Issue Date August 26, 2008	
Audit Report Number 2008-NY-1010	

TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing Commissioner, H

Karen A. Campbell
for

FROM: Edgar Moore, Regional Inspector General for Audit, Region II, 2AGA

SUBJECT: Wells Fargo Bank NA, Rochester, New York, Branch Office, Did Not Always Comply with HUD/FHA Loan Origination Requirements

HIGHLIGHTS

What We Audited and Why

We audited Wells Fargo Bank NA, Rochester, New York, Branch Office (Wells Fargo), a national bank and supervised lender, because its default rate of 2.75 percent for loans with beginning amortization dates between November 1, 2005, and October 31, 2007, was higher than the Buffalo area-wide default rate of 2.42 percent.

The audit objectives were to determine whether Wells Fargo (1) approved insured loans in accordance with U.S. Department of Housing and Urban Development (HUD)/Federal Housing Administration (FHA) requirements, which include following prudent lending practices, and (2) developed and implemented a quality control plan that complied with HUD requirements.

What We Found

Wells Fargo did not always comply with HUD underwriting requirements. Consequently, 16 of the 20 loans reviewed exhibited significant underwriting deficiencies such as minimum cash investment not met, inaccurate calculation of income, inadequate verification of employment, inadequate documentation of 203(k) loans, inadequate verification of debt, inadequate review of appraisals, and overinsured loans. In addition, 8 of the 16 loans contained origination deficiencies, such as inadequate gift fund verification, inadequate assets available to close, questionable clear title to the property, ineligible prior mortgage late payments, inadequate compensating factors, and various borrower credit issues. These deficiencies occurred because Wells Fargo lacked adequate controls to ensure that loans were processed in accordance with HUD requirements. As a result, mortgage loans were approved for potentially ineligible borrowers, causing the HUD/FHA insurance fund to assume an unnecessary insurance risk.

Wells Fargo failed to ensure that its quality control plan was properly implemented in accordance with HUD and its own quality control requirements. Specifically, it did not ensure that management took prompt action to (1) appropriately deal with material findings identified in the quality control reviews; (2) document corrective actions taken, a timetable for completion, and any planned follow-up activities pertaining to the quality control findings; and (3) refer serious program violations to HUD. Consequently, the effectiveness of its quality control plan, which was designed to ensure accuracy, validity, and completeness in its loan underwriting process, was lessened.

What We Recommend

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner require Wells Fargo to (1) reimburse HUD for the loss incurred on one loan with significant underwriting deficiencies in the amount of $50,297, (2) indemnify HUD against future losses estimated to be $514,134 on 15 active loans with significant underwriting deficiencies, (3) establish procedures to ensure that HUD underwriting requirements are properly implemented and documented, and (4) implement procedures to ensure compliance with HUD and its own quality control 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 our review during the audit, provided a copy of the draft report to auditee officials, and requested their comments on July 17, 2008. We held an exit conference on August 4, 2008, and the auditee provided its written comments on August 8, 2008, at which time it generally disagreed with our findings. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Wells Fargo Bank NA is a supervised national bank that became a U.S. Department of Housing and Urban Development (HUD)-approved lender on July 21, 1935. Its original home office, located in Redwing, Minnesota, was terminated on June 3, 1994. Wells Fargo's current home office is located in Des Moines, Iowa, and it has 90 active Federal Housing Administration (FHA)-approved branch offices located throughout the country. There are three active branch offices located in New York State: Fishkill, New York; Melville, New York; and Rochester, New York. All three of these branch offices, also called sales or productions offices, report to the Pittsford, New York, Fulfillment Center for FHA loan underwriting. We performed our on-site audit work at the Pittsford Fulfillment Center.

Between November 1, 2005, and October 31, 2007, Wells Fargo Bank NA, Rochester, New York, Branch Office (Wells Fargo) originated 1,089 FHA-insured mortgages and experienced a default rate of 2.75 percent, which was higher than the Buffalo area-wide default rate of 2.42 percent.

The objectives of this audit were to determine whether Wells Fargo (1) approved insured loans in accordance with HUD/FHA requirements, which include following prudent lending practices, and (2) developed and implemented a quality control plan that complied with HUD requirements.

RESULTS OF AUDIT

Finding 1: Wells Fargo Did Not Always Comply with HUD Underwriting Requirements

Wells Fargo did not always comply with HUD's underwriting requirements. Consequently, 16 of the 20 loans reviewed exhibited significant underwriting deficiencies such as minimum cash investment not being met, inaccurate calculation of income, inadequate verification of employment, inadequate documentation of 203(k) loans, inadequate verification of debt, inadequate reviews of appraisals, and overinsured loans. In addition, 8 of the 16 loans contained origination deficiencies such as inadequate gift fund verification, inadequate assets available to close, questionable clear title to the property, ineligible prior mortgage late payments, inadequate compensating factors, and various borrower credit issues. These deficiencies occurred because Wells Fargo lacked adequate controls to ensure that the loans were processed in accordance with HUD requirements. As a result, mortgage loans were approved for potentially ineligible borrowers, causing the HUD/FHA insurance fund to realize a loss of $50,297 on one loan and assume an unnecessary insurance risk of more than $1.3 million on the remaining 15 loans.

Significant Underwriting Deficiencies

HUD Handbook 4155.1, REV-5, entitled "Mortgage Credit Analysis for Mortgage Insurance," prescribes basic underwriting requirements for FHA-insured single-family mortgage loans. Lenders are to obtain and verify information with at least the same care that would be exercised if the lender were originating a mortgage entirely dependent on the property as security to protect its investment. In addition, paragraph 3-1 of the handbook requires that the loan application package contain sufficient documentation to support a lender's decision to approve a loan. While this decision involves some subjectivity, our examination of 20 loans approved by Wells Fargo disclosed significant underwriting deficiencies in the approval of 16 loans. Specifically, Wells Fargo did not always (1) ensure that the minimum cash investment was provided, (2) accurately calculate borrower income, (3) adequately verify borrower employment, (4) adequately document 203(k) loans, (5) adequately verify borrower debt, (6) adequately review appraisals, and (7) ensure that 203(k) loans were not overinsured.

Since Wells Fargo did not always follow HUD regulations in the approval of 16 of the 20 loans reviewed, it approved one loan for which HUD paid a claim that resulted in an incurred loss of $50,297 related to case number 372-3566538, and HUD remained at risk for more than $1.3 million in potential claims. The significant deficiencies are noted in the chart below and in appendix C. The deficiencies noted are not independent of one another, as several loans had more than one deficiency.

Deficiency	***Number of loans***
Minimum investment not provided	4 of 20 loans
Inaccurate calculation of income	4 of 20 loans
Inadequate employment verification	3 of 20 loans
Inadequate 203(k) loan documentation	3 of 20 loans
Inadequate debt verification	2 of 20 loans
Inadequate appraisal review	2 of 20 loans
Overinsured loan	2 of 20 loans

Specific examples of these significant underwriting deficiencies follow:

- For FHA case #372-3603994, the minimum cash investment was not met. The minimum cash investment required was $3,045. Based on the mortgage credit analysis worksheet, the borrower was supposed to pay $1,242 at closing. However, although the borrower made an earnest money deposit of $1,000, Wells Fargo did not provide documentation to support that the borrower paid the $1,242 at closing, nor the additional $802 representing the difference between the sum of the earnest money deposit, cash to be paid at closing and the minimum required investment. As a result, the borrower's total cash was $1,000, which was $2,045 less than the minimum cash investment of $3,045.

- For FHA case #372-3572477, Wells Fargo did not adequately verify the borrower's other earnings on the mortgage credit analysis worksheet. Specifically, the borrower's $1,134 in other earnings, $831 in commission income and $303 in earnings from a second employer, could not be verified. According to the borrower's pay stubs, the borrower's monthly base pay totaled $1,466. The pay stubs indicated some commission income; however, we could not determine from the pay stubs or other income documents provided how the borrower's commission income was calculated. The verification of employment from this employer was incomplete. Therefore, we could not determine whether the $831 in monthly earnings from commission was accurate. Additionally, Wells Fargo used income from the borrower's second part-time job in calculating the borrower's other income figure. However, in our reverification of income, we determined that the borrower's employment with the second employer terminated nearly a month before closing. We also found questionable documents submitted to HUD pertaining to the second employer. Accordingly, using only the $1,466 in base pay as gross monthly income, the borrower's mortgage payment-to-income ratio would increase to 40.74 percent, and the borrower's total fixed payment-to-income ratio would increase to 79.19 percent.

- For FHA case #372-3566538, Wells Fargo did not adequately verify the borrower's employment. The verification of employment from the borrower's employer indicated that the borrower was a seasonal employee and that his probability of continued employment depended on the employer's workload. The borrower had a history of changing jobs and receiving unemployment compensation, which was documented in the borrower's file for 2003, 2004, and 2005. The borrower had three different employers during this period. Additionally, the reverification of employment that was performed as part of the quality control review determined that the borrower was unemployed and had a history of unemployment in the previous three years. There was no indication in the loan file or the quality control review file of what corrective action was taken to resolve these material findings.

Other Origination Deficiencies

The other origination deficiencies are noted in the chart below and in appendix C. These eight deficiencies are additional deficiencies identified in our review of the loan files that could not be grouped into the categories identified in the chart above.

Deficiency	*Number of loans*
Inadequate gift fund verification	1 of 20 loans
Inadequate assets available to close	1 of 20 loans
Borrower not credit qualified for refinance	1 of 20 loans
Borrower did not reestablish good credit following bankruptcy	1 of 20 loans
Borrower did not demonstrate ability to manage financial affairs	1 of 20 loans
Questionable clear title to subject property	1 of 20 loans
Inadequate or incomplete compensating factors	1 of 20 loans
Ineligible prior mortgage late payments	1 of 20 loans

Specific examples of these significant origination deficiencies follow:

- For FHA case #372-3620067, Wells Fargo did not ensure that the gift funds provided by the borrower's relative were a true gift and not a loan and that no repayment of the gift was expected or implied. The copy of the $2,700 gift check provided by the donor indicated in the memo line that the check was a "loan for house." Wells Fargo's early payment default quality control review identified the inadequate gift fund documentation as a material finding. However, there was no indication in the files or in the quality control review report as to the corrective actions taken to resolve this finding or whether the finding was referred to HUD.

- For FHA case #372-3572477, Wells Fargo did not adequately document the borrower's downpayment assistance gift funds; as a result, the borrower did not have adequate assets available to close. The closing documents indicated that the $4,000 in downpayment assistance gift funds was deposited into the borrower's interest only lawyer's account on April 3, 2006. Since the closing date was March 31, 2006, these funds were not verified before closing; consequently, the borrower did not have adequate funds to close and was short by $2,091.

- For FHA case #372-3585310, the borrower's credit report indicated that the second mortgage that the borrower was refinancing had six payments that were made more than 30 days late within the year before the refinance closing. Mortgagee Letter 2005-43 states that for cash-out refinance transactions, the borrower's payment history must not include any payments that were more than 30 days late and his or her mortgage must be current for the month due.

Conclusion

Wells Fargo did not always follow HUD regulations in the approval of loans. These deficiencies occurred because Wells Fargo lacked adequate controls to ensure that the loans were processed in accordance with HUD requirements. As a result, it approved one loan for which HUD paid a claim that resulted in an incurred loss of $50,297, and HUD remains at risk for more than $1.3 million in potential claims. The final loss that HUD incurs on loans for which a claim was paid depends upon the amount HUD realizes when it disposes of the property. HUD's most recent data disclose that its loss rate is 39 percent.[1] Net sales proceeds after considering carrying and sales expense may mitigate the amount of the claim paid. Requesting that the lender indemnify HUD can mitigate loans for which HUD remains at risk. In this case, the lender reimburses HUD for any insurance claim, taxes, interest, and other expenses connected with the disposition of the property, reduced by any amount recouped by HUD via sale or other disposition.

Appendix C of this report provides a summary of the significant underwriting deficiencies noted in the 16 cases. Appendix D provides a more detailed description of the deficiencies.

[1]Based upon HUD's current 39 percent default loss experience factor, the amount of cost savings or funds to be put to better use for the 15 loans for which indemnification is recommended is estimated at $514,134 (39 percent of $1,318,292); see appendix C.

Recommendations

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner require Wells Fargo to

1A. Reimburse HUD for the loss incurred resulting from the claim paid on case number 372-3566538 in the amount of $50,297.

1B. Indemnify HUD against potential future losses on 15 loans with significant underwriting deficiencies estimated to be $514,134.

1C. Establish procedures to ensure that all HUD loan origination and underwriting requirements are properly implemented and documented.

Finding 2: Wells Fargo Had Weaknesses in the Implementation of Its Quality Control Plan

Wells Fargo had weaknesses in the implementation of its quality control plan. It did not comply with HUD and its own quality control requirements to (1) take prompt action to appropriately deal with material findings identified in the quality control reviews; (2) document corrective actions taken, a timetable for completion, and any planned followup activities pertaining to the quality control findings; and (3) refer serious program violations to HUD. These noncompliances occurred because Wells Fargo did not establish procedures to ensure that its quality control plan was properly implemented. Consequently, the effectiveness of Wells Fargo's quality control plan, which is designed to ensure accuracy, validity, and completeness in its loan underwriting process, was lessened.

Material Deficiencies in Five Sample Loans

Wells Fargo's quality control reviews identified material underwriting deficiencies in five of the loans in our sample. These deficiencies included using overstated income in the underwriting package in which the true income would have resulted in loan rejection due to ratios of 37 percent and 69 percent, questionable gift funds accepted from a borrower's relative, unacceptable current and previous borrower credit history, unsatisfied lien documentation, an unexplained party on the mortgage title without being considered in the application process, and a missing quick claim deed from an ex-spouse of a borrower. For these significant underwriting deficiencies, Wells Fargo could not provide us with documentation to support (1) the corrective actions taken to address the deficiencies; (2) when the action was taken, when the deficiency was resolved, or correspondence regarding the resolution; and (3) followup correspondence pertaining to the specific deficiencies. Also, Wells Fargo did not provide documentation to support that any of these deficiencies were referred to HUD. According to Wells Fargo officials, specific action plans, timetables for deficiency resolution, and followup activity correspondence for the loans in our sample were not maintained.

Paragraph 7-3I of HUD Handbook 4060.1, REV-2, requires that management take prompt action to deal appropriately with any material findings and document in the final report or addendum the actions taken, the timetable for their completion, and any planned followup activities. Paragraph 7-3J of the handbook requires findings of fraud or other serious violations to be immediately referred in writing, along with any available supporting documentation, to the Director of the Quality Assurance Division in the HUD Homeownership Center having jurisdiction (determined by the state where the property is located) within 60 days after initial discovery.

Conclusion

Wells Fargo had weaknesses in the implementation of its quality control plan because it did not (1) take prompt action to appropriately deal with material findings identified in the quality control reviews; (2) document corrective actions taken, a timetable for completion, and any planned followup activities pertaining to the quality control findings; and (3) refer serious program violations to HUD. As a result, the effectiveness of Wells Fargo's quality control plan was lessened. These noncompliances occurred because Wells Fargo did not establish procedures to ensure that its quality control plan was properly implemented.

Recommendations

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner require Wells Fargo to

2A. Establish procedures to ensure that (1) prompt action is taken to deal with material findings identified in the quality control reviews; (2) the corrective actions taken, a timetable for their completion, and any planned followup activities pertaining to the quality control findings are documented; and (3) serious program violations are referred to HUD within 60 days of initial discovery.

SCOPE AND METHODOLOGY

To accomplish our audit objectives, we reviewed applicable laws, regulations, HUD handbooks, mortgagee letters, and reports from HUD's Quality Assurance Division. We interviewed Wells Fargo officials and quality control staff to obtain an understanding of its internal controls.

We reviewed 20 defaulted loan files that were underwritten by Wells Fargo with beginning amortization dates between November 1, 2005, and October 31, 2007. We selected our sample based on loans that (1) had gone into default within the first two years after settlement, (2) were active and not indemnified by HUD, and (3) were not reviewed by the Homeownership Center in Philadelphia. All of the loans selected had gone into default at least once. The results of our detailed testing only apply to the 20 loans tested and cannot be projected.

We performed detailed testing and reviewed Wells Fargo's underwriting procedures. We reviewed documentation from both the FHA Connection system, which included electronic copies of loan endorsement file documents, and loan files provided by the auditee. Our detailed testing and review included (1) an analysis of borrowers' income, assets, and liabilities; (2) a review of borrowers' savings ability and credit history; (3) verification of selected data on the underwriting worksheet and settlement statements; and (4) confirmation of employment and gifts. We discussed compliance issues with HUD and Wells Fargo officials.

We reviewed Wells Fargo's quality control plan and the quality assurance reports provided by its own quality control personnel. We tested the implementation of the quality control plan in regard to the 20 loans in our detailed loan review sample to determine compliance with HUD requirements.

We performed the audit fieldwork from December 2007 through June 2008. We conducted our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding of resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

- Validity and reliability of data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Wells Fargo did not ensure that certain loans were processed in accordance with all applicable HUD requirements (see finding 1).

- Wells Fargo did not adequately implement its quality control plan to ensure compliance with HUD and its own quality control 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	$50,297	
1B		$514,134

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 polices 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. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings, which are specifically identified. In this instance, if HUD implements our recommendations to indemnify loans that were not originated in accordance with FHA requirements, it will reduce FHA's risk of loss to the insurance fund. The amount above details HUD's statistics reflecting that FHA has an average loss experience of 39 percent of the claim amount when it sells a foreclosed property.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

WELLS FARGO HOME MORTGAGE

One Home Campus
MAC: X2401-064
Des Moines, IA 50328

August 8, 2008

Edgar Moore
Regional Inspector General for Audit 2AGA
U.S. Department of Housing and Urban Development
26 Federal Plaza, Room 3430
New York, NY 10278 0068

Dear Mr. Moore,

Wells Fargo Home Mortgage (WFHM) is pleased to provide our response to the recently completed New York HUD OIG audit and corresponding draft audit report dated July 17th, 2008 (the Report). The Report refers to 2 findings identified during the audit of our Rochester, New York Branch Office. WFHM addresses these findings in our summary below.

Comment 1

The Report's primary findings are related to WFHM's approach to quality assurance testing and corrective actions. As the nation's largest FHA lender, WFHM maintains operations throughout the United States with a centralized quality assurance testing department and a national approach to identifying training opportunities.

WFHM's approach to quality assurance and corrective actions has been reviewed and endorsed by FHA. On a monthly basis, WFHM randomly audits recent FHA production and, as required, reviews delinquent FHA loans. Identified material issues are reviewed with decisioners. Material issues are also reviewed comprehensively to determine where training and development are needed. The approach provides more training and broader corrective action. As issues are identified within a branch or region, all underwriters are provided training, not just those who made specific errors.

Finding 1: Wells Fargo – Wells Fargo Did Not Always Comply with HUD Underwriting Requirements

Comment 2

Of the 20 defaulted loans reviewed, WFHM disagrees with the deficiencies identified with 6 of the loans referred to in the Report *(please refer to description of loan detail previously provided)*. As noted within the individual loan responses, 3 of these 6 loans were cited for deficiencies because copies of checks brought to closing for previously verified assets were not provided. Previously, WFHM has verified with [redacted] at HUD National that this process is acceptable. The remaining 3 deficiencies have also been satisfactorily addressed in previous correspondence with HUD.

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

Comment 3

WFHM agrees that we will work with HUD on indemnification of 10 of the defaulted loans that were examined. While WFHM does not believe the findings based on this small, adverse sample of defaulted loans are indicative of the overall quality of WFHM's FHA originations, the feedback helps strengthen our origination and production capabilities.

Comment 4

Because of WFHM's commitment to leadership in FHA lending, we have taken steps to improve originations and underwriting processes and controls. We believe these changes are providing positive results and WFHM will continue to take actions necessary to ensure ongoing improvement in the quality of our FHA originations and underwriting processes.

Finding 2: Wells Fargo Had Weaknesses in the Implementation of Its Quality Control Plan

Comment 4

WFHM consistently strives to meet all of HUD's guidelines when originating, processing and closing loans. We have a series of quality controls and measures in place to ensure that errors are detected and addressed in a timely manner. WFHM maintains numerous processes to identify opportunities, determine root causes and create action plans to appropriately address the issues. Action plans are maintained and monitored to support increased quality both nationally and at local sales fulfillment centers.

Comment 5

The Philadelphia HUD OIG audit finalized July 31st and the HUD QAD Comprehensive audit finalized June 2006 both reviewed the effectiveness of our quality control plan and determined it was sound and effective with no deficiencies. The three issues identified in the NY OIG Report referred to non-compliance with the following items in our quality control plan:

1.) Prompt action to appropriately deal with material findings identified in the quality control reviews.
2.) Document corrective actions taken, a timetable for completing and any planned follow up activities pertaining to the quality control reviews.
3.) Refer serious program violations to HUD.

WFHM has the following processes in place which address issues 1 and 2:

Comment 5

- Results of the Quality Assurance reviews are communicated on a monthly basis to National Underwriting Management for review and discussion with Quality Assurance.
- Final results are delivered to the individual site Underwriting Managers who are required to provide each decisioner with a summary of their deficiencies.
- All individual material findings are included in the individual Decisioner Quality Scorecard
- Individuals who exceed the outlier threshold are required to have a formal corrective action plan.
- Corrective actions are taken based on performance .
- Each plan must include a description of the actions, implementation and expected improvement dates.
- Results are tracked and utilized for both maintaining underwriting authority levels and year end performance evaluation.

In addition, WFHM has employed the following process since May 2005 which addresses issue 3:

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AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

Comment 5

- o Wells Fargo strictly adheres to self reporting all serious program violations as required by HUD through Mortgagee Letter 2005-06. This process was also reviewed and approved by HUD National QAD (*previously provided).*

Additionally, the quality assurance group distributes a monthly Executive Summary Report of all reviews and current corrective action plans. This report is distributed to all senior and executive management and is reviewed in our monthly underwriting quality review meetings.

These actions directly impact WFHM's performance results and WFHM's FHA production continues to perform better than the industry. As the nation's number one originator and servicer of FHA loans, we value our ongoing relationship with HUD.

Conclusion

Comment 6

We appreciate the opportunity to comment on the Report prepared by the New York Office of the Inspector General. While WFHM's overall performance as an FHA originator is among the best in the industry, we also understand that there are always opportunities for improvement. This response includes details on a number of specific steps we have taken to address the issues raised in the audit; steps that already have helped us further improve the quality of our FHA originations. In accordance with WFHM's established process, audit findings will be integrated into our ongoing performance feedback to origination and production offices.

Wells Fargo Home Mortgage is proud of its role as a leading FHA lender and servicer. 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 clarifications on anything that is included in this response.

Sincerely,

Michael J. Heid
Co-President, WFHM

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OIG Evaluation of Auditee Comments

Comment 1 Officials for Wells Fargo state that the audit report's primary findings are related to their approach to quality assurance testing and corrective actions, which has been reviewed and endorsed by FHA. We acknowledge that Wells Fargo has a quality control plan in place. However, for the material weaknesses identified with the loan files we reviewed, Wells Fargo has not provided documentation supporting that action plans or timetables for deficiency resolution were prepared, follow-up actions were taken, and material deficiencies were referred to HUD in accordance with HUD Handbook 4060.1. Further, Wells Fargo has not provided evidence of FHA review and endorsement of their approach to quality assurance and corrective actions.

Comment 2 Officials for Wells Fargo disagree with the deficiencies identified with 6 out of the 20 defaulted loans reviewed. Specifically, auditee officials contend that for three out of the six loans cited for deficiencies, the process of not providing copies of checks for previously verified assets is acceptable by HUD, and that the remaining three deficiencies are satisfied by the additional documentation previously provided with their preliminary response. As discussed with Wells Fargo officials during the audit and at the exit conference, the minimum required investment is a statutory requirement that necessitates the borrower to provide three percent of the estimated acquisition cost of the subject property. Wells Fargo did not provide all the documentation necessary to verify that the borrowers met this requirement for three of the loans cited. Further, the additional documentation submitted subsequent to the audit still does not adequately address the deficiencies identified with the remaining three loans, as it is the same documentation reviewed during the audit. Consequently, the deficiencies pertaining to insufficient calculation of borrower debt payments, inaccurate calculation of monthly gross income, inadequate verification of borrower employment history, and insufficient evidence of clear title to the property at the time of closing are not resolved.

Comment 3 Officials for Wells Fargo agree to work with HUD on the indemnification of ten of the loans reviewed in our sample. However, Wells Fargo does not believe the findings based on a small sample of defaulted loans are indicative of the overall quality of their FHA originations. Wells Fargo's actions are responsive to our recommendations. As noted in the Scope and Methodology section of this report, the results of our detailed testing apply only to the 20 loans tested and cannot be projected; nevertheless, we identified significant origination deficiencies in 16 of the 20 loans we reviewed.

Comment 4 Officials for Wells Fargo state that steps have been taken to improve originations and underwriting processes and controls. Although we recognize the corrective actions taken by Wells Fargo, there is no evidence to support that these actions were implemented during our review; as such, they should be reviewed by HUD as part of the audit resolution process.

Comment 5 Officials for Wells Fargo contend that the audits conducted by the HUD OIG Philadelphia office and the HUD QAD determined that their quality control plan was sound and effective with no deficiencies. In their response, officials outline the process Wells Fargo has in place to address the identified deficiencies. Our review was conducted independently, therefore, we cannot comment on the results obtained from other audits. While we acknowledge that Wells Fargo has a quality control plan in place, Wells Fargo did not provide documents to support that (1) action plans or timetables for deficiency resolution were prepared, (2) follow-up actions were taken, and (3) material deficiencies were referred to HUD. Consequently, we were not provided with evidence of the implementation of the quality control plan. Thus, Wells Fargo's response and our review of additional documentation provided after the exit conference is not sufficient to encourage us to change our determinations.

Comment 6 The actions taken by Wells Fargo officials are responsive to our recommendations.

Appendix C

SUMMARY OF UNDERWRITING AND LOAN ORIGINATION DEFICIENCIES

Case number	Mortgage amount	Amount requested for indemnification	Minimum required investment not provided	Inaccurate calculation of income	Inadequate verification of employment	203(k) loan not adequately documented	Inadequate debt verification	Inadequate appraisal review	Over-insured loan	Other origination deficiencies[2]	Appendix reference
372-3566538	$77,165	$0[3]		X	X		X				D-01
372-3620067	$88,530	$34,527								X	D-02
372-3603994	$99,314	$38,732	X		X						D-03
372-3642193	$73,617	$28,711						X			D-04
372-3572477	$65,607	$25,587		X				X		X	D-05
372-3582996	$61,042	$23,806					X				D-06
372-3568312	$105,633	$41,197	X	X							D-07
372-3644121	$82,865	$32,317								X	D-08
372-3613230	$116,975	$45,620								X	D-09
372-3575531	$78,579	$30,646				X			X	X	D-10
372-3552959	$62,905	$24,533				X					D-11
372-3663900	$89,103	$34,750			X	X			X		D-12
372-3644585	$88,202	$34,399	X								D-13
372-3649705	$118,755	$46,314								X	D-14
372-3632180	$87,188	$34,003	X							X	D-15
372-3585310	$99,977	$38,991		X						X	D-16
Total	**$1,395,457**	**$514,133[4]**	4	4	3	3	2	2	2	8	

[2] The other origination deficiencies include inadequate gift fund verification, inadequate assets available to close, borrower not credit qualified for refinance transaction, borrower did not reestablish good credit following bankruptcy, borrower did not demonstrate the ability to manage financial affairs, questionable clear title to subject property, inadequate or incomplete compensating factors, and ineligible prior mortgage late payments.

[3] HUD realized a loss in the amount of $50,297 on this loan. Since this loan has already gone to claim, we are recommending that HUD be reimbursed for the amount of the loss rather than recommending indemnification.

[4] The total mortgage amount of the 15 loans for which we are requesting indemnification is $1,318,292. Based upon HUD's current 39 percent defaulted loss experience factor, the amount of savings on the loans for which indemnification is recommended is estimated at $514,134 (39 percent of $1,318,292).

Appendix D

CASE SUMMARY NARRATIVES

Case number: 372-3566538
Loan amount: $77,165
Settlement date: February 17, 2006
Status: Claim, HUD incurred loss of $50,297

Pertinent Details

A. Insufficient Calculation of the Borrower's Total Monthly Debt Payments

We could not determine how the borrower's monthly debt payments of $580 were calculated as shown on the mortgage credit analysis worksheet. According to the borrower's credit report, dated February 16, 2006, the borrower had a total monthly debt payment of $598. This is the total of four open debt accounts with greater than 10 payments remaining. HUD Handbook 4155.1, REV-5, paragraph 2-12, states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc., extending 10 months or more. The borrower's total fixed payment-to-income ratio would be increased to 44.97 percent with the $598 monthly debt payment. Auditee officials concurred that a monthly debt payment of $598 should have been used on the borrower's mortgage credit analysis worksheet. We discussed this deficiency in our March 11, 2008 teleconference.

B. Inaccurate Calculation of the Borrower's Gross Monthly Income

Wells Fargo did not accurately calculate the borrower's gross monthly income on the mortgage credit analysis worksheet. According to the borrower's Internal Revenue Service (IRS) Forms W-2 for 2004, the borrower's gross wages totaled $21,134. According to the borrower's year-to-date pay stub for the period ending August 27, 2005, the borrower's gross wages were $13,551. When the borrower's wages from 2004 and 2005 are totaled and divided by 20 months, the borrower's base pay is $1,734, not $2,148 as indicated on the mortgage credit analysis worksheet. This revised base pay amount, along with the increase in monthly debt payments discussed above, would increase the borrower's total fixed payment-to-income ratio to 52.66 percent. Additionally, Wells Fargo's quality control review identified a material weakness pertaining to the income verification performed on this loan. The review indicated that the borrower's $2,837 in total gross monthly income was based on a 24-month average from 2003 and 2004 and did not reflect the borrower's current income and employment situation. The review also indicated a 24-month average from 2004 and 2005 that resulted in a monthly income of $1,857, which would result in ratios of 37 and 69 percent. However, there was no indication in the loan file or the quality control review file of what corrective action was taken to resolve these material findings.

C. Inadequate Verification of the Borrower's Employment History and Job Stability

The borrower's stability of employment was questionable and not adequately verified in the files. The verification of employment from the borrower's employer indicated that the borrower was a seasonal employee and that his probability of continued employment depended on the employer's workload. The borrower had a history of changing jobs and receiving unemployment compensation, which was documented in the borrower's file for 2003, 2004, and 2005. The borrower had three different employers during this period. HUD Handbook 4155.1, REV-5, paragraph 2-6, states that the lender must verify the borrower's employment for the most recent two full years. It also states that the borrower must explain any gaps in employment spanning one month or more. Additionally, Wells Fargo's quality control review identified material weaknesses pertaining to the borrower's employment history, as verified by the underwriter. Specifically, the reverification of employment that was performed as part of the quality control review determined that the borrower was unemployed and had a history of unemployment during the previous three years. However, there was no indication in the loan file or the quality control review file of what corrective action was taken to resolve these material findings.

Case number: 372-3620067
Loan amount: $88,530
Settlement date: October 6, 2006
Status: Default, foreclosure sale held

Pertinent Details

A. Inadequate Gift Fund Verification

Wells Fargo did not ensure that the gift funds provided by the borrower's relative were a true gift and not a loan and that no repayment of the gift was expected or implied. HUD Handbook 4155.1, REV-5, paragraph 2-10C, states that repayment of the gift by the borrower cannot be expected or implied in the loan file. However, the copy of the $2,700 gift check provided by the donor indicated in the memo line that the check was a "loan for house." Wells Fargo's early payment default quality control review identified the inadequate gift fund documentation as a material finding. However, there was no indication in the files or in the quality control review report as to the corrective actions taken to resolve this finding.

Case number:	372-3603994
Loan amount:	$99,314
Settlement date:	August 31, 2006
Status:	Default, Chapter 13 bankruptcy filed

Pertinent Details

A. The Borrower Did Not Provide the Minimum Required Investment

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires a borrower to provide a minimum cash investment of 3 percent of the estimated cost of acquisition. HUD Handbook 4155.1, REV-5, paragraph 2-10, requires that the cash investment in the property equal the difference between the amount of the insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including prepaid expenses and closing costs. The minimum cash investment required was $3,044.67. The borrower made a earnest money deposit of $1,000; however, Wells Fargo did not provide documentation to support that the borrower paid the remaining required investment of $2,044.67.

B. Employment Stability Was Not Adequately Documented

Wells Fargo did not adequately verify the borrower's employment history for the most recent two full years. HUD Handbook 4155.1, REV-5, paragraph 2-6, states that the lender must verify the borrower's employment for the most recent two full years. It also states that the borrower must explain any gaps in employment spanning one month or more. The borrower provided an IRS Form W-2 indicating that he worked for his previous employer in 2005. There was also a verification of employment in the files from the borrower's most recent employer indicating that he started with this employer on February 13, 2006. However, no documentation was provided in the files indicating when the borrower's employment with his previous employer ended. As a result, there is an unexplained gap in employment from at least January 1, 2006, until the borrower started working for his most recent employer on February 13, 2006. Wells Fargo concurred that the gap in employment was not explained in the file.

Case number: 372-3642193
Loan amount: $73,617
Settlement date: February 26, 2007
Status: Current, delinquent

Pertinent Details

A. Appraisal Report Was Not Adequately Reviewed

There was no evidence to support that Wells Fargo questioned the appraised value of the subject property to determine whether the appraiser's conclusions were acceptable. The subject property sold for $25,000 on August 4, 2006. The appraised value was $77,000 on January 31, 2007. This was more than a 200 percent increase in value over a six-month period. The period between the prior sales date and the date of the sales contract is four months. Mortgagee Letter 03-07 states, "If the re-sale date is between 91 and 180 days following acquisition by the seller, the lender is required to obtain a second appraisal made by another appraiser if the resale price is 100 percent or more over the price paid by the seller when the property was acquired. As an example, if a property is re-sold for $80,000 within six months of the seller's acquisition of that property for $40,000, the mortgage lender must obtain a second independent appraisal supporting the $80,000 sales price. The mortgage lender may also provide documentation showing the costs and extent of rehabilitation that went into the property resulting in the increased value but must still obtain the second appraisal." Although there was a second appraisal in the file, this appraisal was conducted one month after closing.

Case number:	372-3572477
Loan amount:	$65,607
Settlement date:	March 31, 2006
Status:	Default, special forbearance

Pertinent Details

A. The Borrower Did Not Provide Adequate Assets to Close

Wells Fargo did not adequately document the borrower's downpayment assistance gift funds; as a result, the borrower did not have adequate assets available to close. The closing documents indicated that $4,000 in downpayment assistance gift funds was deposited into the borrower's interest only lawyer's account on April 3, 2006. Since the closing date was March 31, 2006, these funds were not verified before closing; consequently, the borrower did not have adequate funds to close and was short by $2,090.63.

B. Verification of Other Earnings Was Inadequate

Wells Fargo did not adequately verify the borrower's other earnings on the mortgage credit analysis worksheet. Specifically, the borrower's $1,134 in other earnings, $831 in commission income, and $303 in earnings from a second employer could not be verified. According to the borrower's pay stubs, the borrower's monthly base pay totaled $1,466. The pay stubs indicated some commission income; however, we could not determine from the pay stubs or other income documents provided how the borrower's commission income was calculated. HUD Handbook 4155.1, REV-5, paragraph 2-7A, states that commission income may be used to qualify, but the commission income must be averaged over the past two years. It also states that individuals whose commission income shows a decrease from one year to the next require significant compensating factors to allow for loan approval. The verification of employment from this employer was incomplete. Therefore, we could not determine whether the $831 in monthly earnings from commission was accurate or whether the commission income over the past two years had decreased. Additionally, Wells Fargo used income from the borrower's second part-time job in calculating the borrower's other income figure. However, in our reverification of income, we determined that the borrower's employment with the second employer terminated nearly a month before closing. We also found questionable documents submitted to HUD pertaining to the second employer. Accordingly, using only the $1,466 in base pay as the borrower's gross monthly income, the borrower's mortgage payment-to-income ratio would increase to 40.74 percent, and the borrower's total fixed payment-to-income ratio would increase to 79.19 percent.

C. Appraisal Report Was Not Adequately Reviewed

The appraised value did not support the contract sales price on the HUD-1 settlement statement. There was no documentation to support that Wells Fargo questioned the appraised value of the subject property to determine whether the appraiser's conclusions were acceptable. The appraised value was $66,000 on February 25, 2006. The contract sales price according to the HUD-1 settlement statement was $54,800. This price reflects an increase in the original sales contract price of $50,500 on October 12, 2005. The sales contract was amended on February 10, 2006, to reflect the seller's $4,000 payment to the Genesis Foundation for a downpayment assistance program gift and $300 in applicable fees. The seller's gift fund payment increased the contract sales price to $54,800. The difference between original contract price and the appraised value was $15,500. There was no documentation in the files to support that the underwriter explained this difference or questioned the appraiser's report. Further, the original contract price of $50,500, plus the seller's downpayment assistance gift of $4,000, plus $11,326 in 203(k) total rehabilitation costs according to the 203(k) maximum mortgage totals $65,826, which is just $174 under the appraised value. There was no documentation in the file to support that the underwriter sought an explanation for the appraised value that included a dollar-for-dollar increase in value based on the rehabilitation investment. HUD Handbook 4000.4, paragraph 3-3G, requires the lender's underwriter to review the appraisal to determine whether the appraiser's conclusions are acceptable. The above items are indicators of problems with the appraisal; as such, they should have prompted Wells Fargo to question the reliability of the appraisal report before accepting it.

Case number: 372-3582996
Loan amount: $61,042
Settlement date: June 22, 2006
Status: Default, repayment

Pertinent Details

A. Inaccurate Calculation of the Borrower's Total Monthly Debt Payments

Wells Fargo calculated the borrower's total installment debt as $79 and the borrower's total monthly payments to be $339 on the mortgage credit analysis worksheet. Six borrower credit reports, including the one dated May 31, 2006, indicated that the borrower's installment debt payment should be $279, not $79. Adequate documentation was not in the files to support the underwriter's use of $79 for this monthly payment. HUD Handbook 4155.1, REV-5, paragraph 2-12, states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts, alimony, etc., extending 10 months or more. The borrower's total fixed payment-to-income ratio would be increased to 49.64 percent with the $279 total monthly installment debt payment included.

Case number:	372-3568312
Loan amount:	$105,633
Settlement date:	April 19, 2006
Status:	Default, first legal action to commence foreclosure

Pertinent Details

A. The Borrower Did Not Provide the Minimum Required Investment

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires a borrower to provide a minimum cash investment of 3 percent of the estimated cost of acquisition. HUD Handbook 4155.1, REV-5, paragraph 2-10, requires that the cash investment in the property equal the difference between the amount of the insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including prepaid expenses and closing costs. The borrower made an earnest money deposit of $1,500 and paid $325 outside of closing for an appraisal fee; however, Wells Fargo did not provide documentation to support that the borrower paid $1,695 at closing. As a result, the borrower's total cash investment was $1,825. This is $1,370 less than the minimum required investment of $3,195.

B. Verification of Child Support Income Was Inadequate

Wells Fargo did not adequately verify the borrower's $1,082 in child support income. According to the borrower's judgment of divorce court documents, the borrower was to receive $181.75 per week for child support and childcare expenses. This totals $984 per month for child support including the 125 percent child support factor. Using this information, the borrower's gross monthly income was $3,401, not $3,499 as indicated on the mortgage credit analysis worksheet. This revised child support amount would increase the borrower's mortgage payment-to-income ratio to 31.47 percent and the borrower's total fixed payment-to-income ratio to 44.82 percent. Additionally, HUD Handbook 4155.1, REV-5, paragraph 2-7 F, states that the borrower must provide a copy of court document as well as evidence that payments have been received during the last 12 months in order for child support income to be considered effective income. Wells Fargo only obtained three months of bank statements as support that the borrower received these payments; therefore, the payee's ability and willingness to make these payments over an extended period cannot be determined. Without the child support income, the borrower's total mortgage payment-to-income ratio would be 44.29 percent, and the borrower's total fixed payment-to-income would be 63.08 percent.

Case number:	372-3644121
Loan amount:	$82,865
Settlement date:	March 22, 2007
Status:	Current, delinquent

Pertinent Details

A. Insufficient Credit Qualification of a Refinanced Loan

HUD Handbook 4155.1, REV-5, paragraph 1-12C, states that for credit qualifying streamline refinance transactions, the lender must provide evidence that the remaining borrowers have an acceptable credit history and ability to make payments. Specifically, the lender must provide a verification of income, provide a credit report, compute the debt-to-income ratios, and determine that the borrower will continue to make mortgage payments. Wells Fargo did not provide evidence that it verified income and computed the debt-to-income ratios as required. Not only did it not document evidence to support these calculations, it left these critical fields in the mortgage credit analysis worksheet blank. In addition, the borrower's past mortgage payment history did not indicate an ability to make payments. The borrower's prior FHA mortgage had a history of delinquent payments up to three months before closing on the current loan. The borrower's credit report indicated foreclosure proceedings filed by Wells Fargo in June 2000. Also the borrower's credit report indicated a history of 90-, 60-, and 30-day late payments on four different installment debt accounts. Wells Fargo did not provide documentation to support an acceptable credit history or evidence to support that the borrower would continue to make mortgage payments. Lastly, Wells Fargo's quality control review of this file identified a material finding due to a foreclosure on the prior loan in June 2000 that would have made the refinance not allowable. In Wells Fargo's correspondence regarding not qualifying the loan for credit, it acknowledged, "Current Quality Assurance (QA) review of this loan indicates that the decision-maker did not review or warrant the borrower's credit history. This appears to be an underwriter error that was also noted as an issue when originally reviewed by QA."

Case number: 372-3613230
Loan amount: $116,975
Settlement date: September 20, 2006
Status: Default, modification started

Pertinent Details

A. The Borrower Did Not Reestablish Good Credit Following Bankruptcy

The borrower had nine 30-day delinquencies, two 60-day delinquencies, and three 90-day delinquencies on three revolving accounts after a bankruptcy discharge. HUD Handbook 4155.1, REV-5, paragraph 2-3, states that a bankruptcy will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged and the borrower has reestablished good credit and has demonstrated an ability to manage financial affairs. All of the delinquencies occurred within 20 months of the borrower’s closing date. Wells Fargo did not provide an adequate explanation regarding the derogatory credit issues that occurred after the bankruptcy.

Case number:	372-3575531
Loan amount:	$78,579
Settlement date:	May 8, 2006
Status:	Current, reinstated by borrower

Pertinent Details

A. The Loan Was Overinsured

Wells Fargo did not follow applicable HUD 203(k) program guidelines; as a result, the mortgage was overinsured. Wells Fargo indicated on the borrower's 203(k) maximum mortgage worksheet that the borrower's maximum mortgage amount was $77,418; however, it did not provide adequate receipts for the repair work completed. As a result, the borrower's maximum mortgage amount was $67,909, and the mortgage was overinsured by $9,509 ($77,418 - $67,909). The borrower received a check for rehabilitation work performed at the subject property but did not provide adequate receipts to support that the work was completed. Mortgagee Letter 2005-50 states that the lender may accept receipts or proof of completion of the work to the homebuyer's satisfaction from the contractor as evidence of work completion. Two draws were paid for material purchases totaling $13,430; however, receipts for these material purchases only totaled $2,989. There was no documentation on file to support the remaining $10,441 ($13,430 - $2,989) in purchases. In addition, there was no letter of completion from the borrower provided in the files.

B. The 203(k) Loan Was Not Adequately Documented

The borrower's cost estimate indicated that some of the rehabilitation work was to be done by the borrower; however, no self-help arrangement was provided in the files. The estimate also indicated an estimate for labor costs. Mortgagee Letter 05-50 states that borrowers may not be compensated for their own labor costs. Officials for Wells Fargo concurred that a self-help agreement was not obtained from the borrower and that the borrower received $5,000 for labor costs.

Further, the homeowner/contractor agreement indicated that a contractor was to perform electrical work to the maximum sum of $400. However, there was no documentation in the files to indicate that the contractor performed this work. Additionally, there was no documentation in the files to support that the borrower was qualified to perform the electrical work and gas line installations described in the cost estimate. Mortgagee Letter 05-50 states that "self-help" arrangements, in which the borrower performs the work, are not to be approved unless the borrower can sufficiently demonstrate that he has the necessary expertise and experience to perform the work competently. Since the borrower was a painter, it cannot be reasonably assumed that the borrower could complete this work competently.

In summary, the loan file lacked several key documents; for example, the self-help arrangement, adequate receipts for material purchases, and support for the borrower's ability to perform electrical and gas work. As a result, the loan should not have been approved. The documentation indicated that the work was not completed or was not completed fully. The files lacked adequate support for the work, and there was no borrower letter of completion provided. Mortgagee Letter 05-50 states that the lender may choose to obtain or perform inspections if it believes such actions are necessary for program compliance and/or risk mitigation. Due to the number of missing documents identified above, Wells Fargo should have exercised due diligence by obtaining an inspection of the subject property to ensure that the stated repairs were completed.

C. The Borrower Did Not Demonstrate an Ability to Manage His Financial Affairs

The borrower's credit report indicated two auto repossessions within a year before closing. The repossessions occurred in July and November 2005, and no written explanation was provided. HUD Handbook 4155.1, REV-5, paragraph 2-3, states that major indications of derogatory credit require sufficient written explanation from the borrower. The borrower's credit report also indicated two accounts submitted to collection within the two years before closing. All of the accounts listed on the credit report indicated a history of 90-, 60-, and 30-day late payments.

Case number: 372-3552959
Loan amount: $62,905
Settlement date: January 13, 2006
Status: Default, first legal action to commence foreclosure

Pertinent Details

A. The 203(k) Loan Was Not Adequately Documented

Although a self-help agreement was provided in the files and the borrower received two draw checks for 203(k) repairs completed, the borrower did not provide documentation to support that she had the ability to complete the repairs. Mortgagee Letter 05-50 states that "self-help" arrangements, in which the borrower performs the work, are not to be approved unless the borrower can sufficiently demonstrate that he has the necessary expertise and experience to perform the work competently. The repairs for which the borrower was paid as part of the two draws included installing floor joists and wall frames, repairing subfloor and installing carpeting, and removing and replacing steps and handrails. Since the borrower was a production worker, it cannot be reasonably assumed that the borrower could have completed this work competently. Wells Fargo concurred that an explanation regarding the borrower's ability and expertise to perform the repairs was not provided in the files. In addition, some of the repairs required permits. There was no documentation in the files to support that the borrower received the required building permits before commencing the work. Lastly, HUD Handbook 4240.4, REV-2, paragraph 5-2, states that the length of the rehabilitation period for 203(k) loans will be no longer than six months from the date the loan is closed. The loan closed on January 13, 2006, and the borrower's letter certifying that the rehabilitation work was completed was dated November 22, 2006. Also, the third draw check was dated November 28, 2006, and the holdback check was dated December 1, 2006. There was no documentation provided in the files explaining the rehabilitation period of more than 10 months.

Case number:	372-3663900
Loan amount:	$89,103
Settlement date:	July 27, 2007
Status:	Default, special forbearance

Pertinent Details

A. The Loan Was Overinsured

Wells Fargo did not follow applicable HUD 203(k) program guidelines and, as a result, the mortgage was overinsured. Wells Fargo indicated on the borrower's 203(k) maximum mortgage worksheet that the borrower's maximum mortgage amount was $87,787; however, it did not provide adequate receipts for the repair work completed. As a result, the borrower's maximum mortgage amount was $82,517, and the mortgage was overinsured by $5,270. A national home improvement store received two draw checks for material purchases on behalf of the borrower; however, receipts to support the purchases were not provided. We were only able to verify $4,600 in repair materials and labor provided by a separate contractor of the total $9,948 in rehabilitation work to be performed at the subject property. Wells Fargo concurred that receipts for all rehabilitation work performed at the subject property were not documented. Mortgagee Letter 2005-50 states that the lender may accept receipts or proof of completion of the work to the homebuyer's satisfaction from the contractor as evidence of work completion.

B. The 203(k) Loan Was Not Adequately Documented

In our teleconference with Wells Fargo, it indicated that this was a self-help streamline 203(k) loan. Mortgagee Letter 2005-50 states that self-help arrangements are not to be approved unless the buyer can sufficiently demonstrate that he has the necessary expertise and experience to perform the work competently. There was no documentation in the files to support the borrower's ability and experience to perform the work. Since the borrower worked in the automotive detailing business, it cannot be reasonably assumed that the borrower had the ability to perform the work identified on the 203(k) repair program cost estimate. In addition, Mortgagee Letter 2005-50 states that a description of the proposed 203(k) repairs must be included in the appraisal report and the appraiser must indicate the after-improved value subject to completion of the proposed repairs. However, the appraisal provided in the files did not indicate the nature or extent of repairs to be performed or the after-improved value of the subject property. The quality control review performed on this file identified this issue. However, there is no explanation in the files as to the corrective action taken to resolve this material finding.

In summary, the loan file lacked several key documents; for example, documentation explaining the borrower's ability and expertise to perform the 203(k) repairs, adequate receipts for material purchases, and an appraisal identifying the 203(k) repairs with the after-improved value of the subject property. Mortgagee Letter 05-50 states that the lender may choose to obtain or perform inspections if it believes such actions are necessary for program compliance and/or risk mitigation. Due to the number of missing documents identified above, Wells Fargo should have exercised due diligence by obtaining an inspection of the subject property to ensure program compliance.

C. The Coborrower's Employment Was Inadequately Documented

Wells Fargo did not verify employment for the cosigner for the most recent two full years. HUD Handbook 4155.1, REV-5, paragraph 2-6, states that the lender must verify the borrower's employment for the most recent two full years. The cosigner's employment began with his current employer only one year before closing. There was no documentation in the files regarding the cosigner's prior employer. Without the cosigner's base pay, used in calculating the borrower's gross monthly income, the borrower's ratios would increase to 38.65 percent and 65.74 percent.

Case number: 372-3644585
Loan amount: $88,202
Settlement date: April 4, 2007
Status: Default, special forbearance

Pertinent Details

A. The Borrower Did Not Provide the Minimum Required Investment

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires a borrower to provide minimum cash investment of 3 percent of the estimated cost of acquisition. HUD Handbook 4155.1, REV-5, paragraph 2-10, requires that the cash investment in the property equal the difference between the amount of the insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including prepaid expenses and closing costs. The borrower made an earnest money deposit of $500 and paid $350 for an appraisal fee outside of closing; however, Wells Fargo did not provide documentation to support that the borrower paid $2,267.39 at closing. As a result, the borrower's total cash investment was $850. This is $1,817 less than the minimum required investment of $2,667.

Case number:	372-3649705
Loan amount:	$118,755
Settlement date:	March 23, 2007
Status:	Default, first legal action to commence foreclosure

Pertinent Details

A. The Borrower Lacked Clear Title to the Subject Property

Wells Fargo did not ensure that the borrower had clear title to the subject property before closing. The borrower's title search documents indicated that the seller recorded a mortgage in the amount of $120,550 with HSBC Mortgage Corporation on May 25, 2005. The HUD-1 settlement statement, dated March 23, 2007, indicated that the seller received $110,191 upon settlement. There was no payoff to HSBC Mortgage Corporation identified on the HUD-1, and there was no documentation in the files indicating that the seller's mortgage was satisfied.

Case number:	372-3632180
Loan amount:	$87,188
Settlement date:	January 24, 2007
Status:	Default, first legal action to commence foreclosure

Pertinent Details

A. The Borrower's Total Fixed Payment-to-Income Ratio Exceeded the Acceptable Threshold Permitted by HUD

The borrower's total fixed payment-to-income ratio was 48.0 percent. Mortgagee Letter 2005-16 states that this ratio cannot exceed 43 percent without listing significant compensating factors. Savings ability is not a significant compensating factor as prescribed in HUD Handbook 4155.1, REV-5, paragraph 2-13.

B. The Borrower Did Not Provide the Minimum Required Investment

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires a borrower to provide minimum cash investment of 3 percent of the estimated cost of acquisition. HUD Handbook 4155.1, REV-5, paragraph 2-10, requires that the cash investment in the property equal the difference between the amount of the insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including prepaid expenses and closing costs. The borrower made an earnest money deposit of $1,000; however, Wells Fargo did not provide documentation to support that the borrower paid $1,062.90 at closing or paid $350 for an appraisal fee and $15.12 for a credit report fee outside of closing. As a result, the borrower's total cash investment was $1,000. This is $1,639.40 less than the minimum required investment of $2,639.40.

Case number: 372-3585310
Loan amount: $99,977
Settlement date: May 25, 2006
Status: Default, special forbearance

Pertinent Details

A. The Borrower Made Payments Greater Than 30 Days Late on Prior Real Estate Mortgage

The borrower's credit report indicated that the second mortgage that the borrower was refinancing had six payments that were more than 30 days late within a year before the refinance closing. Mortgagee Letter 2005-43 states that for cash-out refinance transactions, the borrower's payment history must not include any payments that were more than 30 days late and his or her mortgage must be current for the month due.

B. The Borrower's Commission Income Was Inadequately Documented

HUD Handbook 4155.1, REV-5, paragraph 2-7, states that individuals whose commission income shows a decrease from one year to the next requires significant compensating factors to allow for loan approval. Wells Fargo did not provide compensating factors for the borrower's decreasing commission income. The borrower's income from commission was decreasing from $66,934 in 2005 to $62,760 in 2006 (projected).

HUD Handbook 4155.1, REV-5, paragraph 2-7, also states that for commission income to be used in calculating gross monthly income, the borrower must provide copies of signed tax returns for the past two years, along with the most recent pay stub (unreimbursed business expenses must be subtracted from gross income). The borrower received 100 percent commission income, yet all the required documents were not provided. The borrower provided a 2005 federal tax return (unsigned) and 2004 federal tax return summary from an income tax preparation company (unsigned and lacking accompanying schedules).