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TO: Deborah C. Holston, Acting Deputy Assistant Secretary for Single Family Housing,
HU

FROM: *Edgar Moore*
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SUBJECT: Ameritrust Mortgage Bankers, Inc., Lake Success, NY, Did Not Always
Comply With HUD-FHA Loan Origination and Quality Control Requirements

HIGHLIGHTS

What We Audited and Why

We audited Ameritrust Mortgage Bankers, Inc., a nonsupervised¹ lender located in Lake Success, NY, in support of the Office of Inspector General's (OIG) goal of improving the integrity of single-family insurance programs. We selected this lender due to its originating activity and its 8.93 percent default rate for Federal Housing Administration (FHA)-insured single-family loans with beginning amortization dates between November 1, 2008, and October 31, 2010. This rate was nearly triple the New York State average of 3.05 percent for the same period.

The audit objectives were to determine whether Ameritrust officials (1) approved FHA-insured loans in accordance with the requirements of the U.S. Department of Housing and Urban Development (HUD)-FHA and (2) implemented a quality control plan in accordance with HUD-FHA requirements.

What We Found

Ameritrust officials did not always approve FHA-insured loans in accordance with HUD-FHA requirements. Specifically, 11 of the 20 loans reviewed

¹ A nonsupervised lender is a HUD-FHA approved lending institution, the principal activity of which involves lending or investing funds in real estate mortgages.

exhibited material underwriting deficiencies, such as inadequately verified and documented borrowers' income, assets, liabilities, and credit histories. As a result, the FHA insurance fund incurred actual losses of \$183,327 on 1 loan and faces potential losses of more than \$2.7 million on 10 loans, for total losses of more than \$2.9 million. Ameritrust officials also charged the borrowers \$3,843 in unallowable fees, namely excessive loan discount and second appraisal fees, without providing written justification.

Ameritrust officials did not ensure that their quality control plan was implemented in accordance with HUD-FHA requirements. Consequently, the quality control plan provided no assurance that deficiencies in the loan origination and underwriting processes were promptly identified and appropriate corrective actions were taken to prevent recurrences.

What We Recommend

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing require Ameritrust officials to (1) indemnify HUD against future losses related to the 10 loans, which were underwritten in violation of HUD-FHA requirements; (2) reimburse HUD \$183,327 for the claim and related fees paid on one loan; (3) ensure that borrowers have been reimbursed \$3,843 for unallowable excessive loan discount and second appraisal fees; and (4) establish procedures to ensure that the quality control plan is implemented in accordance with HUD-FHA requirements. If the lender officially ceases its operations, the recommendations applicable to the quality control finding are not warranted.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We discussed the results of the audit with auditee officials during the audit, provided them with a copy of the draft report, and requested their comments on July 25, 2011. We held an exit conference on August 3, 2011, at which time the officials generally agreed with the draft report findings. Auditee officials chose not to provide written comments. However, it was agreed during the exit conference to remove the reference to a violation of the tier pricing rule reported in the unallowable fee section of finding one due to the auditee's clarification.

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BACKGROUND AND OBJECTIVES

Ameritrust Mortgage Bankers, Inc., was established in 1987 as a licensed mortgage bank with the New York State Banking Department. Ameritrust operates in New York, New Jersey, and Florida, and its main office is located in Lake Success, NY.

Ameritrust was approved as a nonsupervised lender on October 19, 1994. A nonsupervised lender is a U.S. Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), approved lending institution, the principal activity of which involves lending or investing funds in real estate mortgages. A nonsupervised lender may be approved to originate, sell, purchase, hold, and service FHA-insured mortgages.

For the period November 1, 2008, through October 31, 2010, Ameritrust officials originated 571 loans, of which 51 loans valued at more than \$23.5 million were in default. As a result, the default rate during the 2-year period was 8.93 percent, which was nearly triple the New York State average of 3.05 percent.

On May 24, 2011, we were informed by an Ameritrust official that the mortgage bank was ceasing its operations. Consequently, our last day of audit fieldwork was May 31, 2011. However, as of August 8, 2011, HUD officials advised that the lender's FHA approval status is "still active", as the lender has not notified them of it closing.

The audit objectives were to determine whether Ameritrust officials (1) approved FHA-insured loans in accordance with HUD-FHA requirements and (2) implemented a quality control plan in accordance with HUD-FHA requirements.

RESULTS OF AUDIT

Finding 1: Ameritrust Officials Did Not Always Comply With HUD-FHA Requirements in the Approval of FHA-Insured Loans

Ameritrust officials did not always comply with HUD-FHA requirements in the approval of FHA-insured loans. As a result, 11 of the 20 loans reviewed exhibited material deficiencies, such as inadequate verification of income or employment, unsupported assets, inadequate gift documentation, excessive ratios without adequate compensating factors, underreported liabilities, significant credit-related deficiencies, faxed documentation, skipped mortgage payments, inadequate verification of occupancy, and inconsistent information not reconciled by Ameritrust officials. These deficiencies occurred because officials did not have adequate controls to ensure that the borrowers' income, assets, liabilities, and credit history were adequately verified and documented in accordance with requirements. As a result, the FHA insurance fund incurred a loss of \$183,327 on 1 loan for which a claim was paid and faces potential future losses of \$2,742,810² on 10 loans, for more than \$2.9 million in total losses. Ameritrust officials also charged the borrowers \$3,843 in unallowable fees, such as excessive loan discount and second appraisal fees, without providing written justification.

Material Underwriting Deficiencies Noted

Ameritrust officials originated 11 loans that exhibited material underwriting deficiencies. While the underwriting process is somewhat subjective, these deficiencies occurred because officials neither always followed HUD-FHA requirements nor exercised due diligence in verifying and documenting the borrowers' income, assets, liabilities, and credit history. In addition, officials charged the borrowers unallowable fees without providing written justification. The table below summarizes the deficiencies identified in the 11 loans. These deficiencies are not independent of each other as all loans exhibited at least one material deficiency.

² This amount is computed as 59 percent of the \$4,648,830 unpaid principal balance of the 10 loans. The 59 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 2010 based on actual sales.

<u>Deficiency</u>	<u>Number of loans</u>
Income	4
Assets	3
Gift funds	5
Excessive ratios	3
Liabilities	1
Credit	3
Faxed documentation	9
Skipped mortgage	1
Occupancy	1
Inconsistent information	3
Unallowable fees	5

Appendix B of this report provides a summary of the material underwriting deficiencies identified in each of the 11 loans, and appendix D provides detailed descriptions of these deficiencies, as well as the applicable HUD-FHA requirements.

Inadequate Verification of Income and Employment

Ameritrust officials neither adequately verified nor documented the monthly income of four borrowers approved for FHA-insured loans. For example, regarding FHA case number 374-4979970, officials calculated the borrowers' monthly income by including \$1,732 in the calculation of overtime and other income without properly verifying and documenting that such income had been received for the past 2 years and was likely to continue. Further, the loan file did not contain written verifications of employment or other documentation substantiating an earnings trend for the overtime and other income. Since written verifications of employment were not obtained, Ameritrust officials were required to obtain the borrowers' original pay stubs covering the most recent 30-day period. Verbal verifications of employment were found in the file; however, there was no documented information related to the borrowers' overtime and other income. Lastly, while Ameritrust officials documented the 2006 and 2007 Internal Revenue Service (IRS) Forms W-2 for the borrowers, based on the total wages reported, neither borrower received overtime and other income during the 2-year period examined.

Unsupported Assets

Ameritrust officials did not adequately verify or document the assets of three borrowers approved for FHA-insured loans. For instance, with regard to FHA case number 374-5118521, the borrowers' transaction history disclosed a \$3,087³ preauthorized credit on February 2, 2009, that was not payroll related. In addition, Ameritrust officials reported that the borrowers had verified assets of \$15,043; however, audit results confirmed only \$9,043 of that amount, which included the \$3,087. Since the borrowers needed \$7,800 to close and had verified assets of \$9,043, Ameritrust officials should have obtained an explanation from the borrowers regarding the source of this large credit. Without the explanation, Ameritrust officials did not properly verify and document the borrowers' assets.

Inadequate Gift Documentation

Ameritrust officials neither adequately verified nor documented the source of gift funds used for five borrowers' earnest money deposits or closing requirements. For example, in FHA case number 374-4964772, Ameritrust officials did not adequately document the source of a \$10,000 gift used as part of the borrowers' \$20,000 earnest money deposit. The loan file documented a copy of a gift affidavit from the borrowers' daughter-in-law, indicating that the gift funds were transferred on October 28, 2008; an official check made payable to the seller's attorney on the same day; and a copy of the gift donor's certificate of deposit, showing the donor's ability to provide the gift. While the \$10,000 certificate of deposit was opened on August 19, 2008, it was due to mature on November 19, 2008. Nevertheless, Ameritrust officials did not document evidence of the early withdrawal of the certificate of deposit or a copy of the canceled check as required. Consequently, Ameritrust officials did not provide assurance that the gift funds came from the donor's personal account and ultimately did not come from an unacceptable source.

Excessive Ratios Without Adequate Compensating Factors

Ameritrust officials approved three FHA-insured loans that had qualifying ratios in excess of HUD's benchmark guidelines of 31 and 43 percent, as set forth in Mortgagee Letter 2005-16, without providing valid compensating factors. For instance, regarding FHA case number 374-5118521, the mortgage payment-to-

³ A preauthorized credit is an agreement between the payer and the payee to directly deposit funds from the payer into the payee's bank account.

income (front) and total fixed payment-to-income (back) ratios were 47.14 and 49.05 percent, respectively. The following compensating factors were recorded in the underwriter comments section of the FHA loan underwriting and transmittal summary: “FICO [Fair Isaac Corporation]: 601/611; FHA purchase 3.5% down payment; FHA county limit: \$625,500; Borrower was out on disability for 2 months in 2008 for her 2nd job; Income used for her 2nd job was averaged for 2008 and YTD [year to date] (12 months); Two months reserves available after closing; Stable employment.” Yet, these are not valid compensating factors as defined by the HUD Handbook 4155.1, REV-5, paragraph 2-13. The first four underwriter comments listed are not HUD-prescribed compensating factors. The earnings from the first borrower’s second job were already considered in the qualifying income. Further, while Ameritrust officials reported that the borrowers had 2 months of reserves available after closing, 3 months of documented cash reserves would have been required to justify the loan’s approval. In addition, despite the borrowers’ stable employment, Ameritrust officials did not document the borrowers’ potential for increased earnings.

Underreported Liabilities

Ameritrust officials approved one FHA loan while underreporting the borrowers’ liabilities. For FHA case number 374-4894823, Ameritrust officials excluded from the borrowers’ total monthly installment debt calculation a \$113 payment due on a \$5,018 line of credit reflected on the bank statement as of September 9, 2008. This liability was excluded because it was not reported on the borrowers’ credit report, dated October 1, 2008. While a handwritten notation on the credit report indicated that the borrowers’ had a “new trade” and the loan application listed a \$112 monthly debt on a \$4,500 unpaid balance that was not reflected on the credit report, Ameritrust officials did not provide the account number of the “new trade” or evidence to demonstrate that the debt related to the borrowers’ line of credit. Consequently, Ameritrust officials provided no assurance that they properly accounted for all of the borrowers’ liabilities. Had Ameritrust officials included this liability in the borrowers’ debt calculation, total monthly installment debt would have increased from \$2,202 to \$2,315, and the total fixed payment would have increased from \$5,517 to \$5,630, thereby increasing the total fixed payment-to-income (back) ratio from 55.50 to 56.63 percent. Further, Ameritrust officials did not provide adequate assurance that these funds were not used for the borrowers’ cash investment in the property.

Significant Credit-Related Deficiencies

Ameritrust officials did not properly evaluate the credit histories of three borrowers approved for FHA-insured loans. For example, regarding FHA case number 374-4979970, despite the borrowers’ four chargeoffs, four collection

accounts, and two judgments, Ameritrust officials did not provide a valid justification for approving the loan as required. The first borrower's credit report, dated December 17, 2008, reflected two unsatisfied judgments filed by the landlord in February and November 2006. However, the supplemental credit report, dated December 31, 2008, reflected that one of the two judgments had been satisfied, the other had been removed, and the borrower had not been late on her rental payments during the period March 2004 through December 2008. Since the first borrower's landlord had filed two judgments against her during the period when her rental payments were reportedly made on a timely basis, the information reflected on the two credit reports should have been reconciled. Moreover, the first borrower's written explanation for the derogatory information on the credit report, "My bills got higher than what I expected," was insufficient and demonstrated the borrower's inability to manage debt.

Faxed Documentation

In violation of requirements, Ameritrust officials used documents faxed from interested third parties, either unidentified or unknown sources, and other mortgage companies in the loan underwriting process for nine FHA-insured loans. Consequently, Ameritrust officials provided no assurance that these loan documents were not handled or transmitted by or through an interested party to the transaction. For instance, with regard to FHA case number 374-4894823, the loan file documented verifications of employment for both the borrower and coborrower that were faxed from the same unknown source. Consequently, Ameritrust officials did not provide assurance that the employment verifications passed directly between the employers and Ameritrust officials.

Skipped Mortgage Payments

In one instance with respect to FHA case number 374-5048408, Ameritrust officials allowed the borrower to include three skipped conventional mortgage payments in the new FHA-insured mortgage of the cash-out refinance transaction. The borrower had two mortgages on the refinanced property. Within 12 months before the March 13, 2009, settlement date, the first mortgage had been more than 30 and 60 days late on six occasions each and was not current for the month due, as the borrower had skipped three mortgage payments. Regarding the second mortgage, within the past 11 months, the borrower had been more than 30 days late on two occasions. Moreover, because the first mortgage had been more than 30 days late on six occasions and was not current for the month due and the second mortgage had been more than 30 days late on two occasions, the borrower was not eligible for the cash-out refinance transaction. Consequently, Ameritrust officials should not have approved the loan and included the three skipped mortgage payments in the new mortgage amount.

Inadequate Verification of Occupancy

Regarding one FHA-insured loan, FHA case number 374-5048408, Ameritrust officials did not adequately verify and document the borrower's occupancy. This fact was particularly important since cash-out refinances are only permitted on owner-occupied principal residences owned by the borrower for at least 1 year. The credit report, dated March 9, 2009, indicated that the borrower resided in another State and had done so since March 2006. The borrower's bank statements and the second mortgage loan statement contained in the loan file also reflected the borrower's out-of-State address. However, Ameritrust officials documented letters from the borrower in which he stated that he had resided at the refinanced property since 2006 but had neglected to update his address. In addition, the borrower certified on the loan application that he occupied the refinanced property as his primary residence. Due to these inconsistencies, the borrower's occupancy was questionable. As a result, Ameritrust officials did not provide adequate assurance that the borrower had occupied the refinanced property as a principal residence for at least 1 year before the loan closed on March 13, 2009.

Inconsistent Information Not Reconciled

Ameritrust officials processed three FHA-insured loans without reconciling discrepancies found in the loan file documentation. For example, with respect to FHA case number 374-5032000, Ameritrust officials documented the borrower's rental verification, dated 2 days after the loan settlement, which reported that the borrower had a family size of three. Yet, documents in the loan file reported that the borrower had a family size of six, consisting of the borrower and five adopted children. Moreover, none of the adopted children was listed as a family member on the rental verification. Since Ameritrust officials included the adoption subsidy in the borrower's calculation of monthly qualifying income, this discrepancy should have been reconciled.

Unallowable Fees Charged to Borrowers

In five instances, Ameritrust officials charged the borrowers approved for FHA-insured loans \$3,843 in unallowable excessive loan discount and second appraisal fees without providing written justification. For example, with regard to FHA case number 374-5048408, the borrower was charged \$1,543 in unallowable excessive loan discount fees. The borrower was charged a loan discount fee of 2.5 percent, totaling \$7,713. However, a review of the initial good faith estimate, dated March 13, 2009, revealed that the loan discount fee was 2 percent, or

\$6,170. Since the initial and the final good faith estimate were completed on the same day and Ameritrust officials' retail rate sheet for the period reflected a loan discount fee of 2 percentage points applicable to the borrower's note rate, officials should not have charged an additional 0.5 percent fee.

In another example, regarding FHA case number 374-5055205, the borrower was charged \$550 for a second appraisal report, but Ameritrust officials did not document the need for a second appraisal in accordance with requirements. Neither of the two appraisal reports, dated January 8 and February 17, 2009, indicated that the property was in a declining market. In addition, Ameritrust officials did not document their determination that the property was located in an area in which the housing market was in decline.

Conclusion

Ameritrust officials did not always comply with HUD-FHA requirements in the approval of FHA-insured loans. These deficiencies occurred because Ameritrust officials did not have adequate controls to ensure that the borrowers' income, assets, liabilities, and credit history were verified and documented in compliance with requirements. As a result, 11 of the 20 loans reviewed exhibited material underwriting deficiencies, such as inadequate verification of income or employment, unsupported assets, underreported liabilities, and significant credit-related deficiencies. Thus, indemnification is warranted against future losses on 10 loans with material underwriting deficiencies; the loss to HUD is estimated to be \$2,742,810.⁴ Further, the FHA insurance fund incurred a loss of \$183,327 for a claim and associated fees paid on one loan originated in violation of requirements. Lastly, borrowers were charged \$3,843 in unallowable fees.

Recommendations

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing require Ameritrust officials to

- 1A. Indemnify HUD against any future losses on the 10 loans with material underwriting deficiencies. The projected loss is \$2,742,810 based on HUD's loss rate of 59 percent of the unpaid principal balance of \$4,648,830.
- 1B. Reimburse HUD for the loss of \$183,327 that resulted from the amount of the claim and associated fees paid on one loan with material underwriting deficiencies.

⁴ The potential loss to HUD is 59 percent of the unpaid principal balance of \$4,648,830 for the 10 loans or \$2,742,810 (see appendix C).

- 1C. Ensure that borrowers have been reimbursed \$3,843 for unallowable excessive loan discount and second appraisal fees.

Finding 2: Ameritrust Officials Did Not Implement Their Quality Control Plan in Accordance With HUD-FHA Requirements

Ameritrust officials did not ensure that their quality control plan was implemented in accordance with HUD-FHA requirements. The plan did not ensure that (1) all basic and specific HUD-FHA requirements were included; (2) loans defaulting within the first 6 months were examined; (3) quality control reviews were always conducted monthly; (4) written reverification of the borrowers' employment, deposits, gifts, and other sources of funds was obtained; (5) management responses and planned corrective actions were adequately documented; and (6) quality control files were adequately maintained. These deficiencies occurred because Ameritrust officials had not developed procedures to ensure that their quality control plan was properly implemented. Consequently, the quality control plan lacked effectiveness and provided no assurance that deficiencies in the loan origination and underwriting processes were quickly identified and appropriate corrective actions were taken to prevent recurrences.

Quality Control Plans Missing Basic and Specific Requirements

During the period November 1, 2008, through October 31, 2010, Ameritrust officials implemented two quality control plans: one developed and carried out by its in-house staff and the other by an outsourcing company. While the in-house plan described the staff's responsibilities with regard to sample selection, resolution of deficiencies, record keeping, and other items, the outsourcing company's plan described the policies and procedures the company used to carry out the quality control function on behalf of the lender. However, neither plan was in accordance with HUD-FHA requirements.

The two quality control plans that Ameritrust officials implemented did not include all HUD-FHA-prescribed basic and specific requirements. The plans were missing the following requirements:

- (1) A determination regarding the appropriate percentage of loans, originated and purchased from loan correspondents, to review based on volume, past experience, and other factors.
- (2) Provisions requiring an occupancy reverification in cases in which the occupancy of the subject property is suspect.
- (3) A determination of whether verifications of employment, verifications of deposit, or credit reports are suspect due to handling by an interested third party or the borrower.

- (4) A determination of whether the loan file contains sufficient and documented compensating factors if the debt ratios exceed HUD-FHA limits.
- (5) Provisions requiring the review of loans underwritten by an automated underwriting system.
- (6) Provisions requiring the lender to verify that applications receiving a refer rating from an automated underwriting system are manually underwritten before a final decision is made on the application.
- (7) Provisions requiring the lender to verify that if manual downgrades or overrides are applied, no patterns of illegal discrimination against borrowers were revealed and that the downgrade or override was properly performed.

Given the number of requirements missing from the quality control plans, Ameritrust officials provided no assurance that the loan origination and underwriting functions complied with their own and HUD-FHA requirements and that swift corrective action was taken to prevent the recurrence of identified problems. In September 2010, HUD's Quality Assurance Division also cited the lender for not including all prescribed requirements in its quality control plan.

Loans Defaulting Within First 6 Months Not Reviewed

While the in-house quality control plan stated that all payment defaults occurring within the first 12 months of origination would be selected for review, the outsourcing company's plan provided for an analysis of all loans defaulting within the first 6 months. Nevertheless, Ameritrust officials did not routinely select for review all loans defaulting within the first 12 months or within 6 months as required by HUD Handbook 4060.1, REV-2, paragraph 7-6D. An outsourcing company official provided evidence that early payment default loans from the years 2008 and 2009 had been reviewed. However, she stated that such loans from the year 2010 had not been reviewed because an Ameritrust official did not provide the files. Moreover, an analysis of the loans reviewed disclosed that of the 16 early payment default loans originated during the audit period, November 1, 2008, through October 31, 2010, only three such loans had been reviewed by the outsourcing company. As a result, officials deprived themselves of valuable information concerning the root cause of these early payment defaults, which might have led to swift and appropriate corrective actions, thus preventing the deficiencies from recurring.

Quality Control Reviews Not Always Conducted Monthly

Quality control reviews were not always conducted monthly. The in-house quality control plan stipulated that reviews were to be performed quarterly. Accordingly, during the period November 2008 through March 2010, Ameritrust officials performed quarterly quality control reviews. However, since Ameritrust officials closed an average of 23 loans monthly, HUD Handbook 4060.1, REV-2, paragraph 7-6B, required them to conduct monthly rather than quarterly quality control reviews. By conducting monthly reviews, Ameritrust officials might have detected pervasive processing and underwriting deficiencies earlier and developed procedures to guard against their recurrence. Ameritrust officials began to perform monthly quality control reviews in April 2010. Nevertheless, their quality control plan had not been updated to reflect this change in practice.

Written Reverifications Not Obtained

Ameritrust officials did not ensure that written reverifications of the borrowers' employment, deposits, gifts, and other sources of funds were attempted in accordance with the requirements of HUD Handbook 4060.1, REV-2, paragraph 7-6E2. The in-house quality control plan provided that the quality control reviewer or outsourcing company would send reverifications of employment, deposit, and source of funds on all loans. Further, the outsourcing company's plan stated that certain underwriting documentation was reverified by mail or telephone and listed the following: employment, deposits, liability letters, rent or mortgage information, source of funds for downpayment, gift letters, tax returns, any alternative documentation, and closing costs and annual percentage rate.

Nevertheless, an outsourcing company official stated that verbal rather than written reverifications were attempted. Moreover, the outsourcing company official did not provide documented evidence of the telephone reverifications conducted. Consequently, Ameritrust officials provided no assurance that the information used in the underwriting decision was accurate.

Management Responses and Planned Corrective Action Inadequately Documented

Ameritrust officials did not provide evidence that prompt action was taken to address the material underwriting deficiencies noted in the outsourcing company's quality control reports reviewed. Neither a final report nor an addendum to identify the actions being taken, the timetable for their completion,

and planned follow-up activities was documented in accordance with the requirements of HUD Handbook 4060.1, REV-2, paragraph 7-3I. This deficiency was attributed to an oversight on the part of Ameritrust officials since only one material underwriting deficiency was noted in the quality control reports reviewed.

Quality Control Files Not Adequately Maintained

Ameritrust officials did not adequately maintain the quality control files in compliance with HUD's and their own requirements. HUD Handbook 4060.1, REV-2, paragraph 7-3K, requires officials to retain for a period of 2 years the quality control review report and follow-up, including review findings and actions taken, plus procedural information, such as the percentage of loans reviewed, basis for selecting loans, and who performed the review. Further, the in-house quality control plan provided that the quality control file, containing the loan sample list, final report, checklists, reverifications, responses, and detailed records of any corrective action recommended and implemented, would be retained in the corporate office for a minimum of 3 years. With the exception of the quality control review reports and responses to immaterial findings, neither Ameritrust officials nor the outsourcing company official maintained the required documentation to evidence that the quality control reviews were conducted in accordance with requirements. Moreover, an Ameritrust official stated that he was unaware that the outsourcing company did not maintain the quality control files.

Conclusion

Ameritrust officials did not ensure that their quality control plan was implemented in accordance with HUD-FHA requirements. As a result, (1) all basic and specific HUD-FHA requirements were not included in the plan; (2) loans defaulting within the first 6 months were not reviewed; (3) quality control reviews were not always conducted monthly; (4) written reverification of the borrowers' employment, deposits, gifts, and other sources of funds was not attempted; (5) management responses and planned corrective action were not adequately documented; and (6) quality control files were not adequately maintained. These deficiencies occurred because Ameritrust officials had not developed procedures to ensure that their quality control plan was properly implemented. Consequently, the quality control plan lacked effectiveness; thus, Ameritrust officials could not provide assurance that their quality control process was capable of evaluating, monitoring, and improving the quality of loans originated.

Recommendations

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing require Ameritrust officials to

- 2A. Establish procedures to ensure that their quality control plan is implemented in accordance with HUD requirements, including but not limited to revising the plan to ensure that it includes all basic and specific requirements and ensuring that all required documentation supporting the performance of quality control reviews is retained in the quality control files.

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

- 2B. Verify the lender's implementation of corrective actions taken with regard to its quality control plan.
- 2C. Due to the materiality of the quality control violations, several of which were previously cited during a HUD review, consider referring the lender to the Mortgagee Review Board for an assessment of civil money penalties.

If the lender officially ceases operations, the above recommendations are not warranted.

SCOPE AND METHODOLOGY

To accomplish our audit objectives, we reviewed the HUD case binders provided by the Philadelphia Homeownership Center and the loan files provided by Ameritrust officials. In addition, we reviewed Ameritrust officials' quality control procedures to assess whether they were adequate and properly implemented in accordance with HUD-FHA requirements.

We reviewed applicable laws, regulations, HUD handbooks, and mortgagee letters. We interviewed Ameritrust's management and key staff and an official of the quality control contactor to obtain an understanding of the management and quality control policies and procedures in place. We also analyzed HUD's postendorsement technical reviews, quality assurance reports, and independent audit reports.

We selected a nonstatistical sample of 22 loans originated by Ameritrust officials during the period November 1, 2008, through October 31, 2010. The 22 loans, worth more than \$10.6 million, consisted of 15 defaulted loans, 4 current loans, and 3 terminated loans. Of the 22 loans, 14 were electronically underwritten by the Fannie Mae's (Federal National Mortgage Association's) Desktop Underwriter, and 8 were manually underwritten.

The original sample consisted of 20 loans, 15 defaulted loans, 3 current loans, and 2 terminated loans. However, we added two loans (one terminated and one current) to our sample after survey work revealed that Ameritrust officials streamline refinanced a loan less than 5 months after its initial purchase and an Ameritrust official incorrectly stated that a loan had been indemnified.

We selected the 15 defaulted loans for review based on the following criteria: the loan (1) defaulted after the borrowers had made six or fewer payments, (2) involved gift funds, or (3) had not been indemnified by HUD. Of the 15 loans, 7 involved gifts ranging from \$3,000 to \$250,000.

With the exception of the loans added to the sample after we completed our survey work, we chose the three current and two terminated loans for review because they were manually underwritten by different underwriters. After completion of the survey work, we selected the third terminated loan for review since it predated the streamline refinance by less than 5 months.

While we did not review and assess the controls over computer-processed data for HUD's Neighborhood Watch System, we did use data obtained from the system for informational purposes. We performed a minimal level of testing to ensure the integrity of the computer-processed data relevant to our audit objectives and found the data to be sufficiently reliable. The minimal level of testing consisted of tracing the loan amount, closing date, and front and back ratios, among other items, to the source documentation.

We performed the audit fieldwork from February through May 2011 at Ameritrust's main office located at 1981 Marcus Ave, Lake Success, NY. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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 objectives:

- Loan origination process - Policies and procedures established by management to ensure that FHA-insured loans are originated in accordance with HUD-FHA requirements.
- Quality control process - Policies and procedures established by management to ensure that the quality control plan has been implemented and related reviews are performed in accordance with HUD-FHA requirements.

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 the 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 items are significant deficiencies:

- Ameritrust officials did not ensure that FHA-insured loans were approved in accordance with HUD-FHA requirements (see finding 1).
- Ameritrust officials did not adequately implement a quality control plan that ensured compliance with HUD-FHA requirements (see finding 2).

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		\$2,742,810
1B	\$183,327	
1C	3,843	
Total	<u>\$187,170</u>	<u>\$2,742,810</u>

- 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 instance, if HUD implements our recommendations to indemnify the 10 loans exhibiting material underwriting deficiencies, it will reduce FHA's risk of loss to the insurance fund. The amount above is based on HUD's default loss rate of 59 percent of the total unpaid principal balance of \$4,648,830 as April 30, 2011 (see appendix C).

Appendix B

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA case number	Inadequate verification of income or employment	Unsupported assets	Inadequate gift documentation	Excessive ratio(s) without adequate compensating factors	Underreported liabilities	Significant credit-related deficiencies	Faxed documentation	Skipped mortgage payments	Inadequate verification of occupancy	Inconsistent information not reconciled by lender	Unallowable fees charged to borrowers
374-4894823					X		X				
374-4964772			X				X				X
374-4970551	X	X					X			X	
374-4979970	X		X	X		X	X			X	X
374-5032000	X	X		X		X	X			X	
374-5048408							X	X	X		X
374-5055205	X						X				X
374-5059265			X				X				
374-5118521		X		X		X	X				X
374-5512784			X								
374-5571175			X								
TOTALS	4	3	5	3	1	3	9	1	1	3	5

Appendix C

SCHEDULE OF ACTUAL AND POTENTIAL LOSSES TO THE FHA INSURANCE FUND

FHA case number	Closing date	Number of payments before first default	Original loan amount	Unpaid principal balance	Actual loss to HUD	Potential loss to HUD (59 percent of unpaid principal balance)	Total of actual and potential loss to HUD
374-4894823	10/15/08	5	\$417,449	\$406,266	-	\$239,697	\$239,697
374-4964772	12/19/08	3	\$718,517	\$695,591	-	\$410,399	\$410,399
374-4970551	12/30/08	3	\$454,265	\$440,710	-	\$260,019	\$260,019
374-4979970	01/07/09	4	\$547,771	\$532,050	-	\$313,910	\$313,910
374-5032000	02/24/09	-	\$616,655	\$599,268	-	\$353,568	\$353,568
374-5048408	03/13/09	6	\$308,506	\$299,583	-	\$176,754	\$176,754
374-5055205	03/05/09	4	\$613,679	-	\$183,327	-	\$183,327
374-5059265	04/17/09	6	\$654,761	\$634,947	-	\$374,618*	\$374,618*
374-5118521	03/09/09	2	\$358,388	\$348,696	-	\$205,731	\$205,731
374-5512784	12/14/09	5	\$328,652	\$321,529	-	\$189,702	\$189,702
374-5571175	01/29/10	1	\$378,026	\$370,190	-	\$218,412	\$218,412
Total			<u>\$5,396,669</u>	<u>\$4,648,830</u>	<u>\$183,327</u>	<u>\$2,742,810</u>	<u>\$2,926,137</u>

* The immaterial \$1 difference is due to rounding.

Appendix D

CASE SUMMARY NARRATIVES

FHA case number: 374-4894823

Loan amount: \$417,449

Loan purpose: Purchase

Settlement date: October 15, 2008

Status as April 30, 2011: Delinquent

Payments before first default reported: Five

Summary:

We found material underwriting deficiencies relating to underreported liabilities and faxed documentation used in the loan underwriting process.

Underreported Liabilities

Ameritrust officials underreported the borrowers' liabilities by excluding from the total monthly installment debt calculation a \$113 payment due on a \$5,018 line of credit reflected on the bank statement as of September 9, 2008. Officials excluded this liability because it was not reported on the borrowers' credit report, dated October 1, 2008. While a handwritten notation on the credit report indicated the borrowers' had a "new trade" and the loan application listed a \$112 monthly debt on a \$4,500 unpaid balance that was not reflected on the credit report, Ameritrust officials did not provide the account number of the "new trade" or evidence to demonstrate that the debt related to borrowers' line of credit. Consequently, Ameritrust officials provided no assurance that they properly accounted for all the borrowers' liabilities. Had Ameritrust officials included this liability in the borrowers' debt calculation, the total monthly installment debt would have increased from \$2,202 to \$2,315, and the total fixed payment would have increased from \$5,517 to \$5,630, thereby increasing the total fixed payment-to-income (back) ratio from 55.50 to 56.63 percent. Further, officials did not provide adequate assurance that these funds were not used for the borrowers' cash investment in the property.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL [Technology Open to Approved Lenders] Mortgage Scorecard User Guide, when a debt or obligation (other than a mortgage) is revealed during the

loan process that was not listed on the loan application or credit report and was not considered by the automated underwriting system, the lender must verify the actual monthly payment amount, include the monthly payment amount in the total monthly installment debt, and resubmit the loan if the liability is greater than \$100 per month. In addition, the lender should determine that any funds borrowed were not or will not be used for the home buyer's cash investment in the transaction.

Faxed Employment or Income Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process verifications of employment for both the borrower and coborrower that were faxed from the same unknown source. An Ameritrust official requested the borrower's employment verification on September 10, 2008, and the employer's response was dated September 17, 2008. However, the fax banners indicated that the employment verification was faxed twice: from an unknown source on September 17, 2008, and from an Ameritrust official on September 22, 2008. With regard to the coborrower's employment verification, the fax banner indicated that it was faxed on September 8, 2008, the same day it was requested. Nevertheless, the employer's response was dated September 9, 2008. As a result, Ameritrust officials provided no assurance that the employment verifications passed directly between the employer and the lender without being handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL Mortgage Scorecard User Guide, if income or employment documents are faxed to the lender, the documents must clearly identify the employer and source of information. The lender is accountable for determining the authenticity of the document by examining, among other things, the information included at the top or banner portion of the fax received by the lender. The document itself must also include a name and telephone number of the individual with the employer who can verify the accuracy of the data.

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that the verification of employment may be faxed if it clearly identifies the name of the borrower's employer. Lenders may not accept or use documents relating to the employment or income of borrowers that are handled by or transmitted from or through interested third parties or by using their equipment.

FHA case number: 374-4964772

Loan amount: \$718,517

Loan purpose: Purchase

Settlement date: December 19, 2008

Status as April 30, 2011: First legal action to commence foreclosure

Payments before first default reported: Three

Summary:

We found material underwriting deficiencies relating to gift documentation, faxed documentation used in the loan underwriting process, and fees charged.

Inadequate Gift Documentation

Ameritrust officials did not adequately document the source of a \$10,000 gift used as part of the borrowers' \$20,000 earnest money deposit. The loan file documented a copy of a gift affidavit from the borrowers' daughter-in-law, indicating that the gift funds were transferred on October 28, 2008; an official check made payable to the seller's attorney on the same day; and a copy of the gift donor certificate of deposit, showing the donor's ability to provide the gift. While the \$10,000 certificate of deposit was opened on August 19, 2008, it was due to mature on November 19, 2008. Nevertheless, Ameritrust officials did not document evidence of the early withdrawal of the certificate of deposit or a copy of the canceled check as required. As a result, officials did not provide assurance that the gift funds came from the donor's personal account and ultimately did not come from an unacceptable source.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10C, requires the lender to obtain a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account, when the donor purchases an official check as a means of transferring gift funds.

Faxed Asset and Employment or Income Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process asset and employment or income documents faxed from an interested third party, an unidentified source, and another mortgage company. Ameritrust officials underwrote the loan using bank account histories and a bank statement as of November 12, 2008, faxed from the seller; three employment verification letters initially faxed from the coborrower's employers and then two of the three faxed from an unidentified source and the third from another mortgage company; and 12 coborrower pay stubs faxed from another mortgage company or an unidentified source.

Consequently, Ameritrust officials did not provide assurance that these documents passed directly between the provider and the lender without being handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL Mortgage Scorecard User Guide, if income or employment, asset, or other documents are faxed to the lender, the documents must clearly identify the employer, depository or investment firm's name, and source of information. The lender is accountable for determining the authenticity of the document by examining, among other things, the information included at the top or banner portion of the fax received by the lender. The document itself must also include a name and telephone number of the individual with the employer or financial institution who can verify the accuracy of the data.

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction. In addition, HUD Handbook 4060.1, REV-2, paragraph 2-18, states that lenders may not perform only a part of the loan origination process, such as taking the loan application, and routinely transfer the underwriting package to another lender.

Unallowable Fees Charged to Borrowers

Ameritrust officials charged the borrower a \$650 fee that was prohibited by HUD. They charged the borrower \$650 for a second appraisal report but did not document the need for a second appraisal in accordance with requirements. Neither of the two appraisal reports, dated October 29, 2008, indicated that the property was in a declining market. In addition, Ameritrust officials did not document their determination that the property was located in an area in which the housing market was in decline.

HUD-FHA Requirements:

Mortgagee Letter 2008-09 requires two appraisals if the loan amount, excluding the upfront mortgage insurance premium, exceeds \$417,000; the loan-to-value ratio, excluding any financed upfront mortgage insurance premium, equals or exceeds 95 percent; and the property is determined to be in a declining market.

FHA case number: 374-4970551

Loan amount: \$454,265

Loan purpose: Purchase

Settlement date: December 30, 2008

Status as April 30, 2011: First legal action to commence foreclosure

Payments before first default reported: Three

Summary:

We found material underwriting deficiencies relating to faxed documentation used in the loan underwriting process, employment, inconsistencies not reconciled by Ameritrust officials, and assets.

Faxed Asset and Employment or Income Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process asset and employment or income documents faxed from either unidentified or unknown sources. Ameritrust officials underwrote the loan using the following documents faxed from unidentified sources: a pay stub for the pay period November 8 through November 14, 2008, relating to the second borrower's first job; a letter of explanation concerning the borrower's two jobs; an employment verification letter from the borrower's second employer, dated November 8, 2008; and a lease agreement. Faxed from unknown sources were eight bank statements, three belonging to the first borrower and five to the second borrower. Further, the second borrower's bank statements had been faxed twice from both unidentified and unknown sources. Consequently, Ameritrust officials did not provide adequate assurance that these documents passed directly between the provider and the lender without being handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL Mortgage Scorecard User Guide, if income or employment, asset, or other documents are faxed to the lender, the documents must clearly identify the employer, depository or investment firm's name, and source of information. The lender is accountable for determining the authenticity of the document by examining, among other things, the information included at the top or banner portion of the fax received by the lender. The document itself must also include a name and telephone number of the individual with the employer or financial institution who can verify the accuracy of the data.

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction. The verification of employment may be faxed if it clearly identifies the name of the borrower's employer. Lenders may not accept or use documents

relating to the employment or income of borrowers that are handled by or transmitted from or through interested third parties or by using their equipment.

Inadequate Verification of Employment
Inconsistent Information Not Reconciled by Lender

Ameritrust officials did not adequately verify and document the second borrower's employment. The second borrower had two jobs. With respect to the first job, officials documented six weekly earnings statements, the IRS Forms W-2 for 2006 and 2007, and a telephone contact certification. Regarding the six weekly earnings statements covering 2 weeks in September 2008, 1 week in October 2008, 1 week in November 2008, and 2 weeks in December 2008, the actual payday varied from week to week, and the pay dates fell either on or before the end of the pay period. For example, for the pay period ending September 12, 2008, the pay date was September 11, 2008, a Thursday; yet, for the pay period ending October 24, 2008, the pay date was October 21, 2008, a Tuesday. For pay periods ending December 19 and December 26, 2008, the earnings statements reflected inconsistencies with regard to the year-to-date gross pay, taxes, and deductions. Further, the employer miscalculated the Social Security and Medicare deductions reported on all of the earnings statements. While the deductions reported on the Forms W-2 for 2006 and 2007 were correct, the employer misspelled the second borrower's last name.

Regarding the second borrower's second job, Ameritrust officials obtained an employment verification letter stating that the borrower had been employed since January 2008, or nearly 1 year, at the settlement date and the borrower's probability of continued employment was "very good." Nevertheless, as previously indicated, since the employment verification letter was faxed from an unidentified source, officials did not provide adequate assurance that it came directly from the employer without being handled by an interested third party to the transaction

In a letter faxed from an unidentified source on March 23, 2007, the second borrower stated that he worked at his second job on Wednesdays from 5:00 to 7:00 p.m., Fridays from 7:00 a.m. to 7:00 p.m., Saturdays from 7:00 a.m. to 7:00 p.m., and Sundays from 7:00 a.m. to 7:00 p.m., for a total of 38 hours per week. Yet, the three earnings statements reflected that he worked a total of 40 hours per week. Additionally, he stated that he worked at his first job Monday through Friday from 8:00 a.m. to 4:00 p.m. However, the hours he purportedly worked on Fridays overlapped, since he asserted that he worked from 8:00 a.m. to 4:00 p.m. at his first job and 7:00 a.m. to 7:00 p.m. at his second job. The earnings statements for both jobs also reported different marital statuses. The first job's earnings statements reported that the borrower was married, whereas the second job's earnings statements reported that he was single. Given these unresolved inconsistencies, Ameritrust officials did not adequately verify and document the second borrower's employment.

HUD-FHA Requirements:

Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

Unsupported Assets

Ameritrust officials did not adequately verify and document the borrowers' assets. A review of the borrowers' bank statements disclosed \$9,680 in unexplained deposits during the period September 8 through October 6, 2008. Of that amount, \$4,780 pertained to the first, and \$4,900 pertained to the second borrower. Further, there was no indication that the following were payroll deposits.

<u>Date</u>	<u>Amount</u>	<u>Bank statement</u>
September 22, 2008	\$1,000	First borrower
September 25, 2008	\$1,780	First borrower
September 29, 2008	<u>\$2,000</u>	First borrower
First borrower total	\$4,780	
September 8, 2009	\$1,900	Second borrower
October 6, 2008	<u>\$3,000</u>	Second borrower
Second borrower total	\$4,900	
Grand total	<u>\$9,680</u>	

Before the \$1,000 unexplained deposit on September 22, 2008, the first borrower had an account balance of \$504. The first borrower issued a \$1,000 earnest money deposit check to the seller's attorney on September 20, 2008, and receipt of the check was acknowledged on September 25, 2008. However, since the check was cashed on October 1, 2008, a portion of the first borrower's unexplained deposits was used for the earnest money deposit. While a handwritten notation, "See explanation," appeared next to the deposits recorded on the second borrower's bank statements, Ameritrust officials documented neither the second nor the first borrower's explanation as to the source of these large deposits, which totaled more than 2 percent of the property's sales price (\$9,680 (unexplained deposits) divided by \$470,000 (sales price) equals 2.06 percent). Without the borrowers' explanations, Ameritrust officials did not properly verify and document the borrowers' assets.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL Mortgage Scorecard User Guide, the lender must obtain an explanation and documentation for recent large deposits in excess of 2 percent of the property's sales price. The lender must also determine that any recent debts were not incurred to obtain part or all of the required cash investment on the property being purchased.

FHA case number: 374-4979970

Loan amount: \$547,771

Loan purpose: Purchase

Settlement date: January 7, 2009

Status as April 30, 2011: Ineligible for loss mitigation

Payments before first default reported: Four

Summary:

We found material underwriting deficiencies relating to income, gift documentation, credit history, inconsistencies not reconciled by Ameritrust officials, fees charged, faxed documentation used in the loan underwriting process, and qualifying ratios.

**Incorrect Calculation of Income Resulting in Understated Qualifying Ratios
Excessive Debt-to-Income Ratio Without Valid Compensating Factors**

Ameritrust officials incorrectly calculated the borrowers' total monthly income, thereby understating the qualifying ratios. Officials calculated the borrowers' monthly income by including \$1,732 in the calculation of overtime and other income without properly verifying and documenting that such income had been received for the past 2 years and was likely to continue. Officials did not obtain written verifications of employment or other documentation substantiating an earnings trend for overtime and other income. Therefore, they were required to but did not obtain the borrowers' original pay stubs covering the most recent 30-day period. The loan file documented five nonconsecutive biweekly pay stubs for the first borrower with the following pay end dates: July 30, 2008, August 27, 2008, October 8, 2008, October 22, 2008, and December 17, 2008, and seven nonconsecutive weekly pay stubs for the second borrower with the following pay period ending dates: August 19, 2008, August 26, 2008, September 9, 2008, September 16, 2008, November 4, 2008, November 11, 2008, and December 16, 2008. While the loan file contained verbal verifications of employment disclosing that the borrowers had been employed since February 26, 1998, and August 8, 2006, respectively, they did not contain information related to the borrowers' overtime and other income. Ameritrust officials also documented the 2006 and 2007 IRS Forms W-2 for both borrowers; however, based on the total wages reported, the borrowers had not received overtime and other income throughout the 2-year period. For example, in 2008, the first borrower had an annual base salary of \$41,172; yet, in 2006 and 2007, the borrower earned \$30,633 and \$43,150, respectively. Similarly, in 2008, the second borrower had an annual base salary of \$34,780 but earned only \$7,406 and \$23,259 in 2006 and 2007, respectively.

Ameritrust officials calculated the first borrower's overtime and other income of \$1,409 by dividing \$16,902 in year-to-date earnings for preshift briefings, overtime meals, and overtime reflected on the pay stub for the pay period ending October 22, 2008, by 12 months. Regarding

the second borrower, Ameritrust officials calculated overtime and other income of \$323 by dividing \$3,879 in year-to-date double earnings and job safety income reflected on the pay stub for the pay period ending December 16, 2008, by 12 months. While Ameritrust officials documented approximately 10 and 12 months of overtime and other income received by the first and second borrower, respectively, they did not provide a written justification for using such income for qualifying purposes for a period of less than 2 years.

As a result of our recalculation of the borrowers' total monthly income, which excluded overtime and other income, the qualifying ratios increased. Specifically, the borrowers' mortgage payment-to-income (front) ratio, which had already exceeded HUD's benchmark guideline of 31 percent without a valid compensating factor, increased from 41.93 to 51.12 percent, and the total fixed payment-to-income (back) ratio increased from 43.49 to 53.02 percent. Because both recalculated ratios exceeded HUD's benchmark guidelines of 31 and 43 percent, respectively, the loan would require significant compensating factors to justify its approval. The following compensating factors were recorded in the underwriter comments section of the FHA loan underwriting and transmittal summary: "FICO: 582, 598; FHA County Limit: 934,200 Purchase; First Time Homebuyer; Borrower has been on her job for more than 10 years; Excellent Job Stability; Second borrower has been on his job for over two years; Overtime income used for both borrowers were annualized; Mother will be moving into the subject property also and will help contribute to the monthly expenses." However, these are not valid compensating factors as defined by HUD Handbook 4155.1, REV-5, paragraph 2-13.

The first three underwriter comments listed are not HUD-prescribed compensating factors. While the first borrower's 10 years on the job illustrated job stability, Ameritrust officials did not document the borrower's potential for increased earnings. Improperly documented overtime income was already considered in the borrowers' qualifying income, and although the mother's moving into the subject property demonstrated that additional income could be used to meet the housing expenses, she was not a party to the transaction. Additionally, the borrowers would experience "payment shock" since the proposed monthly mortgage payment of \$4,039 was more than 400 percent greater than the previous monthly housing payment of \$971. Therefore, the absence of documented significant compensating factors greatly increased this loan's risk to the FHA insurance fund.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-7A, states that overtime income may be used to qualify if the borrower has received such income for the past 2 years, it is likely to continue, and the employment verification does not state that such income is unlikely to continue.

Additionally, the lender must develop an average of overtime income for the past 2 years; periods of less than 2 years can be used if the lender justifies and documents the reason for using the income for qualifying purposes. Further, paragraph 3-1E states that as an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS Forms W-2 from the previous 2 years, and the lender must verify by telephone all current employers.

Mortgagee Letter 2005-16 states that the qualifying ratios are 31 and 43 percent. If either or both ratios are exceeded, the lender must describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, requires ratios exceeding HUD's benchmark guidelines to be accompanied by significant compensating factors, documented on the mortgage credit analysis worksheet, to justify the approval of the mortgage loan and supported by documentation.

Inadequate Gift Fund Documentation

Ameritrust officials did not adequately document the source of two gifts in the amount of \$10,000 and \$3,500, totaling \$13,500. The loan file contained a gift letter for a \$10,000 gift to the borrowers, a copy of a canceled check made payable to the seller's attorney on October 3, 2008, and a copy of the donor's bank statement reflecting the withdrawal of the gift funds. However, the donor's bank statement disclosed a \$2,000 ATM deposit on September 25, 2008, and two telephone transfers on September 29 and October 1, 2008, in the amount of \$5,000 each. Further, the loan file documented a copy of a \$2,000 canceled check the first borrower issued to the gift donor on the same day as the ATM deposit. Before the September 25, 2008, ATM deposit, the gift donor had an account balance of \$1,358. Consequently, without additional evidence concerning the \$10,000 in telephone transfers, Ameritrust officials did not provide adequate assurance that these funds were from the donor's personal account and ultimately did not also come from an unacceptable source, namely a party to the transaction.

Regarding the \$3,500 gift, the loan file contained a gift letter, dated December 26, 2008; a copy of a cashier's check made payable to the seller; a bank receipt reflecting an available balance of \$24,229 as of December 26, 2008; and a copy of the donor's transaction history reflecting a balance of \$26,925 as of December 24, 2008. However, Ameritrust officials did not document the withdrawal document or the canceled check as required to demonstrate that the funds came from the donor's personal account. Further, the difference between the \$26,925 transaction history balance as of December 24, 2008, and the receipt reflecting an available balance of \$24,229 as of December 26, 2008, was \$2,696, which did not support the \$3,500 withdrawal for the transfer of the gift.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10C, requires the lender to obtain a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account, when the donor purchases an official or cashier's check as a means of transferring gift funds. If the donor borrowed the gift funds and cannot provide documentation from the bank or other savings account, the lender must obtain written evidence from the donor that those funds were borrowed from an acceptable source, not from a party to the transaction.

Significant Credit-Related Deficiencies
Inconsistent Information Not Reconciled by Lender

Despite the borrowers' four chargeoffs, four collections, and two judgments, Ameritrust officials did not provide a valid justification for approving the loan as required. The first borrower's credit report, dated December 17, 2008, reflected two unsatisfied judgments filed by the borrower's landlord in February and November 2006. However, the supplemental credit report, dated December 31, 2008, reflected that one of the two judgments had been satisfied, the other had been removed, and the borrower had not been late on her rental payments during the period March 2004 through December 2008. Given the discrepancy with regard to the first borrower's rental payment history, Ameritrust officials should have reconciled the information reflected on the two credit reports. Further, Ameritrust officials obtained the first borrower's written explanation for the derogatory information shown on the credit report, which read, "My bills got higher than what I expected." However, the explanation was insufficient because it demonstrated the borrower's inability to manage debt. Since the borrowers had major indications of derogatory credit, Ameritrust officials should have but did not provide a valid written justification for approving the loan as indicated in the above "Incorrect Calculation of Income Resulting in Understated Qualifying Ratios" section.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan. Major indications of derogatory credit, including judgments, collections, and other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file. Further, paragraph 2-3A states that the payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligation through either the credit report or verification of rent directly from the landlord (with no identity of interest with the borrower). Paragraph 2-4A2, requires lenders to document in writing an analysis of the reasons for any discrepancies between the credit reports.

Unallowable Fees Charged to Borrowers

Ameritrust officials charged the borrower a \$650 fee that was prohibited by HUD. They charged the borrower \$650 for a second appraisal report but did not document the need for a second appraisal in accordance with requirements. Neither of the two appraisal reports, dated November 12 and November 15, 2008, indicated that the property was in a declining market. In addition, Ameritrust officials did not document their determination that the property was located in an area in which the housing market was in decline.

HUD-FHA Requirements:

Mortgage Letter 2008-09 requires two appraisals if the loan amount, excluding the upfront mortgage insurance premium, exceeds \$417,000; the loan-to-value ratio, excluding any financed

upfront mortgage insurance premium, equals or exceeds 95 percent; and the property is determined to be in a declining market

Faxed Asset and Income Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process asset and income documents faxed from unidentified and unknown sources. Officials processed and underwrote the loan using the following documents faxed from unidentified sources: the gift donor's canceled check, dated October 3, 2008; bank statements showing the withdrawal of gift funds from the donor's account; and the second borrower's pay stub, dated December 16, 2008. Further, the gift donor's bank statements had been faxed twice from both unidentified and unknown sources. Consequently, Ameritrust officials did not provide adequate assurance that these faxed documents passed directly between the provider and the lender without being handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction. Lenders may not accept or use documents relating to the employment or income of borrowers that are handled by or transmitted from or through interested third parties or by using their equipment.

FHA case number: 374-5032000

Loan amount: \$616,655

Loan purpose: Purchase

Settlement date: February 24, 2009

Status as April 30, 2011: Current

Payments before first default reported: N/A

Summary:

We found material underwriting deficiencies relating to assets, inconsistencies not reconciled by Ameritrust officials, faxed documentation used in the loan underwriting process, income, qualifying ratios, and credit history.

Unsupported Assets

Inconsistent Information Not Reconciled by Lender

Faxed Asset Documentation

Ameritrust officials did not adequately verify and document the borrower's assets. Specifically, officials did not obtain a credible explanation for the unexplained deposits, did not reconcile inconsistencies found in the loan file documentation, and used faxed documentation in the loan underwriting process. A review of the borrower's bank statements and bank receipts disclosed three large unexplained deposits, totaling \$11,665. The bank statement reflected a deposit in the amount of \$5,818 into the borrower's savings account on October 1, 2008. A handwritten notation on the bank statement indicated that the source of the funds was "ACS income" and as support for the deposit, Ameritrust officials documented a check stub, dated October 1, 2008. However, the check stub reflected \$5,716, which did not correspond with the deposit amount. Since the difference of \$102 was not properly explained, Ameritrust officials did not provide a credible explanation for the source of the funds.

The bank statement reflected an additional unexplained deposit on December 2, 2008, in the amount of \$2,500. Further, a bank deposit verification letter, dated February 24, 2009, reported that the borrower had a checking account balance of \$5,424. However, within the previous 2-week period, the account balance had increased \$3,347, and the increase was not attributable to the borrower's payroll or adoption income. As a result, Ameritrust officials should have documented a credible explanation for the increase.

While the borrower needed \$14,600 to close, Ameritrust officials documented \$14,699 in available assets. Yet, we verified two available asset balances, \$12,620 and \$15,845. We verified \$12,620 based on the account balances reflected on the borrower's bank statements and account histories as follows:

Date	Account	Amount
January 31, 2009	Credit union	\$21
February 10, 2009	Checking	\$2,077
February 20, 2009	Savings	\$10,522
	Total	<u>\$12,620</u>

Regarding the \$15,845 available asset balance, we verified that the borrower had a credit union account balance of \$21, and the bank deposit verification letter reported that the borrower had a combined bank balance of \$15,824, representing \$10,400 and \$5,424 in the savings and checking accounts, respectively. However, the deposit verification letter did not reference specific savings and checking account numbers.

In addition, Ameritrust officials did not reconcile discrepancies found in the loan file documentation before approving the loan. Officials documented the borrower's retirement account summary as of December 31, 2008, which reported a retirement savings balance of \$1,913. Yet, documentation in the file revealed that the borrower obtained an \$11,300 loan from an additional retirement account on February 6, 2009. A handwritten notation on the retirement loan documentation revealed that the \$11,300 in loan proceeds, along with a check in the amount of \$553, was deposited into the borrower's savings account, and an account transaction history reflected the \$11,853 deposit on February 9, 2009. However, other than the retirement loan documentation, Ameritrust officials provided neither evidence of the borrower's additional retirement account nor a copy of the loan proceeds check. Since a portion of the loan proceeds was used for closing, officials should have reconciled the discrepancies found in the loan file documentation.

Ameritrust officials used in the loan underwriting process asset documents faxed from unknown sources. Account transaction histories, dated December 9, 2008, January 9, 2009, and February 10, 2009, were all faxed from the same unknown source on February 23, 2009. As a result, Ameritrust officials did not provide adequate assurance that these faxed documents passed directly between the provider and the lender without being handled or transmitted by or through an interested third party to the transaction.

Based on the facts above, Ameritrust officials did not adequately verify and document the borrower's assets needed for closing because they did not obtain a credible explanation for the unexplained deposits and reconcile inconsistencies found in the loan file documentation and used in the loan underwriting process documents faxed from unidentified sources.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. Further, paragraph 2-10B states that if there is a large increase in an account, the lender must obtain a credible explanation of the source of those funds. Paragraph 3-1 provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction.

Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

Incorrect Calculation of Income Resulting in Understated Qualifying Ratios
Inconsistent Information Not Reconciled by Lender
Excessive Debt-to-Income Ratios Without Valid Compensating Factors

Ameritrust officials incorrectly calculated the borrowers’ total monthly income, thereby understating the qualifying ratios. Officials calculated the borrowers’ monthly base income as \$2,736 by dividing the current rate of pay of \$32,839, reported on employment earnings verification, by 12 months. Although the earnings verification was completed on February 19, 2009, the employer signed and dated it February 19, 2007, and according to the fax banner, it was faxed from the employer before its completion on February 15, 2009. Nevertheless, Ameritrust officials did not reconcile these inconsistencies. Moreover, based on the nine pay stubs documented in the loan file, the borrower earned \$2,624 per month. The calculation of the borrower’s monthly base pay is as follows:

Pay type	Biweekly pay x pay periods per year	Total yearly pay	Monthly total (total/12 months)
Base income	\$1,180 x 26	\$30,680	\$2,557
Pensionable longevity increment	\$31 x 26	\$806	\$67
Total	\$1,211 x 26	\$31,486	\$2,624

Officials should have reconciled the \$112 difference between the borrower’s monthly base income, calculated using the employment earnings verification (\$2,736), and the nine documented pay stubs (\$2,624). This difference in base income resulted in an increase in the borrower’s qualifying ratios, which already exceeded HUD’s benchmark guidelines of 31 and 43 percent, without a valid compensating factor. Specifically, the mortgage payment-to-income (front) ratio increased from 41.91 to 42.38 percent, and total fixed payment-to-income (back) ratio increased from 45.73 to 46.24 percent. Since both recalculated ratios exceeded HUD’s benchmark guidelines, compensating factors would have been needed to justify the loan’s approval. The following compensating factors were recorded in the underwriter comments section of the FHA loan underwriting and transmittal summary: “FICO: 600; FHA Purchase; 3.5% Downpayment; Borrower has stable employment with savings plan; Borrower receives adoptive income; minimal monthly debt; prior derogatory due to extenuating circumstances.” Nevertheless, these are not valid compensating factors as defined by HUD Handbook 4155.1, REV-5, paragraph 2-13. The first three underwriter comments listed are not HUD-prescribed compensating factors. While the underwriter commented that the borrower had stable employment with a savings plan, Ameritrust officials documented neither the borrower’s potential for increased earnings nor the saving plan. Moreover, since the adoption subsidy was already considered in the borrower’s qualifying income, it could not be used as a compensating factor. Minimal monthly debt, by itself, is not a valid compensating factor unless it is accompanied by the borrower’s demonstrated ability to accumulate savings, which officials did not document in this case. Ameritrust officials also did not document the extenuating circumstances contributing to the borrower’s past derogatory credit history.

In addition, Ameritrust officials should have but did not reconcile the following inconsistencies between the total wages reported on the employment and earnings verification and the IRS Forms W-2 for the years 2007 and 2008:

Year	Total income per earnings verification	Total income per IRS W-2	Difference
2007	\$30,197	\$29,396	\$801
2008	\$30,975	\$30,125	\$850

Based on the facts above, the integrity of the information reflected on the employment earnings verification was questionable. Consequently, Ameritrust officials should not have relied on this verification to calculate the borrower's monthly base income.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, states that lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans to be insured by FHA. Further, paragraph 3-1L states that explanatory statements or additional documentation necessary to make a sound underwriting decision are to be included in the case binder.

Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

Mortgagee Letter 2005-16 states that the qualifying ratios are 31 and 43 percent. If either or both ratios are exceeded, the lender must describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, requires ratios exceeding HUD's benchmark guidelines to be accompanied by significant compensating factors, documented on the mortgage credit analysis worksheet, to justify the approval of the mortgage loan and supported by documentation.

Significant Credit-Related Deficiencies **Inconsistent Information Not Reconciled by Lender** **Faxed Documentation**

Despite the borrower's six collection accounts and a late payment on an auto loan, the latter occurring within the past 2 years, Ameritrust officials did not provide a valid justification for approving the loan as required. Ameritrust officials obtained the borrower's written explanation for the major indications of derogatory credit reflected on the credit report. However, the explanation addressed only five of the six collection accounts. Further, other than the explanation obtained for the three medical collections, Ameritrust officials did not document a sufficient explanation regarding the three remaining accounts. The borrower's explanation merely stated that one of the two accounts had been paid and the other was being paid off. Since the borrower had major indications of derogatory credit, Ameritrust officials should have but did

not provide a valid written justification for approving the loan as indicated in the above “Incorrect Calculation of Income Resulting in Understated Qualifying Ratios” section.

In addition, Ameritrust officials did not properly verify and document the borrower’s rental payment history. They documented the borrower’s rental verification, dated February 26, 2009, 2 days after the settlement date of February 24, 2009, which reported the borrower’s address, monthly rent, family size, and other information. A handwritten notation on the verification stated, “Tenant paid her rent from 2007 to 2008, and also 2009.” Nevertheless, according to the fax banner, the verification did not come directly from the landlord. It appeared to have been faxed from the borrower’s employer. Moreover, the verification reported that the borrower had a family size of three. Yet, documents in the loan file reflected that the borrower had a family size of six, consisting of herself and five adopted children; however, none of the children was listed as a family member on the rental verification. The resolution of this inconsistency was particularly important since Ameritrust officials included the adoption subsidy in the borrower’s monthly qualifying income calculation. Consequently, since the rental verification was dated after the settlement date, was not faxed directly from the landlord, and contained inconsistencies, officials did not properly verify and document the borrower’s rental payment history.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3A, states that the payment history of the borrower’s housing obligations holds significant importance in evaluating credit. The lender must determine the borrower’s payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity of interest with the borrower) or verification of mortgage directly from the mortgage servicer, or canceled checks covering the most recent 12-month period. Further, paragraph 2-3C states that FHA does not require collection accounts to be paid off as a condition of mortgage approval. Collections and judgments indicate a borrower’s regard for credit obligations and must be considered in the analysis of creditworthiness, with the lender documenting its reason for approving a mortgage when the borrower has collection accounts or judgments. Paragraph 3-1 provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction.

Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

FHA case number: 374-5048408

Loan amount: \$308,506

Loan purpose: Refinance

Settlement date: March 13, 2009

Status as April 30, 2011: Modification started

Payments before first default reported: Six

Summary:

We found material underwriting deficiencies relating to skipped mortgage payments, occupancy, fees charged, and faxed documentation used in the loan underwriting process.

Skipped Mortgage Payments

Ameritrust officials allowed the borrower to include three skipped conventional mortgage payments in the new FHA-insured mortgage of the cash-out refinance transaction. The borrower inherited the property from a relative and had two mortgages. While the first mortgage was in the relative's name, the second mortgage was in the borrower's name. Within the previous 12 months of the March 13, 2009, settlement date, the first mortgage had been more than 30 and 60 days late on six occasions each and was not current for the month due. An analysis of the loan servicing billing statement, dated February 12, 2009, revealed that the last mortgage payment had been made in December 2008, as the borrower had skipped three mortgage payments. The billing statement reported the following amounts due on March 1, 2009: current payment amount of \$1,275, total amount now due of \$4,072, and late charges due of \$81. The billing statement also reported that on March 1, 2009, the monthly principal and interest payment was set to adjust from \$1,358 to \$1,275. Using the information above, we calculated the borrower's three skipped mortgage payments as follows:

Months	Skipped mortgage payments	Late charges	Total
January 2009	\$1,358	\$27	\$1,385
February 2009	\$1,358	\$27	\$1,385
March 2009	\$1,275	\$27	\$1,302
Total due on March 1, 2009	\$3,991	\$81	\$4,072

Regarding the second mortgage, within the past 11 months, the borrower had been more than 30 days late on two occasions. Moreover, because the first mortgage had been more than 30 days late on six occasions and was not current for the month due and the second mortgage had been more than 30 days late on two occasions, the borrower was not eligible for the cash-out refinance

transaction. Thus, Ameritrust officials should not have approved the loan and included the three skipped mortgage payments in the new mortgage amount.

HUD-FHA Requirements:

Mortgagee Letter 2005-43 states that to be eligible for a cash-out refinance transaction, the borrower must have made all of his or her mortgage payments within the month due for the previous 12 months, no payment may be more than 30 days late, and the mortgage must be current for the month due.

Paragraph 1-10E of HUD Handbook 4155.1, REV-5, provides that lenders are not permitted to allow borrowers to skip payments and the borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement because FHA does not permit the inclusion of mortgage payments skipped by the homeowner in the new mortgage amount.

Inadequate Verification of Borrower's Occupancy

Ameritrust officials did not adequately verify and document the borrower's occupancy. This fact was particularly important since cash-out refinances are only permitted on owner-occupied principal residences owned by the borrower for at least 1 year. The credit report, dated March 9, 2009, indicated that the borrower had resided in another State since March 2006. The borrower's bank statements and the second mortgage loan statement also reflected the borrower's out-of-State address. However, Ameritrust officials documented letters from the borrower, in which he stated that he had resided at the refinanced property since 2006 but had neglected to update his address. The borrower also certified on the loan application that he occupied the refinanced property as his primary residence.

In addition, the borrower explained in writing that the payments on the first mortgage had been late because he was unaware that the legal guardian appointed by the court in 2006 to manage his ailing relative's affairs had not made the payments in a timely manner. Had the borrower occupied the refinanced property, he would have been aware that the mortgage payments were delinquent. Due to the previously mentioned inconsistencies, the borrower's occupancy was questionable. Consequently, Ameritrust officials did not provide adequate assurance that the borrower occupied the refinanced property as a principal residence for at least 1 year before the loan closed on March 13, 2009.

HUD-FHA Requirements:

Mortgagee Letter 2005-43 states to be eligible for a cash-out refinance transaction, the subject property must have been owned by the borrower as his or her principal residence for at least 12 months preceding the date of the loan application.

HUD Handbook 4155.1, REV-5, paragraph 1-11B, states that cash-out refinances are only permitted on owner-occupied principal residences and are limited to a combined LTV(FHA-insured first and any subordinate liens) of 85 percent of the appraised value, provided the property has been owned by the borrower for at least 1 year.

Unallowable Fees Charged to Borrowers

Ameritrust officials charged the borrower \$1,543 in unallowable fees. Officials charged the borrower a loan discount fee of 2.5 percent, totaling \$7,713. However, a review of the initial good faith estimate, dated March 13, 2009, revealed that the loan discount fee was 2 percent, or \$6,170. Since the initial and the final good faith estimate were completed on the same day and Ameritrust officials' retail rate sheet for the period reflected a loan discount fee of 2 percentage points applicable to the borrower's note rate, officials should not have charged an additional 0.5 percent fee.

HUD-FHA Requirements:

Mortgagee Letter 2006-04 requires lenders to charge and collect from borrowers those customary and reasonable costs necessary to close the mortgage. All fees and charges must comply with Federal and State disclosure laws and other applicable laws and regulations.

Faxed Asset, Employment and Income, Loan, and Property Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process asset, employment and income, loan, and property documents faxed from unknown sources. Ameritrust officials processed and underwrote the loan using the following documents faxed from the same unknown source: a verification of employment, dated March 9, 2009; two bank statements covering the period November 19, 2008, through January 16, 2009; a quit claim deed, dated March 23, 2006; and an ARM (adjustable-rate mortgage) interest rate and payment adjustments letter, dated December 24, 2008. In addition, the breakdown of amount owed for the second mortgage was faxed from a different unknown source. Consequently, Ameritrust officials did not provide adequate assurance that these documents passed directly between the provider and the lender without being handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

According to FHA TOTAL Mortgage Scorecard User Guide, if income or employment, asset, or other documents are faxed to the lender, the documents must clearly identify the employer, depository or investment firm's name, and source of information. The lender is accountable for determining the authenticity of the document by examining, among other things, the information included at the top or banner portion of the fax received by the lender. The document itself must also include a name and telephone number of the individual with the employer or financial institution who can verify the accuracy of the data.

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction. Verification of employment may be faxed if it clearly identifies the name of the borrower's employer. Lenders may not accept or use documents relating to the employment or income of borrowers that are handled by or transmitted from or through interested third parties or by using their equipment.

FHA case number: 374-5055205

Loan amount: \$613,679

Loan purpose: Purchase

Settlement date: March 5, 2009

Status as April 30, 2011: Preforeclosure⁵ sale completed; HUD paid a claim, totaling \$183,327, on January 23, 2011

Payments before first default reported: Four

Summary:

We found material underwriting deficiencies relating to income, fees charged, and faxed documentation used in the loan underwriting process.

Incorrect Calculation of Income Resulting in Understated Qualifying Ratios

Ameritrust officials incorrectly calculated the borrower's total monthly income, thereby understating the qualifying ratios. By incorrectly calculating the borrower's base and other income, officials overstated the borrower's total monthly income by \$3,654. Of that amount, \$921 related to the borrower's base income and \$2,733 to other income.

Ameritrust officials incorrectly calculated the borrower's base income as \$8,049 (the sum of \$76,025 and \$84,956 (total income for 2007 and 2008, respectively, as reported on the verification of employment, dated February 24, 2009) divided by 20 months). However, we calculated the borrower's base income as \$7,128 (the hourly rate of \$47 multiplied by 35 hours per week multiplied by 52 weeks divided by 12 months). Consequently, base income was overstated by \$921.

In addition, Ameritrust officials incorrectly calculated the borrower's monthly other income as \$3,045. Officials computed other income by dividing \$12,180 (the sum of \$5,608 and \$1,878 in additional security benefit funds reflected on the IRS Forms W-2 for 2007 and 2008, respectively, and \$4,694 in vacation holiday unemployment pay reflected on the 2007 IRS Form W-2) by 4 months. Nevertheless, we calculated the borrower's monthly other income as \$312 by dividing \$7,486 (the sum of \$5,608 and \$1,878 in 2007 and 2008 additional security benefit funds, respectively) by 24 months. The 2007 vacation holiday unemployment pay was excluded

⁵ In a preforeclosure sale, the lender allows the borrower in default to sell his/her home and use the net sale proceeds to satisfy the mortgage debt even though the proceeds are less than the amount owed. Since the lender allows the borrower to sell the property before foreclosure is completed, ownership of the property is not transferred to HUD.

from our computation because Ameritrust officials did not document that such income had been received for the past 2 years and was likely to continue.

As a result of our recalculation, the borrower's total monthly income decreased from \$12,794 to \$9,140, substantially increasing the qualifying ratios. Specifically, the borrower's mortgage payment-to-income (front) ratio increased from 32.48 to 45.46 percent, and the total fixed payment-to-income ratio (back) increased from 45.73 to 64.01 percent. Since both recalculated ratios exceeded HUD's benchmark guidelines of 31 and 43 percent, respectively, Ameritrust officials would have had to resubmit the current corrected information through the automated underwriting system to determine whether the risk classification had changed. If so, the loan would have required significant compensating factors to justify its approval. The following compensating factors were recorded in the underwriter comments section of the FHA loan underwriting and transmittal summary: "FICO: 703; prior homeowner with an excellent mortgage payment history; stable employment with the union." However, these are not valid compensating factors as defined by HUD.

The first underwriter comment listed is not a HUD-prescribed compensating factor. While the credit report reflected the borrower's "excellent mortgage payment history" over the past 70 months, the proposed monthly mortgage payment of \$4,155 was approximately 308 percent greater than the previous payment of \$1,350. Moreover, Ameritrust officials reported that the borrower had stable employment; however, they did not document the borrower's potential for increased earnings as indicated by job training or education in the borrower's profession.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL Mortgage Scorecard User Guide, the lender is responsible for verifying the accuracy of the amount of income being reported and for determining whether it can be considered as effective income in determining the payment-to-income and debt-to-income ratios. If any information regarding a borrower's income or employment changes during loan processing, the lender must resubmit current corrected information through its automated underwriting system to determine whether the risk classification changes.

HUD Handbook 4155.1, REV-5, section 2, provides that the lender must establish the anticipated amount of income and the likelihood of continuance. Income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Further, paragraph 2-6 states that the lender is responsible for verifying the borrower's employment history for the most recent 2 years.

Unallowable Fees Charged to Borrower

Ameritrust officials charged the borrower a \$550 fee that was prohibited by HUD. They charged the borrower \$550 for a second appraisal report but did not document the need for a second appraisal in accordance with requirements. Neither of the two appraisal reports, dated January 8 and February 17, 2009, indicated that the property was in a declining market. In addition, Ameritrust officials did not document their determination that the property was located in an area in which the housing market was in decline.

HUD-FHA Requirements:

Mortgage Letter 2008-09 requires two appraisals if the loan amount, excluding the upfront mortgage insurance premium, exceeds \$417,000; the loan-to-value ratio, excluding any financed upfront mortgage insurance premium, equals or exceeds 95 percent; and the property is determined to be in a declining market.

Faxed Asset and Other Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process asset and other documents faxed from another mortgage company and an unidentified source. They processed and underwrote the loan using the following documents faxed from another mortgage company: a retirement plan distribution statement, dated January 13, 2009, and a Judgment of divorce, dated July 11, 2008. In addition, a residential contract of sale, dated November 12, 2008; a builder's certification, dated February 25, 2009; and a mortgage account statement, dated January 5, 2009, were all faxed from an unidentified source. Since these documents were faxed from another mortgage company and an unidentified source, Ameritrust officials did not provide adequate assurance that these documents were not handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

According to chapter 2 of the FHA TOTAL Mortgage Scorecard User Guide, if asset or other documents are faxed to the lender, the documents must clearly identify the depository or investment firm's name and source of information. The lender is accountable for determining the authenticity of the document by examining, among other things, the information included at the top or banner portion of the fax received by the lender. The document itself must also include a name and telephone number of the individual with the financial institution who can verify the accuracy of the data.

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction. In addition, HUD Handbook 4060.1, REV-2, paragraph 2-18, states that lenders may not perform only a part of the loan origination process, such as taking the loan application, and routinely transfer the underwriting package (appraisal report or mortgage credit package) to another lender.

FHA case number: 374-5059265

Loan amount: \$654,761

Loan purpose: Purchase

Settlement date: April 17, 2009

Status as April 30, 2011: First legal action to commence foreclosure

Payments before first default reported: Six

Summary:

We found material underwriting deficiencies relating to gift documentation and faxed documentation used in the loan underwriting process.

Inadequate Gift Fund Documentation
Faxed Documentation

Ameritrust officials did not adequately document the source of two gifts in the amount of \$19,000 and \$35,000, totaling \$54,000. The loan file contained a gift letter for the \$19,000 gift to the borrower, a copy of a cashier's check made payable to the borrower's attorney on March 16, 2009, and a copy of the gift donor's transaction history reflecting the withdrawal of the gift funds. However, the donor's transaction history disclosed a \$14,000 online transfer and a \$5,000 deposit on the day the donor provided the gift. Before the online transfer and the deposit, the donor had an account balance of \$237.

In addition, a fax banner reflected on a copy of the canceled cashier's check indicated that it was faxed from an unidentified source on April 1, 2009, and a copy of the donor's transaction history indicated that it was faxed twice from unidentified sources on March 18 and April 1, 2009, respectively. Consequently, Ameritrust officials did not provide assurance that these documents passed directly between the provider and the lender without being handled or transmitted by or through an interested third party to the transaction.

With regard to the \$35,000 gift, the loan file contained a gift letter, dated July 9, 2008, a copy of an official check made payable to the seller's attorney on the same day, and a copy of the donor's bank statement reflecting the withdrawal of the gift funds. However, the donor's bank statement disclosed a wire transfer in the amount of \$80,278 on July 2, 2008. Before the wire transfer, the donor had a checking account balance of \$0. Later the same day, the donor transferred \$70,000 into her primary share account, which had a previous balance of \$31. Using the funds transferred into her primary share account, the donor purchased an official check on July 9, 2008, to transfer the \$35,000 gift. Nevertheless, without additional evidence regarding the source of the transfers and the deposit, Ameritrust officials did not provide adequate assurance that the gifts were from the donor's personal funds and ultimately did not come from an unacceptable source.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10C, requires the lender to obtain a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account, when the donor purchases an official or cashier's check as a means of transferring gift funds. If the donor borrowed the gift funds and cannot provide documentation from the bank or other savings account, the lender must obtain written evidence from the donor that those funds were borrowed from an acceptable source, not from a party to the transaction. Further, paragraph 3-1 provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction.

FHA case number: 374-5118521

Loan amount: \$358,388

Loan purpose: Purchase

Settlement date: March 9, 2009

Status as April 30, 2011: First legal action to commence foreclosure

Payments before first default reported: Two

Summary:

We found material underwriting deficiencies relating to qualifying ratios, assets, credit history, fees charged, and faxed documentation used in the loan underwriting process.

Excessive Debt-to-Income Ratios Without Valid Compensating Factors

Ameritrust officials did not document valid compensating factors to justify the approval of a loan with mortgage payment-to-income (front) and total fixed payment-to-income (back) ratios of 47.14 and 49.05 percent, respectively, which exceeded HUD's benchmark guidelines of 31 and 43 percent. They recorded the following compensating factors in the underwriter comments section of the FHA loan underwriting and transmittal summary: "FICO: 601/611; FHA purchase 3.5% down payment; FHA county limit: \$625,500; Borrower was out on disability for 2 months in 2008 for her 2nd job; Income used for her 2nd job was averaged for 2008 and YTD (12 months); Two months reserves available after closing; Stable employment." Nevertheless, these are not valid compensating factors as defined by HUD Handbook 4155.1, REV-5, paragraph 2-13.

The first four underwriter comments listed are not HUD-prescribed compensating factors. The earnings from the first borrower's second job were already considered in the borrowers' qualifying income. While Ameritrust officials reported that the borrower had 2 months of reserves available after closing, 3 months of documented cash reserves would have been required to justify the loan's approval. In addition, despite the borrowers' stable employment, Ameritrust officials did not document the borrowers' potential for increased earnings.

HUD-FHA Requirements:

Mortgagee Letter 2005-16 states that the qualifying ratios are 31 and 43 percent. If either or both ratios are exceeded, the lender must describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, requires ratios exceeding HUD's benchmark guidelines to be accompanied by significant compensating factors, documented on the mortgage

credit analysis worksheet, to justify the approval of the mortgage loan and supported by documentation.

Unsupported Assets

Ameritrust officials did not adequately verify and document the borrowers' assets. A review of the borrowers' transaction history disclosed a \$3,087 preauthorized credit on February 2, 2009, that was not payroll related. In addition, officials reported that the borrowers had verified assets of \$15,043; however, we confirmed only \$9,043 of that amount, which included the \$3,087. Since the borrowers needed \$7,800 to close and had verified assets of \$9,043, Ameritrust officials should have obtained an explanation from the borrowers regarding the source of this large credit. Without the explanation, officials did not properly verify and document the borrowers' assets needed for closing.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. Further, paragraph 2-10B states that if there is a large increase in an account, the lender must obtain a credible explanation for the source of those funds.

Significant Credit-Related Deficiencies

Ameritrust officials did not adequately analyze the borrower's credit history. Officials obtained neither credible written explanations from the borrowers regarding derogatory information reflected on their credit reports, including five collections and a chargeoff, nor all inquiries occurring within the past 90 days. Moreover, despite the borrowers' major indications of derogatory credit, Ameritrust officials did not document their justification for approving the loan as required. (See the above "Excessive Debt-to-Income Ratios Without Valid Compensating Factors" section.)

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraphs 2-3B and C, provide that collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness, with the lender documenting its reason for approving a mortgage when the borrower has collection accounts or judgments. The borrower must explain in writing all collections and judgments, as well as inquiries shown on the credit report within the past 90 days.

Unallowable Fees Charged to Borrowers

Ameritrust officials charged the borrowers a \$450 fee that was prohibited by HUD. They charged the borrowers \$450 for a second appraisal report but did not document the need for a second appraisal in accordance with requirements. Since the loan amount, excluding the upfront mortgage insurance premium, was \$352,225 and did not exceed the \$417,000 limit, a second appraisal was not required. Further, the loan file did not contain the second appraisal report.

HUD-FHA Requirements:

Mortgagee Letter 2008-09 requires two appraisals if the loan amount, excluding the upfront mortgage insurance premium, exceeds \$417,000; the loan-to-value ratio, excluding any financed upfront mortgage insurance premium, equals or exceeds 95 percent; and the property is determined to be in a declining market.

Faxed Asset or Income and Other Documentation

Contrary to requirements, Ameritrust officials used in the loan underwriting process asset, income, and credit documents faxed from another mortgage company and an unidentified source. Ameritrust officials processed and underwrote the loan using the following documents faxed from another mortgage company: a letter from the treasurer of a private savings club; a CD-IRA (certificate of deposit-individual retirement account) withdrawal slip, dated January 7, 2009; a deposit transaction history as of February 18, 2009; and the second borrower's two pay stubs reflecting pay dates of February 13 and February 27, 2009. In addition, the following documents were faxed from an unidentified source: a private savings club account ledger; a deposit slip, dated March 5, 2009; the first borrower's two pay stubs from different employers reflecting pay dates of February 26 and February 27, 2009; two student loan statements, dated August 14, 2008; and a collection satisfaction letter, dated February 24, 2009. Since these documents were faxed from another mortgage company and an unidentified source, Ameritrust officials did not provide adequate assurance that they were not handled or transmitted by or through an interested third party to the transaction.

HUD-FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1, provides that no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction. Lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties or by using their equipment.

HUD Handbook 4060.1, REV-2, paragraph 2-18, states that lenders may not perform only a part of the loan origination process, such as taking the loan application, and routinely transfer the underwriting package (appraisal report or mortgage credit package) to another lender.

FHA case number: 374-5512784

Loan amount: \$328,652

Loan purpose: Purchase

Settlement date: December 14, 2009

Status as April 30, 2011: Ineligible for loss mitigation

Payments before first default reported: Five

Summary:

We found material underwriting deficiencies relating to gift documentation.

Inadequate Gift Fund Documentation

Ameritrust officials did not adequately document the source of two gifts in the amount of \$6,000 and \$5,000, totaling \$11,000. The loan file contained gift letters, dated November 25 and December 8, 2009, respectively; copies of official checks issued to the borrower; the borrower's deposit tickets showing the deposit amounts; and the transaction histories showing the withdrawals from the donor's account. However, a review of the transaction histories revealed that the gift funds had been deposited into the donor's account on the day they were withdrawn. Before the \$6,000 and \$5,000 deposits on November 25 and December 8, 2009, respectively, the gift donor had account balances of approximately \$5 and \$12, respectively. Since Ameritrust officials did not document additional information regarding whether these funds had been borrowed from an acceptable source, officials provided no assurance that the gifts were from the donor's personal account and ultimately did not come from a party to the transaction.

HUD-FHA Requirements:

HUD Handbook 4155.1, paragraph 5.B.4.d, states that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not provided by an unacceptable source and were the donor's own funds. Further, paragraph 5.B.4.e. states that as a general rule, FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction. Donors may borrow gift funds from any other acceptable source, provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift.

FHA case number: 374- 5571175

Loan amount: \$378,026

Loan purpose: Purchase

Settlement date: January 29, 2010

Status as April 30, 2011: Chapter 7 bankruptcy

Payments before first default reported: One

Summary:

We found a material underwriting deficiency relating to gift documentation.

Inadequate Gift Fund Documentation

Ameritrust officials did not adequately document the source of two gifts in the amount of \$8,791 and \$5,000, totaling \$13,791. Concerning the \$8,791 gift, the loan file contained a gift letter, dated January 21, 2010; a copy of an official check made payable to the seller's attorney on January 9, 2010; and a transaction journal showing the withdrawal of the gift funds from the donor's account. However, a review of the donor's transaction journal disclosed an \$8,700 automated phone transfer on the day the donor provided the gift. Further, before the January 9, 2010, deposit, the donor had an account balance of \$911.

Regarding the \$5,000 gift, the loan file contained a gift letter, dated January 20, 2010; a copy of a cashier's check made payable to the coborrower on December 28, 2009; the borrowers' bank statement showing the deposit; and the demand deposit account statement inquiry as of December 28, 2009, evidencing the withdrawal of the gift funds from the donor's account. However, the donor's statement inquiry merely reflected transactions from December 22 through December 28, 2009. Since the donor's statement inquiry reflected a beginning balance of \$2,169 on December 10, 2009, and an ending balance of \$1,204 on December 28, 2009, during the 18-day period, a total of \$7,025 was deposited, and \$7,989 was withdrawn from the account, including \$5,000 for the gift. Consequently, Ameritrust officials should have documented the entire statement inquiry or additional information with regard to the source of the donor's deposits to provide assurance that the gift funds were from the donor's personal account and ultimately did not come from an unacceptable source.

In addition, since the borrowers used the \$13,791 in gift funds for the earnest money deposit, required no funds to close, and made only one payment before defaulting on the loan, the borrower's investment in the property was minimal.

HUD-FHA Requirements:

HUD Handbook 4155.1, paragraph 5.B.4.d, states that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not

provided by an unacceptable source and were the donor's own funds. Further, paragraph 5.B.4.e states that as a general rule, FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction. Donors may borrow gift funds from any other acceptable source, provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift.