



Issue Date September 6, 2011
Audit Report Number 2011-NY-1014

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

FROM: *Edgar Moore*  
Edgar Moore, Regional Inspector General for Audit, New York/New Jersey, Region, 2AGA

SUBJECT: All American Home Mortgage Corp., Brooklyn, NY, Did Not Always Comply With HUD-FHA Loan Underwriting Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited All American Home Mortgage Corp., a nonsupervised<sup>1</sup> lender located in Brooklyn, 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 because of its 8.8 percent default and claim ratio for insured single-family loans with beginning amortization dates between September 1, 2008, and August 31, 2010. This rate was more than double the New York State average of 3.57 percent for the same period. The audit objectives were to determine whether All American (1) approved Federal Housing Administration (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.

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

## What We Found

All American officials did not always approve FHA-insured loans in accordance with HUD-FHA requirements. Specifically, material underwriting deficiencies were noted regarding 6 of the 20 loans reviewed, such as inadequate verification of gift funds, the statutory minimum investment, source of funds, improper calculation of income and inconsistent information not reconciled. As a result, loans were approved for potentially ineligible borrowers, which caused HUD-FHA to incur an unnecessary insurance risk. In addition, All American officials charged the borrowers \$680 in unallowable fees, such as wire and courier fees.

All American officials did not ensure that their quality control plan was implemented in accordance with HUD-FHA requirements. Consequently, the effectiveness of the plan was impaired, resulting in a lack of assurance that loan origination problems were identified and appropriate corrective action was taken to prevent similar occurrences.

## What We Recommend

We recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing require All American officials to (1) indemnify HUD against future losses of more than \$1.07 million related to the five loans that were underwritten in violation of HUD-FHA requirements, (2) reimburse HUD for the \$181,515 in claims and associated fees paid on one loan with significant underwriting deficiencies, (3) ensure that borrowers have been reimbursed \$680 for unallowable wire and courier fees, (4) establish procedures to ensure that all HUD-FHA underwriting requirements are properly implemented and documented, and (5) implement quality control procedures to ensure that management responses and planned corrective action are adequately documented and quality control reviews are always conducted in accordance with HUD-FHA requirements.

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 21, 2011. We held an exit conference with auditee officials on July 27, 2011, and they provided their written comments on August 3, 2011, at which time they generally disagreed with finding 1 and agreed with finding 2. The complete text of auditee officials' response, along with our evaluation of that response, can be found in appendix B of this report.

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## BACKGROUND AND OBJECTIVES

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All American Home Mortgage Corp., was incorporated in the State of New York in December 1989 under the name AllBank Mortgage Corp. In June 1992, it adopted the name AllMoney Mortgage Bankers, Inc., which was changed in April 2002 to its current name. All American has three active branch offices located in Lake Worth, FL, Uniondale, NY, and its main office is located in Brooklyn, NY.

All American became an authorized Federal Housing Administration (FHA) direct endorsement lender on August 25, 1993. It is a nonsupervised lender, the principal activity of which involves lending or investing funds in real estate mortgages. A nonsupervised lender may originate, sell, purchase, hold, or service FHA-insured mortgages, depending on its wishes and qualifications.

All American originated 500 loans with amortization dates between September 1, 2008, and August 31, 2010. As of August 31, 2010, 44 of the 500 loans originated by All American were in default, and its loan default rate was 8.8 percent. This rate was more than double the New York State average of 3.57 percent for the same period.

All American originated 32 of 44 defaulted loans using FHA's Technology Open To All Lenders (TOTAL) Mortgage Scorecard and the remaining 12 defaulted loans were originated manually. The TOTAL Mortgage Scorecard is not an Automatic Underwriting System<sup>2</sup> (AUS). It is a mathematical equation for use within an AUS. To underwrite an FHA loan electronically a mortgagee must process the request through an AUS that communicates with TOTAL. FHA's TOTAL Mortgage Scorecard evaluates the overall creditworthiness of the applicants based on a number of credit variables. When TOTAL combines with the functionalities of the AUS, it indicates a recommended level of underwriting and documentation in determining a loan's eligibility for insurance by FHA. The combined analysis by TOTAL and the AUS will either conclude that the borrowers' credit and capacity for repayment of the mortgage is acceptable or refer the loan application to an individual Direct Endorsement (DE) underwriter for further consideration and review.

For mortgage loans scored as "accept" or "approve," FHA has granted a number of credit policy waivers and documentation relief from the instructions in HUD Handbook 4155.1 as described in FHA TOTAL Mortgage Scorecard User Guide, dated September 2003. However, lenders must still comply with outstanding eligibility requirements and ensure the integrity of the data used to render a decision. For loans receiving a "refer" risk classification and are remanded to a DE underwriter, FHA's credit policies as described in HUD Handbook 4155.1 apply. The lender using the TOTAL Mortgage Scorecard must conduct a manual underwriting review according to FHA's guidelines for all loan applications that generate a "refer" rating. The underwriter must

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<sup>2</sup> An Automated Underwriting System is a computerized system for doing automated underwriting. The most widely used are Fannie Mae's "Desktop Underwriter" and Freddie Mac's "Loan Prospector".

determine if the borrower is creditworthy in accordance with FHA standard credit policies and guidelines.

The objectives of the audit were to determine whether All American officials (1) approved insured loans in accordance with HUD-FHA requirements, and (2) implemented a quality control plan that complied with HUD-FHA requirements.

## RESULTS OF AUDIT

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### Finding 1: All American Officials Did Not Always Comply With HUD-FHA Underwriting Requirements

All American officials did not always approve FHA-insured loans in accordance with HUD-FHA requirements. Specifically, material underwriting deficiencies were noted regarding 6 of the 20 loans reviewed, such as inadequate verification of gift funds, inadequate verification of statutory minimum investment, inadequate verification of source of funds, improper calculation of income and improper verification of employment, unsupported cash reserves on Desktop Underwriter underwriting findings, and inconsistent information not reconciled. These deficiencies occurred because All American officials did not have adequate controls to document, verify, and reconcile the borrowers' information; therefore, officials did not ensure that all loans were processed in compliance with HUD-FHA requirements. As a result, the FHA insurance fund incurred a loss of \$181,515 on one loan and continues to be at risk for more than \$1.07 million<sup>3</sup> on five loans. All American officials also charged the borrowers \$680 in unallowable fees, such as wire and courier fees. However, officials are taking corrective action to reimburse the borrowers for the unallowable fees charged.

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#### Material Underwriting Deficiencies Noted

All American officials originated six 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 and assets. The table below summarizes the deficiencies identified in the six loans. These deficiencies are not independent of each other as all loans exhibited at least one material deficiency.

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<sup>3</sup> This amount is estimated at \$1,070,963 (59 percent of the \$1,815,191 unpaid principal balance of the five loans). The 59 percent loss rate is based on HUD's Single Family Acquired Asset Management System's (SAMS) Case Management Profit and Loss by Acquisition computation for Fiscal Year 2010 based on actual sales.

<b><u>Deficiency</u></b>	<b><u>Number of loans</u></b>
<b>Gift funds and statutory minimum investment</b>	<b>1</b>
<b>Source of funds</b>	<b>2</b>
<b>Income or employment resulting in incorrect ratios</b>	<b>3</b>
<b>Cash reserves</b>	<b>3</b>
<b>Inconsistent information</b>	<b>1</b>

Appendix C of this report provides a summary of loans with material underwriting deficiencies identified in each of the seven cases, and appendix E provides detailed descriptions of these deficiencies, as well as the applicable HUD-FHA requirements.

### **Inadequate Verification of Gift Funds and Statutory Minimum Investment**

All American officials neither adequately verified nor documented the source of gift funds used for one borrower's earnest money deposits. Consequently, the statutory minimum investment was not obtained since the borrower's investment in the property was not verified. For example, in FHA case number 374-5045917, All American officials did not adequately verify the source of a \$9,160 gift used as part of the borrowers' \$13,655 earnest money deposit. The Desktop Underwriter underwriting findings showed that the borrowers' minimum statutory investment requirement was \$13,615 (\$389,000 x 3.5 percent), and the lender file contained a gift letter with no date from the coborrower's stepbrother for a \$9,160 gift to the coborrower to be applied toward the property purchase. The lender file contained a check, dated January 16, 2009, from the donor to the borrower's closing attorney for \$9,160. However, the lender file did not contain documentation verifying that the source of the gift funds was indeed the donor's own funds because the transaction journal dated December 15, 2008, to January 16, 2009, from the donor's bank showed that the donor had a negative balance at the beginning of the month. It showed the following: a negative balance of (\$523) on December 15, 2008, a deposit of \$10,000 on December 16, 2008, several withdrawals totaling \$10,010 during the period December 19 to December 22, 2008, and a deposit of \$9,300 and withdrawal of \$9,170 on January 16, 2009. Consequently, All American 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. Without documentation verifying that the gift funds were from an acceptable source, the borrower did not make the minimum cash investment in the property, and the lender did not verify and document the borrower's gift and investment in the property.

### **Inadequate Verification of the Source of Funds**

All American officials did not adequately verify the source of the funds for two borrowers. For example, in case number 374-4874336, All American officials did not provide adequate support to show that the borrower had sufficient funds to complete the transaction. The Desktop Underwriter underwriting findings stated that the depository assets totaling \$15,258 were available to underwrite this case. However, \$11,492 of the \$15,258 was not supported because the bank statements exceeded the 120-day documentation requirement. In addition, the earnest money of \$10,000 was not properly documented because the lender did not verify the source of funds. Further, the verified assets of \$3,766 ( $\$15,258 - \$11,492$ ) were not sufficient funds to close the loan because the HUD-1 settlement statement showed that the borrower needed \$11,735 ( $\$10,000$  earnest money +  $\$1,735$  required cash from borrower) in funds to close. Therefore, the lender did not verify that the borrower had sufficient funds to complete the transaction.

### **Inadequate Verification of Income or Employment that Resulted in the Incorrect Calculation of Qualifying Ratios**

All American officials inadequately verified the income or employment for three borrowers resulting in the incorrect calculation of qualifying ratios. For instance, in case number 374-4840303, the Desktop Underwriter underwriting findings showed that total income of \$15,568 was listed as available on the loan application to underwrite this case. However, \$2,157 ( $\$15,568 - \$13,411$  verified income) of the \$15,568 was overstated because All American officials did not average the base pay for the two borrowers for 30.33 months (January 1, 2006, to July 10, 2008, the dates on the verification of employment). All American officials concurred that the borrowers' income was overstated. Therefore, the mortgage payment-to-income ratio (front) was increased from 24.05 to 27.91 percent ( $\$3,744/\$13,411$ ) and the total fixed payment-to-income ratio (back) was increased from 40.29 to 46.76 percent ( $\$6,272/\$13,411$ ). The verified income was 13.85 percent [ $(\$15,568 \text{ report income} - \$13,411 \text{ verified income})/\$15,568$ ] less than that reported by the borrowers. Since the difference in verified income was 13.85 percent, or more than the 5 percent difference allowed by HUD, there was a need to rescore the mortgage loan.



## **Inadequate Verification of Cash Reserves**

All American officials inadequately verified cash reserves on Desktop Underwriter underwriting findings for three borrowers. For instance, in case number 374-4874336, the underwriting findings showed cash reserves of 3 months; however, this amount was not supported by the borrowers' assets. All American officials stated that the correct available funds were \$3,766, which was well below the 3 months of cash reserves after the closing amount as noted on the underwriting findings. The HUD-1 settlement statement showed that the borrower needed \$1,735 to close. The underwriting findings showed that the borrower had cash reserves of \$11,094; however, this amount was incorrect because the borrower only had cash reserves of \$2,031 ( $\$3,766 - \$1,735$ ) after closing. Therefore, after closing, the borrower had cash reserves of less than a month, or 68 percent of the total mortgage payment ( $\$2,031/\$2,991$ ). The cash reserve verified amount was \$2,031, which was 82 percent [ $(\$11,094 - \$2,031)/\$11,094$ ] less than the Underwriting Findings, or more than 10 percent less than that reported by the borrowers on the loan application; therefore, the lender should have rescored the mortgage loan as required.

## **Inconsistent Information Not Reconciled**

All American officials processed one FHA-insured loan without reconciling discrepancies found in the loan file documentation. For example, with respect to FHA case number 374-5019085, the direct endorsement approval for a HUD-FHA-insured mortgage showed an interest rate of 5 percent; the uniform residential loan application and mortgage note had an interest rate of 5 percent and principal and interest of \$3,004. However, FHA's loan underwriting and transmittal summary had an interest rate of 6.5 percent and principal and interest of \$3,538, and the Desktop Underwriter underwriting findings had an interest rate of 6.5 percent and principal and interest of \$3,556. As a result, the lender incorrectly calculated the borrowers' back and front ratios because All American overstated the mortgage payment and interest by \$552 ( $\$3,556 - \$3,004$ ) and the front and back ratios were decreased from 40.85 to 35.53 percent [ $(\$4,240 - \$552)/\$10,379$ ] and 45.15 to 39.83 percent [ $(\$4,686 - \$552)/\$10,379$ ], respectively. All American officials stated that the file was qualified initially at a 6.5 percent interest rate and closed at a decreased interest rate of 5 percent. All American officials further stated that resubmission used to be required only for an increase on the interest rate and the mortgage note rate of 5 percent and that the principal and interest of \$3,004 was the correct one. We agreed that the loan was not required to be rescored because of the decrease on the interest rate; however, Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

## Unallowable Fees

All American officials charged borrowers unallowable fees such as wire or courier fees on 9 of the 20 loans. However, as a result of our audit work, the lender disbursed a check to the borrowers for the unallowable fees charged. Four of the nine loans contained material underwriting deficiencies and are included in appendix C. The remaining five loans had deficiencies that were not deemed significant enough to impact the insurability of the loan

The table below details the loans in which unallowable fees were charged to the borrowers.<sup>4</sup>

Case number	Unallowable fees charged to borrowers
374-5043583	45
374-4874336	90
374-5045917	90
374-5119533	90
374-4974705	45
374-4778212	90
374-4805280	45
374-5105511	90
374-5179044	95
<b>Total</b>	<b>680</b>

## Conclusion

Six of the twenty loans reviewed exhibited material underwriting deficiencies that posed a material risk to the FHA insurance fund, such as inadequate verification of gift funds, statutory minimum investment, inadequate verification of the source of funds, improper calculation of income or inadequate verification of employment resulting in the incorrect calculation of qualifying ratios, inadequate verification of cash reserves, and inconsistent information not reconciled. In addition, the lender charged borrowers \$680 in unallowable fees, such as wire and

<sup>4</sup> Four loans highlighted in green are included in appendix C. The five loans highlighted in blue contained deficiencies deemed not significant enough to impact the insurability of the loan.

courier fees. Thus, indemnification is warranted against future losses on five loans with material underwriting deficiencies; the loss to HUD is estimated to be at more than \$1.07 million. Further, the HUD-FHA insurance fund incurred a loss of \$181,515 for claims and associated fees paid on one loan. These deficiencies occurred because All American officials did not have adequate controls to document, verify, and reconcile the borrowers' information; therefore, officials did not ensure that all loans were processed in compliance with HUD-FHA requirements.

## Recommendations

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

- 1A. Indemnify HUD against any future losses on the five loans with material underwriting deficiencies. The projected loss is \$1,070,963 based on HUD's default loss rate of 59 percent of the unpaid principal balance of \$1,815,191.
- 1B. Reimburse HUD for the loss of \$181,515 that resulted from the amount of claims and associated fees paid on one loan with significant underwriting deficiencies, case number 374-4840303.
- 1C. Ensure that borrowers have been reimbursed \$680 for unallowable wire and courier fees.
- 1D. Establish underwriting procedures that will provide assurance that borrowers' information are documented, verified, and reconciled to ensure that HUD-FHA requirements are always complied with by being properly implemented and documented.

## Finding 2: All American Officials Did Not Implement a Quality Control Plan in Accordance With HUD-FHA Requirements

All American officials did not ensure that a quality control plan was implemented in accordance with HUD-FHA requirements. The plan implemented did not include basic and specific HUD-FHA requirements. Specifically, officials did not ensure that (1) management responses and planned corrective actions were adequately documented, (2) quality control reviews were conducted in a timely manner, (3) all early payment defaulted loans defaulting within 6 months were routinely reviewed, and (4) quality control reviews complied with HUD-FHA requirements. These deficiencies occurred due to weaknesses in All American officials' implementation of their quality control plan. Consequently, the effectiveness of All American's quality control plan was impaired, resulting in a lack of assurance that loan origination problems were identified and appropriate corrective action was taken to prevent similar occurrences.

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### Quality Control Plans Not in Accordance With HUD-FHA Requirements

During the period September 1, 2008, through October 31, 2010, All American officials implemented three quality control plans, dated August 2006, July 2009, and October 2010. However, the three quality control plans were not in accordance with HUD-FHA requirements. The three quality control plans were developed by a contractor, and All American officials added controls to them to be carried out by the contractor.

The two quality control plans, dated August 2006 and July 2009, were implemented during the audit period but did not contain all HUD-FHA requirements. All American officials had incorporated most of the requirements into their updated quality control plan, dated October 2010; however, there were three basic requirements that were not included.

The updated plan did not include the clauses that are required by HUD Handbook 4060.1 REV 2, Paragraphs 7-3(I), 7-6(B), and 7-6(C). Specifically,

- Quality control reports that identified deficiencies were to include a final report that identified the corrective actions taken, the timetable for completion of actions, and any planned follow-up activities.
- If more than 15 loans were closed per month, the quality control reviews were to be conducted at least monthly, addressing one month's activities. If 15 or fewer loans were closed per month, the quality control reviews were to be conducted at least quarterly.

- If 3,500 or fewer FHA loans were originated or underwritten per year, 10 percent of the FHA loans were to be reviewed. If more than 3,500 FHA loans were originated or underwritten per year, 10 percent of the FHA loans or a statistical random sampling that provided a 95 percent confidence level with 2 percent precision was to be reviewed.

### **Management Responses and Planned Corrective Action Inadequately Documented**

All American officials did not adequately document management responses and planned corrective actions for deficiencies identified during quality control reviews. During the audit period, 58 loans were reviewed under the quality control plans dated August 2006 and July 2009; however, quality control reports did not adequately document management responses and planned corrective actions. All American officials did not provide evidence that the deficiencies were addressed for 35 of the 58 quality control reports. HUD Handbook 4060.1, REV-2, paragraph 7-3I, states that management must take prompt action to deal appropriately with any material findings. The final report or an addendum must identify actions being taken, the timetable for their completion, and any planned follow-up activities. In addition, All American's quality control policies and procedures, dated August 2006, states that senior management should respond to all deficiencies noted from quality control reports. Further, All American's quality control policies and procedures, dated July 2009, states that a third-party provider is used for quality control reviews and the third-party provider follows FHA guidelines. However, 43 of 58 quality control reports did not always identify the actions being taken, a timetable for completion of the actions taken, and planned follow-up activities. These weaknesses occurred because All American officials did not establish procedures to ensure that their quality control plan was properly implemented.

### **Quality Control Reviews Not Conducted in a Timely Manner**

All American officials did not conduct quality control reviews in a timely manner. Of the 58 loans reviewed under the quality control plan, 32 were not reviewed within 90 days of the closing of the loan as required by HUD. HUD Handbook 4060.1, REV-2, paragraph 7-6A, states that loans must be reviewed within 90 days from the end of the month in which the loan closed. In addition, monthly quality control reviews were not conducted when All American officials closed more than 15 loans during 15 months within a 2-year audit period. HUD Handbook 4060.1, REV-2, paragraph 7-6B, states that lenders closing more than 15 loans monthly must conduct quality control reviews at least monthly and the reviews must address 1 month's activities. This requirement is intended to ensure

that problems left undetected before closing are identified as early after closing as possible. The deficiency described above occurred because All American officials did not provide the contractor with a closed loan report in a timely manner.

### **Loans Defaulting Within the First 6 Months Not Routinely Reviewed**

All American officials did not routinely select loans defaulting within the first 6 months for review as required by HUD. HUD Handbook 4060.1, REV-2, paragraph 7-6D, states that in addition to the loans selected for routine quality control reviews, lenders must review all loans going into default within the first six payments. As defined here, early payment defaults are loans that become 60 days past due. All American officials provided an early payment defaulted list of 34 loans; however, quality control reviews were not conducted for 10 of the 34 early payment defaulted loans. In addition, 19 of 34 early payment defaulted loans were not reviewed until 61 to 567 days after the loans defaulted within the first six payments. According to the quality control contractor, the early payment defaulted loans were not reviewed because All American officials did not provide the contractor with the list of all the early payment defaulted loans. Quality control reviews of early payment defaulted loans can provide valuable information about the origin of default that may indicate inadequate underwriting. All American officials acknowledged this weakness and stated that they would provide the contractor all of the early payment defaulted loans.

### **Quality Control Reviews Not in Compliance With HUD Requirements**

All American officials did not conduct quality control reviews in accordance with HUD requirements. Six of the fifty-eight loans were examined to determine whether quality control reviews were conducted in accordance with HUD requirements. The examination revealed that three of the six loan files did not contain evidence that the borrower's sources of funds were reverified as required. HUD Handbook 4060.1, REV-2, paragraph 7-6E(2), states that documents contained in the loan files, such as documents relating to the borrower's income, gifts, or sources of funds, should be checked for sufficiency and subjected to written reverification. All American officials acknowledged the inadequacy of the reviews and planned to take corrective action by engaging another quality control company to conduct their second quarter (April to June 2011) quality control reviews.

## Conclusion

All American 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) management responses and planned corrective actions were inadequately documented, (3) quality control reviews were not conducted in a timely manner, (4) loans defaulting within the first 6 months were not routinely reviewed, and (5) quality control reviews did not comply with HUD-FHA requirements. These deficiencies occurred due to weaknesses in All American officials' implementation of their quality control plan. Consequently, the effectiveness of the quality control plan was impaired; thus, All American officials could not provide assurance that their quality control process was capable of evaluating, monitoring, and improving the quality of loans originated.

## Recommendation

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

- 2A. Update their current quality control plan, dated October 2010, to include all of the requirements. Specifically, the plan should include language detailing that
- Quality control reports identifying deficiencies should include a final report that identifies the corrective actions taken, the timetable for completion of actions, and planned follow-up activities.
  - If more than 15 loans are closed per month, quality control reviews should be conducted at least monthly, addressing 1 month's activities. If 15 or fewer loans are closed per month, quality control reviews should be conducted at least quarterly.
  - If 3,500 or fewer FHA loans are originated - or underwritten per year, 10 percent of the FHA loans must be reviewed. If more than 3,500 FHA loans are originated or underwritten per year, 10 percent of the FHA loans or a statistical random sampling that provides a 95 percent confidence level with 2 percent precision must be reviewed.
- 2B. Implement procedures to ensure that (1) management responses and planned corrective actions are adequately documented, (2) quality control reviews are conducted in a timely manner, (3) all loans defaulting within

the first 6 months are reviewed, and (4) quality control reviews comply with HUD requirements.

We further recommend that the Director of HUD's Homeownership Center's Quality Assurance Division

- 2C. Follow up with All American officials to ensure that the required quality control procedures have been implemented.



## SCOPE AND METHODOLOGY

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To accomplish the audit objectives, we reviewed documentation from HUD's Philadelphia, PA, Homeownership Center's loan endorsement files, as well as case files provided by All American officials. We also reviewed All American's quality control procedures to assess whether they were adequate and properly implemented in accordance with HUD requirements.

We reviewed applicable laws, regulations, HUD handbooks, and mortgagee letters. We interviewed All American's loan originator, loan processor, underwriter, quality control manager, and postclosing coordinator as well as an official of the quality control contractor to obtain an understanding of the policies and procedures related to the lender's management controls. We analyzed HUD's postendorsement technical reviews, Approval Recertification Review Tracking System findings, and independent audit reports.

We reviewed a nonstatistical sample of 20 of the 44 FHA defaulted loans that were originated and underwritten by All American officials during the period September 1, 2008, through August 31, 2010. The population consisted of 44 loans with total mortgage amounts of more than \$18.6 million. A nonstatistical sample of 20 FHA loans with a total mortgage amount of more than \$8.6 million was selected for review as follows: (1) we selected 14 loans for which 6 payments or fewer were made before the first 90-day default was reported, (2) 4 loans were selected for which 7 payments were made before the first 90-day default was reported and that were manually underwritten, and (3) 2 loans were selected for which 8 payments were made before the first 90-day default. The 20 loans included 14 purchased TOTAL Mortgage Scorecard loans, 1 refinanced TOTAL Scorecard loan, and 5 refinanced manual loans.

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 assure the integrity of the computer-processed data relevant to our audit objectives and found the data to be sufficiently reliability. The minimal level of testing consisted of tracing the loan amount, closing date, among other items to the source documentation.

We performed our audit fieldwork from February through June 2011 at All American's main office located at 1001 60<sup>th</sup> Street, Brooklyn, 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

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

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

Internal controls comprise the plans, 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.

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## Relevant Internal Controls

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

- Controls over the loan origination process - Policies and procedures that management has in place to reasonably ensure that the loan origination process complies with HUD program requirements.
- Controls over the quality control plan - Policies and procedures that management has in place to reasonably ensure the implementation of HUD quality control 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:

- All American officials did not ensure that loans were underwritten in accordance with HUD-FHA requirements (see finding 1).
- All American 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		\$1,070,963
1B	\$181,515	
1C	\$680	
Total	\$182,195	\$1,070,963

- 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 recommendation to indemnify the five 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 \$1,815,191, as April 30, 2011 (see appendix D).

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments



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August 1<sup>st</sup>, 2011

#### **VIA FEDERAL EXPRESS**

Edgar Moore – Regional Inspector General; Region 2AGA  
Office of the Inspector General Region of the  
U.S. Department of Housing and Urban Development  
26 Federal Plaza – Room 3430  
New York, NY 10278-0068

RE: Audit Report Number 2011-NY-10XX

Dear Mr. Moore,

All American Home Mortgage Corp. appreciates and values this opportunity to provide a detailed response to the draft audit report from the Office of the Inspector General regarding whether we approved FHA loans in accordance with the written guidelines and requirements established by FHA-HUD and implemented a quality control plan in accordance with FHA-HUD requirements.

Our institution was established in May of 1986 originally and became a mortgage banker in 1989, an FHA DE lender in November of 1993 as well as an approved FannieMae Seller servicer in 1994. During its 25 year history it has served the New York City and Metro areas approving, funding and providing quality performing government and conventional loans; which in includes fair lending to our underserved communities. The majority of these mortgages continue to perform and the borrowers continue to return to us for all of their future family's and friend's housing financing needs.

We have built a strong reputation for helping the growth of our communities relying on our partnerships with the Secondary Market, GSE's and HUD/FHA's commitment to our communities. Our mission mirrors that of the Department of HUD/FHA which in part is *"...to create strong, sustainable, inclusive communities and quality affordable homes for all. HUD is working to strengthen the housing market to bolster the economy and protect consumers; meet the need for quality... utilize housing as a platform for improving quality of life; build inclusive and sustainable communities free from discrimination; and transform the way HUD does business..."* *"...to contribute to the building and preservation of healthy neighborhoods and communities maintain and expand homeownership, ... stabilize credit markets in times of economic disruption operate with a high degree of public and fiscal accountability and recognize and value its customers, staff, constituents and partners..."* We strongly believe we met and continue to meet these goals.

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F.H.A./V.A DIRECT ENDORSED FNMA SELLER/SERVICER  
LICENSED MORTGAGE BANKER, NY, NJ, CT, FL, IL, PA, BANKING DEPTS.

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## AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Comment 1

##### **SNAPSHOT OF THE AUDIT PERIOD**

The OIG audit period is from September 1, 2008 to August 30, 2010. Without considering the FHA-to-FHA None Credit Qualifying Streamline Refinances (6 out of 20) that fall under the audit period; our institution's default rate would have been below HUD's established thresholds. We believe that we were instrumental in applying HUD and FHA's mission statements to our individual market place while protecting our company from the financial crisis that was and continues to be a major handicap to our industry; without compromising HUD-FHA guidelines and eligibility requirements and furthermore ensuring compliance with the credit policy and documentation relief permitted to mortgage risk scored by TOTAL Mortgage Scorecard and its related User Guide. Despite the uncertainty and restrictive lending of our other FHA partners and major banks, we were able to quickly adapt and handle the market conditions without compromising our underwriting integrity or our warehousing facilities; while moving in the right direction strengthening and intensifying the robustness of our underwriting practices.

##### **BASIS FOR REVIEW COMMENTS**

The OIG states that "we selected All American because of its 8.8% default claim while others in New York State averaged 3.57 %."

6 out of 20 Selected Loans were FHA-to-FHA None Credit Qualifying Streamline Refinances.

14 out of 20 Selected Loans were evaluated using FHA's TOTAL Mortgage Scorecard and its related User Guide.

7 out of 20 loans were also evaluated using FHA's TOTAL Mortgage Scorecard and its related User Guide; we did not and do not agree with the auditors evaluation on 6 out of 7 cited loans and do not contest 1 out of 7 cited loans.

##### **WHAT WE FOUND**

##### **FINDING 1**

OIG's noticeable discomfort or preconceived opinions towards the deployment of FHA's Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard; a different interpretation than HUD of the regulatory standards that were in effect for the time period and activities examined.

Uncertainty as to the accuracy of National Default Ratio; that should demand the OIG's attention; e.g. 2/17/2010 Mortgagee Review Board Administrative Action Docket No. 10-1630-MR.

Sufficient supplementary data was provided to prevent findings before they were committed in writing; as such, the related finding should be stricken from the final report.

#### Comment 2

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#### Comment 3

Immediate corrective action initiated and implemented swiftly in the areas needing so.

We felt it was critical and vital in our review of the draft findings and throughout the actual period to determine the ultimate reason for default as to whether it was due to underwriting deficiencies, economic conditions, misrepresentation or the modification boom during the audit period which encouraged borrowers to become delinquent so they could get lower interest rates.

Our conclusion is that many of the borrowers that were reviewed continue to be employed by the same employer, at the same or increased level of income as when the loan was approved. Some subsequent to closing had lost their jobs, had problems with tenants and others went down the path of thinking they could receive a lower rate via modification as played up by the media and unscrupulous players. In almost all the cases cited, All American's underwriting had absolutely nothing to do with the borrowers defaulting on the mortgage loan; mortgages were in fact underwritten according to the program directives in effect for the time period examined.

We fully support ECOA and Fair Housing statutes. We have made credit available to any and all qualified applicants. We are proud to serve all of our communities including the communities of the cited loans; in these cases underserved. Denying credit of the cited cases based on opinion or different interpretation of the regulation would have most certainly been a violation of ECOA and Fair Housing Act.

**Case Number: 374-5019085**

Loan Type: Purchase

Closing Date: 01-14-2009

Occupancy: Owner Occupied

Underserved Census: Yes

Minority: Yes

Protected Class: Yes

Fair Housing Act/ECOA Met: Yes

Modification Reported: Yes

TOTAL/AUS DU Requirement Met: Yes

Minimum Statutory Investment Requirement Met: Yes

#### Comment 4

The audit fails to acknowledge the Department of HUD regards towards TOTAL Mortgage Scorecard deployed in May 2004 as a proven successful tool for lenders; and appears to discard post 1992 notices provided by HUD that were somewhat impacted by the deployment of TOTAL.

For instance, Mortgagee Letter 2005-15 indicates in part: "...Based on FHA's positive experience with TOTAL, it has become clear that minor changes to certain application variables, e.g., **cash reserves** after closing, income, and the total mortgage payment used to render the risk classification from TOTAL do not warrant the need for rescoring the mortgage. Furthermore, **several documents currently required do not add value in determining creditworthiness and will no longer be required under certain conditions.** Therefore, this Mortgagee Letter announces tolerance levels before rescoring is required and additional documentation relief for lenders using TOTAL. These changes are effective immediately..."

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**Comment 4**

Tolerance Levels: FHA is now providing a degree of tolerance before triggering the requirement that a mortgage be rescored. Often, there are minor differences between what the borrower reports for income or assets on the loan application and what the documentation verifies. In these cases, rarely would the difference between data entered into TOTAL and verified by the lender result in a change in risk classification. Therefore, the following tolerances are now available to FHA-approved mortgage lenders scoring loans through TOTAL.

- **Cash Reserves:** There is no need to resubmit the mortgage to TOTAL for rescoring provided the cash reserves verified are not more than 10 percent less than that reported by the borrowers on the loan application.
- **Income:** There is no need to resubmit to TOTAL provided the verified income is not more than five percent less than that reported by the borrowers on the loan application.
- **Tax and Insurance Escrows:** There is no need to resubmit to TOTAL when tax and insurance escrow estimates used at scoring and later verified at or near loan settlement do not result in more than a two-percentage point increase in the payment-to-income and debt-to-income ratios..."

The asset in question represents an unintended asset variable of approx. 5% (less than 10% recognized). The borrowers did in fact have sufficient assets to complete the transaction without the retirement account; cash reserves are not required by the department of HUD on 1-2 Fam. Dwellings. The variable would have not trigger a change in risk classification. Total assets needed to close were \$26,000 and the total assets verified were \$28,929.94.

TOTAL Scorecard/AUS data contains the most accurate information as of the approval and as a result the electronic data submitted to CHUMS prior to endorsement was consistent with TOTAL/AUS. The audit did not review the final submission to TOTAL/AUS CHUMS at the HOC; instead, the audit appears to have reviewed a preliminary recommendation finding that was not the final. We are in the process of recovering the final transmission from the investor which will be provided to the audit team as soon as received. The noted inadvertent discrepancy on the paper form does not increase the risk nor was it the cause for the mortgagor's default; moreover, as confirmed by the audit, the DTI's were more favorable to these mortgagors, as the interest rate was 1.50% less than preliminary qualified at.

The mortgagor indicated in writing that the reason for default was related to her "...mother being diagnosed with bone cancer and was hospitalized for sixteen weeks before she was assigned to a rehabilitation center for continued treatment. After she lost her coverage and the aide I had to take care of her and help her get treatment she needed. This put a financial burden on my household income..."

**Comment 5**

**Case Number: 374-5179044**

Closing Date: 5/21/2009

Purchase

Underserved Census: Yes

Minority: Yes

Protected Class: Yes



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#### Comment 5

Fair Housing Act/ECOA Met: Yes

#### **ASSETS:**

Pertaining to the gift and 2000-28 which in part:

If the gift funds are in the homebuyer's account (WHICH IT WAS):

**"If the loan application was underwritten by a FHA-approved automated underwriting system and the gifts funds are already in the homebuyer's account, then the documentation requirements stated in the appropriate user guide are to be met..."**

The gift was documented according to the documentation relief provided by TOTAL Scorecard; which only required to "...List the name, address, telephone number, relationship to the homebuyer, and the dollar amount of the gift on the loan application or in a gift letter for each cash gift received. You must document and retain a copy of the transfer of gift funds and confirm that those funds came from an acceptable source." This requirement was met. This gift **was** documented with fully executed **GIFT LETTER** that includes the donor attestation that the gift funds were not made available from any person or entity with an interest in the sale of the property including seller, real estate agent or broker, builder, loan officer, or any entity associated with them; the donor also attested that no repayment of the gift is expected or implied, and the gift source indicated with name, address and account number of the depository institution from which the gift was withdrawn. We also obtained the copy of the **CANCELLED GIFT CHECK** and **DONOR'S ACCOUNT STATEMENT** that confirms sufficient funds, all consistent with the gift letter and proof of **TRANSFER** into Borrower's account.

As a 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. The lenders are not required to investigate the donor's personal habits. The underwriter complied with the Verification Messages/Approval Conditions by TOTAL Scorecard User Guide documentation relief requirement listed in the DU Underwriting Findings report and User Guide. The borrower made required minimum cash investment. The requirements were met.

#### **User Guide requirement (in part):**

**"Gift Funds---**The borrower must list the name, address, telephone number, relationship to the homebuyer, and the dollar amount of the gift on the loan application or in a gift letter for each cash gift received. **If sufficient funds required for closing are not already verified (sufficient funds were already verified)** in the borrower's accounts, you must document the transfer of the gift funds to the homebuyer in accordance with instructions described in Mortgagee Letter 00-28...."

#### **INCOME:**

The current verified **ANNUAL SALARY** was **\$67,763.00** as of May 1<sup>st</sup>, 2009; which when divided by 12 = **\$5,646.92**; the most recent paystub reflects regular salary

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### Comment 6

earned as of March 15, 2009 of \$15,300.00 which when divided by 2.48 Mos. = **\$6,169.72** which more than supports the annual salary.

This demonstrates, among other things, such as validating the underwriter's decision to allow bonus 'less than' two years (the Electronic Verification did not provide the breakdown for the year 2007) that the income trend was clearly increasing and stable.

2010	2009	2008	2007
\$85,410.01*	\$80,758.00*	\$78,767.02	\$28,307.60

\*May not include non taxable income earned.

As of 2011 this mortgagor continued to be employed by same employer. 2008, 2009, & 2010 documentation once again supports the underwriting decision.

The employer reported data concerning the bonuses earned by the applicant as of 2008 in the amount of \$13,260.69 and 2009 \$9,231.71 were the most reliable indicators to perform the average qualifying bonus income; together with the employer reported Annual Rate of Pay of \$67,763.00 which was more than supported by pay stubs. The income calculation was in fact appropriate.

#### **ADDITIONAL NOTES:**

While there is minor unintentional discrepancy on the estimate amount of hazard on the conditional commitment, TOTAL Scorecard/AUS data contains the most accurate information as of the approval date and as a result the electronic data submitted to CHUMS was consistent with TOTAL/AUS; the noted discrepancy on the paper form does not increase the risk nor was it the cause for the mortgagor's default.

#### **Case Number: 374-4974705**

Closing Date: 1/29/2009

Purchase

Owner Occupied: Yes

Underserved Census: Yes

Minority: Yes

Protected Class: Yes

Fair Housing Act/ECOA Met: Yes

Modification: Pending

The borrower Social Security Disability Award Letter that was issued by the Social Security Administration confirms eligibility to receive Disability SS Income Post Lottery Winnings and indicates that she may use it for Bank Loans. The SSA Disability Income was being received for over eight months post winnings; we had to conclude the income was effective; furthermore a conversation with this mortgagor as of July 2011 indicates that she continues to receive SSD income; so the audit conclusion to omit the income and request re-calculation to a 5.02% variance is not supported, nor significant.

While there is minor unintentional discrepancy on the estimate amount of taxes on the transmittal summary dated November 2008, TOTAL Scorecard/AUS data contains the most accurate information as of the final approval date of January 2009; and as

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#### Comment 7

a result the electronic data submitted to CHUMS was consistent with TOTAL/AUS; the noted discrepancy on the paper form does not increase the risk nor was it the cause for the mortgagor's default.

The audit does not seem to recognize the Department of HUD regards TOTAL Mortgage Scorecard deployed in May 2004 as a proven successful tool for lenders; and appears to discard post 1992 notices provided by HUD that were somewhat impacted by the deployment of TOTAL

**Case Number: 374-4840303**  
Closing Date: 8/26/2008  
No Cash Out Refinance  
Underserved Census: Yes  
Minority: Yes  
Protected Class: Yes  
Fair Housing Act/ECOA Met: Yes

The terms & conditions for the retirement accounts were recovered and provided to the OIG and applicants were eligible for withdrawals for conditions other than that related to the borrower's employment or death; assets were sufficient to complete the transaction. FHA does not require reserves on SFD's.

According to the applicants; the reason for the default was curtailment of income due to their loss of employment; as of the time of the default they were not allowed sufficient time to secure employment and resume their mortgage payments.

Even the department of HUD has finally recognized this as a real economic problem thereby amending the Type I Special Forbearance Program for up to 12 months (2011-23) as it relates to unemployed borrowers; which these borrowers did not have the benefit of.

Income & DTI recalculation as requested by the auditor, although there is no hard rule as to how to calculate this type of income; historical TOTAL/AUS-DU data shows the loan would have still received an Approve/Eligible recommendation; with your recalculated **27.89/46.72** DTI and zero reserves; furthermore, considering the other factors on this loan the same would have also qualify for manual underwriting approval.

Sample of historical TOTAL Scorecard Approve/Eligible recommendation includes:

**43.56/48.75%**  
2FAM. DWELLING  
NO PRIOR HOUSING VERIFICATION  
PURCHASE  
96.50% LTV  
CASE ID# 1036040490

**42.08/53.73%**  
1FAM. DWELLING  
REFINANCE NO CASH OUT  
97.00% LTV  
CASE ID #946194882

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### Comment 8

**43.28/49.83%**  
1FAM DWELLING  
REFINANCE NO CASH OUT  
96.67% LTV  
CASE ID #942854856

The applicants monthly payment changed was minimal including all monthly PITI and P&I itself was decreasing as well.

These applicants had a verified excellent mortgage payment record, as reported by the servicer.

All applicants had noted scheduled salary increases on VOE's.

Applicants made significant cash investment into the transaction.

Applicants were Converting from a current ARM to a Fixed Rate Mortgage thereby providing some protection from large interest rate swings as encouraged by the GSE's

**Case Number: 374-5045917**  
Loan Type: Purchase  
Closing Date: 2/10/2009  
Occupancy: Owner Occupied 2011  
Underserved Census: Yes  
Minority: Yes  
Protected Class: Yes  
Fair Housing Act/ECOA Met: Yes  
TOTAL/AUS DU Requirement Met: Yes

#### **GIFT FUNDS:**

The gift was documented further than that of the documentation relief provided by TOTAL Scorecard; which only required to "...List the name, address, telephone number, relationship to the homebuyer, and the dollar amount of the gift on the loan application **or** in a gift letter for each cash gift received. You must document and retain a copy of the transfer of gift funds and confirm that those funds came from an acceptable source." We went beyond this requirement; this gift **was LISTED ON THE APPLICATION**, was additionally documented with **GIFT LETTER** that includes a warning; the donor clearly attested that the gift funds were not made available from any person or entity with an interest in the sale of the property including seller, real estate agent or broker, builder, loan officer, or any entity associated with them; furthermore the donor also indicates that no repayment of the gift is expected or implied. We also obtained the copy of the **GIFT CHECK** and **TRANSFER** into Seller's Attorney Escrow; and **ESCROW LETTER** from Seller's Attorney. While the date was not handwritten on the gift letter; the supporting documentation clearly indicates the date the gift was given, furthermore notice that AUS/DU does not require to list the date on the application or in a gift letter.

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#### Comment 8

As a 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 (HUD Handbook 4155.1, REV-5 October 2003). The lenders are not required to investigate the donor's personal habits. The underwriter complied with the Verification Messages/Approval Conditions by TOTAL Scorecard User Guide documentation relief requirement listed in the AUS/DU Underwriting Findings report. The borrower made required minimum cash investment. The requirements were met.

Mortgagee Letter 2000-28 contains provisions missed by the auditor, in part:

If the gift funds are in the homebuyer's account (WHICH IT WAS):

**"If the loan application was underwritten by a FHA-approved automated underwriting system *and* the gifts funds are already in the homebuyer's account, then the documentation requirements stated in the appropriate user guide are to be met..."**

User Guide requirement (in part):

**"Gift Funds---**The borrower must list the name, address, telephone number, relationship to the homebuyer, and the dollar amount of the gift on the loan application or in a gift letter for each cash gift received. **If sufficient funds required for closing are not already verified (sufficient funds were verified)** in the borrower's accounts, you must document the transfer of the gift funds to the homebuyer in accordance with instructions described in Mortgagee Letter 00-28...."

We provided an adequate explanation, furthermore the audit failed to consider the borrowers overall pattern of banking and focuses only on a minor deposit that not in excess of 2% of the sales price and does not appear excessive considering that the client habit's or the history of accumulating savings and, also considering that there's no indication of any recent debt incurred for any part of the cash investment on the subject property.

From November 2008 to January 2009 this borrower made combined withdrawals from her accounts totaling about \$9,295.00; and combined deposits of about \$16,548.00. The \$1,499.00 deposit is not to be considered a large deposit based on the borrower's banking profile.

The statutory minimum investment requirement was in fact met.

Based on TOTAL Scorecard/AUS DU feedback and based on the above; this minor transaction is not excessive.

#### **ADDITIONAL NOTES:**

As of 10-2009 the client told us that she would not be paying the mortgage because someone told her if she modified she could get a 3.50% rate, so she stopped paying the mortgage for no other reason but that.

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#### Comment 9

As of 4-1-2011 the clients remained employed with the City of New York were she has been for the last 8 years.

As of 7-11-2011 Public Data shows owner occupied (reverse directory/mls)

As of 7-12-2011 it appears she listed the property for sale shortly after closing (10-2009) and outrageously was able to negotiate a Short Sale (MLS #2234314).

**Case Number: 374-5043583**

Loan Type: Purchase  
Closing Date: 03-27-2009  
Occupancy: Owner Occupied  
Underserved Census: Yes  
Minority: Yes  
Protected Class: Yes  
Fair Housing Act/ECOA Met: Yes

A review of the file with the loan originator revealed that this co-borrower had prior employment and income for the year of 2007 which we are trying to recover the documentation, furthermore since both borrowers continued to be employed with the same employer and level of income as approved; we believe that the co-borrower's length of employment indicated for the current employment was not the reason for default. This co-borrower was averaging consistent income of approx. \$2,736 P/M between 3/3/2008 and 5/8/2010 (26.19 Mos. Avg.); which further confirms the accuracy of the TOTAL/AUS Data submitted.

#### Comment 10

**Case Number: 374-4874336**

Loan Type: Purchase  
Closing Date: 08-21-2008  
Occupancy: Owner Occupied  
Underserved Census: Yes  
Minority: Yes  
Protected Class: Yes  
Fair Housing Act/ECOA Met: Yes  
Bankruptcy: Yes

We do not contest and agree to indemnify.

#### Comment 11

**FINDING 2**

The OIG audit of our Quality Control Plans was determined to be sound and effective as of the latest revision with the exception of three missing issues identified in the OIG Report referred to not in accordance with HUD-FHA Requirements; which we immediately effectuate corrective action as follows:

"Quality control reports that identified deficiencies were to include a final report that identified the corrective actions taken, the timetable for completion of actions, and any planned follow-up activities"

- Final reports are delivered to management on a monthly basis,
- Final reports are provided to each decisioner with a summary of any deficiencies noted,
- Material findings are included in the individual performance report,

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### Comment 12

- Corrective action must be taken within 7 business days in regards to any and all material findings.
- Description of the actions, implementation and expected improvement dates is reflected in the Plan.
- Results are tracked, maintained, and utilized in the underwriting authority levels, and year end performance evaluation.

"If more than 15 loans were closed per month, the quality control reviews were to be conducted at least monthly, addressing one month's activities. If 15 or fewer loans were closed per month, the quality control reviews were to be conducted at least quarterly"

- Quality Control reviews are now performed monthly, regardless of the number of loans closed; 10% of the loans are to be reviewed and 100% of any defaulted loan.

"Loans Defaulting Within the First 6 Months Not Routinely Reviewed"

- 100% Quality Control of any and all 60 and 90 day delinquency is performed as well as 100% Quality Control of any and all loan defaulting within the first year.

Our Quality Control Subcontractor has agreed to maintain supporting verification and re-verification documents for a period of not less than two years.

#### **Unallowable Fees**

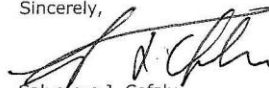
As acknowledged by the OIG the unallowable fees were not only refunded to the clients but also immediate corrective action was taken; our closing department and settlement agents were promptly notified and this issue was immediately resolved.

#### **Conclusion**

Once again we appreciate the opportunity to comment and respond to the OIG's concerns; we are confident that we have provided sufficient documentation to reiterate our policies that we do approve FHA loans in accordance within the written guidelines and requirements established by FHA-HUD and we have implemented a quality control plan in accordance with full FHA-HUD requirements.

We are proud of our role as an FHA lender; we are committed to a strong, long-term partnership with the Department of Housing and Urban Development. Please contact me if you have any additional questions or need clarification on anything that is included in this report.

Sincerely,



Salvatore J. Cefalu  
President

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### OIG Evaluation of Auditee Comments

- Comment 1** All American officials assert that their default rate of 8.8 percent would have been below HUD's established threshold if FHA-to-FHA Non Credit Qualifying Streamline Refinances were not taken into consideration. Further, officials disagree with the review results pertaining to 6 of the 7 loans found to contain material underwriting deficiencies and do not contest 1 out of 7 cited loans. Nevertheless, although we recognize the officials' opinion, the fact remains that their 8.8 percent default rate was nearly triple the New York State average of 3.57 percent during the same period, and the results of our review are supported by documentation provided during and subsequent to the audit.
- Comment 2** All American officials allude to discomfort and preconceived opinions on OIG's part towards the use of FHA's TOTAL Mortgage Scorecard. Officials contend that the regulatory standards that were in effect during the period for the activities examined were misinterpreted, and that sufficient supplementary documentation was provided to prevent the findings. Further, officials express that the uncertainty as to the accuracy of the national default rate demands OIG's attention, citing for example, the February 17, 2010 Mortgage Review Board Administrative Action Docket No. 10-1630-MR. Contrary to the officials' perception; OIG does not have a preconceived opinion towards the use of FHA's TOTAL Mortgage Scorecard. We commend the use of the TOTAL Scorecard technology, which enhances FHA's ability and capacity to oversee its expanded market share in order to achieve HUD's strategic goal of strengthening the nation's housing market to bolster the economy and protect consumers. In contrast with the officials' beliefs, the regulatory standards that were in effect at the time of the activities, along with documentation provided during and subsequent to the audit field work were taken into consideration. The officials' citing of the Mortgage Review Board Docket that pertains to the administrative action taken by HUD against another lender does not in any way support the contention that the national default rate is inaccurate. Nevertheless, in this case the audit results concluded that All American officials did not always comply with HUD-FHA requirements in the approval of FHA-insured loans. Accordingly, we have not removed the finding from the final report.
- Comment 3** All American officials state that immediate corrective action was initiated and implemented swiftly in the areas needing so, and that their underwriting had absolutely nothing to do with borrowers defaulting on their mortgages. The actions taken by the officials are responsive to the audit; however, since the audit disclosed material underwriting deficiencies that could have lead to some borrowers going into default, this fact further supports our stance on not removing finding 1 from the final report.



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### OIG Evaluation of Auditee Comments

**Comment 4** For case number 374-5019085, OIG agrees that the asset in question of \$1,508 (unverified retirement savings withdrawal) was approximately five percent of the total asset (\$1,508/\$29,468). However, the verified assets of \$27,960 (\$29,468 - \$1,508) [not the \$28,930 in the lenders comments] were not sufficient and did not equal the 2 months of cash reserves after the closing (\$12,368), as reported on the underwriting findings. The total depository assets of \$29,468 included the unverified retirement savings plus a gift of \$25,000 that the HUD-1 settlement statement showed was required at closing. Thus the borrower had cash reserves of only \$2,960 (\$29,468-\$1,508-\$25,000) after closing. Therefore, since the cash reserve verified amount was \$2,960, which was 76 percent less [ $(\$12,368 - \$2,960) / \$12,368$ ], or more than 10 percent less than that reported by the borrowers on the loan application; All American officials should have rescored the mortgage loan as required. Further, All American officials contend that the final submission to TOTAL/AUS was not reviewed during the audit, and promised to provide the final transmission for review soon. Unfortunately, officials never provided the final TOTAL/AUS submission subsequent to the audit and the concluding exit conference. Thus, the issue of source of funds is unchanged.

**Comment 5** For case number 374-5179044, OIG removed the issue of inadequate verification of the source of gift funds and the statutory minimum investment from the final report based on the review of supporting documentation provided during the exit conference. Specifically, All American officials provided a transaction summary from the donor's checking account that shows that the donor had funds of \$13,406 on March 20, 2009, which were enough to cover the gift of \$9,000 as noted on the gift letter dated April 3, 2009. OIG also removed the issue of inconsistent information not reconciled by the lender from the final report due to documentation supporting the immateriality of the \$12 fire insurance discrepancy (\$100 less \$88). However, the issue of improper verification and calculation of income that resulted in incorrect calculated ratios is unchanged because according to the borrower's pay stubs for pay period ending February 1, February 15, and March 15, 2009, the base biweekly pay was \$2,550; therefore, the monthly pay should have been \$5,525 ( $\$2,550 \times 26 / 12$ ) instead of \$5,647. In addition, the borrower's increasing income trend and stability does not support that the lender appropriately verified the borrowers' bonus income for two years, as required by HUD. Therefore, the issue of improper verification and calculation of income that resulted in incorrect calculated ratios is unchanged because the lender lacked evidence of two years of bonus income.

**Comment 6** For case number 374-4974705, OIG removed the issue of inconsistent information not reconciled by the lender from the final report since the underwriter resubmitted the loan using TOTAL Mortgage Scorecard with the

## Appendix B

### OIG Evaluation of Auditee Comments

correct tax and special assessment. In addition, we removed the issue of inadequate verification of income resulting in incorrectly calculated ratios. Although the borrower's April 2008 lottery winnings of \$1 million will probably make her ineligible to receive SSI; the lender did obtain a letter from the Social Security Administration, dated almost seven months after the lottery winnings, stating that the borrower was receiving SSI payments. As such, it is not the lenders responsibility to notify the Social Security Administration that a borrower receiving SSI has won the lottery. Accordingly, the only issue that remains is the unallowable fee charges that may have been repaid.

**Comment 7** For case number 374-4840303, the terms and conditions for the retirement accounts provided during the exit conference were reviewed and found to only support the withdrawals for one of the borrower's retirement accounts. The other retirement account of \$9,779 remains unsupported. However, during the exit conference, All American officials also provided a copy of a cancelled check of \$9,807 from the borrower to the closing agent, therefore, the issue of inadequate verification of the source of funds was removed from the final report. However, All American officials did not support the income calculation that was used to approve the loan. Therefore, the issue of inadequate verification of the borrowers' income resulting in incorrectly calculated ratios and inadequate verification of cash reserves on the Desktop Underwriter Underwriting Findings are unchanged.

**Comment 8** For case number 374-5045917, All American officials stated that the gift was documented further than required by Total Scorecard. They stated that the gift was listed on the application and there is a gift letter for which the donor attested that the gift was not made available from any person with an interest in the sale and that no repayment is expected. They provided copies of the gift check and the transfer of funds into the seller's attorney escrow account, etc., however, officials could not provide documentation to support that the gift funds came from an acceptable source and were indeed the donor's own funds. Mortgagee Letter 00-28 provides that the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds. However, among other things, on January 16, 2009 there were two unexplained deposits totaling \$9,300 into the donors account followed by the check to the escrow attorney for the \$9,160 gift. Further, contrary to All American officials comment that the gift funds were already in the homebuyer's account prior to the application, the gift funds were not in the homebuyers account as evident by the transfer of funds between the donor and the escrow attorney, and the borrowers banking transactions. Lastly, based on further review we agree that the borrower had sufficient funds available to close so we have removed the issue of inadequate verification of the source of funds from the case

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narrative; but we will not remove the issue of inadequate verification of the source of gift funds and statutory minimum investment.

- Comment 9** For case number 374-5043583, All American officials did not verify two years of employment, as required by the Desktop Underwriter Underwriting Findings, or the source of income for 2007. Therefore, All American officials should not have used the coborrower's income for determining the mortgage loan eligibility. In addition, since officials only confirmed during the audit that the coborrower had 11.6 months of employment history from March 3, 2008, to February 14, 2009, and not the required two years or 24 months; the issue of inadequate verification of employment or income resulting in incorrectly calculated ratios is unchanged.
- Comment 10** For case number: 374-4874336, All American officials do not contest the audit results and agree to indemnify.
- Comment 11** All American officials are in agreement with finding 2. Their implemented corrective actions are responsive to the recommendations.
- Comment 12** All American officials agree with the issue of unallowable fees and have implemented corrective action to reimburse the borrowers for the unallowable fees charged.

## Appendix C

### SUMMARY OF LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

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Case number	Inadequate verification of gift funds and statutory minimum investment	Inadequate verification of the source of funds	Improper calculation of income or verification of employment resulted in the incorrect calculation of ratios	Inadequate verification of cash reserves	Inconsistent information not reconciled
374-4840303			X	X	
374-5019085		X		X	X
374-5043583			X		
374-4874336		X		X	
374-5045917	X				
374-5179044			X		
<b>Total</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>3</b>	<b>1</b>

## Appendix D

### SCHEDULE OF ACTUAL AND POTENTIAL LOSSES TO THE FHA INSURANCE FUND

Case number	Closing date	Number of payments before first default	Original loan amount	Unpaid principal balance As of April 30, 2011	Actual loss to HUD	Potential loss to HUD (59 percent of unpaid principal balance)	Total of actual and potential loss to HUD
374-4840303	08/26/2008	2	\$414,779	-	\$181,515	-	\$181,515
374-5019085	01/14/2009	2	\$559,675	\$539,747	-	\$318,451	\$318,451
374-5043583	03/27/2009	2	\$333,841	\$323,776	-	\$191,028	\$191,028
374-4874336	08/21/2008	2	\$323,916	\$314,929	-	\$185,808	\$185,808
374-5045917	02/10/2009	3	\$381,954	\$369,427	-	\$217,962	\$217,962
374-5179044	05/21/2009	7	\$274,928	\$267,312	-	\$157,714	\$157,714
		<b>Total</b>	<b>\$2,289,093</b>	<b>\$1,815,191</b>	<b>\$181,515</b>	<b>\$1,070,963</b>	<b>\$1,252,478</b>

## Appendix E

### CASE SUMMARY NARRATIVES

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Case number:	374-4840303
Loan type:	No cash-out refinance
Mortgage amount:	\$414,779
Closing date:	8/26/2008
Payments before first 90-day default reported	Two
Default status as of April 30, 2011	Preforeclosure Sale Completed

#### Summary:

We found material underwriting deficiencies relating to inadequate verification of the income resulting in improper calculation of ratios and unsupported cash reserves.

#### **Inadequate Verification of the Borrowers' Income Resulting in Incorrectly Calculated Ratios**

The Desktop Underwriter underwriting findings showed that total income of \$15,568 was listed as available on the loan application to underwrite this case. However, \$2,157 (\$15,568 - \$13,411) of the \$15,568 was overstated because All American officials did not average the base pay for the two borrowers for 30.33 months (January 1, 2006, to July 10, 2008, the dates on verification of employment). All American officials concurred that the borrowers' income was overstated. Therefore, the mortgage payment-to-income ratio (front) was increased from 24.05 to 27.91 percent (\$3,744/\$13,411), and the total fixed payment-to-income ratio (back) was increased from 40.29 to 46.76 percent (\$6,272/\$13,411). Thus, the verified income was 13.85 percent  $[(15,568 \text{ reported income} - 13,411 \text{ verified income})/15,568]$  less than that reported by the borrowers. Since the difference in verified income was 13.85 percent, or more than the 5 percent difference allowed by HUD, there was a need to rescore the mortgage loan.

#### **HUD-FHA Requirements:**

Mortgage Letter 2005-15 states that there is no need to resubmit loans to TOTAL for rescoring provided the verified income is not more than 5 percent less than that reported by the borrowers on the loan application.

HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance", prescribes that lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans to be insured by FHA.

#### **Inadequate Verification of Cash Reserves on the Desktop Underwriter Underwriting Findings**

The Desktop Underwriter underwriting findings showed that the borrower had 3 months of cash reserves; however, this amount was not supported by the borrower's assets. The underwriting findings noted deposited assets totaling \$11,639, and the HUD-1 settlement statement showed that the borrower needed \$10,207 in funds to close. The underwriting findings showed that the borrower had cash reserves of \$11,597; however, this amount was incorrect because the

borrower had cash reserves of only \$1,432 (\$11,639 - \$10,207) after closing. Therefore, after the closing, the borrower had cash reserves of less than a month, or 38 percent of the total mortgage payment (\$1,432 cash after closing /\$3,744 total mortgage payment). The cash reserve verified amount was \$1,432, which was 87 percent less [ $(\$11,597 - \$1,432)/\$11,597$ ], or more than 10 percent less, than that reported by the borrowers on the loan application; therefore, the lender should have rescored the mortgage loan as required.

**HUD-FHA Requirement:**

Mortgagee Letter 2005-15 states that there is no need to resubmit loans to TOTAL for rescoring provided the cash reserves verified are not more than 10 percent less than those reported by the borrowers on the loan application.

Case number:	374-5019085
Loan type:	Purchase
Mortgage amount:	\$559,675
Closing date:	1/14/2009
Payments before first 90-day default reported	Two
Default status as of April 30, 2011	Delinquent

Summary:

We found material underwriting deficiencies relating to inadequate verification of the source of funds and cash reserves, and inconsistent information not reconciled by the lender.

**Inadequate Verification of the Source of Funds and Cash Reserves on Desktop Underwriter Underwriting Findings**

The Desktop Underwriter underwriting findings showed that assets of \$29,468 were available to underwrite this case. However, \$1,508 of the \$29,468 was not supported because there was no evidence in the lender file to show that the borrower was qualified to withdraw and/or borrow from the retirement funds. As a result, the verified assets of \$27,960 (\$29,468 - \$1,508) were not sufficient and did not equal the 2 months of cash reserves after the closing as noted on the underwriting findings. The total assets of \$29,468 included a gift of \$25,000 that the HUD-1 settlement statement showed was required at closing. The underwriting findings showed that the borrower had cash reserves of \$12,368. However, this amount was incorrect because the borrower had cash reserves of only \$2,960 (\$27,960 - \$25,000) after closing. Therefore, after closing, the borrower had cash reserves of less than a month, or 70 percent of the total mortgage payment (\$2,960/\$4,240). The cash reserve verified amount was \$2,960, which was 76 percent less  $[(\$12,368 - \$2,960)/\$12,368]$ , or more than 10 percent less, than that reported by the borrowers on the loan application; therefore, the lender should have rescored the mortgage loan as required.

**HUD-FHA Requirements:**

HUD Handbook 4155.1, REV-5, dated October 2003, section 2-10, states that all funds for the borrower's investment in the property must be verified and documented.

Approval condition number 43 in the Desktop Underwriter underwriting findings stated that documentation must be provided to show that the borrower was eligible to withdraw funds from the retirement accounts, along with evidence that the account allowed for withdrawal for conditions other than those related to the borrower's employment or death and that the borrower qualified for withdrawal and/or borrowing.

Mortgagee Letter 2005-15 states that there is no need to resubmit loans to TOTAL for rescoring provided the cash reserves verified are not more than 10 percent less than those reported by the borrowers on the loan application.



### **Inconsistent Information Not Reconciled by Lender**

The direct endorsement approval for a HUD-FHA-insured mortgage showed an interest rate of 5 percent; the uniform residential loan application and mortgage note showed an interest rate of 5 percent and principal and interest of \$3,004. However, the FHA loan underwriting and transmittal summary showed an interest rate of 6.5 percent and principal and interest of \$3,538, and the Desktop Underwriter underwriting findings showed an interest rate of 6.5 percent and principal and interest of \$3,556. As a result, the lender incorrectly calculated the borrowers' back and front ratios because All American officials overstated the mortgage payment and interest by \$552 (\$3,556 - \$3,004) and the front and back ratios were decreased from 40.85 to 35.53 percent  $[(\$4,240 - \$552)/\$10,379]$  and 45.15 to 39.83 percent  $[(\$4,686 - \$552)/\$10,379]$ , respectively. All American officials stated that the file was qualified initially at a 6.5 percent interest rate and closed at a decreased interest rate of 5 percent. All American officials further stated that resubmission used to be required only for an increase in the interest rate and the mortgage note rate of 5 percent and principal and interest of \$3,004 was the correct one. We agreed that the loan was not required to be rescored because of the decrease in the interest rate; however, Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

### **HUD-FHA Requirement:**

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

Case number:	374-5043583
Loan type:	Purchase
Mortgage amount:	\$333,841
Closing date:	3/27/2009
Payments before first 90-day default reported	Two
Default status as of April 30, 2011	First Legal Action to Commence Foreclosure

**Summary:**

We found material underwriting deficiencies relating to inadequate verification of employment or income resulting in improper calculation of ratios, and unallowable fees charged to the borrower.

**Inadequate Verification of Employment or Income Resulting in Incorrectly Calculated Ratios**

All American officials did not verify 2 years (24 months) of employment history for the coborrower as required. The lender file contained a 2008 Internal Revenue Service Form W-2 (Wage and Tax Statement) and three pay stubs for periods ending January 3, 2009, January 17, 2009, and February 14, 2009, from the coborrower's employer. During the audit, the lender confirmed that the coborrower had 11.6 months of employment history from March 3, 2008, to February 14, 2009. Therefore, the coborrower's income should not have been used because the coborrower did not have 2 full years of employment history as required. Without the coborrower's income, the front and back ratios would increase from 39.97 to 62.03 percent (\$3,111/\$5,015) and 46.85 to 72.70 percent (\$3,646/\$5,015). Also, the verified income was \$5,015, and the reported income was \$7,782, which was 35.56 percent  $[(\$7,782 - \$5,015)/\$7,782]$  less than that reported by the borrower. Since the difference in verified income was 35.56 percent, or more than the 5 percent difference allowed by HUD, there was a need to rescure the mortgage loan.

**HUD-FHA Requirements:**

HUD Handbook 4155.1, REV-5, section 2-6, states that we do not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years.

Mortgage Letter 2005-15 states that there is no need to resubmit loans to TOTAL for rescoring provided the verified income is not more than 5 percent less than that reported by the borrowers on the loan application.

**Unallowable Fees Charged to Borrower**

All American officials charged the borrowers \$45 in unallowable wire fees. However, as a result of our audit work, the lender issued a refund check to the borrowers for the unallowable closing fees charged.

**HUD-FHA Requirement:**

HUD Handbook 4000.2, REV-3, chapter 5, paragraph 5-20, states that courier fees and wire fees may be charged only on refinances and only for delivery of the mortgage payoff statement to the

lien holder and for closing documents to the settlement agent. It further provides that the borrower must agree in writing to pay for courier and wire fees before loan closing.

Case number:	374-4874336
Loan type:	Purchase
Mortgage amount:	\$323,916
Closing date:	8/21/2008
Payments before first 90-day default reported	Two
Default status as of April 30, 2011	First Legal Action to Commence Foreclosure

**Summary:**

We found material underwriting deficiencies relating to inadequate verification of the source of funds and cash reserves, and unallowable fees charged to the borrower.

**Inadequate Verification of the Source of Funds**

All American officials did not provide adequate support to show that the borrower had sufficient funds to complete the transaction. The Desktop Underwriter underwriting findings showed the depository assets totaling \$15,258 that were available to underwrite this case. However, \$11,492 of the \$15,258 was not supported because the bank statements exceeded the 120-day documentation requirement. In addition, the earnest money of \$10,000 was not properly documented because there was no source of funds. Further, the verified assets of \$3,766 (\$15,258 - \$11,492) were not sufficient funds to close the loan because the HUD-1 settlement statement showed that the borrower needed \$11,735 (\$10,000 earnest money + \$1,735 required cash from borrower) in funds to close. Therefore, the lender did not verify that the borrower had sufficient funds to complete the transaction.

**HUD-FHA Requirements:**

HUD Handbook 4155.1, REV-5, section 3-1, states that all documents may be up to 120 days old at the time the loan closes (180 days for new construction) unless this or other applicable HUD instructions specify a different timeframe.

HUD Handbook 4155.1, REV-5, paragraphs 2-10A and B, provide: “A. Earnest Money Deposit. If the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower’s history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower’s cancelled check. A certification from the deposit-holder acknowledging receipt of funds and separate evidence of the source of funds is also acceptable. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made the average balance was sufficient to cover the amount of the earnest money deposit. B. Savings and Checking Accounts. A verification of deposit (VOD), along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.”

**Inadequate Verification of Cash Reserves on Desktop Underwriter Underwriting Findings**

The Desktop Underwriter underwriting findings showed that cash reserves of 3 months were not supported by the borrowers’ assets. All American officials stated that the correct available funds were \$3,766, which was well below the 3 months of cash reserves after the closing amount as

noted on the underwriting findings. The HUD-1 settlement statement showed that the borrower needed \$1,735 to close. The underwriting findings showed that the borrower had cash reserves of \$11,094; however, this amount was incorrect because the borrower had cash reserves of only \$2,031 (\$3,766 - \$1,735) after closing. Therefore, after closing, the borrower had cash reserves of less than a month, or 68 percent of the total mortgage payment (\$2,031/\$2,991). The cash reserve verified amount was \$2,031, which was 82 percent  $[(\$11,094 - \$2,031)/\$11,094]$  less, or more than 10 percent less, than that reported by the borrowers on the loan application; therefore, the lender should have rescored the mortgage loan as required.

**HUD-FHA Requirement:**

Mortgagee Letter 2005-15 states that there is no need to resubmit loans to TOTAL for rescoring provided the cash reserves verified are not more than 10 percent less than those reported by the borrowers on the loan application.

**Unallowable Fees Charged to Borrower**

All American officials charged the borrowers \$90 in unallowable wire and courier fees. However, as a result of our audit work, the lender took corrective action to reimburse the borrowers for the unallowable closing fees charged.

**HUD-FHA Requirement**

HUD Handbook 4000.2, REV-3, chapter 5, paragraph 5-2O, states that courier fees and wire fees may be charged only on refinances and only for delivery of the mortgage payoff statement to the lien holder and for closing documents to the settlement agent. It further provides that the borrower must agree in writing to pay for courier and wire fees before loan closing.

Case number:	374-5045917
Loan type:	Purchase
Mortgage amount:	\$381,954
Closing date:	2/10/2009
Payments before First 90-day default reported	Three
Default status as of April 30, 2011	Ineligible for Loss Mitigation

**Summary:**

We found material underwriting deficiencies relating to inadequate verification of the source of gift funds and the statutory minimum investment, and unallowable fees charged to the borrower.

**Inadequate Verification of the Source of Gift Funds**

**Inadequate Verification of the Statutory Minimum Investment**

All American officials did not adequately verify the source of a \$9,160 gift; therefore, the borrower's investment in the property was not verified. The Desktop Underwriter underwriting findings showed that the borrowers' minimum statutory investment requirement was \$13,615 (\$389,000 x 3.5 percent), and the case binder contained a gift letter with no date from the coborrower's stepbrother for a \$9,160 gift to the coborrower to be applied toward the property purchase. The loan closed on February 10, 2009, and the lender file contained a check, dated January 16, 2009, from the donor to the borrower's closing attorney for \$9,160. However, the lender file did not contain documentation verifying that the source of the gift funds was indeed the donor's own funds because the transaction journal, dated December 15, 2008, to January 16, 2009, from the donor's bank showed that the donor had a negative balance at the beginning of the month. It showed the following: a negative balance of (\$523) on December 15, 2008, a deposit of \$10,000 on December 16, 2008, several withdrawals totaling \$10,010 from December 19 to December 22, 2008, and a deposit of \$9,300 and withdrawal of \$9,170 on January 16, 2009. The lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the gift funds were from an acceptable source, the borrower did not make the minimum cash investment in the property, and the lender did not verify and document the borrower's gift and investment in the property. All American officials did not concur on this deficiency because they used the FHA TOTAL Mortgage Scorecard User Guide requirement. However, the FHA TOTAL Mortgage Scorecard User Guide, dated September 2003, provides that if sufficient funds required for closing are not already verified in the borrower's accounts, the transfer of the gift funds to the home buyer must be documented in accordance with the instructions described in Mortgagee Letter 00-28, which provides that the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds.

**HUD-FHA Requirements:**

HUD Handbook 4155.1, REV-5, dated October 2003, section 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds.

Mortgagee Letter 2008-23, issued September 5, 2008, provides that the borrower must make a 3.5 percent minimum cash investment in the property and borrower-paid closing costs may not be used to meet the cash investment requirements.

The TOTAL Mortgage Scorecard User Guide, dated September 2003, provides that the borrower must list the name, address, telephone number, relationship to the home buyer, and dollar amount of the gift on the loan application or in a gift letter for each cash gift received. If sufficient funds required for closing are not already verified in the borrower's accounts, the transfer of the gift funds to the home buyer must be documented in accordance with instructions described in Mortgagee Letter 00-28.

Mortgagee Letter 00-28 provides that the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds.

Approval condition number 31 in the Desktop Underwriter underwriting findings provides that the lender must document and retain a copy of the transfer of the gift and confirm that those funds came from an acceptable source.

**Unallowable Fees Charged on HUD-1 Settlement Statement**

All American officials charged the borrowers \$90 in unallowable wire and courier fees. However, as a result of our audit work, the lender disbursed a check to the borrowers for the unallowable closing fees charged.

**HUD-FHA Requirement:**

HUD Handbook 4000.2, REV-3, chapter 5, paragraph 5-2O, provides that courier and wire fees may be charged only on refinances and only for delivery of the mortgage payoff statement to the lien holder and for closing documents to the settlement agent. It further provides that the borrower must agree in writing to pay for courier and wire fees before loan closing.

Case number:	374-5179044
Loan type:	Purchase
Mortgage amount:	\$274,928
Closing date:	5/21/2009
Payments before first 90-day default reported	Seven
Default status as of April 30, 2011	Ineligible for Loss Mitigation

Summary:

We found material underwriting deficiencies relating to inadequate verification of income resulting in, improper calculation of ratios and unallowable fees charged to the borrower.

**Improper Verification and Calculation of Income that Resulted in Incorrect Calculated Ratios**

All American officials failed to properly verify income because they did not document that bonus income was going to continue for 2 years or explain why bonus income of less than 2 years was used. The lender file contained a pay stub for the pay period ending March 15, 2009, with two awards for a total of \$9,232. The lender file also contained an Employment & Income Verification Service report stating that bonuses for 2009 and 2008 were \$9,232 and \$13,261, respectively, and it did not report a bonus for 2007. However, using the Form W-2 for 2008, we calculated the bonus as \$11,674. The Form W-2 for 2008 showed gross wages of \$77,180, and according to the Employment & Income Verification Service report, the borrower's base pay was \$65,506 ( $\$77,180 - \$65,506$ ), supporting a bonus of \$11,674. In addition, in calculating allowable bonus income, the lender only documented 16.03 months worth of bonuses (January 1, 2008, to May 1, 2009, based on the date of the Employment & Income Verification Service report). Since the borrower did not have 2 full years' worth of bonuses and the Employment and Income Verification Service report did not state that bonuses were likely to continue, the bonus income should not have been factored into the debt-to-income ratio.

Also, the lender calculated the borrower's base income as \$5,647, which was incorrect. According to the borrower's pay stubs for pay period ending February 1, February 15, and March 15, 2009, the base biweekly pay was \$2,550; therefore, the monthly pay should have been \$5,525 ( $\$2,550 \times 26 / 12$ ) instead of \$5,647. Without the bonus and with the correct base income, the mortgage payment-to-income ratio (front) and the total fixed payment-to-income ratio (back) would have increased from 39.52 to 50.42 percent ( $\$2,786 / \$5,525$ ) and from 48.51 to 61.90 percent [ $(\$2,786 + \$634) / \$5,525$ ], respectively.

All American officials stated that the underwriter allowed a bonus for a period of less than 2 years because the employer generously rewarded its employees and the borrower continued to be an employee who had an increasing income. We do not agree with this reasoning as it was not documented at the time the loan was approved. In addition, the base pay was calculated incorrectly. The verified and reported incomes were \$5,525 and \$7,050, respectively, which was 21.63 percent [ $(\$7,050 - \$5,525) / \$7,050$ ] less than those reported by the borrowers. Since the difference in verified income was 21.63 percent, or more than the 5 percent difference allowed by HUD for verified income, there was a need to rescore the mortgage loan.



**HUD-FHA Requirements:**

HUD Handbook 4155.1, paragraph 4D (2)(b), states that both overtime and bonus income may be used to qualify a borrower if such income was received for the past 2 years and is likely to continue. The lender must develop an average of bonus or overtime income for the past 2 years, and the employment verification must not state that such income is unlikely to continue. Periods of less than 2 years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

Mortgagee Letter 2005-15 states that there is no need to resubmit loans to TOTAL for rescoring provided the verified income is not more than 5 percent less than that reported by the borrowers on the loan application.

**Unallowable Fees Charged**

All American officials charged the borrowers \$95 in unallowable wire and courier fees. However, as a result of our audit work, the lender disbursed a check to reimburse the borrowers for the unallowable closing fees charged.

**HUD-FHA Requirement:**

HUD Handbook 4000.2, REV-3, chapter 5, paragraph 5-2O, states that courier fees and wire fees may be charged only on refinances and only for delivery of the mortgage payoff statement to the lien holder and for closing documents to the settlement agent. It further provides that the borrower must agree in writing to pay for courier and wire fees before loan closing.