

**Subject:** Evergreen Home Loans, Las Vegas, NV, Branch Did Not Always Comply With HUD FHA Origination Regulations

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Evergreen Home Loans.

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

The Inspector General Act, 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 213-534-2471.



**Audit Report Number: 2016-LA-1011**

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**Evergreen Home Loans, Las Vegas, NV, Branch Did Not Always Comply  
With HUD FHA Origination Regulations**

## Highlights

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### What We Audited and Why

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We performed a survey of Evergreen Moneysource Mortgage Company, doing business as Evergreen Home Loans, regarding its Federal Housing Administration (FHA) loan origination process. The review was part of our efforts to improve the integrity of single-family insurance programs. We selected Evergreen's Las Vegas branch because of its compare ratio.<sup>1</sup> Our audit objective was to determine whether Evergreen's Las Vegas branch complied with U.S. Department of Housing and Urban Development (HUD) requirements in the origination of FHA-insured loans

### What We Found

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Evergreen did not always originate FHA-insured loans in accordance with HUD regulations. Specifically, it did not identify unacceptable restrictive covenants<sup>2</sup> on 14 FHA loans that received downpayment assistance. Also, 3 additional loans reviewed included significant underwriting deficiencies, which would have affected the insurability of the loans. These deficiencies resulted in potential losses to the FHA insurance fund of more than \$1.1 million.

### What We Recommend

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We recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing require Evergreen to (1) work with HUD to nullify the restrictions on conveyance<sup>3</sup> that violate HUD policy or indemnify HUD against future losses of \$867,134 for the 14 loans; (2) indemnify HUD for 3 actively insured loans, which could cause potential losses of \$304,871 if they are foreclosed upon and resold; (3) develop procedures to ensure that it reviews all closing

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<sup>1</sup> The compare ratio is the percentage of originations that are seriously delinquent or were claim terminated divided by the percentage of originations that are seriously delinquent or were claim terminated for the selected geographic area. From November 1, 2013, through October 31, 2015, Evergreen's Las Vegas branch had a compare ratio of 211 percent.

<sup>2</sup> Unacceptable restrictive covenants in this case are provisions found in any legal instrument, law or regulation applicable to the mortgagor or the mortgaged property, including but not limited to a lease, deed, and sales contract that attempts to cause a conveyance made by the mortgagor be subject to limits on the amount of sales proceeds retainable by the seller.

<sup>3</sup> Conveyance is the transfer of property from one person to another.

documents, including closing documents for second mortgages associated with downpayment assistance, before closing the loan; and (4) ensure that it has adequately trained its employees regarding HUD underwriting requirements, including unallowable restrictions on conveyance. We also recommend that HUD's Associate General Counsel for Program Enforcement pursue civil and administrative remedies if legally sufficient.

# Table of Contents

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<b>Background and Objective.....</b>	<b>3</b>
<b>Results of Audit .....</b>	<b>4</b>
<b>Finding: Evergreen Did Not Always Originate FHA Loans in Accordance With HUD Requirements.....</b>	<b>4</b>
<b>Scope and Methodology.....</b>	<b>7</b>
<b>Internal Controls.....</b>	<b>9</b>
<b>Appendixes.....</b>	<b>10</b>
<b>A. Schedule of Funds To Be Put to Better Use.....</b>	<b>10</b>
<b>B. Auditee Comments and OIG’s Evaluation.....</b>	<b>11</b>
<b>C. Criteria.....</b>	<b>19</b>
<b>D. Schedule of Estimated Losses for Loans With Significant Deficiencies .....</b>	<b>23</b>
<b>E. Narrative Loan Summaries for Significant Underwriting Deficiencies.....</b>	<b>24</b>
<b>F. Schedule of Active Loans Containing Unacceptable Restrictions on Conveyance.....</b>	<b>27</b>

# Background and Objective

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Evergreen Home Loans was founded in 1987 and is headquartered in Bellevue, WA. It was approved as a nonsupervised direct endorsement lender<sup>4</sup> on July 1, 1993, and has 42 active branch offices throughout the western United States. Evergreen's Las Vegas branch, located at 8945 West Russell Road, Suite 210, Las Vegas, NV, was approved by the Federal Housing Administration (FHA) on August 17, 2010. The Las Vegas branch originated 843 loans from November 1, 2013, through October 31, 2015. During this period, 13 of the loans were at least 90 days delinquent, resulting in a compare ratio of 211 percent.

FHA provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA insures mortgages on single-family homes. It is the largest insurer of mortgages in the world, insuring more than 44 million properties since its beginning in 1934. FHA mortgage 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. All transaction must be scored through FHA's Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard<sup>5</sup>, except streamline refinances, refinanced transactions and assumptions. Lenders access TOTAL Mortgage Scorecard through an approved Automated Underwriting System (AUS). The mortgagee must verify the integrity of all data elements entered into the AUS to ensure the outcome is valid.

The objective of the audit was to determine whether Evergreen's Las Vegas branch complied with HUD requirements in the origination of FHA-insured loans.

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<sup>4</sup> Nonsupervised direct endorsement lender is one that has as its principal activity the lending or investing of funds in real estate mortgages and is permitted by HUD to underwrite single family mortgages without FHA's prior review and submit them directly for FHA insurance endorsement.

<sup>5</sup> FHA TOTAL Mortgage Scorecard is a statistically derived algorithm developed by HUD to evaluate borrower credit history and application information.

# Results of Audit

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## **Finding: Evergreen Did Not Always Originate FHA Loans in Accordance With HUD Requirements**

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Evergreen did not always originate FHA-insured loans in accordance with HUD requirements. It did not identify unallowable restrictive covenants in 14 loans. Also, we found underwriting deficiencies in 3 additional loans. Specifically, Evergreen did not always identify warning signs that indicated irregularities, correctly calculate income, or identify all liabilities. This condition occurred because Evergreen's procedures did not provide for its underwriters or closing department to review all closing documentation associated with second mortgages before closing. Also, its underwriters failed to exercise due diligence and prudent underwriting. As a result of the origination deficiencies noted in the FHA loans, Evergreen placed the FHA insurance fund at an increased risk of loss of more than \$1.1 million. Additionally the restrictive covenants placed the borrowers at risk of paying more than the downpayment assistance provided.

### **Evergreen Allowed Unallowable Restrictive Covenants**

Evergreen did not identify unacceptable restrictive covenants on 14 loans. The borrowers on these 14 loans received downpayment assistance ranging from about \$7,500 to \$25,000 from the Neighborhood Stabilization Program (NSP)<sup>6</sup> through the City of Las Vegas (appendix F). In exchange for the downpayment assistance, the borrowers agreed to a repayment clause that required repayment to the City of an amount equal to the current market value of the property, less any portion of the value attributable to expenditures of non-NSP3 funds for acquiring or improvements to the property. The City may exercise this clause if the borrower sells, transfers, leases, or otherwise loses possession of the property within the affordability period.<sup>7</sup> Under these circumstances, the provisions at issue subjected the borrower to contractual liability other than repayment of the assistance provided. This practice violated HUD regulations at 24 CFR (Code of Federal Regulations) 92.254 and 24 CFR 203.41.

### **Evergreen Did Not Identify Warning Signs That Indicated Irregularities For One Loan**

Evergreen did not identify warning signs of potential fraud when underwriting one loan (FHA case number 332-5994293). The borrower received a pay raise just after closing that tripled his income, which allowed him to qualify for the FHA mortgage. Only a month after closing, the borrower's salary dropped back to the original amount. FHA underwriting requires a careful analysis of many aspects of the mortgage. HUD regulations state that the underwriter must be aware of the warning signs that may indicate irregularities and be alert and able to detect fraud. The regulations also state that simply establishing that a loan transaction meets the minimum

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<sup>6</sup> HUD's Neighborhood Stabilization Program provides grants to states, local communities and other organizations to purchase foreclosed or abandoned homes and to rehabilitate, resell, or redevelop these homes in order to stabilize neighborhoods and stem the decline of home values of neighboring homes.

<sup>7</sup> The affordability period for the 14 loans was 5 or 10 years, depending on the amount of assistance received.

standards does not necessarily constitute prudent underwriting.<sup>8</sup> The large increase in salary was a significant warning sign that raised the level of risk for this loan. However, the underwriter did not exercise prudent underwriting and took no additional action to ensure that the promotion was legitimate.

### **Evergreen Did Not Correctly Calculate Income or Identify All Liabilities For Two Loans**

Evergreen incorrectly calculated commission income when underwriting another loan (FHA case number 332-5771783). HUD regulations state that commission income must be averaged over 2 years.<sup>9</sup> However, Evergreen's underwriter made the decision to calculate income using a letter from the employer of a new job the borrower started just before closing. Evergreen should have calculated income using the average commission income for the previous 2-year period. As a result of this error, Evergreen overstated the borrower's income. If Evergreen had averaged the income over a 2-year period, the front and back ratios would have been 39 and 60.75 percent<sup>10</sup>, respectively.

During the underwriting of a third loan (FHA case number 332-5857550), Evergreen incorrectly calculated the borrower's income and liabilities. HUD requirements state that a period of more than 2 years must be used in calculating the average overtime income if it varies significantly.<sup>11</sup> In this case, the underwriter made the decision to use less than 2 years, despite a large increase in the borrower's overtime income. Evergreen also did not identify an increase in the borrower's child support liability. As a result of these errors, the underwriter overstated the overtime income and understated the liabilities. If Evergreen had calculated the income and liabilities correctly, the front and back ratios would have been 25.17 and 61 percent, respectively.

A more detailed analysis of each loan is documented in appendix E of the report.

### **Conclusion**

Evergreen's failure to follow HUD's FHA regulations and requirements placed the FHA insurance fund at increased risk for losses. Fourteen loans contained unallowable restrictive covenants, and three had significant underwriting deficiencies. This condition occurred because Evergreen did not have procedures to identify unallowable restrictive covenants and underwriters did not always exercise sound judgment and due diligence when underwriting FHA loans. The total unpaid mortgage balance for the loans with significant underwriting deficiencies was more than \$2.3 million with an estimated loss to HUD of more than \$1.1 million (appendix D).

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<sup>8</sup> HUD Handbook 4155.2, paragraph 2-A(4)(b); HUD Handbook 4155.1, paragraph 4-F(1)(b)

<sup>9</sup> HUD Handbook 4155.1, paragraph 4-D(2)(g)

<sup>10</sup> FHA's limit for the mortgage payment to income (front) ratio is 31 percent and total obligations to income (back) ratio is 43 percent.

<sup>11</sup> HUD Handbook 4155.1, paragraph 4-D(2)(c)

## **Recommendations**

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing require Evergreen to

- 1A. Work with HUD to nullify the restrictions on conveyance that violate HUD policy or indemnify HUD. This action will protect HUD against future losses of \$867,134 for the 14 loans (appendix F).
- 1B. Indemnify HUD against potential losses of \$304,871 for the three loans that did not comply with FHA underwriting requirements (appendix E).
- 1C. Develop and implement procedures to ensure that it reviews all closing documents, including closing documents for second mortgages associated with downpayment assistance, before closing the loan.
- 1D. Ensure that it has adequately trained its employees regarding HUD underwriting requirements, including calculating commission and overtime income, identifying irregularities and red flags, and unallowable restrictions on conveyance.

We recommend that HUD's Associate General Counsel for Program Enforcement

- 1E. Determine legal sufficiency and if legally sufficient, pursue civil and administrative remedies, civil money penalties, or both against Evergreen, its principals, or both for incorrectly certifying to the integrity of the data, the eligibility for FHA mortgage insurance, or that due diligence was exercised during the origination of FHA loans.

# Scope and Methodology

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Our audit period covered loans with beginning amortization dates from November 1, 2013, to October 31, 2015. We selected the Las Vegas branch because its compare ratio was 211 percent. We conducted our fieldwork at the Las Vegas branch office between February and May 2016.

To accomplish our objective, we

- Reviewed HUD regulations and reference materials on single-family requirements;
- Reviewed reports and information in HUD's Neighborhood Watch system;
- Reviewed the lender's processing, underwriting, and closing policies and procedures;
- Conducted interviews with lender staff;
- Reviewed the lender's FHA-insured loan files;
- Reviewed the quality control plan and reviews; and
- Performed site visits to employers when available to reverify employment documentation

During the course of the audit we received a referral from HUD related to an Evergreen loan with NSP down payment assistance. As a result, we reviewed the closing documents for all loans that received downpayment assistance from NSP. We obtained a listing of all NSP downpayment assistance loans awarded by the City of Las Vegas, Clark County, and the City of Henderson. Using HUD's Single Family Data Warehouse, an extensive collection of database tables organized and dedicated to support analysis of single-family housing data, we identified which downpayment assistance loans were associated with FHA loans and originated by Evergreen. We determined that Evergreen originated 28 FHA-insured loans that received NSP downpayment assistance and were still active; this included the one loan referred to us by HUD. The City of Las Vegas provided the NSP downpayment assistance for 14 of the 28 loans identified. We obtained and reviewed the closing documents for all 28 loans.

Also, we reviewed the underwriting documentation for 13 FHA-insured loans. We used Neighborhood Watch, HUD's online information system for FHA-insured loans, to identify all loans originated by the branch that were seriously delinquent which is defined as 90 days or more days past due. We identified and reviewed all 13 loans that were seriously delinquent. As a result, we are unable to project our results. The 13 loans had a total mortgage amount of more than \$2.7 million. We used the data from Neighborhood Watch to identify loans for review but did not rely on the data as a basis for our conclusions. Therefore, we did not assess the reliability of the data.

We used the source documents provided by the lender and HUD for our review. Our testing and review included (1) analysis of borrowers' income, assets, and liabilities; (2) review of borrowers' savings ability and credit history; (3) verification of selected data on the underwriting worksheet and settlement statements; and (4) confirmation of employment.

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

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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:

- Policies and procedures intended to ensure that FHA-insured loans are properly originated, underwritten, and closed.
- Policies and procedures intended to ensure that the lender's quality control program is an effective tool in reducing underwriting errors and noncompliance.

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 Deficiencies**

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

- Evergreen did not have adequate internal controls to reasonably ensure that loan originations complied with HUD requirements and prudent lending practices (finding).

# Appendixes

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## Appendix A

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**Schedule of Funds To Be Put to Better Use**

<b>Recommendation number</b>	<b>Funds to be put to better use 1/</b>
1A	\$867,134
1B	304,871
<b>Total</b>	<b>1,172,005</b>

- 1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. If HUD implements our recommendations to indemnify loans not originated in accordance with FHA requirements, it will reduce FHA’s risk of loss to the insurance fund. Recommendation 1A represents the total loan amount of \$867,134 for the 14 loans containing unallowable restrictive covenants. When the covenants are removed or FHA insurance is terminated, this will reduce risk to the FHA insurance fund. The projected loss of \$304,871 for recommendation 1B is equal to 50 percent of the unpaid balance of loans containing significant underwriting deficiencies. It is based on HUD’s calculation that FHA loses on average 50 percent of the claim amount when it sells a foreclosed-upon property. The 50 percent loss 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. (The calculation is shown in appendix D.)

# Appendix B

## Auditee Comments and OIG's Evaluation

### Ref to OIG Evaluation

### Auditee Comments

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August 16, 2016

*Via E-mail*

Tanya E. Schulze  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
300 N. Los Angeles Street, Suite 4070  
Los Angeles, CA 90012

Re: Evergreen Home Loans  
Response to Draft Audit, FHA Single-Family Housing Mortgage Insurance Program

Dear Ms. Schulze:

On behalf of Evergreen Home Loans, I am transmitting their response to the above-referenced draft audit.

Please feel free to contact me if you have any questions.

Sincerely,  
  
Constantinos G. Panagopoulos

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## **Response of Evergreen Moneysource Mortgage Company dba Evergreen Home Loans to HUD Office of Inspector General Audit: Federal Housing Administration Single-Family Housing Mortgage Insurance Program**

Ballard Spahr LLP submits this response to the above-referenced audit draft dated July 28, 2016 (“Draft Audit”) on behalf of Evergreen Moneysource Mortgage Company dba Evergreen Home Loans (“EHL”).

EHL originated and closed over \$525 million in Federal Housing Administration (“FHA”) loans in 2015 and over \$370 million year to date for 2016. EHL was founded in 1987 and has been an FHA approved lender since 1993. EHL takes great pride in the overall quality of our underwriting and file review process as reflected in many satisfactory audit reviews over the years. EHL fully embraces HUD’s mission to create strong, sustainable, inclusive communities and quality affordable homes for all.

The Draft Audit makes certain conclusions that suggest that the results of the audit could be generalized on a global level related to risk of losses and underwriting. EHL strongly disagrees with any such generalization. The Draft Audit involved a survey, and does not use a methodology involving review of statistically valid samples of loans. The audit targeted review of only a delinquent files, automatically skewing the sample and rendering generalized conclusions invalid. Given the volume of FHA loans that EHL originates, this global conclusion is simply not supported. We understand matter was discussed at the exit conference held on August 2, 2016. [REDACTED] of HUD OIG indicated that he understood EHL’s perspective and agreed he would recommend that the global conclusion be updated to only be applicable to the specific loans reviewed.

EHL also respectfully disagrees with the majority of the findings in the Draft Audit and the recommendations for resolving the purported issues identified by the Office of Inspector General (“OIG”).

- 1. Evergreen was not responsible for conducting a detailed legal review of secondary mortgage documents but, even if it were so required, the secondary mortgage documents do not on their face violate any applicable HUD requirements.**

The Draft Audit’s first finding pertains to purportedly “unallowable restrictive covenants” associated with debt that was subordinate to loans originated by EHL. The subordinate loans were originated by the City of Las Vegas (“City”) as part of a Neighborhood Stabilization

DMEAST #20012346 v2

Comment 1

**\*Names redacted for privacy reasons.**

Program (“NSP”) downpayment assistance program. The subordinate loan documents drafted and signed by the City included a repayment clause requiring the borrower to “pay to the City an amount equal to the current market value of the Property...less any portion of the value attributable to expenditures of non-NSP funds for the acquisition of, or improvements to the Property” (hereafter this referred to as the “Repayment Clause”). It is this Repayment Clause that is purportedly unallowable restrictive covenant. Below are specific responses to the assertions in the Draft Audit pertaining to this covenant.

**(a) *The Draft Audit Improperly Seeks to Place New Requirements on Evergreen that Would Render It Responsible for Detailed Legal Review of non-FHA Requirements Contained in Subordinate Debt.***

The City is the recipient of the NSP grant from HUD. The City has presumably entered into a grant agreement or similar legal arrangement with HUD requiring the City to administer the NSP grant in accordance with NSP requirements. EHL has no contractual or other responsibilities to ensure that the City complies with NSP program requirements. Nonetheless, the Draft Audit seeks to make EHL responsible for conducting a detailed legal review of the City’s subordinate loan documents. Specifically, the Draft Audit asserts that EHL should have determined that the Repayment Clause contained in the City’s legal documents violates NSP requirements – even though EHL has no responsibility for complying with the NSP program. Compliance with NSP requirements is the responsibility of the City and its borrowers. Although, as discussed below, we do not believe that the subordinate loan documents necessarily violate NSP requirements, it is unreasonable and inconsistent with HUD and industry practice to make lenders like EHL responsible for the compliance of a HUD NSP grantee with NSP program requirements. As such, we request that HUD remove any findings that EHL was responsible for any HUD NSP program violations (namely, the reference to 24 CFR § 92.254).

**(b) *The Repayment Clause Does Not, On Its Face, Violate NSP Requirements So Such Finding Should Be Removed from the Audit.***

It appears the OIG has misunderstood the NSP program requirements applicable to the Repayment Clause. The NSP program is one that has no regulations. Created by Congress to address the housing crisis in 2008, the program is governed exclusively through the authorizing statute, HUD notices and HUD guidance, which generally incorporate requirements of other HUD programs (primarily Community Development Block Grant program) as guidelines. The NSP program requires grantees (here, the City) to establish program requirements that preserve the long-term affordability of properties financed using NSP funds, and identifies HOME regulations at 24 CFR § 92.254 as a *safe harbor* for such regulations. However, HUD clearly states in guidance that grantees may establish more stringent requirements than those at the cited HOME regulation.<sup>1</sup> Thus the City was not *required* to include the HOME requirements as its

<sup>1</sup> See U.S. Department of Housing and Urban Development “Guide to Neighborhood Stabilization Program (NSP) Eligible Uses”, at p. 3 (“HUD will consider any grantee adopting the HOME program standards at 24 CFR 92.252(a), (c), (e) and (f), and 92.254 to be in minimal compliance with this affordability standard and expects any other standards proposed and applied by a grantee to be enforceable and longer in duration.”); see also U.S. Department of Housing and Urban Development, “NSP Homebuyer Programs: Financing and Long Term Affordability,”

Comment 2

Comment 3

Comment 4

Comment 5

affordability restrictions in the subordinate loan documents and was free, with HUD approval, to establish alternate requirements.

To the extent the Repayment Clause varies from the HOME safe harbor, it appears that the City may have established such alternate affordability requirements. EHL, in reviewing the subordinate documents, would have no indication based on the contents of the loan documents as to the nature of City's agreement with HUD with respect to the Repayment Clause. It would be reasonable to assume that the City – the NSP grantee – obtained any necessary HUD approvals with respect to the requirements contained in the City's subordinate loan documents.

*(c) Evergreen did not violate the "free assumability" exceptions*

The Draft Audit also alleges that the Repayment Clause is contrary to 24 CFR § 203.41, presumably with reference to 24 CFR § 203.41(d), which allows, in relevant part, that eligible governmental programs may restrict conveyance of the mortgaged property so long as it does not "subject[] the mortgagor to contractual liability other than requiring repayment (at a reasonable rate of interest) of assistance provided to make the property affordable as low or moderate-income housing." While the Repayment Clause could certainly have been drafted more clearly, it was not unreasonable for EHL to conclude that the clause did not violate the aforementioned regulation. The clause only applies during the first five years of homeownership and requires repayment of all non-NSP financing for acquisition or improvements prior to payment to the City of the difference between the current market value of the property less the non-NSP financing. This clause would prevent a borrower from being required to pay to the City any amounts in excess of the market value of the home, thus in a situation of declining value, less than the full amount of downpayment assistance would be required to be repaid. Indeed in 2008, single-family home prices were in freefall in the Las Vegas area. *See Las Vegas Review Journal, July 8, 2016.* In 2006, the median sales price for a home in Las Vegas was \$315,000. *Id.* By 2012, the median price had dropped to \$118,000. *Id.* Median housing prices in Las Vegas are still more than 25% below 2006 housing prices. *Id.* While the Repayment Clause could be read to require a borrower to repay more than the full amount of downpayment assistance in the event that the market value of the home increased, the growth of real estate prices in a 5-year period would be unlikely to be so significant as to result in repayment of anything more than the NSP downpayment assistance plus a reasonable rate of interest. As such, there was no violation of the "free assumability" exceptions in the FHA regulations.

**2. Warning Signs did Indicate Irregularities with FHA Case number 332-5994293.**

In reviewing the loan file, EHL has informed us that agrees with the OIG findings that the increase in the borrower's income from \$26K in 2014 to \$85K in 2015 was a red flag and the increase of income was not reasonable and should have not been used in order to qualify the borrower. The underwriter is no longer employed by EHL and has not been an employee since

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at p. 17, available at <https://www.hudexchange.info/resources/documents/HomebuyerFinancingandLongtermAffordability.pdf> ("NSP grantees may adopt these [HOME] rules as a safe harbor or, with HUD approval the NSP grantee may impose more stringent standards.")

the summer of 2015. To prevent this issue from reoccurring, the loan will also be discussed in the next underwriting meeting as an example of income that cannot be used in qualifying.

**3. Evergreen Correctly Calculated Income and Identified Liabilities**

*(a) FHA Case number 332-5771783*

We understand from EHL that the borrower in the above-referenced case did change employers just prior to loan closing, going from a Mazda dealership to a Nissan dealership. The level of his position typically does not involve an employment contract; only an opening for a position in which he had the skills to fill. The new dealership provided a breakdown of his new earnings with them. The borrower has been in the auto dealership service since at least 2011 as is supported by his 2011 W2's. He was employed in California until 6/12 when he relocated to Las Vegas, NV accepting employment with the Mazda dealership and was employed with them until accepting a position with Nissan. Below is history of borrowers' commission earnings that support the \$3700/month commission used to qualify.

2013	\$39,529.88	Mazda commissions	9.0 months = \$4392.20
2012	\$11,587.78	Mazda commissions	4.0 months = \$2896.94 **
2012	<u>\$31,539.09</u>	Other commissions	<u>5.5 months</u> = \$5734.38
	\$82,357.08	divided by	18.5 months = \$4467.93
2013	\$10,412.34	Mazda base pay	9.0 months = \$1156.92
2012	<u>\$ 2,400.00</u>	Mazda base pay	<u>4.0 months</u> = \$ 600.00
	\$95,169.42	Total earnings divided by	18.5 months = \$5144.29

Nissan income is \$1,000/month base pay + commissions (ranging from \$3700 – \$7200/month). Income used to qualify was the \$1000/month base pay plus commissions of \$3700 for a total of \$4700/month. This income is well supported in his history of commission plus base pay earnings.

\*\*2012 commission earnings from Mazda are based on 4 months because there was a break in employment with them due to a disagreement of pay. He worked for them from 7/2/12 thru 8/23/12 and returning to Mazda on 10/16/12. In addition the borrower relocated from California to Nevada, which took him a little bit of time to re-establish himself in Nevada. His earnings while in CA in 2012 averaged \$5734.38/month.

*(b) FHA Case Number 332-5857550*

We understand from EHL that the borrower in the above-referenced case had been employed with her current employer for approximately 3.5 years at the time of her loan application. She had received overtime income for at least the past 3 years and the employer indicated it was likely to continue. It was deemed appropriate to analyze her overtime income over 2013 and 2012 as she was shy only 12 days of a complete 24 months. Her overtime income was increasing each year and the 2011 overtime income was earned over two years before and was not a reflection of the current income she was actually earning.

Comment 6

Comment 7

FHA's guidelines in place at the time (4155.1 4.D.2.b-Overtime and Bonus Income) clearly gives the underwriter the flexibility to consider less than a two year average of overtime income when justified. It states:

*"The lender must develop an average of bonus or overtime income for the past two years. Periods of overtime and bonus income less than two years may be acceptable, provided the lender can justify and document in writing the reason for using the income for qualifying purposes."* (highlights added)

EHL used the overtime for 2013 based on the borrower's 12/27/13 paystub reflecting pay through 12/18/13 and the 2012 based on the VOE to calculate the overtime income that would be used to qualify. Her overtime income did vary, however this income was trending upward each year; there was no decline. The use of a 23.60 month average was clearly justified in this case.

	Overtime				
2013 (YTD thru 12/18/13)	\$17,250.85	11.58 months	\$1,489.71		
2012	\$6,605.59	12 months	\$550.47		
2011	\$4,599.05	12 months	\$383.25		
Total	\$28,455.49	35.60 months	\$799.31	+	\$4,158.27
					<b>\$4,958.03</b>

	Overtime				
2013 (YTD thru 12/18/13)	\$17,250.85	11.58 months	\$1,489.71		
2012	\$6,605.59	12 months	\$550.47		
Total	\$23,856.44	23.60 months	\$1,010.87	+	\$4,158.27
					<b>\$5,169.99</b>

The monthly child support debt of \$400 used for qualifying was based on the actual amount the borrower was paying at the time of the loan application as was evidenced on her bank statement although the borrower had always historically only paid \$350.

The Order of Child Support did state that the amount could increase by \$50 per month based on every \$10K increase in the borrower's pay of \$26K in 2004 but it was clear that the respondent had not pursued having the amount increased as the borrower had been paying the original \$350 since 2004. The borrower was paying \$400 for seven months based on a previous arrangement with the respondent where she paid an additional \$50 for seven months if he allowed her to skip one month of payment (documented in the file). Based on the fact that the increase clause in the child support agreement had never been exercised in 10 years, despite clear evidence that our borrower's wages were over \$36K in 2011 and over \$46K in 2012, and the child support for the oldest child would only be continuing for another 2 years, the underwriter was justified in using the amount of \$400 to qualify. Even if the amount of \$450 was used to qualify based on the borrower's income increasing \$20K since the original agreement this would have only increased the total debt to income ratio by 1.02% and within AUS tolerance.

Comment 8

## OIG Evaluation of Auditee Comments

- Comment 1 Evergreen is correct that we did not perform a statistical sample. We reviewed 100 percent of all loans listed as seriously delinquent in Neighborhood Watch. As a result, the results of our audit pertain to the files reviewed and cannot be projected to the entire universe of Evergreen FHA loans. We revised the wording to two of the paragraph headings in the finding section of the report.
- Comment 2 We disagree with Evergreen's statement that the audit seeks to place new requirements on Evergreen. HUD policy HUD Handbook 4155.2, paragraph 2(A)(4)(b) requires lenders to review all closing documents and legal instruments.
- Comment 3 We disagree with Evergreen's statement that the audit report seeks to make it responsible for determining whether the repayment clause in the City's legal documents complied with NSP requirements. The restrictive covenants violated NSP (24 CFR 92.254) and FHA requirements (24 CFR 203.41.) Evergreen's responsibility was to review the closing documents and identify the violation of FHA policies found in 24 CFR 203.41.
- Comment 4 OIG did not analyze the city of Las Vegas' compliance with NSP requirements. The objective of this audit was to determine if Evergreen originated FHA insured loans in accordance with HUD regulations. Evergreen did not originate the loans identified in Appendix D in accordance with HUD requirements. Evergreen did not review the closing documents and legal instruments as required by HUD Handbook 4155.2 paragraph 2 (A)(4)(b) and did not identify the covenants which violate 24 CFR 203.41, an FHA requirement.
- Comment 5 We disagree with Evergreen's statement that it did not violate 24 CFR 203.41(d). Evergreen did violate the exceptions found in 24 CFR 203.41(d.) because the repayment clause subjects the borrower to a contractual liability other than the repayment of the assistance provided. Also, the policy does not make any exceptions based on market conditions as described by Evergreen. Comment 6 We disagree with Evergreen's statement that it correctly calculated income for FHA case 332-5771783. As stated in Appendix E of the report HUD requires lenders to average commission income over a two year period. In this case the borrower used a period of less than 2 years to average the income. Evergreen used 18.5 months as the basis for calculating the income. However, income information in the file showed that the borrower worked the two years prior to loan closing with only a two week gap in work when he moved from California to Nevada and the two months he voluntarily left work because of a disagreement in pay. Commission income can be very unpredictable as was the case here. As a result, Evergreen should have averaged the borrower's income over the full 24 months as required by HUD to better establish the borrower's ability to repay the loan.

- Comment 7 We disagree with Evergreen's statement that it correctly calculated income for FHA case 332-5857550. The borrower earned overtime income for three years prior to receiving the home loan and the borrower's overtime income increased significantly during that time period. Evergreen's response shows the borrower's over time income as \$4,599 in 2011, \$6,605 in 2012, and \$17,250 in 2013. From 2011 to 2013, the overtime increased by 275%. HUD regulations require the lender to use a period of more than two years if the income varies significantly from year to year. In this case, using a period of less than two years was not justified. As a result of using 2 years instead of 3, Evergreen overstated the borrower's monthly income by \$212.
- Comment 8 We disagree with Evergreen's statement that its underwriter was justified in using the amount of \$400 in child support payments to qualify the borrower. The Order of Child Support required the borrower to pay \$350 in child support plus \$50 for every \$10,000 increase in earnings. The borrower's income at the time of the agreement was \$26,000. The borrower earned just over \$67,000 in 2013. This increase resulted in a total potential child support liability of \$550. The file did not have documentation releasing the borrower from the responsibility of paying the additional child support in the future. Also, the file was missing an explanation from the underwriter explaining why the additional child support was not included in qualifying the borrower.

## Criteria

### **HUD Handbook 4155.2, paragraph 2-A(4)(b)**

*Detection of Warning Signs:* The underwriter must be

- attuned to warning signs that may indicate any irregularities, and
- alert and be able to detect fraud.

*Closing Review and Certification:* The underwriter (or the lender or the lender's closing department) must

- Review all
  - closing documents
  - certifications on the closing statements, and
  - legal instruments and other documents executed at closing, and
- certify on page 4 of form HUD-92900-A, HUD/VA [U.S. Department of Veterans Affairs] Addendum to Uniform Residential Loan Application, that the
  - transaction and loan meet statutory and regulatory requirements of the FHA and National Housing Act, and
  - loan has been closed in accordance with the terms and sales price specified in the sales contract.

### **HUD Handbook 4155.1, paragraph 4-F(1)(b)**

Underwriting requires a careful analysis of many aspects of the mortgage.

Each loan is a separate and unique transaction, and there may be multiple factors that demonstrate a borrower's ability and willingness to make timely mortgage payments.

Simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. When qualifying a borrower, it is important to avoid the danger of "layering flexibilities" when assessing the mortgage insurance risk.

### **HUD Handbook 4155.1, paragraph 4-D(2)(g)**

Commission income *must* be averaged over the previous two years. To qualify with commission income, the borrower must provide

- copies of signed tax returns for the last two years, and
- the most recent pay stub.

Commission income showing a decrease from one year to the next requires significant compensating factors before a borrower can be approved for the loan.

A borrower whose commission income was received for more than one year, but less than two years may be considered favorably if the underwriter can

- document the likelihood that the income will continue, and
- soundly rationalize accepting the commission income.

#### **HUD Handbook 4155.1, paragraph 4-D(2)(c)**

The lender *must* establish and document an earnings trend for overtime and bonus income. If either type of income shows a continual decline, the lender *must* document in writing a sound rationalization for including the income when qualifying the borrower.

A period of more than two years must be used in calculating the average overtime and bonus income if the income varies significantly from year to year.

#### **HUD Handbook 4155-1, paragraph 4-C(4)(b)**

**When computing the debt-to-income ratio, the lender must include the following recurring obligations:**

- **monthly housing expense, and**
- **additional recurring charges extending ten months or more, such as**
  - **payments on installment accounts**
  - **child support or separate maintenance payments**
  - **revolving accounts, and**
  - **alimony**

#### **HUD Handbook 4155.1, paragraph 4-C(6)(a)**

Debt payments such as a student loan or balloon note scheduled to begin or come due within 12 months of the mortgage loan closing must be included by the lender as anticipated monthly obligations during the underwriting analysis.

Debt payments do not have to be classified as projected obligations if the borrower provides written evidence that the debt will be deferred to a period outside the 12-month timeframe.

#### **HUD Handbook 4155.1, paragraph 4-F(2)(b)**

##### **Mortgage Payment Expense to Effective Income Ratio**

The relationship of the mortgage payment to income is considered acceptable if the total mortgage payment does not exceed 31% of the gross effective income.

A ratio exceeding 31% may be acceptable only if significant compensating factors, as discussed in [HUD 4155.1 4.F.3](#), are documented and recorded on Form [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*. For those borrowers who qualify under FHA's Energy Efficient Homes (EEH), the ratio is set at 33%.

## **HUD Handbook 4155.1, paragraph 4-F(2)(c)**

### **Total Fixed Payments to Effective Income Ratio**

The relationship of total obligations to income is considered acceptable if the total mortgage payment and all recurring monthly obligations do not exceed 43% of the gross effective income.

A ratio exceeding 43% may be acceptable only if significant compensating factors, as discussed in [HUD 4155.1 4.F.3](#), are documented and recorded on Form [HUD-92900-LT](#), *FHA Loan Underwriting and Transmittal Summary*. For those borrowers who qualify under FHA's [EEH](#), the ratio is set at 45%.

### **FHA TOTAL Mortgage Scorecard User Guide**

The lender must conduct a manual underwriting review according to FHA requirements for all loan applications that generate a “refer” rating. The DE underwriter must determine if the borrower is creditworthy in accordance with FHA standard credit policies and requirements. It is FHA policy that no borrower be denied an FHA insured mortgage loan solely based on a risk assessment generated by TOTAL.

#### **24 CFR 203.41**

**(b) *Policy of free assumability with no restrictions.*** A mortgage shall not be eligible for insurance if the mortgage property is subject to legal restriction on conveyance, except as permitted by this part.

**(c) *Exception for eligible governmental or nonprofit programs.*** Legal restrictions on conveyance are acceptable if:

- (1)** The restrictions are part of an eligible governmental or nonprofit program and are permitted by paragraph (d) of this section; and
- (2)** The restrictions will automatically terminate if title to the mortgaged property is transferred by foreclosure or deed-in-lieu of foreclosure, or if the mortgage is assigned to the Secretary.

**(d) *Exception for eligible governmental or nonprofit programs—specific policies.*** For purposes of paragraph (c) of this section, restrictions of the following types are permitted for eligible governmental or nonprofit programs, provided that a violation of legal restrictions on conveyance may not be grounds for acceleration of the insured mortgage or for an increase in the interest rate, or for voiding a conveyance of the mortgagor's [borrower] interest in the property, terminating the mortgagor's interest in the property, or subjecting the mortgagor to contractual liability other than requiring repayment (at a reasonable rate of interest) of assistance provided to make the property affordable as low or moderate-income housing.

#### **24 CFR 92.254(a)(5)(ii)(A)**

The following options for recapture requirements are acceptable to HUD. The participating jurisdiction may adopt, modify or develop its own recapture requirements for HUD approval. In

establishing its recapture requirements, the participating jurisdiction is subject to the limitation that when the recapture requirement is triggered by a sale (voluntary or involuntary) of the housing unit, the amount recaptured cannot exceed the net proceeds, if any. The net proceeds are the sales price minus superior loan repayment (other than HOME [HOME Investment Partnerships program] funds) and any closing costs.

## Appendix D

### Schedule of Estimated Losses for Loans With Significant Deficiencies

FHA case no.	Deficiency	Mortgage balance	Estimated loss to HUD (50%)
332-5813440	Restrictive covenants	\$184,734	\$92,367
332-5916924	Restrictive covenants	173,918	86,959
332-5831710	Restrictive covenants	152,814	76,407
332-5759928	Restrictive covenants	139,413	69,707
332-5774881	Restrictive covenants	136,564	68,282
332-5684104	Restrictive covenants	135,355	67,678
332-5701299	Restrictive covenants	131,092	65,546
332-5730165	Restrictive covenants	126,224	63,112
332-5765453	Restrictive covenants	114,624	57,312
332-5613744	Restrictive covenants	112,804	56,402
332-5758315	Restrictive covenants	105,137	52,569
332-5726790	Restrictive covenants	100,031	50,016
332-5362214	Restrictive covenants	61,531	30,766
332-5461596	Restrictive covenants	60,021	30,011
Total	Recommendation 1A	1,734,262	867,134
332-5994293	Income	259,107	129,554
332-5771783	Income	203,681	101,841
332-5857550	Income & liabilities	146,951	73,476
Total	Recommendation 1B	609,739	304,871
<b>Total recommendations 1A and 1B</b>		<b>2,344,001</b>	<b>1,172,005</b>

## Appendix E

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### Narrative Loan Summaries for Significant Underwriting Deficiencies

The following narratives provide the details for the significant underwriting deficiencies noted in the finding.

**FHA case number: 332-5994293**

Loan amount: \$265,505

Closing date: December 31, 2014

Status: active

Unpaid balance: \$259,107

#### Evergreen Did Not Identify Warning Signs Indicating Fraud

We are seeking indemnification of this loan because Evergreen's underwriter did not exercise due diligence and prudent underwriting. The income used to qualify the borrower was based on a promotion, which increased the borrower's income from \$27,000 per year to \$85,000 per year. We identified issues with the quality of the job offer letter, and a verification of employment conducted during postclosing stated that the borrower returned to his original position and salary after just 1 month. HUD Handbook 4155.1, paragraph 4-F(1)(b), states that simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. Additionally, HUD Handbook 4155.2-A(4)(b) states that an underwriter must be aware of the warning signs, which may include any irregularities, and alert and able to detect fraud. The borrower worked for the same employer for 3 years without a significant change in salary. Also, the file indicated that the borrower was still a student and, therefore, had likely not experienced a change in his qualifications that would have justified such a large pay raise. Yet, Evergreen did not recognize the large pay raise as an indicator of potential fraud. As a result, Evergreen did not take additional steps to ensure that the job offer was valid. Without the raise, the borrower would not have qualified for the loan.

**FHA case number: 332-5771783**

Loan amount: \$212,480

Closing date: October 10, 2013

Status: active

Unpaid balance: \$203,681

#### Evergreen Did Not Calculate the Borrower's Income Correctly

We are seeking indemnification of this loan because Evergreen incorrectly calculated the borrower's commission income. The borrower had an established history of earning commission income. However, Evergreen calculated the borrower's income based on potential earnings

stated in a letter from a new employer. HUD Handbook 4155.1, paragraph 4-E(5)(d), states that projected income from a new job is acceptable for qualifying purposes if there is a guaranteed nonrevocable contract for employment. Evergreen did not obtain support that the contract was guaranteed and nonrevocable. Therefore, Evergreen was required to follow HUD Handbook 4155.1, paragraph 4-D(2)(g), which states that commission income must be averaged over the previous 2 years. We averaged the borrower's income over 2 years and determined that Evergreen overstated the borrower's income by \$380 per month. Using the correct income, we calculated the front and back ratios as 39 and 60.75 percent, respectively. FHA's limit for the front ratio and back ratios are 31 and 43 percent.

We obtained access to HUD's FHA Connection, which has a Total Mortgage Score Card emulator. We submitted the loan through the emulator using the correct income and ratios. The emulator returned a "refer" recommendation because the back ratio was too high. A feedback message of "refer" requires the lender to manually underwrite the loan<sup>12</sup>. When manually underwritten, the qualifying ratios can be exceeded only when there are significant compensating factors. Because this loan was not manually underwritten and there was a lack of significant compensating factors, this loan was not eligible for FHA insurance

**FHA case number: 332-5857550**

Loan amount: \$152,625

Closing date: January 17, 2014

Status: active

Unpaid Balance: \$146,951

Evergreen Did Not Correctly Calculate the Borrower's Income and Did Not Identify an Increase in Liabilities

We are seeking indemnification of this loan because Evergreen did not calculate the borrower's income correctly and did not include all of the borrower's liabilities. The borrower's overtime income varied significantly, increasing from approximately \$6,600 in 2012 to approximately \$17,300 in 2013. HUD Handbook 4155.1, paragraph 4-D(2)(C), states that a period of more than 2 years must be used in calculating the average overtime if the income varies significantly from year to year. Evergreen, however, averaged the borrower's income over less than 2 years, despite having 3 years of overtime data available. We calculated the overtime income using the 3 years of overtime data available and determined that Evergreen overstated income by \$212 per month.

Also, Evergreen did not identify a potential increase to the borrower's liabilities. HUD Handbook 4155.1, paragraph 4-C(6)(a), states that debt payments, such as a student loan or balloon note scheduled to begin or come due within 12 months of the mortgage loan closing,

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<sup>12</sup> TOTAL Scorecard Emulator is used to assist lenders in making credit decisions. FHA TOTAL Scorecard evaluates a borrower's creditworthiness and returns either an Accept or Refer underwriting decision. A Refer decision indicates the borrower may not be a good risk. In this case, the loan must be manually underwritten in order to make a final determination of the borrower's creditworthiness for the loan.

must be included by the lender as anticipated monthly obligations during the underwriting analysis. The borrower's divorce decree stated that she was required to pay child support payments of \$350 per month, plus an additional \$50 for every \$10,000 made annually in excess of \$26,000. Based on the income used to qualify the borrower, the child support liability for the following year was \$150 per month more than Evergreen calculated. Using the correct income and liabilities, we calculated front and back ratios as 25.17 and 60.89 percent, respectively. HUD's limit for the front ratio is 31 percent and back ratio is 43 percent.

We obtained access to HUD's FHA Connection, which has a Total Mortgage Score Card emulator. We submitted the loan through the emulator using the correct income, liabilities, and ratios. The emulator returned a "refer" recommendation because the back ratio was too high. A feedback message of "refer" requires the lender to manually underwrite the loan. When manually underwritten, the qualifying ratios can be exceeded only when there are significant compensating factors. Because this loan was not manually underwritten and there was a lack of significant compensating factors, this loan was not eligible for FHA insurance.

## Appendix F

### Schedule of Active Loans Containing Unacceptable Restrictions on Conveyance

FHA case no.	Origination date	Mortgage Balance	Downpayment assistance	Affordability period (years)
332-5813440	10/1/2013	\$184,734	\$17,650	10
332-5916924	8/1/2014	173,918	17,080	10
332-5831710	1/1/2014	152,814	14,395	5
332-5759928	6/1/2013	139,413	14,549	5
332-5684104	3/1/2013	135,355	14,779	5
332-5774881	7/1/2013	136,534	14,819	5
332-5701299	3/1/2013	131,092	25,000	10
332-5730165	5/1/2013	126,224	14,343	5
332-5765453	6/1/2013	114,624	13,118	5
332-5613744	12/1/2012	112,804	12,238	5
332-5758315	8/1/2013	105,137	12,772	5
332-5726790	5/1/2013	100,031	21,856	10
332-5362214	5/1/2011	61,531	7,597	5
332-5461596	2/1/2012	60,021	19,128	10
<b>Totals</b>		<b>1,734,262</b>	<b>219,324</b>	