Issue Date December 17, 2008
Audit Report Number 2009-KC-1003

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

//signed//

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

SUBJECT: CTX Mortgage Did Not Follow HUD's Requirements When Underwriting 12 FHA Loans and Developing Its Quality Control Plan

HIGHLIGHTS

What We Audited and Why

We reviewed 23 Federal Housing Administration (FHA) loans originated by CTX Mortgage's Overland Park, Kansas, branch office. Our audit objectives were to determine whether CTX Mortgage followed U.S. Department of Housing and Urban Development (HUD) requirements for (1) borrower eligibility and creditworthiness and property eligibility when underwriting loans and (2) developing a written quality control plan.

We audited CTX Mortgage's Overland Park, Kansas, branch office because it had a default rate 37 percent higher than the national average. From June 1, 2006, through May 31, 2008, the Overland Park, Kansas, branch office originated 389 FHA loans valued at $48 million. During this same period, 25 of the loans (6.4 percent) defaulted, with six resulting in claims against the FHA insurance fund.

What We Found

CTX Mortgage did not follow HUD's requirements when underwriting 12 FHA loans. These loans had material underwriting deficiencies that affected the insurability of the loans. In addition, CTX Mortgage's written quality control plan did not contain all of HUD's required elements.

What We Recommend

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner require CTX Mortgage to indemnify HUD for 12 loans with unpaid principal balances totaling more than $1.2 million. Further, we recommend that HUD ensure that CTX Mortgage revises its quality control plan to fully comply with HUD's 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

CTX Mortgage agreed with our conclusions and recommended corrective actions. We provided the draft report to CTX Mortgage on December 2, 2008, and requested a response by December 16, 2008. It provided written comments on December 15, 2008.

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

CTX Mortgage is a Federal Housing Administration (FHA)-approved direct endorsement lender based in Dallas, Texas. It became an authorized FHA loan originator in October 1984. At the beginning of our audit, CTX Mortgage operated 90 branches in 30 states. During the audit, it closed or sold several of its retail branches, including the Overland Park, Kansas, branch office.

HUD authorized the Overland Park, Kansas, branch office to originate FHA loans in August 1996. The branch office originated FHA loans, but CTX Mortgage's corporate office in Dallas, Texas, underwrote all of the loans. Lenders have the option of using HUD-approved computerized underwriting systems to evaluate borrower creditworthiness for FHA loans. Loans approved using the automated underwriting systems require less documentation than manually underwritten loans. CTX Mortgage underwrote loans using HUD-approved underwriting systems. When the automated systems referred a loan for manual underwriting, CTX Mortgage had to underwrite the loans using full documentation requirements of HUD Handbook 4155.1, REV- 5.

From June 1, 2006, through May 31, 2008, the Overland Park, Kansas, branch office originated 389 FHA loans valued at $48 million. During this same period, 25 of the loans (6.4 percent) defaulted, including six claims that were paid by the FHA insurance fund.

CTX Mortgage participates in HUD's Lender Insurance program. The Lender Insurance program enables high-performing FHA-approved direct endorsement lenders with acceptable default and claim rates to endorse FHA loans without a preendorsement review by FHA. The program also eliminates the lender's submission of case binders to FHA.

Our audit objectives were to determine whether CTX Mortgage followed HUD requirements for (1) borrower eligibility and creditworthiness and property eligibility when underwriting loans and (2) developing a quality control plan.

RESULTS OF AUDIT

Finding 1: CTX Mortgage Did Not Follow HUD Requirements When Underwriting 12 FHA Loans

CTX Mortgage did not follow HUD's requirements when underwriting 12 FHA loans. This condition occurred because CTX Mortgage experienced a large volume of loan business in 2006 and 2007 with inexperienced loan processing and underwriting staff handling FHA loans. As a result HUD insured 12 loans that unnecessarily placed the FHA insurance fund at risk.

Underwriting Did Not Meet HUD Standards

CTX Mortgage did not follow HUD's requirements when underwriting 12 FHA loans. The chart in appendix D categorizes the material deficiencies and appendix E provides a detailed narrative of the deficiencies for each of the 12 loans.

FHA-approved lenders must follow HUD Handbook 4155.1, REV-5, Mortgage Credit Analysis for Mortgage Insurance, One- to Four-Family Properties, and HUD mortgagee letters when underwriting FHA loans. Appendix C provides details of HUD underwriting requirements.

The underwriting deficiencies primarily involved the following:

Unsupported Assets

CTX Mortgage did not adequately support assets (funds available to close) claimed by borrowers in six loans. HUD requires the lender to obtain a verification of deposit from the financial institution and the most recent bank statement for automated underwriting approvals. If a verification of deposit is not available, additional months of bank statements are required. HUD requires two months of bank statements on manual approvals. For the deficient loans, the lender did not obtain a verification of deposit or bank statements when the borrowers paid closing costs, or the lender had inadequate documentation for the borrowers' earnest money deposits.

For example, in FHA case number 291-3545704, the borrower made an earnest money deposit of $1,000 and needed $6,815 in additional funds to close the loan. The lender obtained a one-page statement from a bank, but the statement was illegible. The statement contained a handwritten note, stating that the balance was $2,383, but even if the documentation had been acceptable, the amount was not adequate to close the loan. The lender also obtained a letter from a trust company, stating that a wire transfer would take place for $7,500, but this documentation was not adequate to show that the borrower possessed the funds to close. There was also a wire transfer in the file verifying that $1,025 was transferred from the borrower to the title company for the earnest money deposit, but the additional $25 was an insufficient funds fee, indicating that the borrower did not have the funds available. The lender should have obtained legible bank statements from the borrower, showing that she had the earnest money available and had received the funds to close from the trust company.

Unpaid Judgments

CTX Mortgage did not adequately assess borrower credit histories in five loans. Three borrowers had no established traditional credit or nontraditional credit, one borrower had an open judgment on his credit report, and one borrower had delinquent federal debt on her credit report, which made her ineligible for an FHA loan.

For example, in FHA case number 291-3497893, the borrower had two unpaid judgments on his credit report. CTX Mortgage did not require the borrower to pay one of the judgments for $2,343 before the loan closed. The loan documentation was not clear regarding whether the second judgment had been discharged with the borrower's chapter 7 bankruptcy. This judgment was listed in the bankruptcy paperwork but was not identified as an item resolved under bankruptcy on the borrower's credit report. Court-ordered judgments are supposed to be paid before a mortgage loan is eligible for FHA insurance. The loan processor noted that the judgments were included in the bankruptcy, which was discharged on April 27, 2006; however, the judgment for $2,343 was filed on February 13, 2007, well after the bankruptcy was discharged. Further, the lender should have obtained proof that the remaining judgment was included in the bankruptcy.

Appraisal Deficiencies

CTX Mortgage did not obtain a second independent appraisal for two property flip transactions in two loans. If the resale 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 of, or more than the price paid by the seller when acquiring the property.

For example, in FHA case number 182-0840585, the subject property previously sold on March 30, 2007, for $23,101. The CTX Mortgage borrower purchased the property on July 18, 2007, for $69,900. The prior sale occurred 108 days earlier, and the sales price had increased by more than 300 percent. In such cases, HUD requires the lender to obtain a second independent appraisal to support the increased sales price. Although the lender documented several receipts for materials and labor used to rehabilitate the subject property, it did not obtain a second independent appraisal.

Underwriters Were Not Adequately Trained

CTX Mortgage senior management officials told us that their FHA loan business dramatically increased in 2006 and 2007. Because of the increased volume, they increased their FHA loan processing and underwriting staff. The officials also told us that the new staff were inexperienced and not adequately trained regarding FHA requirements. As a result of the inexperienced staff, CTX Mortgage management officials noticed that their default rates increased in 2007.

According to CTX Mortgage management officials, at the end of 2007 and the beginning of 2008, they addressed the inexperience by providing FHA training to the processing and underwriting staff. They also implemented new policies and procedures that addressed credit and risk assessment for FHA loans. Senior management officials told us that the additional training and guidance corrected the problems. Additionally, they told us that their FHA loan volume had significantly decreased recently and they had decreased their staff accordingly, retaining the most experienced staff.

All of the loans that we questioned due to material deficiencies closed before the additional training and guidance took place. We reviewed the most recent CTX Mortgage policies and procedures, including the guidance that CTX Mortgage issued in response to the problems that it had identified. The most recent policies and procedures adequately addressed the deficiencies identified in our 12 questioned loans. If the new guidance is followed, it should help mitigate future deficiencies in the problem areas identified.

Loans Containing Material Deficiencies Were Submitted for FHA Insurance

HUD cannot be assured that borrowers are eligible for FHA insurance on their loans when lenders do not properly monitor their underwriting efforts.

CTX Mortgage submitted 12 loans for FHA insurance that had material deficiencies. The loans had unpaid principal balances of about $1.2 million as of October 2008. Therefore, HUD insured 12 loans that should not have been insured. The loans unnecessarily placed the FHA insurance fund at risk for more than $500,000 in potential losses.

Recommendations

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner

1A. Require CTX Mortgage to indemnify HUD for nine actively insured loans with unpaid principal balances totaling $808,100. The projected loss is $339,402 based on the FHA insurance fund average loss rate of 42 percent for fiscal year 2008 (see appendix D).

1B. Require CTX Mortgage to indemnify HUD for future losses on three loans with unpaid principal balances totaling $438,846, for which HUD has already paid claims but the properties have not yet been sold. The projected loss is $184,315 based on the FHA insurance fund average loss rate of 42 percent for fiscal year 2008 (see appendix D).

Finding 2: CTX Mortgage's Quality Control Plan Lacked 10 HUD-Required Elements

CTX Mortgage's quality control plan lacked 10 HUD-required elements. This condition occurred because CTX Mortgage's senior managers relied on a quality control plan drafted by its attorneys. In addition, it relied on a March 2007 letter from HUD, stating that the plan complied with HUD requirements. As a result, CTX Mortgage could not ensure the accuracy, validity, and completeness of its loan originations.

Quality Control Plan Did Not Meet HUD Standards

CTX Mortgage's written quality control plan did not meet HUD requirements. The plan lacked 10 HUD-required elements. HUD Handbook 4060.1, REV-2, states that all FHA-approved lenders must implement and continuously have in place a quality control plan for the origination of insured mortgages as a condition of receiving and maintaining FHA approval. Further, the handbook establishes several basic elements that are required in all quality control programs. Appendix C provides the detailed HUD quality control requirements.

CTX Mortgage's quality control plan did not state that

- Findings involving fraud or other serious violations must be immediately referred to the Director of the Quality Assurance Division in the HUD homeownership center having jurisdiction. The plan only stated that the referral should be made to the "appropriate Agency." Further, the plan did not state that the lender must immediately refer findings of fraud, but, instead, it set the timeframe of within 60 days of initial discovery.

- If HUD staff are suspected of involvement in an identified fraud, that the matter must be referred to the Office of Inspector General (OIG).

- The lender will verify the identity of the loan applicant.

- The early payment default review was set up to identify patterns of the same appraiser, loan officer, loan processor, underwriter, or realtor.

- The lender was to reverify borrowers' other income documentation. The plan stated only that employment income would be reverified.

- The desk review of appraisals must include a review of the appraisal data, the validity of the comparables, the value conclusions, any changes by the underwriter, and the overall quality of the appraisal. Further, the plan did not state that CTX Mortgage would perform field reviews on 10 percent of the loans selected during the sampling process and that the appraisal field review must be performed by licensed appraisers listed in FHA's roster of appraisers.

- If it is found that the borrower was not occupying the subject property, the lender must report this information to HUD's Quality Assurance Division in the HUD homeownership center having jurisdiction.

- Legal documents would be reviewed to determine whether they were accurate and complete. The plan stated only that CTX Mortgage would determine whether the loan file contained all of the required legal documents.

- The lender would review the appraisal to determine whether the appraised value was established using reasonable comparables, reasonable adjustments, and in expectation of repairs required to meet minimum safety and soundness requirements.

- The lender's file review would determine whether more than one credit report was ordered and all credit reports were submitted to the direct endorsement underwriter. The plan stated only that the lender was to determine whether more than one credit report was ordered and that all reports were in the loan file sent to the related agency.

CTX Mortgage Relied on Its Attorneys and HUD Letter

CTX Mortgage's senior management officials believed that the written quality control plan complied with HUD requirements because CTX Mortgage's attorneys had drafted the plan. In addition, HUD provided a letter to the lender in March 2007, stating that the quality control plan complied with HUD requirements.

We discussed the March 2007 letter with HUD's Quality Assurance Division staff. Although HUD agreed that it had provided the letter to CTX Mortgage, it was unable to locate the CTX Mortgage quality control plan referred to in the letter. Therefore, HUD could not verify that the written plan referred to in the March 2007 letter was the same plan that CTX Mortgage provided to us as being in effect for our audit period. However, HUD staff reviewed the written plan provided to us and agreed that it lacked critical elements that HUD requires.

Loans Might Not Meet HUD Standards

The lender could not ensure that it consistently

- Complied with HUD requirements when originating loans;
- Protected itself and HUD from unacceptable risk; and
- Guarded against errors, omissions, and fraud.

In addition, HUD lacked assurance that CTX Mortgage consistently identified and corrected potential deficiencies in its loan origination process before submitting loans for FHA insurance.

Recommendation

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner

2A. Ensure that CTX Mortgage revises its quality control plan to fully comply with HUD's requirements.

SCOPE AND METHODOLOGY

To accomplish our objectives, we reviewed the FHA underwriting policies and procedures for HUD and CTX Mortgage. We interviewed CTX Mortgage management and staff and HUD staff. We also reviewed CTX Mortgage's quality control plan and quality control reports.

CTX Mortgage's Overland Park, Kansas, branch office originated 389 FHA loans between June 1, 2006, and May 31, 2008. Of the 389 loans, 25 reached a 90-day defaulted status. We reviewed CTX Mortgage's loan files for 23 of the 25 defaulted loans. We removed two loans that were streamline refinances because these loans required less than full underwriting.

When identifying underwriting deficiencies, we assessed whether the deficiencies were material and should have caused the lender to disapprove the loan. We considered any deficiencies that affected the approval and insurability of the loans as significant and recommended that HUD take appropriate action on these loans. When identifying underwriting deficiencies that we considered minor, we informed CTX Mortgage of the deficiencies but did not recommend that HUD take action on these loans.

We assigned a value to the potential savings to HUD if it implements our recommendations to require CTX Mortgage to indemnify loans with material deficiencies. For those loans for which HUD had not yet incurred a loss, we applied FHA's average loss experience for fiscal year 2008 provided by HUD. We calculated the savings value at $523,717, which is 42 percent of the unpaid principal balance of $1,246,946.

We relied on computer-processed data contained in HUD's Single Family Data Warehouse system. During the audit, we assessed the reliability of the data and found it to be adequate. We also performed sufficient tests of the data, and based on the assessments and testing, we concluded that the data were sufficiently reliable to be used in meeting our objectives.

We performed audit work from July through October 2008. We conducted work at CTX Mortgage's Overland Park, Kansas, branch office until it closed and completed the remainder of the work through communications with the CTX Mortgage corporate office in Dallas, Texas.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

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

Relevant Internal Controls

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

- Controls to ensure that direct endorsement underwriters are adequately trained.

- Controls to ensure that the quality control plan is written and implemented to comply with HUD's requirements.

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 that the following items are significant weaknesses:

- CTX Mortgage did not adequately train its direct endorsement underwriters (finding 1).

- CTX Mortgage did not have adequate controls in place to ensure that it followed HUD requirements when developing its written quality control plan for FHA loans (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$ 339,402
1B	$ 184,315

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include 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 that are specifically identified.

Implementation of our recommendations to require CTX Mortgage to indemnify HUD for materially deficient loans will reduce the risk of loss to the FHA insurance fund. The amount above reflects that, upon sale of the mortgaged properties, FHA's average loss experience is about 42 percent of the unpaid principal balance based upon statistics provided by HUD.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Auditee Comments

CTX MORTGAGE COMPANY

December 15, 2008

3100 McKinnon Street
3rd Floor
Dallas, TX 75201

Phone: 214 468-4000
Fax: 214 468-4212

Mr. Ronald J. Hosking
Regional Inspector General for Audit
U.S. Dept of Housing and Urban Development
Office of Inspector General, Region 7 Office of Audit
Gateway Tower II – 5th Floor
400 State Avenue
Kansas City, KS 66101-2406

Dear Mr. Hosking:

CTX Mortgage Company appreciates the opportunity to respond to the audit report of our Overland Park, Kansas, branch office.

In early 2008, CTX implemented policy and risk assessment criteria focused on multiple layering of risk factors and conducted training to insure that staff clearly understood and applied FHA guidelines. We believe that these changes and training conducted will mitigate the problems which were identified in this audit.

At the time of this audit, CTX was in the process of consolidating our branch structure. CTX closed the Overland Park, Kansas, branch in August 2008. Future loan originations will originate from the following structure:

- CTX will continue to have branch locations across the country.
- Loan applications will primarily be taken via web or phone through the CTX center located in Dallas, but Mortgage Counselors will continue to be available in the branches to take applications, when necessary.
- All loan processing, underwriting, and closing is being centralized at the Dallas Center.
- There will be one primary manager at the center.
- The operations, underwriting, and closing department managers will all report to the center's primary manager. There will be team structures made up of our most experienced staff in each area with team managers reporting to the individual department managers.
- Currently, we are phasing out processing at branch locations and by March 2009, 100% of loan processing will be done in the Dallas Center.

We believe that this new structure will remedy and alleviate recurrence of problems identified as a result of this audit.

- Guidelines not met on the 12 loans cited in this audit report.

CTX Response: As previously discussed with the HUD OIG auditor, CTX agrees with the findings for indemnification of the loans cited as deficient in this report.

Internal Controls:

- Deficiencies identified in the CTX Quality Control Plan.

CTX Response: CTX has undertaken review of our existing QC plan (which was approved by HUD Washington on Mar. 20, 2007) and agrees to implement the criteria cited in the audit.

- DE Underwriter Training not adequate.

CTX Response: CTX undertook additional underwriter training during 2008 in conjunction with the implementation of additional policy and risk assessment controls. In addition, the majority of the underwriters, who approved the loans cited as deficient in this audit, are no longer employed with CTX. Current underwriting staff is made up of highly qualified, seasoned DE underwriters with years of experience in decisioning FHA loans.

ONE TEAM
ONE VISION

We respectfully submit our response to this audit report. CTX Mortgage Company, LLC, values our relationship with HUD and will use the final audit document and the constructive information provided by the HUD OIG auditor to further improve our operations and our loan quality review to confirm continuing compliance with HUD requirements.

Sincerely,

Susan A. Billings

Susan A. Billings
Senior Vice President
CTX Risk Management

OIG Evaluation of Auditee Comments

CTX Mortgage provided additional documentation for two of the questioned loans, aside from its comments on the report. CTX Mortgage acknowledged that the documentation did not change the overall conclusion that the loans contained material deficiencies. We evaluated the new information as follows:

In FHA case number 291-3495094, we questioned a property appraisal with material deficiencies involving the date of the appraisal, photographs of the subject property and comparable properties, and the timing of the appraisal. CTX Mortgage provided a dated signature page of the appraisal, which indicated that the appraisal was performed shortly before the loan closed instead of a year earlier, as was indicated on the appraisal report used for loan approval. However, CTX Mortgage did not provide any additional documentation demonstrating that the underwriter had questioned or addressed the other material deficiencies of the appraisal. See appendix E for details on this loan.

In FHA case number 291-3522148, we questioned a borrower's Social Security Administration income that CTX Mortgage had included in the qualifying financial ratios but was not supported by anything other than deposits shown on two bank statements. CTX Mortgage provided a statement from the Social Security Administration that listed the borrower's name but the address was not the same as the address associated with the FHA loan or the borrower's previous address. Further, the document did not indicate what type of benefits the borrower was receiving or if they would continue for the first three years of the FHA mortgage. See appendix E for details on this loan.

Appendix C

CRITERIA

Criterion 1
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C, states that HUD looks to the underwriter as the focal point of the direct endorsement program. The underwriter must assume the following responsibilities:

- Compliance with HUD instructions, the coordination of all phases of underwriting, and the quality of decisions made under the program.
- The review of appraisal reports, compliance inspections, and credit analyses performed by fee and staff personnel to ensure reasonable conclusions, sound reports, and compliance with HUD requirements.
- The decisions relating to the acceptability of the appraisal, the inspections, the buyer's capacity to repay the mortgage, and the overall acceptability of the mortgage loan for HUD insurance.
- The monitoring and evaluation of the performance of fee and staff personnel used for the direct endorsement program.
- Awareness of the warning signs that may indicate irregularities and an ability to detect fraud, as well as the responsibility to ensure that underwriting decisions are performed with due diligence in a prudent manner.

Criterion 2
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-3G, states that the lender's underwriter is to review the appraisal to determine whether the appraiser's conclusions are acceptable. If the appraisal is acceptable, the property is eligible for HUD mortgage insurance. The review consists essentially of the following:

- Verification (as possible from available data) that the factual information submitted is correctly reported.
- Determination of the plausibility and consistency of the conclusions based upon data presented in the report.
- Determination of the consistency of the reported conclusions by comparison with other data conclusions reported in similar cases recently processed.
- Compliance with underwriting instructions in HUD Handbooks 4145.1 and 4150.1.

If the underwriter concludes that the appraisal report findings are inconsistent or otherwise unacceptable, he may contact the appraiser or return the case to the appraiser for reconsideration.

Criterion 3
HUD Handbook 4060.1, REV-2, section 7-3, states that there are several basic elements that are required in all quality control programs that apply to both origination and servicing.

Criterion 4

HUD Handbook 4060.1, REV-2, paragraph 7-3J, states that findings of fraud or other serious violations must be immediately referred to HUD using the lender reporting feature in the Neighborhood Watch Early Warning System. If HUD staff is suspected of involvement, the findings should be referred to the Office of Inspector General at 451 7th Street, SW, Room 8256, Washington, DC 20410.

Criterion 5

HUD Handbook 4060.1, REV-2, paragraph 7-5A, states that lenders should monitor the application process and must verify the identity of the loan applicant.

Criterion 6

HUD Handbook 4060.1, REV-2, paragraph 7-5C, states that lenders must identify patterns of early defaults by location, program, loan characteristic, loan correspondent, or sponsor. Lenders may use HUD's Neighborhood Watch Early Warning System to identify patterns. Lenders must identify commonalities among participants in the mortgage origination process to learn the extent of their involvement in problem cases. Loans involving appraisers, loan officers, processors, underwriters, etc., who have been associated with problems, must be included in the review sample.

Criterion 7

HUD Handbook 4060.1, REV-2, paragraph 7-6E(2), states that documents contained in the loan file should be checked for sufficiency and subjected to written reverification. Examples of items that must be reverified include but are not limited to the borrower's employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds.

Criterion 8

HUD Handbook 4060.1, REV-2, paragraph 7-6E(3), states that a desk review of the property appraisal must be performed on all loans chosen for a quality control review except streamline refinances and HUD-owned real estate sales. The desk review must include a review of the appraisal data, the validity of the comparables, the value conclusion, any changes made by the underwriter, and the overall quality of the appraisal. Lenders are expected to perform field reviews on 10 percent of the loans selected during the sampling process. Field reviews must be performed by licensed appraisers listed on FHA's roster of appraisers.

Criterion 9

HUD Handbook 4060.1, REV-2, paragraph 7-6E(4), states that in cases in which the subject property is suspect, lenders must attempt to determine whether the borrower is occupying the property. The failure of the borrower to occupy the property may be an indication that the loan contains other problems. If it is found that the borrower is not occupying a property mortgaged as owner-occupied, lenders must report this information, in writing, to the Quality Assurance Division in the HUD homeownership center having jurisdiction.

Criterion 10
HUD Handbook 4060.1, REV-2, paragraph 7-6G, states that each loan selected for a quality control review must be reviewed to determine whether the closing and legal documents are accurate and complete.

Criterion 11
HUD Handbook 4060.1, REV-2, paragraph 7-7B, states that the quality control program must address appraisals and determine whether the appraised value was established using reasonable comparables, reasonable adjustments, and in expectation of repairs required to meet minimum safety and soundness requirements.

Criterion 12
HUD Handbook 4060.1, REV-2, paragraph 7-7F, states that the quality control program must address credit documentation and the lender must determine whether more than one credit report was ordered and whether all credit reports were submitted with the loan package to HUD/FHA or the direct endorsement underwriter.

Criterion 13
HUD Handbook 4155.1, REV-5, paragraph 1-8A, states that identity-of-interest transactions on principal residences are restricted to a maximum loan-to-value ratio of 85 percent. Identity of interest is defined as a sales transaction between parties with family relationships or business relationships. However, maximum financing above 85 percent loan to value is permissible under the following circumstance:

The 85 percent limit may be waived if the family member has been a tenant in the property for at least six months immediately predating the sales contract. A lease or other written evidence must be submitted to verify occupancy.

Criterion 14
HUD Handbook 4155.1, REV-5, paragraph 1-11A(2), states that in refinances, the amount of the existing first mortgage may not include delinquent interest, late charges, or escrow shortages.

Criterion 15
HUD Handbook 4155.1, REV-5, chapter 2, states that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

Criterion 16
HUD Handbook 4155.1, REV-5, section 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. A borrower who has made payments on previous and current obligations in a timely manner represents reduced risk. Conversely, if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

While minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments, collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

Neither the lack of credit history nor the borrower's decision not to use credit may be used as a basis for rejecting the loan application. HUD also recognizes that some prospective borrowers may not have an established credit history. For those borrowers and for those who do not use traditional credit, the lender must develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider. The lender must document that the providers of nontraditional credit exist and verify the credit information. Documents confirming the existence of a nontraditional credit provider may include a public record from the state, county, or city records or other means providing a similar level of objective confirmation. To verify the credit information, lenders must use a published address or telephone number for that creditor.

As an alternative, the lender may elect to use a nontraditional mortgage credit report developed by a credit-reporting agency, provided that the credit-reporting agency has verified the existence of the credit providers and the lender verifies that the nontraditional credit was extended to the applicant. The lender must verify the credit using a published address or telephone number to make that verification.

The basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history unless there is major derogatory credit on his or her revolving accounts.

Criterion 17
HUD Handbook 4155.1, REV-5, paragraph 2-3A, states that the lender must pay particular attention to the borrower's previous rental or mortgage payment history. The payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity of interest with the borrower), verification of mortgage directly from the mortgage servicer, or canceled checks covering the most recent 12-month period.

Criterion 18
HUD Handbook 4155.1, REV-5, paragraph 2-3C, states that court-ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement. An exception may be made if the borrower has agreed with the creditor to make regular and timely payments on the judgment and documentation is provided that the payments have been made in accordance with the agreement.

Criterion 19
HUD Handbook 4155.1, REV-5, paragraph 2-5B, states that if the borrower, as revealed by public records, credit information, or HUD's Credit Alert Interactive Voice Response System, is presently delinquent on any federal debt or has a lien, including taxes, placed against his or her property for a debt owed to the United States, the borrower is not eligible until the delinquent account is brought current, paid, or otherwise satisfied or a satisfactory repayment plan is made between the borrower and the federal agency owed and is verified in writing. Tax liens may remain unpaid provided the lien holder subordinates the tax lien to the FHA-insured mortgage. If any regular payments are to be made, they must be included in the qualifying ratios.

Although eligibility for an FHA-insured mortgage may be established by performing the actions described above, the overall analysis of the creditworthiness must include consideration of a borrower's previous failure to make payments to the federal agency in the agreed-to manner and must document its analysis of how the previous failure does not represent a risk of mortgage default.

Criterion 20
HUD Handbook 41551, REV-5, section 2-6, states that the lender must verify the borrower's employment for the most recent two full years. If a borrower indicates he or she was in school or in the military during any of this time, the borrower must provide evidence supporting this claim, such as college transcripts or discharge papers. The borrower also must explain any gaps in employment spanning one month or more.

Criterion 21
HUD Handbook 4155.1, REV-5, section 2-7, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. If the borrower intends to retire during this period, the effective income must be the amount of documented retirement benefits, Social Security payments, or other payments expected to be received in retirement.

In most cases, the borrower's income will be limited to salaries or wages. Income from other sources can be included as effective income with proper verification by the lender.

Criterion 22
HUD Handbook 4155.1, REV-5, paragraph 2-7E, states that retirement and Social Security income require verification from the source (i.e., former employer, Social Security Administration) or federal tax returns. If any benefits expire within the first full three years, the income source may be considered only as a compensating factor.

Criterion 23
HUD Handbook 4155.1, REV-5, paragraph 2-7P, states that income from trusts may be used if guaranteed, constant payments will continue for at least the first three years of the mortgage term. Documentation is required and includes a copy of the trust agreement or other trustee's statement, confirming amount, frequency of distribution, and duration of payments. Funds from

the trust account also may be used for the required cash investment with adequate documentation.

Criterion 24

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

Criterion 25

HUD Handbook 4155.1, REV-5, paragraph 2-10B, states that a verification of deposit, 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.

Criteria 26

HUD Handbook 4155.1, REV-5, paragraph 2-10C, states that an outright gift of the cash investment is acceptable if the donor is the borrower's relative, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. The gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. No repayment of the gift may be expected or implied. (As a rule, HUD is not concerned with how the donor obtains the gift funds provided they 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.) This rule also applies to properties of which the seller is a government agency selling foreclosed properties, such as the U.S. Department of Veterans Affairs or U.S. Department of Agriculture, Rural Housing Service. Only family members may provide equity credit as a gift on a property being sold to other family members.

The lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. In addition, the lender must document the transfer of funds from the donor to the borrower as follows:

1. If the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document, showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that show the deposit are also required.

2. If the gift funds are to be provided at closing,

a. If the transfer of the gift funds is by certified check made on the donor’s account, the lender must obtain a bank statement, showing the withdrawal from the donor’s account, as well as a copy of the certified check.

b. If the donor purchased a cashier’s check, money order, official check, or any other type of bank check as a means of transferring the gift funds, the donor must provide a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor’s personal account. If the donor borrowed the gift funds and cannot provide documentation from the bank or other savings account, the donor must provide written evidence that those funds were borrowed from an acceptable source, i.e., not from a party to the transaction, including the lender. “Cash on hand” is not an acceptable source of the donor’s gift funds.

Regardless of when the gift funds are made available to the homebuyer, 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. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Criterion 27

HUD Handbook 4155.1, REV-5, paragraph 2-11A, 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 other recurring charges extending 10 months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts, alimony, etc. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower’s ability to make the mortgage payment during the months immediately after loan closing. This is especially true if the borrower will have limited or no cash assets after loan closing.

Criterion 28

HUD Handbook 4155.1, REV-5, paragraph 2-11C, states that if a debt payment, such as a student loan, is scheduled to begin within 12 months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis, unless the borrower provides written evidence that the debt will be deferred to a period outside this timeframe. Similarly, balloon notes that come due within one year of loan closing must be considered in the underwriting analysis.

Criterion 29

HUD Handbook 4155.1, REV-5, section 2-13, states that compensating factors that may be used in justifying approval of mortgage loans with ratios exceeding the guidelines include those listed below. Underwriters must state in the “remarks” section of the Form HUD-92900WS the compensating factors used to support loan approval.

A. The borrower has successfully demonstrated the ability to pay housing expenses equal to or greater than the proposed monthly housing expense for the new mortgage over the past 12-24 months.
B. The borrower makes a large downpayment toward the purchase of the property.
C. The borrower has demonstrated a conservative attitude toward the use of credit and an ability to accumulate savings.
D. Previous credit history shows that the borrower has the ability to devote a greater portion of income to housing expenses.
E. The borrower receives compensation or income not reflected in effective income but directly affecting the ability to pay the mortgage, including food stamps and similar public benefits.
F. There is only a minimal increase in the borrower's housing expense.
G. The borrower has substantial documented cash reserves (at least three months of mortgage payments) after closing. In determining whether an asset can be included as cash reserves or cash to close, the lender must judge whether the asset is liquid or readily convertible to cash and can be so converted absent retirement or job termination.
H. The borrower has substantial nontaxable income (if no adjustment was made previously in the ratio computations).
I. The borrower has potential for increased earnings, as indicated by job training or education in the borrower's profession.
J. The home is being purchased as the result of relocation of the primary wage earner, and the secondary wage earner has an established history of employment, is expected to return to work, and has reasonable prospects for securing employment in a similar occupation in the new area. The underwriter must address the availability of such possible employment.

Criterion 30

HUD Handbook 4155.1, REV-5, paragraph 3-1C, states that the lender is required to document a valid Social Security number for each borrower, coborrower, and cosigner on the mortgage. All individuals eligible for legal employment in the United States must have a Social Security number. Each borrower must provide the lender with evidence of his or her own valid Social Security number as issued by the Social Security Administration. This requirement applies to purchase money loans and all refinances, including streamline refinances. While the actual Social Security card is not required, the lender is required to validate the Social Security number. Lenders may use various means for validating the Social Security numbers, including examining the borrower's pay stubs, passport, and valid tax returns, and may use service providers including those with direct access to the Social Security Administration. The lender is also required to resolve any inconsistencies or multiple Social Security numbers for individual borrowers that are revealed during loan processing and underwriting.

Criterion 31

HUD Handbook 4155.1, REV-5, paragraph 3-1E**,** states that a verification of employment and the borrower's most recent pay stub are to be provided. "Most recent" means at the time the initial loan application is made. If the document is not more than 120 days old when the loan closes (180 days old on new construction), it does not have to be updated.

As an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service (IRS) W-2 forms from the previous two years. The pay stub(s) must show the borrower's name, Social Security number, and year-to-date earnings. Any copies of the IRS W-2 form not submitted with the borrower's income tax returns are considered "original" W-2s. (These original documents may be photocopied and returned to the borrower.) The lender also must verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified. For all loans processed in this manner, the lender also must obtain a signed copy of Form IRS 4506, Request for Copy of Tax Form; Form IRS 8821; or a document that is appropriate for obtaining tax returns directly from the IRS. The lender also may use an electronic retrieval service for obtaining the IRS W-2 form and tax return information.

Criterion 32

HUD Handbook 4155.1, REV-5, paragraph 3-1F, states that a verification of deposit and most recent bank statement are to be provided. "Most recent" means at the time the initial loan application is made. Provided the document is not more than 120 days old when the loan closes (180 days old on new construction), it does not have to be updated.

As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower original bank statements covering the most recent three-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements.

Criterion 33

HUD Handbook 4155.1, REV-5, paragraph 3-1J, states that a payment history of present mortgages must be in the form of a direct verification from the landlord or mortgage servicer or through information shown on the credit report.

Criterion 34

Mortgagee Letter 2005-16 states that FHA's benchmark payment-to-income and debt-to-income ratios of 29 percent and 41 percent, respectively, were promulgated before Congress enacted recent federal tax cuts. Consequently, most borrowers seeking FHA mortgage insurance have enjoyed a reduction to their federal income tax during the last several years, thus increasing their buying power and disposable income.

Therefore, for manually underwritten mortgages in which the direct endorsement underwriter must make the credit decision, the qualifying ratios are raised to 31 percent and 43 percent. This change will allow a larger number of deserving families to purchase their first home while not increasing the risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Criterion 35
Mortgagee Letter 2005-27 states that although FHA provides validation checks on Social Security numbers, lenders are reminded that it is their responsibility, not FHA's, to verify each borrower's Social Security number as well as each borrower's identity. FHA provides this validation process to protect the insurance funds it manages.

Criterion 36
Mortgagee Letter 2006-14 states that if the resale 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.

Criterion 37
Desktop Underwriter User's Guide for FHA Loans, September 2005, chapter 2, states that the lender is required to review the credit report and is accountable for compliance with FHA guidelines. Information on the credit report that has not been recognized by Desktop Underwriter may require the lender to downgrade the underwriting recommendation.

Appendix D

SCHEDULE OF SIGNIFICANT UNDERWRITING DEFICIENCIES

			Deficiency area(s)								
FHA case number	Unpaid principal balance	Insurance status	Unsupported income or questionable employment history	Underreported liabilities	Excessive ratio(s) (including debt- and loan-to-value ratios)	Unsupported assets	Inadequate gift documentation	Significant credit-related deficiencies or no credit	Missing verification of rent or mortgage payment history	Significant appraisal deficiencies	Social Security number discrepancies
182-0810192	$ 82,448	Active	x			x					
182-0834009	$ 77,693	Active			x			x	x		
182-0840585	$ 68,504	Active								x	
182-0845162	$ 99,164	Active			x			x		x	
183-0048777	$ 85,152	Active			x				x		
291-3446152	$ 108,429	Claim				x		x			
291-3495094	$ 95,370	Active	x			x				x	
291-3497893	$ 126,077	Active						x		x	x
291-3522148	$ 43,366	Active	x	x	x	x					
291-3524483	$ 168,581	Claim		x	x				x		
291-3545704	$ 161,836	Claim	x			x		x	x		
291-3550001	$ 130,327	Active				x	x				
Total	**$ 1,246,946**										

Appendix E

CASE STUDIES FOR 12 QUESTIONED LOANS

Case number: 182-0810192

Insured amount: $84,549

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 3rd payment

Date of loan closing: May 31, 2006

Current status: First legal action to commence foreclosure in September 2008

Underwriter type: Manual

Unsupported Income and Questionable Employment History

CTX Mortgage did not establish an acceptable employment history for the borrower or obtain adequate support for the borrower's earnings at the time of loan closing. The lender did not verify employment for any of the four employers listed in the letter of explanation of employment history provided by the borrower. Further, the lender obtained only one pay stub as employment documentation for the borrower's employer at the time of closing.

The following chart depicts the borrower's claimed employment, based on the loan documentation.

Dates of employment	Employer	Letter of explanation	IRS Form W-2	Loan application
May 2006	A	X		X
January through April 2006	B	X		X
2005	C	X	X	
2005	D		X	
August 2003 to August 2005	E	X	X	X

According to a letter of explanation from the borrower, he worked for four different employers in the two years before loan closing (employers A, B, C, and E). The borrower also stated in the letter of explanation that he changed jobs from employer B to employer A because he was working for a temporary employment agency and did not receive benefits. The name of the temporary employment agency was not listed in the letter.

According to the final uniform residential loan application, the borrower worked for only three employers in the two years before loan closing (employers A, B, and E). The application showed that the borrower worked for employer E for two years, from August 2003 through August 2005. The next employment listed was January through April 2006 with employer B and then with employer A as of May 2006. The borrower provided no explanation for an employment gap between August 2005 and January 2006, which was indicated on the loan application. However, the IRS Forms W-2 for 2005 show that the borrower was employed by employer C, employer D, and employer E. Employers C and D may have been the borrower's employers between August of 2005 and the end of 2005. We were unable to confirm this information because CTX Mortgage did not verify employment for any of the five different employers listed in the loan documentation.

Further, we were unable to determine when the borrower worked for the temporary employment agency because the loan documentation did not contain the agency's name or dates of employment at the agency. It is unlikely that the borrower worked for the temporary employment agency in 2005 because these types of companies pay the employees directly and the temporary employer pays the agency. If the borrower worked for the temporary employment agency in 2005, there should have been an IRS Form W-2 from the agency.

We compiled the employment history using the loan application, the letter of explanation, and the IRS Forms W-2; however, there was not enough information to determine whether there were gaps in employment. Further, it was unclear why the borrower did not disclose employer D on either the loan application or the letter of explanation. CTX Mortgage did not address this discrepancy.

Finally, CTX Mortgage did not establish an earnings trend supporting the borrower's rate of pay at the time of loan closing. The borrower's IRS Forms W-2 for 2005 supported income of $1,274 per month ($7,425 + $4,845 + $3,023 / 12 months). CTX Mortgage approved the borrower using $3,467 per month. The borrower's sole pay stub listed a rate of pay of $20 per hour, which equates to $3,467 per month ($20 * 40 hours * 52 weeks / 12 months); however, CTX Mortgage did not obtain a verification of employment that would have indicated the borrower's projected rate of pay and whether the borrower's continued employment was probable.

Further, when comparing year-to-date gross earnings with the current pay period earnings on the pay stub, we calculated that the borrower had worked only 137 hours year-to-date (approximately three weeks for the current employer, when accounting for overtime). We also questioned the legitimacy of the borrower's pay stub. The "pay date" shown on the pay stub (May 5, 2006) predates the "pay period" (May 6 through May 19, 2006).

Without sufficient documentation of the borrower's employment history and income continuance, we question the underwriter's ability to accurately underwrite the loan.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, chapter 2 (criterion 15)
HUD Handbook 4155.1, REV-5, section 2-6 (criterion 20)
HUD Handbook 4155.1, REV-5, section 2-7 (criterion 21)
HUD Handbook 4155.1, REV-5, paragraph 3-1E (criterion 31)

Unsupported Assets

CTX Mortgage did not verify assets of $2,133 used to close the loan. According to the HUD-1 settlement statement, the borrower paid $2,133 at closing. However, the borrower's ending bank account balance as of April 24, 2006, was only $703. Therefore, we question the source of funds that were used to close the loan.

In addition, the loan file contained incomplete bank statements for the borrower. The borrower's March 2006 bank statement did not contain any pages showing withdrawals, checks, or other reductions to the account. Further, the April 2006 statement showed an incomplete list of checks or other withdrawals from the account. The April 2006 statement showed $2,079 in reductions to the account that were not supported by details of the bank statement. This documentation was not an adequate verification of the source of funds used to close the loan.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-10 (criterion 24)
HUD Handbook 4155.1, REV-5, paragraph 3-1F (criterion 32)

Case number: 182-0834009

Insured amount: $78,960

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: April 26, 2007

Current status: First legal action to commence foreclosure in September 2008

Underwriter type: Manual

Missing Verification of Rental Payments

CTX Mortgage did not obtain a sufficient rental payment history. The borrower provided a letter of explanation, stating that due to marital problems at some point in 2005, he moved in with his parents. The letter states that in October 2006, he and his wife moved back in together and paid rent of $650 for two months. The borrower provided one illegible money order to support the October 2006 rent, but no name was included in the “pay to” field. The borrower provided several handwritten receipts to support cash payments of $250, $300, and $150 throughout November 2006 for the November rent. No rent was paid in December 2006 or January 2007. The borrower then moved again. The borrower provided a typed receipt for February 2007 rent in the amount of $700. The borrower also provided a copy of the March 2007 rent check for $750. The lender did not obtain a verification of rent from either landlord. The money orders, receipts, and letter of explanation accounted for only four months of the two years before loan application. Further, the receipts from November demonstrated that the borrower could not make the entire housing payment at the beginning of the month, as would be required by a mortgage.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 2-3A (criterion 17)
HUD Handbook 4155.1, REV-5, paragraph 3-1J (criterion 33)

Questionable Credit History

CTX Mortgage did not obtain a sufficient nontraditional credit history. The borrower had a minimal credit history and did not provide sufficient nontraditional letters of credit. The credit report showed only one credit score (510) and included several small collections. The lender included a letter of explanation for the collection accounts, which also stated that the borrower had made on-time payments for two years on an auto loan. The lender did not obtain independent documentation to support this claim, and no auto loan was listed on the borrower’s credit report. The only account other than those in collection was an installment debt that had a current balance that was the same as the maximum balance; therefore, it appeared that no payments had been made on the account. The installment debt did not appear to be the car loan referred to in the letter of explanation. The loan file contained no documentation of the auto loan, and, therefore, the lender did not verify that the loan was paid off and did not need to be included in the liabilities when calculating financial ratios. Another letter of explanation stated that all utilities were maintained in the spouse’s name.

HUD Requirements – Appendix C
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-3 (criterion 16)

Excessive Ratios and Inadequate Compensating Factors
CTX Mortgage did not document adequate compensating factors for excessive qualifying ratios when approving the loan. The borrower's qualifying income ratios were 36 percent and 48 percent. The underwriter listed the following compensating factors on the mortgage credit analysis worksheet:

- Housing is decreasing,
- Used average income to qualify, and
- Not a credit user and borrower is able to devote more income to housing.

The decreased housing compensating factor was inadequate. The housing payment decreased by only $25 per month. The receipts showed that the borrowers paid rent of $750 per month for February and March 2007, and the mortgage credit analysis worksheet showed the new housing payment at $727 per month. This was not a significant decrease in housing payments. Further, the borrower was unable to make the full rental payment at the beginning of the month for November 2006 (see rental history section above).

The average income compensating factor was inadequate and not one that HUD allows. As a general practice in calculating income, the lender should have used the average monthly income to qualify the borrower, and, therefore, this was not a compensating factor.

As noted above, the borrower was not a significant credit user; however, this fact did not equate to more income being available for housing expenses. According to the borrower's credit report, the borrower was unable to make the credit payments that he did incur, and the lender did not establish a nontraditional credit history, such as utility payments. In November 2007, the borrower made rent payments in installments. The borrower showed no history of savings in a bank or at home.

The layering of risk makes this loan materially deficient.

HUD Requirements – Appendix C
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-13 (criterion 29)
Mortgagee Letter 2005-16 (criterion 34)

Case number: 182-0840585 | Insured amount: $69,351

Section of Housing Act: 203(b) | Status upon selection: Defaulted on 4th payment

Date of loan closing: July 18, 2007 | Current status: Active – five months delinquent

Underwriter type: Manual

Missing Appraisal for Property Flip Transaction

CTX Mortgage did not obtain a second appraisal for a property flip transaction. The subject property previously sold on March 30, 2007, for a sales price of $23,101, and the borrower purchased the property on July 18, 2007, for a sales price of $69,900. The prior sale occurred only 108 days earlier, and the sales price had increased by 302.58 percent. In such cases, HUD requires the lender to obtain a second independent appraisal to support the increased sales price. Although the lender documented several receipts for materials and labor used to rehabilitate the subject property, the loan file contained no evidence that the lender obtained a second independent appraisal.

Instead, the lender obtained a letter from the same appraiser, stating that the subject property was purchased as a distressed sale from HUD on March 30, 2007. This claim did not represent an exception to the rule because the borrower did not purchase the property directly from HUD. Rather, the subject property was purchased by the seller and sold to the borrower with a substantial increase in the sales price.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
Mortgagee Letter 2006-14 (criterion 36)

Case number: 182-0845162 | Insured amount: $100,207

Section of Housing Act: 203(b) | Status upon selection: Defaulted on 4th payment

Date of loan closing: September 14, 2007 | Current status: Active – three months delinquent

Underwriter type: Manual

Missing Appraisal for Property Flip Transaction

CTX Mortgage did not obtain a second appraisal for a property flip transaction. The subject property previously sold on May 29, 2007, for a sales price of $28,601, while the current borrower purchased the property on September 14, 2007, for a sales price of $100,207. The prior sale occurred only 105 days earlier, and the sales price had increased by 350.36 percent. In such cases, HUD requires the lender to obtain a second independent appraisal to support the increased sales price. Although the lender documented several receipts for materials and labor used to rehabilitate the subject property, the loan file contained no evidence that the lender obtained a second independent appraisal.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
Mortgagee Letter 2006-14 (criterion 36)

Questionable Credit History

CTX Mortgage did not establish a credit history for the borrower. Based on the documentation in the loan file, the borrower had never established any form of credit. Therefore, the lender required the borrower to provide a letter from his mother indicating that he had lived at home with her and helped pay utilities that were in her name.

In cases in which the borrower does not have an established credit history, HUD requires the lender to develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider. CTX Mortgage did not obtain an acceptable nontraditional credit history.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-3 (criterion 16)

Excessive Ratios and Inadequate Compensating Factors

CTX Mortgage did not document adequate compensating factors for excessive qualifying ratios when approving the loan. The borrower's front and back qualifying ratios (as stated on the mortgage credit analysis worksheet) were excessive at 46.21 percent and 46.21 percent. Further, the compensating factors listed on the mortgage credit analysis worksheet were not sufficient to justify approval of the mortgage.

The underwriter listed the following compensating factors:

- No debt user and
- Prepurchase home buyer counseling.

The compensating factors were not consistent with the allowable compensating factors listed in HUD Handbook 4155.1, REV-5, section 2-13. Therefore, the compensating factors were inadequate.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-13 (criterion 29)
Mortgagee Letter 2005-16 (criterion 34)

Case number: 183-0048777

Insured amount: $87,428

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 19th payment

Date of loan closing: May 26, 2006

Current status: Active – four months delinquent

Underwriter type: Manual

Maximum Mortgage Amount Exceeded for Identify-of-Interest Transaction

CTX Mortgage approved the FHA loan with a 97 percent loan-to-value ratio instead of the required 85 percent loan-to-value ratio for identify-of-interest transactions. The loan application showed that the borrower had been living in the house that he was going to purchase for more than two years and was paying $960 in monthly rent. According to the HUD-1 settlement statement and the gift letter, the borrower was purchasing the house from his sister. The borrower's bank statements showed that the borrower paid $960 for a mortgage payment on December 15, 2005; January 10, 2006; and February 8, 2006. A handwritten note on the bank statement stated "pays mortgage payment directly instead of rent check to landlord." However, the borrower's credit report showed no mortgage payments. Also, the file contained no verification of rent, rental/lease agreement, credit report for the sister, or payoff statement from the sister's mortgage company, showing a satisfactory payment history.

The appraisal listed the house value as $89,000, the contract sales price was $88,800, and the mortgage without the up-front mortgage insurance premium was $86,136. Calculating the loan-to-value ratios using these amounts, they would be 96.78 percent ($86,136 / $89,000) using the appraised value and 97 percent ($86,136 / $88,800) using the sales price. These ratios exceeded the 85 percent loan-to-value ratio allowed in identity-of-interest transactions, and the lender obtained no evidence that the 85 percent limit was properly waived (i.e., the file contained no lease or written evidence to properly verify the borrower's occupancy).

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 1-8A (criterion 13)
HUD Handbook 4155.1, REV-5, paragraph 2-3A (criterion 17)
HUD Handbook 4155.1, REV-5, paragraph 3-1J (criterion 33)

Excessive Ratios

CTX Mortgage did not document adequate compensating factors for excessive qualifying ratios when approving the loan. The mortgage credit analysis worksheet properly calculated the income ratios at 34.36 percent and 48.91 percent. However, these ratios exceeded HUD's limits of 31 and 43 percent, respectively. The lender did not provide compensating factors on the mortgage credit analysis worksheet. However, the housing payment appeared to be going down from $960 to $774 according to the mortgage credit analysis worksheet and loan application, but we could not verify this information because the lender did not obtain a rental payment history for the borrower. This payment history could be seen as a possible compensating factor;

however, the lender did not obtain adequate documentation to show that the borrower paid the indicated rent for an extended period.

HUD Requirements – Appendix C
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-13 (criterion 29)
Mortgagee Letter 2005-16 (criterion 34)

Case number: 291-3446152

Insured amount: $110,761

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 12th payment

Date of loan closing: May 31, 2006

Current status: Claim – property not yet sold

Underwriter type: Automated

Ineligible Borrower

CTX Mortgage approved an FHA loan with an ineligible borrower. The borrower had delinquent federal debt totaling more than $30,000 at the time of loan approval. The borrower's credit report showed a number of education loans that were transferred to two federal government-backed loans. These loans were later assigned to the federal government, with the credit report status listed as a government claim. These loans showed up again as collection accounts through another federal government-backed loan. Two other entries in collection were described as federal government unsecured, guaranteed loans. The lender should have reviewed the credit report and downgraded the automated "accept" underwriting recommendation and conducted manual underwriting of the loan. The defaults on the government-backed loans should have been a "red flag" to the lender, which should have required documentation to support the satisfaction of the loans or deemed the borrower ineligible.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-3 (criterion 16)
HUD Handbook 4155.1, REV-5, paragraph 2-5B (criterion 19)
Desktop Underwriter User's Guide for FHA Loans, September 2005 (criterion 37)

Unsupported Assets

CTX Mortgage did not verify the source of $2,268 used to close the loan. The borrower and coborrower provided bank statements, dated two months before loan closing, for four joint accounts with funds totaling $1,963. The prior month balances totaled only $578. The remaining assets used to approve the loan were the coborrower's retirement fund of $14,114 and an investment portfolio of $139,103, to which the coborrower had access but which did not solely belong to her.

The automated underwriting findings report required the underwriter to obtain the most recent depository or brokerage statement for each retirement account to verify sufficient funds to close. Additionally, the findings report required documentation of the terms and conditions of the retirement account, and evidence that the account allowed for withdrawals for conditions other those that related to employment or death and that the borrower qualified for withdrawals and/or borrowing.

Without more recent bank statements, it is unclear whether the borrower and coborrower had the funds to close in their bank accounts or had to take out a loan from their retirement account or access their investment portfolio. In addition, the lender did not sufficiently document the level of liquidity of the investment portfolio to include it as funds available to close the loan.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-10 (criterion 24)
HUD Handbook 4155.1, REV-5, paragraph 2-10B (criterion 25)
HUD Handbook 4155.1, REV-5, paragraph 3-1F (criterion 32)

Case number: 291-3495094

Insured amount: $97,093

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 8th payment

Date of loan closing: January 24, 2007

Current status: Active – reinstated after loss mitigation in September 2008

Underwriter type: Manual

Unsupported Income

CTX Mortgage did not obtain adequate support for the borrower's income. The loan file included a verbal and a written verification of income but no pay stubs or IRS Forms W-2 to corroborate these verifications. The borrower had been employed at this job for only six weeks. The verbal verification of income listed the probability of continued employment as "unknown." The written verification (in the form of a letter from the borrower's supervisor) listed paycheck numbers with pay dates, but the check numbers were out of order, and copies of the actual checks or check stubs were not in the file.

We attempted to complete a reverification of employment. An initial call to the employer's office requesting a verification of employment resulted in a transfer to the borrower, indicating that the borrower's job may have involved employment verifications. The reverification stated that the borrower worked 35-40 hours per week. The original qualification obtained by the lender was based on a 40-hour work week. There were no pay stubs, IRS Forms W-2, or tax returns to support the income claimed. Therefore, we question the validity of the employment verifications.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-6 (criterion 20)
HUD Handbook 4155.1, REV-5, section 2-7 (criterion 21)
HUD Handbook 4155.1, REV-5, paragraph 3-1E (criterion 31)

Questionable Appraisal

CTX Mortgage did not question an appraisal in which the pictures of the property and comparable properties were not taken at the time of the appraisal. One picture of the subject property and all pictures of the comparables appear to have been taken in the spring or summer, showing green grass and foliage. The other pictures of the subject property were taken in the winter, showing snow. The appraisal was dated January 15, 2006, and the loan closed on January 24, 2007. Additionally, there was a "for sale" sign in the yard of one of the comparables. The lender should have questioned the validity of the appraisal and asked the appraiser for explanations regarding the timing of the pictures and the true status of the subject property and comparables.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-3G (criterion 2)

Unsupported Assets

CTX Mortgage did not obtain adequate support for $265 in assets needed to close the loan. The lender obtained only what appeared to be a bank activity report, rather than complete bank statements. The only assets available were from a bank account, but the lender did not obtain a verification of deposit. In addition, the lender obtained documents that appeared to list financial transactions, but the documents did not name the financial institution or the account holder.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-10 (criterion 24)
HUD Handbook 4155.1, REV-5, paragraph 2-10B (criterion 25)
HUD Handbook 4155.1, REV-5, paragraph 3-1F (criterion 32)

Case number: 291-3497893

Insured amount: $127,991

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 3rd payment

Date of loan closing: April 16, 2007

Current status: Active – one month delinquent

Underwriter type: Manual

Unpaid Judgment

CTX Mortgage did not require the borrower to pay an unpaid judgment for $2,343 before the loan closed. The borrower's credit report listed two judgments as unpaid; however, one of the judgments may have been discharged with the borrower's chapter 7 bankruptcy. The loan documentation was not clear regarding whether one judgment had been discharged with the borrower's chapter 7 bankruptcy. This judgment was listed in the bankruptcy paperwork but was not identified on the borrower's credit report as an item resolved under bankruptcy. Court-ordered judgments are supposed to be paid before a mortgage loan is eligible for FHA insurance.

The loan processor noted that both judgments were included in the bankruptcy, which was discharged on April 27, 2006. However, the judgment for $2,343 was filed on February 13, 2007, well after the bankruptcy was discharged. Further, the lender should have obtained proof that the remaining judgment was included in the bankruptcy.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 2-3C (criterion 18)

Social Security Number Discrepancy

CTX Mortgage did not resolve a Social Security number discrepancy. The borrower's credit report obtained by the lender showed two additional Social Security numbers for the borrower. HUD requires the lender to resolve any Social Security number discrepancies. The lender should have obtained a Social Security number verification from another source or an acceptable explanation from the borrower.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 3-1C (criterion 30)
Mortgagee Letter 2005-27 (criterion 35)

Questionable Appraisal

CTX Mortgage did not question an appraisal in which all three comparable properties were in a different city and county, nor did it question a 20 percent adjustment on one of the comparable properties. Further, all three comparable properties appeared to be significantly different in style and appearance from the subject property. The lender should have questioned the validity of the appraisal and obtained acceptable explanations from the appraiser regarding the choice of comparable properties and the large adjustment.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-3G (criterion 2)

Case number: 291-3522148

Insured amount: $44,009

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 3rd payment

Date of loan closing: April 19, 2007

Current status: Active – reinstated after loss mitigation in May 2008

Underwriter type: Manual

Unsupported Income

CTX Mortgage overstated the coborrower's income by $731 per month. The mortgage credit analysis worksheet and loan application showed that the coborrower had other earnings of $731 per month from the Social Security Administration. The bank statements showed that the borrower received two payments of $731 (on February 2 and March 2, 2007) from the "U.S Treasury – SSA." Apart from these two personal bank account credits, the loan file contained no supporting documentation indicating that this income would continue. HUD requires that Social Security income be verified from the source or from federal tax returns. In addition, if any benefits expire within the first full three years, the income source may be considered only as a compensating factor. Since there was no supporting documentation for the Social Security income, the lender overstated gross monthly income by $731 per month.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-7 (criterion 21)
HUD Handbook 4155.1, REV-5, paragraph 2-7E (criterion 22)

Underreported Liabilities

CTX Mortgage underreported the borrower's liabilities by $419 per month. The borrower's application and mortgage credit analysis worksheet did not accurately include the borrower's projected obligations. The borrower had student loans in deferment, the repayment of which was scheduled to begin on September 24, 2007, within 12 months of the mortgage loan closing on April 19, 2007. HUD requires inclusion of the anticipated monthly obligation in the underwriting analysis unless the borrower provides written evidence that the debt will be deferred longer than 12 months after closing. Similarly, if the account shown on the credit report has an outstanding balance, monthly payments for qualifying purposes must be calculated at the greater of 5 percent of the balance or $10 unless the account shows a specific minimum monthly payment.

According to the U.S. Department of Education Web site (http://studentaid.ed.gov/PORTALSWebApp/students/english/repaying.jsp), student borrowers have up to 10 years to repay loans, which equates to 120 monthly payments. One monthly payment is .0833 percent (1 / 120) of the balance, or nearly 1 percent. Therefore, we used a 1 percent repayment amount in calculating the underreported liabilities. Although we took a conservative approach, the borrower's liabilities increased by an additional $419 per month.

When eliminating the unsupported $731 Social Security income and including the underreported liabilities, the qualifying back ratio would be 53.5 percent ($859 / $1,603), which is well above

HUD's limit of 43 percent. The lender obtained a letter from the borrower stating that he anticipated returning to school before the end of the deferment period, but the lender did not obtain additional documentation to support this claim.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 2-11A (criterion 27)
HUD Handbook 4155.1, REV-5, paragraph 2-11C (criterion 28)
HUD Handbook 4155.1, REV-5, section 2-13 (criterion 29)
Mortgagee Letter 2005-16 (criterion 34)

Unsupported Assets

CTX Mortgage did not obtain adequate support for the funds needed to close until two weeks after the loan closed. On March 16, 2007, the borrower's checking account statement had a balance of $232. According to the HUD-1 settlement statement, $592 was needed to close the loan on April 19, 2007. The lender did not obtain bank statements to show that the remaining $359 in assets necessary to close the loan was available at the time of the loan closing. Further, the lender did not obtain a verification of deposit from the bank. However, the same checking account had a balance of $921 on May 3, 2007. This was well after the loan closing date of April 19, 2007.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-10 (criterion 24)
HUD Handbook 4155.1, REV-5, paragraph 2-10B (criterion 25)
HUD Handbook 4155.1, REV-5, paragraph 3-1F (criterion 32)

Case number: 291-3524483

Insured amount: $170,321

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: April 30, 2007

Current status: Claim – property not yet sold

Underwriter type: Manual

Underreported Liabilities

CTX Mortgage understated the borrowers' monthly liabilities by $851 on the mortgage credit analysis worksheet, resulting in an excessive fixed payment-to-income qualifying ratio of 56.7 percent. This condition occurred because the lender did not include two car payments drafted directly from the borrowers' checking account and did not include or explain a recurring deduction shown on the coborrower's weekly pay stub.

The credit report did not show the car payments, nor was there evidence in the loan file that the lender followed up on the car payments to determine whether they should have been included in the liabilities. The lender did not verify whether the car loans had more than 10 months of payments left or show that it had considered whether the monthly payments would have significantly affected the borrowers' ability to repay the mortgage soon after closing.

The mortgage credit analysis worksheet reflected $607 in monthly liabilities from the borrowers' individual credit reports. The lender mistakenly double counted a monthly liability of $258 because this liability appeared on the borrower's and coborrower's individual credit reports. Subtracting the duplicate liability and adding the understated liabilities increased the total liabilities to $1,458 per month ($607 - $258 + 319 + 387 + $403 = $1,458). Therefore, the lender understated the borrower's monthly liabilities on the mortgage credit analysis worksheet by $851 ($1,458 - $607).

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 2-11A (criterion 27)

Excessive Qualifying Ratios and Inadequate Compensating Factors

CTX Mortgage approved the borrowers with an excessive back ratio of 56.7 percent ($2,752 / $4,854) and inadequate compensating factors. Using the income and monthly liabilities, the borrowers' fixed payment-to-income ratio greatly exceeded HUD's limit of 43 percent.

Further, the compensating factors listed on the mortgage credit analysis worksheet, as shown below, were not consistent with the allowable compensating factors listed in HUD Handbook 4155.1, REV-5, section 2-13. Therefore, the compensating factors were inadequate.

- Borrowers have job stability – 3 and 3.7 years and
- Refinance will place borrowers in a better financial position and reduce the interest rate from 9.875 to 6.5 percent.

Job stability is not a financial compensating factor, and the borrowers' principal and interest payment was decreasing by only $31 per month ($1,108 - $1,077). Therefore, these compensating factors were not valid.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-13 (criterion 29)
Mortgagee Letter 2005-16 (criterion 34)

Missing Verification of Mortgage Payment History

CTX Mortgage did not obtain a verification of mortgage payment history for the borrowers. The HUD-1 settlement statement showed that the borrowers had a $25,307 second mortgage, which was paid off at closing when the borrowers refinanced it into the new FHA-insured mortgage. The second mortgage was not listed on either the borrower's or coborrower's credit report, and the lender did not obtain verification of the mortgage payment history. Therefore, we could not verify that the borrowers were current on the second mortgage. HUD does not allow refinances to include delinquent interest, late charges, or escrow shortages. Further, we could not analyze the payment information for this mortgage to determine whether the reduction in payment was an adequate compensating factor (see excessive ratio section above).

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 1-11A(2) (criterion 14)
HUD Handbook 4155.1, REV-5, paragraph 2-3A (criterion 17)
HUD Handbook 4155.1, REV-5, paragraph 3-1J (criterion 33)

Case number: 291-3545704

Insured amount: $163,209

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 2nd payment

Date of loan closing: July 17, 2007

Current status: Claim – property not yet sold

Underwriter type: Manual

Unsupported Income

CTX Mortgage did not obtain adequate trust income verification for trust income of $2,800 per month. HUD requirements state that income from trusts may be used to qualify the borrower if guaranteed, constant payments will continue for at least the first three years of the mortgage. HUD requires certain documentation, including a copy of the trust agreement or other trustee's statement that confirms amount, frequency of distribution, and duration of payments. CTX did not obtain the trust agreement or a trustee's statement. The only income documentation obtained was a letter from the trust company, stating that trust distributions were set to begin for the borrower in the future. Also, the fax header on the document indicated that it was faxed from somewhere other than the trust company. Further, the trust income was from the borrower's father-in-law, and the borrower was in the process of divorcing her husband. CTX Mortgage should have obtained an actual trust agreement and/or trustee's statement and proof that the borrower would receive the trust income after the pending divorce. The trust income was the only income for the borrower.

In addition, the loan file documentation contained income information from 2005, which indicated that the borrower earned only $713 per month in that year. The lender obtained no income information from 2006, and the loan closed in July 2007. The borrower's proposed housing payment was $1,315, and her qualifying ratios were 47 percent and 47 percent using only the trust income. The underwriter noted as a compensating factor that the trust had more than $2 million in it; however, the expected trust fund distributions were unsupported.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, chapter 2 (criterion 15)
HUD Handbook 4155.1, REV-5, paragraph 2-7P (criterion 23)

Unsupported Assets

CTX Mortgage did not obtain adequate documentation for the borrower's earnest money deposit and the funds to close. The borrower paid $1,000 in earnest money and paid $6,815 at loan closing. The lender obtained a one-page statement from a bank, but the statement was illegible. The statement contained a handwritten note, stating that the balance was $2,383, but even if the documentation had been acceptable, the amount was not adequate to close the loan. The lender also obtained a letter from the trust company, stating that a wire transfer of $7,500 would take place from the trust company to the borrower's bank account, but this was not adequate documentation that the borrower was in possession of the funds to close. There was also a wire transfer in the file verifying that $1,025 was transferred from the borrower to the title company on July 5, 2007, for the earnest money deposit, but the additional $25 was an insufficient funds fee, indicating that the borrower did not have the funds available. Further, the sales contract was dated June 12, 2007, and this is typically when the borrower pays the earnest money. The lender should have obtained legible bank statements from the borrower, showing that she had the earnest money available and had received the funds to close from the trust company.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-10 (criterion 24)
HUD Handbook 4155.1, REV-5, paragraph 2-10B (criterion 25)
HUD Handbook 4155.1, REV-5, paragraph 3-1F (criterion 32)

Questionable Credit History

CTX Mortgage did not establish a credit history for the borrower. The borrower's credit report listed only open medical collection items. The credit report also listed four names for the borrower. The borrower referenced her married name and her maiden name in a letter of explanation. The lender did not obtain an explanation from the borrower for the two other names used. Further, the underwriter conditioned loan closing on receiving four acceptable lines of nontraditional credit to assess the creditworthiness of the borrower. The lender obtained only three sources of credit for the borrower. One of the sources was in the name of the borrower's husband, whom she was in the process of divorcing. Further, another source of credit provided no details regarding payment history. Only one of the four requested sources was adequate for credit worthiness determination, and, therefore, the closing condition was not met. The lender did not establish an acceptable credit history when using only one nontraditional letter of credit.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-3 (criterion 16)

Missing Verification of Rental or Mortgage History

CTX Mortgage did not obtain a rental or mortgage payment history for the borrower. None of the versions of the uniform residential loan application identified whether the borrower rented or owned her previous residence. All of the applications stated that she had lived in the same residence for 11 years. However, CTX Mortgage did not verify whether the borrower rented or owned the property, and the lender did not obtain a history of rental or mortgage payments for the previous residence. Also, the addendum to the loan application indicated that the borrower was a first-time homebuyer, and the underwriter instructed the borrower to attend prepurchase homebuyer counseling. Further, the schedule of real estate owned included in the uniform residential loan application listed the previous residence, but a mortgage was not referenced in the borrower's credit report. HUD considers the history of payments for housing obligations to be of significant importance and requires the lender to include the payment history in all FHA loan applications.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 2-3A (criterion 17)
HUD Handbook 4155.1, REV-5, paragraph 3-1J (criterion 33)

Case number: 291-3550001

Insured amount: $131,929

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 4th payment

Date of loan closing: August 9, 2007

Current status: Active – three months delinquent

Underwriter type: Manual

Inadequate Gift Documentation

CTX Mortgage did not obtain adequate documentation for a $5,000 gift used to close the loan. It obtained a gift letter from a relative for $5,000 and a copy of a cashier's check for that amount payable to the borrower. However, the lender did not obtain bank statements for either the donor or the borrower, showing that the amount was withdrawn from the donor's accounts and/or deposited into the borrowers' accounts. Further, the cashier's check did not show that it was negotiated, nor was there any other evidence of the transfer of funds.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 26)

Unsupported Assets

CTX Mortgage did not verify assets used to approve or close the loan. The mortgage credit analysis worksheet, dated August 1, 2007, listed $10,747 in assets available and included $4,500 in gift funds. According to the application, dated August 9, 2007, the borrower had $4,500 in gift funds, $500 in earnest money, and $6,247 in a credit union. However, the lender did not obtain verifications of deposit to indicate that the $6,247 was available. The lender obtained a bank statement for April 1 through April 30, 2007, with a savings account balance of $25 and a checking account balance of $1,080. The lender also obtained documentation from an insurance company, dated July 20, 2007, indicating that the borrower would receive $5,000 in a claims settlement at some point in the future. However, these funds were not shown as having been deposited into any of the bank accounts.

Also, the lender did not verify the source of $3,208 paid at closing. According to the HUD-1 settlement statement, the $3,208 was in addition to $5,000 in gift funds and $500 in earnest money.

HUD Requirements – Appendix C

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 2-4C (criterion 1)
HUD Handbook 4155.1, REV-5, section 2-10 (criterion 24)
HUD Handbook 4155.1, REV-5, paragraph 2-10B (criterion 25)
HUD Handbook 4155.1, REV-5, paragraph 3-1F (criterion 32)